

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(TP)A No.3131/Bang/2018
(Assessment Year: 2014-15)

M/s. Microsoft Research Lab India Pvt. Ltd.,
'Vigyan', No.9, Lavelle Road, Bangalore.
PAN AAECM 2252R

....Appellant

Vs.

Dy. Commissioner of Income Tax,
Circle 4(1)(2), Bangalore.

.....Respondent.

Assessee By:	Shri Nageswar Rao, Advocate.
Revenue By:	Shri Pradeep Kumar, CIT (D.R)

Date of Hearing :	09.12.2019
Date of Pronouncement :	05.02.2020

ORDER

PER SHRI PAVAN KUMAR GADALE, JM :

The assessee has filed an appeal against the order passed under Section 143(3) r.w.s.144C of the Income Tax Act, 1961 ('the Act') in pursuance to the directions of Dispute Resolution Panel (DRP) Dt.21.08.2018.

2. The assessee has raised the following grounds of appeal :

1. That impugned order dated 24.09.2018 passed by Ld. Assessing Officer ("AO") making an adjustment of INR 10,15,92,292 to returned income of the Appellant in respect of international transaction pertaining to provision of software research and development services ("Impugned Transaction") to its Associated Enterprise ("AE") is invalid and bad in law.
2. That on facts and in law, Ld. DRP/ AO / TPO have erred by rejecting the economic analysis undertaken by Appellant in accordance with provisions of Income Tax Act' 1961 ("the Act") read with Income Tax Rules' 1962 ("the Rules"), conducting a fresh economic analysis and holding that Impugned Transactions are not at arm's length.
3. That 'Notice of demand' under section 156 dated 30.11.2017 and 'Notice of initiation of penalty proceedings' under section 274 r.w.s. 271(1)(c) of the Act issued alongwith draft assessment order are not in accordance with law, invalid and void in law. Upholding of same by Ld. DRP by relying on section 292B is unlawful and invalid. Further, proceedings including impugned order and notice of demand dated 24.09.2018 are not in accordance with law and invalid.
4. That on facts and in law, transfer pricing adjustment of INR 10,15,92,292 made by Ld. AO pursuant to directions of Ld. DRP is bad in law inter-alia for the reason that:
 - a) order of Ld. TPO is bad in law in as much as based on an invalid reference made by Ld. AO without complying with statutory requirements;
 - b) Appellant's AE being chargeable to tax at a higher rate in the US, there was no question of shifting of any profit from a low tax paying country to a high tax paying country
5. That on facts and in law, Ld. DRP/ AO /TPO have erred by :
 - a) Using single year data of companies to determine the arm's length price of the Impugned Transaction and disregarding the Appellant 's claim for use of multiple year data for computing the arm's length price; and
 - b) Rejecting data used by Appellant which was available to it at the relevant time and proceeding to use data which was available only at the time of transfer pricing audit.
6. Ld. DRP/ AO / TPO erred in rejecting/ including companies in final set citing invalid grounds and/ or by applying incorrect filters.
7. Without prejudice to above Ld. DRP/ AO/ TPO erred in including certain non-comparable companies, on wrong notion that Appellant is estopped from contesting inclusion of non-comparable companies if initially selected by itself.
8. Ld. DRP/ AO / TPO erred in facts and in law, by resorting to cherry picking of companies to determine ALP for the Impugned Transaction by:
 - a) Adding certain functionally dissimilar companies to the final set of comparables namely

Larsen & Toubro Infotech Limited, Persistent Systems Limited, Infosys Limited, Mindtree Limited, Cigniti Technologies Limited and Thirdware Solutions Limited; and

- b) Rejecting certain functionally similar companies selected by the Appellant as valid comparables namely Akshay Software Technologies Limited, Cat Technologies Limited, Zylog Systems Limited, SagarSoft India Limited, Evoke Technologies Private Limited, Lucid Software Limited, E-zest Solutions Limited, InfoMile Technologies Limited Pure software Private Limited, Sybrant Technologies Private Limited, Maveric Systems Limited, Sasken Communication Technologies Limited, Caliber Point Business Solutions Limited, Helios & Matheson Information Technology Limited and TVS Infotech Limited.

on irrelevant and unlawful considerations.

1. That on facts and in law, Ld. DRP/ AO/ TPO erred by ignoring the difference in working capital employed by the comparable companies vis-à-vis the Appellant and not allowing suitable adjustments to account for differences in working capital.
2. That on facts and in law, Ld. DRP/ AO/ TPO erred by ignoring that Appellant, being only a captive service provider and a risk free entity, is entitled to suitable adjustments to account for differences in its risk profile vis-à-vis the comparables.
3. That on facts and in law, Ld. DRP/ AO/ TPO have erred in considering provision for doubtful debts, liabilities no longer required written back and advances written off as non-operating item while computing operating margin of the comparable companies as well as tested party.
4. That on facts and in law, Ld. TPO's order under section 92CA(3) of the Act has computational errors while computing operating margin of comparable companies as well as tested party.
5. That on facts and in law, Ld. TPO has erred, by not discharging the statutory onus to establish that the conditions specified in clause (a) to (d) of Section 92C(3) of the Act have been satisfied before disregarding the ALP determined by the Appellant and proceeded to determine the ALP himself.
6. That on facts and in law, Ld. AO/Ld. TPO have erred by:
 - a) Exercising powers under section 133(6) of the Act to obtain information which was not available in public domain and relying on the same for comparability purposes; and
 - b) Selectively using power section 133(6) of the Act to collect information for only one company i.e. Persistent Systems Limited, where there are various other companies whose complete business/financial information is not available in public domain to determine comparability. The Ld. AO / Ld. TPO has thus resorted to selective approach in regard to using power under section 133(6).

15. That on the facts and circumstances of the case, Ld. AO has erred in levying interest under section 234A of the Act without appreciating the fact that the return of income was duly filed within the due date.
16. That on facts and in law, Ld. AO has erred in levying interest under section 234B of the Act.
17. That on facts and in law, Ld. AO has erred by initiating penalty proceedings u/s 271(1)(c) of the Act.

3. At the time of hearing, the learned Authorized Representative has not pressed Ground of appeal Nos.11 to 14 and made endorsement, hence they are treated as withdrawn and dismissed; The assessee raised additional Ground of appeal on the Turnover criteria and is admitted and read as under :

1. The transfer pricing adjustment of INR 101,592,292 made by the Ld. AO based on the order of Ld. TPO and confirmed by the Hon'ble Dispute Resolution Panel for provision of software development services is bad in law inter-alia for the reason that:
 - (a) The Ld. TPO / Hon'ble DRP has erred in law by applying a lower turnover filter to reject companies with software development income less than INR 1 Crore but not applying a higher turnover filter.

The Appellant craves, to consider the above ground and the grounds raised in the appeal filed, are without prejudice to each other and craves leave to add, alter, delete or modify all or any of the above grounds of appeal.

4. The Brief facts of the case are that the assessee was incorporated in January, 2005 as a wholly owned subsidiary of Microsoft Corporation, US (M S Corp.). The Assesse company is engaged primarily in rendering Software Development Research and Development Services to its Associated Enterprise (AE) M.S.Corp. The assessee company filed the Original Return of Income on 28.11.2014 with total income of Rs.18,21,06,039 and filed the Revised Return of

Income on 30.03.2016 with total income of Rs.17,22,00,910. Subsequently, the case was selected for scrutiny under CASS and Notice under Section 143(2) & 142(1) of the act were issued. In compliance the learned Authorized Representative appeared from time to time and submitted the details. The Assessing Officer find that the assessee has international transactions and the matter was referred with prior approval of PrCit to the Transfer Pricing Officer (TPO). The assessee is engaged in Software Development Segment (SDS) and the financials are referred at Para 2.3 and 2.4 of T.P. Order which is as under :

2.3. THE FINANCIALS OF THE TAXPAYER FOR THE F.Y. 2013-14 AS PER P&L IS AS UNDER

Financial segmental of Software development services by MSR

Particulars	Financial year 2013-14 (Amounts In INR millions)			
	Income From Operations (A)	Non-Operating (B)	Total (A+B)	Total as per Profit & Loss Account
Income				
Fees or research and development	840920519		840920519	840920519
Interest Income from banks		10163475	10163475	10163475
Interest income from income tax		1118345	1118345	1118345
Miscellaneous income	17261		17261	17261
Liabilities no longer required written back	74182		74182	74182
Operating Revenue	841011962		852293782	852293782
Expenditure				
Employee Costs	438678847		438678847	438678847
Other Expenses	234981009		234981009	234981009
Interest on rent		1601998	1601998	1601998
Donations		857850	857850	857850
Finance Costs		4040928	4040928	4040928
Depreciations	67283495		67283495	67283495
Operating Cost	740943351		747444127	747444127
Net Profit Before Tax				104849655
Operating Profit	100068611			
Operating Profit/Operating Cost	13.51%			104849655

2.4 SEGMENTAL FINANCIALS OF THE TAXPAYER FOR THE F.Y. 2013-14 AS PER TPO IS AS UNDER

Particulars	Amount in Millions
Total income	852.29
Less: other income	11.37
Total operating income	840.92
Total expenses	747.44
Less: donation	0.86
Total operating expenses	746.58
Total operating profit	94.34
OP/ OC	12.64%
OP/OR	11.22%

5. The assessee filed the TP Study Report in Software Development Services and adopted 22 comparables for analysis and PLI of Op/Oc is 12.64%. Whereas the TPO has rejected the TP Study and applied filters and dealt on the functionality of comparables and adoption of filters at Para 4.2 to 7.3 of TPO order. Further TPO issued Show Cause Notice and the assessee filed objections on TPO's remark. Finally the TPO considered the functionality and working criteria and has selected 8 comparables at page 33 para 14 of the order which are as under:

14. 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

S NO	NAME OF TAX PAYER	Amounts in Rs. Lakh			OP/OC (in %)
		OR/SALES	OC	OP	
1	Infosys Ltd.	46,91,700	32,77,700	11,84,200	36.13%
2	Larsen & Toubro Infotech Ltd.	4,54,360	3,64,619	89,741	24.61%
3	Mindtree Ltd.	2,99,010	2,48,290	5,072	20.43%
4	Persistent Systems Ltd.	1,18,412	87,649	3,07,625	35.10%
5	R S Software (India) Ltd.	35,188	28,321	6,867	24.25%
6	Cigniti Technologies Ltd.	5,563	4,359	1,204	27.62%
7	S Q S India B F S I Ltd.	20,061	16,394	3,667	22.37%
8	Thirdware Solution Ltd.	19,883	13,742	6,140	44.68%
	Average				29.40%

6. The TPO determined the Arm's Length Price (ALP) at Para 15.4 which is as under:

15.4. Computation of Arm's Length Price:

15.4.1 The arm's length price of the services rendered by the taxpayer to its AE(s) is computed as under

SWD

Arm's Length Mean Margin on cost	20.90%
Operating Cost	659,048,261
Arm's Length Price(ALP) @ 130.68%	777,017,900
of Operating Cost)	
Price Received	733,299,209
Variation in Price	43,718,691
3% of price received	21,998,976
Shortfall being adjustment	43,718,691

7. The TPO has passed the order under Section 92CA of the act dt.30.10.2015. Subsequently Rectification Order under Section 92CA r.w.s.154 of the Act was passed on 31.10.2017 with ALP adjustments of Rs.12,51,62,123. The A.O. has passed draft assessment order under Section 143(3) r.w.s. 144C of the Act Dt.30.10.2017. Against the draft assessment order dt.30.11.2017, the assessee has filed objections with DRP in Form 35A, whereas the DRP has passed the order under Section 144C(5) Dt.21.8.2018. Subsequent to the DRP directions of inclusion of two comparables, Final assessment order dt24.09.2018 under Section 143(3) r.w.s.144C of the Act was passed. Aggrieved by the order, the assessee has filed an appeal with the Tribunal.

9. At the time of hearing, the learned Authorized Representative argued and submitted on the Ground of Appeal No.3 in respect of issue of Notice of Demand under Section 156 of the act dt.31.11.2017 and Notice of initiation of penalty proceedings under Section 274 r.w.s. 271(1)(c) of the Act were issued along with Draft assessment order are not in accordance with law and invalid. Further The

LdAr, submitted that 6 comparables are to be excluded and 5 comparables are to be included and Working Capital and risk Adjustment has to be granted and supported with the voluminous Paper Book and chart and prayed for allowing the appeal. Contra, the learned Departmental Representative relied on the orders of the lower authorities and filed written submissions.

10. We heard the rival contentions and perused the material on record. Prima facie, the learned Authorized Representative has made submissions on exclusion of comparables relying on the additional ground of appeal of Turnover Criteria. First we shall deal with the exclusion of comparables as under:

(i) Infosys Limited : The turnover being rs.44,341 Crores and it is functionally not comparable as the turnover is more than 500 times of the assessee turnover of Rs.84.09 Crores. The company is engaged in developing software products Pinnacle and was rejected by the DRP in assessee own case for the Assessment Year 2011-12. Further has high brand value and incurred huge expenditure in R & D with exceptional areas of operation and earned super natural profits and is engaged in diversified activities. We found that the comparable was excluded by the co-ordinate Bench decision of the Tribunal in the case of M/s. Marwell India P. Ltd. Vs. DCIT in IT(TP)A No.3082/Bang/2018 for the Assessment Year 2014-15 Dt.23.10.2019 at page 20 para 4.2 (b) which read as under :

“ 4.2 (b). **Infosys Ltd:**

It has been submitted by Ld.Counsel that this comparable has been included by Ld.TPO in finalist. It has been submitted that this comparable is not comparable due to high turnover and intangibles owned by this company. It has been submitted that *Hon'ble Delhi High Court* in case of *CIT vs Agnity India technologies* reported in (2013) 36 *Taxmann.com* 289 has held this company to be bad comparable to a company which is captive service provider under the segment. It has been submitted that this company provides end to end business solutions that leverage technology to enable clients to enhance business performance.

Ld. CIT DR placed reliance upon the order passed by authorities below.

We have perused submissions advanced by both sides in the light of the records placed before us.

Admittedly this company owns huge intangibles and is an entrepreneur in the field of software service development service segment. At page-1100 of paper book, Vol.III it is observed that this company primarily derives revenue from software development and related services and from licensing of products. In segmental details at page-1110, it is observed that revenue generated from software services is Rs.4253/- Crores which is much high and hence cannot be compared to a captive service provider like that of assessee.

Respectfully following decision of orderable Delhi High Court (supra) we direct Ld. AO/TPO to exclude this comparable from the final list.”

We considering the facts, functional profile and the decision of the co-ordinate Bench, direct the TPO to exclude the comparable from the final list of comparables for determination of ALP.

(ii). Similarly, Third ware Solutions Limited, whose turnover is Rs.206.76 Crores in comparison to Rs.84.09 Crores of the assessee ,and it is functionally different and earns revenue from sale of products. The company engaged in business of sale

of user licenses in software development with insufficient segmental data and earns super natural profits. We find the comparable was excluded by the coordinate Bench of the Tribunal in the case of Marwell India Pvt. Ltd. Vs. DCIT (supra) at page 22 para 4.2(d) of the order as under :

“4.2 (d). **Thirdware solutions Ltd**

it has been submitted that this company has been included by Ld.TPO in final list of comparables even though test functionally not similar with that of assessee. Ld.Counsel submitted that this company carries out diverse set of activities such as planning and budgeting, MIAs reporting, analytics, rollouts, due diligence, upgrade and migration, data centre migration infrastructure architecture etc. He submitted that the entire operating income is derived from sale of product it is also been submitted that this company fails RPT filter of 15% as applied by Ld.TPO. Ld.Counsel submitted that during the year under consideration this company had extraordinary growth 45.34% be next secluded by various decisions of coordinate bench of this Tribunal.

Ld. CIT DR on the contrary placed reliance upon orders passed by authorities below.

We have perused submissions advanced by both sides in the light of the records placed before us.

On perusal of the annual reports placed at page 573 of paper book volume 2, it is observed that this company has developed its own product by the name “PAPA”. It is observed that this company has incurred huge expenses towards import of software services evidencing outsourcing of software services unlike that of assessee. It is also observed that this company is into production of software product and therefore cannot be functionally is held similar to a contract service provider under this segment like that of assessee. Ld.Counsel placed reliance upon decision of coordinate bench of this Tribunal in case of *Nomura Research Institute Financial Tech (India) Pvt. Ltd., vs DCIT in ITA No. 284/Kol/2016 vide order dated 26/10/2018.*

Respectfully following the same we direct Ld. AO/TPO to exclude this comparable from the finalist.”

Accordingly, we rely on the tribunal and direct the TPO to exclude this comparable from the final list selected in determining the ALP..

(iii) Persistent Systems Limited : The company has a turnover of Rs.1184.12 Crores and functionally different with insufficient segmental information. Further has significantly large scale of operations and specialized in software product services and technology innovation referred at page 1495 of Paper Book and is engaged in provision of diversified services and product solutions of the entire product cycle. Further incurred High R & D and has generated revenue from licensing and support products and also earns super natural profit and is engaged in operating different module of business. The comparable was excluded by the coordinate Bench of the Tribunal in the case of Mar well India Pvt. Ltd. Vs. DCIT (supra) at page 21 para 4.2 (c) of the order which is read as under :

“4.2 (c). **Persistent Systems Ltd:**

This company has been included by Ld.TPO and assessee disputes it to be functionally not similar. It has been submitted that this company during the year under consideration derived income from licensing of products, royalty and sale of products, maintenance contract, outsourced product development etc and no segmental details are available in regards to the same.

Ld. CIT DR placed reliance upon the orders passed by authorities below and insisted on the inclusion of this company.

We have perused submissions advanced by both sides in the light of the records placed before us.

At page-1432, it is observed that companies operations predominantly relates to providing software products services and technology, innovation covering full life cycle of product to its customers.

It is observed that Delhi ITAT in case of *Aginity India Technologies India private limited (supra)* has held as follows:

“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 decisions rendered by ITAT Delhi Benches in case of cash edge India private limited vs ITU in ITA No. 64/del/2015 vide order dated 23/09/15 and the details of orderable Delhi High Court in case of sexual India private limited (supra). The findings in this regard are contained in paragraph 4.14 to 4.16 of its order.”

Respectfully following the same we are of considered opinion that this company deserves to be excluded from the final list.”

We, respectfully follow the coordinate Bench decision, and direct the TPO to exclude the comparable from the final list of comparable for determination of ALP.

(iv) L & T InfoTech Limited, turnover is Rs.4643.94 Crores, and during the year has undertaken capital expenditure of Rs.12348 Lakhs which works out to approximately 1.5 times of turnover of the assessee being Rs.84 Crores. The comparable is engaged in provision of software sales of products and no segmental information is available and is engaged in resale of products and packages and has High brand value with extraordinary events and operates in different model of business. We support our view relying on the decision of the co-ordinate Bench of the Tribunal in the case of *Marwell India Pvt. Ltd. Vs. DCIT (supra)* at page 23 para 4.2 (e) of the order which read as under :

“4.2 (e). **Larsen and Toubro Infotech Ltd:**

It has been submitted by Ld.Counsel that this company has been included by Ld.TPO, though it is not comparable with that of assessee as it is a huge company owning large intangibles.

It has been submitted that is to be excluded for following reasons: (i) this company is functionally dissimilar to that of SWD service provider and that it develops Software products ; (ii) Segmental Information of various segments are not available; (iii) Scale of operation and presence of intangibles, brand etc. It has been submitted that *Delhi ITAT* in case of *Agilis information technologies India Pvt. Ltd., vs ACIT* reported in (2018) 89 taxman.com 440 has excluded this company and the same has been upheld by *Hon'able Delhi High Court*.

Ld.CIT DR placed reliance upon the orders passed by authorities below and insisted on the inclusion of this company.

We have perused submissions advanced by both sides in the light of the records placed before us.

It is observed that Delhi ITAT in case of *Aginity India Technologies India private limited (supra)* has held as follows:

“Larsen and Toubro Infotech Ltd was excluded from the list of comparable companies by relying on the decision of the Delhi bench ITAT in case of Saxo India d vs ACIT. The discussion is contained at para 4 .8 to 4.10 of tribunal’s order. The tribunal held that LMT Infotech Ltd was software product company and segmental information on SWT services was not available. The tribunal also noticed that appeal filed by revenue against rivals order was dismissed by orderable Delhi High Court in ITA No. 682/2016.

Respectfully following the same we are of considered opinion that this company deserves to be excluded from the final list.”

We rely on the coordinate bench decision and direct the TPO/A.O. to exclude the comparable from the final list for determination of ALP.

(v) Mindtree Limited: The company turnover is Rs.3,031.06 Crores as against the assessee turnover of Rs.84 Crores. Further it is dissimilar to the assessee business model with no segmental data is available and brand value with huge intangibles.

We found for the Assessment Year 2014-15, the company was excluded by the co-ordinate Bench decision in the case of Marwell India Pvt. Ltd. Vs. DCIT (supra) at page 24 para 4.2 (f) of the order as under :

“4.2 (f). **Mindtree Ltd**

This comparable has been included by Ld.TPO the final list. Ld. counsel submitted that it is functionally not similar with that of assessee. It is submitted that assessee engaged in providing services such as Agile, analytics and information management, application development and maintenance, business process management, business technology consulting, Cloud, Digital business, independent testing, infrastructure management services, mobility, product engineering and SAP services. Ld.AR referred to page 1088 in support. It is further been submitted that this company does not have segmental information on the basis of which revenue earned from different verticals could be identified. This company also owns huge intangibles and therefore deserves to be excluded.

On the contrary Ld. CIT DR placed reliance upon orders passed by authorities below.

We have examined the annual reports of this company and it is observed that this company carries out research and development activities and has created large intangibles. Under such circumstances we do not find this company to be comparable with that of a captive service provider like assessee.

We therefore direct the Ld. AO/TPO to exclude this comparable from the final list.”

Considering the functional dissimilarity and High turnover criteria and judicial decision, we direct the TPO/A.O. to exclude the comparable from the final list of comparables for determination of ALP.

(vi) Cignity Technologies Limited, the comparable is engaged in Software Development Services and is a captive service provider to its AEs on Cost Plus

basis. Further company has applied for global patents for its iGenerate Test, Scenarios Tool part which is a part of SMART Tools Portfolio and has specialized services in the field of software testing. We found this comparable was excluded by the co-ordinate Bench of the Tribunal in the case of Marwell India Pvt. Ltd. Vs. DCIT (supra) at page 18 para 4.2 (a) of the order as under :

“4.2 (a). Cignity Technologies Ltd:

Ld.TPO held this company to be comparable as it is engaged in software development services. Ld.Counsel submitted that Ld.TPO treated this company to be comparable assessee, irrespective of different verticals of SWD. He submitted that assessee before us was a captive service provider rendering exclusive services to its AE and works on a cost plus markup basis. He submitted that assessee renders services under SWD segment on the basis of specifications provided by the AE. Whereas this comparable for the year under consideration has Ld. counsel placed before us the annual report of this company in support of his submissions to establish that this company has outgrown independently in software testing and has been awarded “Automated Software Testing Services” by Frost & Sullivan. He also submitted that this company has applied global/U.S. patents for its iGenerate TestScenarios tool part which is a part of SMART tools portfolio. Whereas assessee before us has been submitted to be providing various services in which testing of integrated circuit is one of the small activity carried out by assessee for its AE.

Ld. counsel submitted that from the profile of the comparable in the annual report one can hold this company to be a pioneer in software testing market catering to clients all over the world in different geographies.

On the contrary, Ld.CIT DR submitted that this is no different function than what assessee has been carrying out for its AE and therefore is a perfect comparable.

We have perused submissions advanced by both sides in the light of the records placed before us.

We have also perused the annual report very carefully and is observed that this company is involved exclusively into software

testing and has created innovations in the software testing. It is also observed that this company is acquired hundred percent shares in a U.S.-based software testing service company called Gallop Solutions Inc based in Texas USA. It is also observed that this company has been listed on Bombay stock exchange, Bangalore stock exchange and maybe Madras stock exchange with a paid-up capital of Rs. 22.92 crores. It is an undisputed fact that entire revenue has been generated by this company from software testing services rendered to its independent clients as against simple testing carried out by assessee of integrated circuits along with designing, customer support of integrated circuits related ancillary services provided by assessee only to its AE.

Considering the holistic approach having regards to the annual reports of this company and the specialised services provided by this company to its own clients in the field of software testing as against captive service provided by assessee exclusively to its AE, we are of considered opinion that this company cannot be held as a good comparable with that of assessee.

Therefore we direct Ld. AO/TPO to exclude this company from the final list of comparables.”

Following the judicial precedence, we found the company is in specialized area and has to be excluded. Accordingly, we direct the TPO/A.O. to exclude from the final list of comparables.

12. Now we shall take up the comparables for inclusion.

The learned Authorized Representative in Ground of appeal No.8 (b) has prayed for inclusion of 15 comparables but at the time of hearing has restricted his arguments for inclusion of only 5 comparables and made endorsement. And relied on voluminous material and filed Chart.

(i) Akshay Software Technologies Ltd., the company's margin is 1.81% and was rejected by the DRP as a foreign brand expenditure is 85% of total cost . Whereas

RPT is 3.49% of total sales and Ldar referred to page 1705 and 1714 of paper book. Further the company was rejected by the TPO on the RPT filter and the observations are incorrect, The company is functionally similar and is engaged in providing Software Development Services including procurement, implementation and maintenance of ERP Products and also services in India and overseas which does not have impact on functional operations. Whereas in assessee own case for the Assessment Year 2016-17 it was accepted as comparable. Accordingly, considering the functional profile, and it was accepted by the Revenue in subsequent Asst Years, we direct the TPO to include the comparable company in the final list for determination of ALP.

(ii) Sagarsoft India Limited : This comparable company turnover is Rs.11.29 Crores and was rejected by the DRP as Annual Report and financial details are not available in public domain and was not included by the assessee . It is engaged in Software Development Services and passes the filters applied by the TPO. Now, Annual Report of the comparable company is available in public domain. The ldAr filed the Annual Report in the Paper Book and further was accepted by the TPO in assessee own case for the Assessment Year 2016-17. We found that this comparable company Annual Report was available during the TP Study and the a not included. Accordingly, we restore this comparable to the file of TPO to examine and verify the functionality of the company.

(iii) Pure Soft Private Limited, the comparable margin is 13.72% and the company was not included in the TP Study by the assessee and was rejected by TPO. The learned Authorized Representative submitted that it is functionally similar and is engaged in design and development services of software applications including customized and packaged software and also providing services testing and passes the filters applied by the TPO and selected for comparable. We found the comparable was not part of the TP Study of the assessee and has to be verified. Accordingly, we restore this issue to the file of TPO to verify and examine the comparable for determination of ALP.

(iv) Sybrant Technologies Private Limited, it has margin of 15.25% and turnover of Rs.3.52 Crores and was rejected on the ground that it was not considered by the assessee in TP Study. The learned Authorized Representative submitted that it is engaged in development of embedded software and project management in the field of Information Technology . We found that this comparable was not part of the TP Study of the assessee, hence has to be tested on functional profile. Accordingly, we restore this comparable to the file of TPO to examine and verify functionality for determination of ALP.

(v) Lucid Software Limited, has a margin of (-) 0.57% and the turnover is Rs.3.60 Crores. It was rejected on the ground that it is engaged in the business of software development and rendering software services to the global non-destructive testing

and material sciences industry and further the company has incurred losses for the previous year ending March, 2013 and March, 2014. The LdAr submit that the comparable is functionally similar and is engaged in the business of software development and passes all the filters, and whereas persistent loss filters has been incorrectly applied. The learned Authorized Representative relied on the decision of Pune Bench Tribunal Yazaki india Pvt Ltd Vs DCit in ITA No.621/Pune/2014 Dt.11.7.2019 at paras 21 to 23 which is read as under :

“ 21. The Hon'ble jurisdictional High Court in CIT Vs. Goldman Sachs (India) Securities (P) Ltd. (2016) 290 CTR 236 (Bom.) considered a similar issue of persistent loss making companies. In that case, the TPO excluded Capital Trust Ltd. on the ground of persistent loss making company. The Tribunal included this company by noticing that it was not a persistent loss making company as for the A.Y. 2005-06 it made profit although it was loss for subsequent two years, namely, A.Y. 2006-07 and 2007-08. Considering the factual position obtaining in the instant case, it is seen that though FCI Technology Services Ltd. suffered loss for the A.Y. 2008-09 and the year under consideration but, in fact, there was profit for the A.Y. 2007-08 at 5.08%. As this company earned profit of 5.08% for the A.Y. 2007-08, it ceases to be a persistent loss making company in so far as the A.Y. 2009-10 is concerned, since one of the three years is in profit though the other two years are in loss.

22. The Id. DR invited our attention towards the direction given by the DRP on page 12 in which it has returned a categorical finding that FCI Technology Services Ltd. started manufacturing connectors during the A.Y. 2008-09 and there was no manufacturing of connectors during the A.Y. 2007-08, for which the assessee is claiming that this company has positive PLI.

23. We have gone through the Annual report of this company relevant for the A.Ys. 2009-10 and 2008-09. Page 467 of the paper book for the assessment year under consideration gives details of stock, production and sales for the year ending 31-12-2007 which has opening stock of connectors as well. Similar is the position for the preceding year as well, which depicts that there was opening stock of connectors. In that view of the matter, it becomes evident that this company was already into manufacturing of connectors, which product has been considered as similar by the DRP. Ex consequenti, the relevant contrary finding recorded by the DRP about that company not engaged in manufacturing of connectors during the A.Y. 2007-08 is, therefore, not correct. As FCI Technology Services Ltd. is not a persistent loss making company and further the functional similarity has not been disputed by the TPO, we order to include this company in the list of comparables.”

We found this comparable was included by the Pune Bench of the Tribunal for the Assessment Year 2009-10. whereas in the present case, the Assessment Year is

2014-15 and also the observations of the TPO that it is a loss making company for the year ending March, 2013 and March, 2014. Considering the functionality and precedent losses and the decision of the co-ordinate Bench of the Tribunal, we restore this comparable to the file of TPO to examine and verify the functional profile for inclusion in determination of ALP.

13. On the Working Capital Adjustment, the learned Authorised Representative submitted that the DRP has not granted the Working Capital Adjustment as no details are filed. Whereas the learned Authorized Representative submitted that the details were filed before the TPO and referred to Paper Book-2 Page 887 & 889 in particular at page 3431 paras 16 & 17. Further, the TPO has erred in ignoring the Working Capital analysis of comparables and also overlooked the adjustments of risk profile of comparables. We considering the submissions and supporting material envisaged in the course of hearing, direct the TPO to grant the Working Capital and risk profile Adjustment after examining the facts and profiles of comparables.

14. Interest under Section 234A & 234B of the act are consequential in nature and has to be calculated in accordance with law. The learned Authorized Representative made submissions on legal issue in Ground of appeal No.3 referring to Notice of Demand under Section 156 of the act and Notice of initiation of penalty proceedings under section 274 r.w.s 271(1) (c) of the Act.

Since we have decided the assessee appeal on merits, we have left open the legal issue of the Assessee and partly allowed grounds of appeal of the assessee for statistical purpose.

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

Order pronounced in the open court on 5th Feb., 2020.

Sd/-

(B.R. BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Dated: 05.02.2020.

*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