

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

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

IT(TP)A No.184/Bang/2017
Assessment year: 2012-13

Synamedia India Pvt. Ltd., (formerly known as Cisco Video Technologies India Pvt. Ltd.,) Block 9A & 9B, Pritech Park, Survey No.51-64/4, Sarjapur Outer Ring Road, Bellandur Village, Bengaluru – 560 103. PAN: AACCN 1140K	Vs.	The Assistant Commissioner of Income Tax, Circle 2(1)(1), Bengaluru.
APPELLANT		RESPONDENT

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

Date of hearing	:	28.01.2020
Date of Pronouncement	:	06.02.2020

ORDER

Per N.V. Vasudevan, Vice President

This appeal by the assessee is against the fair order of assessment dated 25.11.2016 passed u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [the Act] by the ACIT, Circle 2(1)(1), Bangalore relating to assessment year 2012-13.

2. The only issue that arises for consideration in this appeal is with regard to addition made by the AO consequent to determination of ALP in

respect of an international transaction entered into by the assessee with its AE. The assessee is a company which is engaged in the business of rendering software development and related services. It is not in dispute that the assessee rendered software development services to its Associate Enterprise (AE), NDS, UK. The aforesaid transaction was an international transaction and as laid down under the provisions of section 92 of the Act and accordingly the income from the aforesaid transaction has to be determined keeping in mind the arm's length price.

3. The assessee in support of its claim, that the price received in the international transaction was at arm's length, filed a TP analysis for which the assessee had chosen TNMM as the most appropriate method for determining the ALP. The Profit Level Indicator (PLI) chosen for the purpose of comparison of the profit margin of the assessee with the comparable companies was OP/OC. The OP/OC as worked out by the assessee and as done by the TPO was as follows:-

Segmental financials as given in TP Study

Particulars	Software Research & Development	Marketing Support Services
Income		
Segment revenue	3,90,15,86,819	1,48,62,204
Foreign Exchange gain	15,13,57,335	
Total operating income	4,05,29,44,154	1,48,62,204
Expenditure		
Segment cost	3,54,45,16,069	1,29,23,657
Total operating cost	3,54,45,16,069	1,29,23,657
Operating profit	50,84,29,085	19,38,547
Operating profit/ Operating cost	14.34%	15.00%

As recomputed by TPO

Particulars	Software Research & Development	Marketing Support Services	Non AE	Total
Income				
Segment revenue	4,05,29,44,154	1,48,62,204	31,46,23,733	438,24,30,091
Less: Other income	15,13,57,335		17,78,152	15,31,35,487
Total operating income	390,15,86,819	1,48,62,204	31,28,45,581	4229294604
Expenditure				
Total Expenses	3,54,45,16,069	1,29,23,657	238,427,243	3795866969
Less: Provision for doubtful advances			27327365	
: Bank charges			2794176	
Total operating cost	3,54,45,16,069	1,29,23,657	208,305,702	3,765,745,428
Operating profit	357070750	19,38,547	104539879	
Operating profit/ Operating cost	10.07%	15.00%	50.18%	

4. As can be seen from the above table, the PLI computed by the assessee was modified by the TPO and this is because of the action of the TPO in considering the foreign exchange gain of Rs.15,13,57,335 as not part of the operating income of the assessee. This is the reason why the PLI computed by the assessee was 14.34%, while TPO computed the PLI at 10.07%.

5. After rejecting the TP analysis of the assessee, the TPO chose 10 comparable companies and the average arithmetic profit margin of those 10 companies was as follows:-

Sl. No.	Name of the Company	OP/OC %
1	Datamatics Global Services Ltd.	14.57
2	Genesys International Services 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	R S 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

6. The TPO determined the ALP and the consequent addition to be made to the total income of the assessee as follows:-

“12.4 The arithmetic mean of the Profit Level indicators is taken as the arm’s length margin. Please see Annexure B for details of computation of PLI of the comparables. Based on this, the arm’s length price of the services rendered by the tax payer to its AE(s) is computed as under:

SOFTWARE DEVELOPMENT SERVICES

Arm's Length Mean Margin on cost	22.63%
Less: Working Capital Adjustment (As per Annex. C)	0.95%
Adjusted margin	21.68%
Operating Cost	3544516069
Arms Length Price(ALP) (121.68% of Operating Cost)	4312967153
Price Received	3901586819
Shortfall being adjustment u/s 92CA:	411380334

5% of price received	1950,79,341
Since the shortfall is exceeding the 5% of the International Transaction , adjustment is made	

The above shortfall of Rs. **41,13,80,334/-** is treated as transfer pricing adjustment u/s 92CA in respect of software development segment of the taxpayer's international transactions.”

7. Aggrieved by the order of TPO, which was incorporated in the draft order of assessment by the AO, the assessee preferred objections before the DRP. The DRP accepted the plea of the assessee that out of 10 comparable companies chosen by the TPO, 6 companies cannot be regarded as good comparables and only the following four can be regarded as companies:-

Sl. No.	Names of the companies	OP/OC %	Adjusted OP/OC after working capital adjustment
1	Larsen & Toubro Infotech Ltd.	25.47%	26.50%
2	Mindtree Ltd.	15.01%	15.76%
3	Persistent Systems Ltd.	27.20%	27.90%
4	R S Software (India) Ltd.	15.34%	18.58%
Mean margin		20.75%	22.18%

8. The DRP, however, opined that it would be appropriate to consider the entire 10 set of comparables as by doing so, the larger set of comparables will take care of differences between the comparables. With regard to the action of the TPO in considering the foreign exchange gain as not part of operating profits for the purpose of computing OP/OC, the DRP held that foreign exchange gain has to be treated as part of the OP while computing OP/OC of the assessee and in doing so, following the decision of the Bangalore Tribunal in the case of *SAP Labs (I) P. Ltd. v. ACIT [2011] 44 SOT 156 (Bang. Trib)*. Despite the above direction, the TPO while

giving effect to the directions of the DRP dated 24.11.2016, excluded six comparable companies which was held by the DRP to be not comparable with the assessee. In the aforesaid order, the TPO did not give effect to the directions of the DRP to consider foreign exchange gain as part of operating profits of the assessee.

9. Before us, the Id. counsel for the assessee seeks exclusion of 2 out of 4 comparable companies that remain after the order of DRP and order giving effect to the directions of the DRP passed by the TPO dated 24.11.2016. The 2 companies which the assessee seeks exclusion are L&T Infotech Ltd. and Persistent Systems Ltd.

10. The Id. counsel for the assessee filed before us an order of the Tribunal dated 21.12.2018 in IT(TP)A No.216/Bang/2017 for AY 2012-13 in the case of *Evolving Systems Network (I) P. Ltd.* In this decision also with reference to the software development services provider such as the assessee where the very same 10 comparables were chosen by the TPO as in the present case, the Tribunal held that L&T Infotech Ltd. and Persistent Systems Ltd. cannot be regarded as comparable with the following observations :-

“8. 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 & Tourbro 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.

9. 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.”

11. Following the aforesaid decision of the Tribunal, we direct the exclusion of Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd. from the list of comparable companies.

12. It was submitted that with the exclusion of the aforesaid companies from the list of comparable companies and if foreign exchange gain is regarded as operating profit and the PLI is reworked, then the profit margin of the assessee and the average arithmetic profit mean of the comparable companies that remain after exclusion of the aforesaid two companies would be within the arm's length range and therefore no addition could be made on account of determination of ALP. Hence the other grounds of appeal raised by the assessee in the appeal were not pressed for adjudication.

13. We are of the view that the aforesaid submission is accepted and the other grounds of appeal in challenging the TP adjustment are held to be academic and not decided. We, however, direct the TPO to consider the foreign exchange gain as part of operating profit of assessee and work out the PLI.

14. Only two comparable companies remain after exclusion of 8 out of 10 companies chosen by the TPO viz., Mindtree Ltd. and R S Software (I) Ltd. The TPO is directed to determine the ALP as per the directions contained in this order, after affording due opportunity to the assessee.

15. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on this 6th day of February, 2020.

Sd/-

(B R BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 6th February, 2020.

/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.