

IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE
BEFORE SMT.BEENA PILLAI, JUDICIAL MEMBER
AND
SHRI. O. P. MEENA, ACCOUNTANT MEMBER

IT(TP)A 3136/Bang/2018
Assessment Year : 2014 - 15

M/s. Trainz Holdings Pvt. Ltd., # 165/2, 6 th Floor, 'Kalyani Magnum', Doraisanipalya, IIM Post, Bannerghatta Road, Bengaluru - 560 076. PAN NO : AAFCA8051P	Vs.	Assistant Commissioner of Income - Tax, Circle - 7 (1) (1), 80 Ft. Road, BMTc Building, 2 nd Floor, Koramangala, 8 th Block, Bengaluru - 560 095.
APPELLANT		RESPONDENT

Appellant by	:	Shri. K. R. Vasudevan, Advocate
Respondent by	:	Mr. Muzaffar Hussain, CIT - DR

Date of Hearing	:	22-01-2020
Date of Pronouncement	:	26-02-2020

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal has been filed by assessee against order dated 26/09/18 passed by Ld. ACIT Circle - 7(1)(1), Bangalore for assessment year 2014 - 15 on following grounds of appeal:

1. Assessment Order passed by the learned Assessing Officer not in compliance with provisions of law

- 1.1. The order passed by the learned Assessing Officer (“AO”) is bad in law and liable to be quashed for the reason that the same is not in conformity with the directions of the Hon’ble Dispute Resolution Panel (“DRP”) and has been passed by the learned AO without application of mind.
- 1.2. The order passed by the learned AO is not line with the statutory procedure prescribed in sections 144C (10), 144C (13) and 144C (14) of the Income-tax Act, 1961 (“the Act”) and is accordingly liable to be quashed.
- 1.3. The learned AO has failed to comply with the rules framed by the Central Board of Direct Taxes (“CBDT”) under section 144C(14) of the Act i.e. Rule 12 of Income-tax (Dispute Resolution Panel) Rules, 2009, under which the learned AO is required to pass an order in conformity with the directions of the DRP.
- 1.4. The final assessment order passed by the learned AO were not in accordance with the directions of the DRP and hence a void order under the provisions of the Act.

2. Transfer Pricing

- 2.1. The learned Assessing Officer (‘learned AO’), learned Transfer Pricing Officer (‘learned TPO’) and the Honourable Dispute Resolution Panel (‘Hon’ble DRP’) have grossly erred in determining an adjustment of INR 42,79,30,761/- to revenue earned by the Appellant from the Associated Enterprises (‘AEs’) with respect to provision of software development services under section 92CA read with section 143(3) and 144C of the Income-tax Act, 1961 (‘the Act’).
- 2.2. The learned AO/ learned TPO/ Hon’ble DRP have erred in rejecting the Transfer Pricing (‘TP’) documentation maintained by the Appellant by invoking provisions of sub-section (3) of section 92C of the Act.
- 2.3. The learned AO/ learned TPO/ Hon’ble DRP have erred in not appreciating the business arrangement of the Appellant and failed to recognize that the revenue earned by the Appellant from rendering software development services represents the entire revenue earned by the AE from third party customer contracts, and thus is in essence an arm’s length transaction.

2.4. The learned AO/ learned TPO/ Hon'ble DRP have erred in rejecting the economic analysis performed by the Assessee in the TP documentation and the Comparable Uncontrolled Price ('CUP') as the most appropriate method in support of arm's length nature of international transaction of receipt of software revenue.

2.5. The learned AO/ learned TPO/ Hon'ble DRP have erred in re-characterizing the provision of software development services by the Appellant as an entrepreneur to a contract software development services to AEs bearing insignificant risk, and thereby applying Transactional Net Margin Method ('TNMM') as the most appropriate method.

2.6. Without prejudice to the above argument (i.e. 1, 2, 3, 4, 5 and 6) of the Appellant:

(a) the learned AO/ learned TPO/ Hon'ble DRP have erred in not commenting and accepting the segmental P&L of the Appellant. In doing so, the Hon'ble DRP have erroneously interpreted the segmented financial of the Appellant as the segmented financial of the AEs, and contended that the Appellant is incurring losses on provision of services to the AEs.

(b) the learned AO/ learned TPO/ Hon'ble DRP have erred in not applying upper limit to the turnover filter.

(c) the learned AO/ learned TPO/ Hon'ble DRP have erred in applying different financial year ending filter while selecting the comparable companies thereby not considering the fact that the relevant data for the concerned financial year could be deduced from the corresponding financials.

(d) the learned AO/learned TPO/Hon'ble DRP have erred in applying the service income filter of 75% of the total sales, leading to a narrower set of comparable companies.

(e) the learned AO/learned TPO/Hon'ble DRP have erred in applying export earning filter of 75% of the total sales, leading to a narrower set of comparable companies.

(f) the learned AO/learned TPO/Hon'ble DRP have erred in rejecting companies having employee cost of less than 25% of the total sales, leading to a narrower set of comparable companies.

(g) the learned AO/learned TPO/Hon'ble DRP have erred in applying Related Party Transactions ('RPT') filter of more than 25% of the sales, leading to a narrower set of comparable companies.

(h) the learned AO/learned TPO/Hon'ble DRP have erred in not considering the provision for bad and doubtful debts as operating in nature.

(i) the learned AO/ learned TPO/ Hon'ble DRP have grossly erred in not rejecting the following companies as comparable:

- Infosys Ltd.
- Larsen & Toubro Infotech Ltd.



- Mindtree Ltd.
 - Persistent Systems Ltd.
 - Cigniti Technologies Ltd.
 - R S Software (India) Ltd.
 - Thirdware Solution Ltd.
- (j) the learned AO/ learned TPO/ Hon'ble DRP have grossly erred in computing the margin of Infosys Ltd at 36.13%.
- (k) the learned AO/ learned TPO/ Hon'ble DRP have grossly erred in not restricting the transfer pricing adjustments, (if, any) only to the international transactions of the Appellant. In doing so, the Hon'ble DRP has erroneously characterized the operations of the Appellant as a manufacturing activity having imports from AEs ignoring the fact that the Appellant is an entrepreneurial software development service provider.
- (l) the learned AO/ learned TPO/ Hon'ble DRP have grossly erred in rejecting companies that ought to have been accepted as comparable:
- Akshay Software Technologies Ltd.
 - KALS Information Systems Ltd.
 - Helios & Matheson Information Technology Ltd.
 - Sasken Communication Technologies Ltd.
 - Daffodils Software Ltd.
 - I2T2 India Ltd.
 - Maveric Systems Ltd.
 - Evoke Technologies Ltd.

3. Corporate Tax

3.1 Disallowance of expenditure under section 14A of the Act - INR 23,90,960

- 3.1.1 The learned AO/ Hon'ble DRP erred in law while disallowing expenditure under section 14A of the Act read with Rule 8D of the Income-tax Rules, 1962, when the Appellant was not in receipt of any exempt income during the year.
- 3.1.2 The learned AO/ Hon'ble DRP failed to appreciate that no expenditure was incurred by them in relation to the investment made in shares.

3.2 Disallowance under section 10AA of the Act - INR 5,85,556

- 3.2.1 The learned AO has erred in re-computing the deduction under section 10AA of the Act.
- 3.2.2 The learned AO ought to have observed that the expenditure incurred foreign currency and concluded the same were not attributable to delivery of software or incurred in rendering of services outside India and the same need not be reduced from the export turnover.

3.2.3 *Notwithstanding and without prejudice to the above*, the learned AO ought to have observed that, if the said foreign currency expenses were excluded from export turnover, the same ought to also be reduced from total turnover in computing deduction under Section 10AA of the Act.

3.3 Non-grant of set off of brought forward business losses of STPI Unit – INR 6,03,79,168

3.3.1 The learned AO/ Hon'ble DRP had erred in law while not recognizing the brought forward business loss pertaining to the STPI unit of the Appellant.

3.3.2 The learned AO/ Hon'ble DRP grossly erred while non-granting the set off of brought forward business losses of STPI unit for AY 2007-08 and 2008-09 with the profits of AY 2014-15 in the assessment order.

3.3.3 For the year under consideration the company had brought forward business losses of STPI unit for AY 2007-08 and 2008-09 to an extent of INR 19,23,113 and INR 5,84,56,055.

3.4 Non-grant of carry forward and set off of Unabsorbed depreciation – INR 36,44,840

3.4.1 The learned AO/ Hon'ble DRP had erred in law while non-granting the setting off the brought forward unabsorbed depreciation of the Appellant against the income from other sources of the Appellant.

3.4.2 As per the provisions of the Act, the unabsorbed depreciation can be carried forward and set off against income from other sources.

3.4.3 The Appellant submits that the learned AO has not considered the carry forward of unabsorbed depreciation of INR 36,44,840 in the assessment order to be set off against the income from other sources.

3.5 Levy of interest under section 234A of the Act- INR 10,90,760

3.5.1 The learned AO has erred in levying interest under section 234A of the Act amounting to Rs. 31,38,070.

3.5.2 The due date of filing the return of income in case of an Assessee who is required to furnish a report referred under section 92E of the Act, is 30th November of the Assessment year.

3.5.3 The learned AO ought to have appreciated that the appellant has filed the return of income on 29 November 2014 i.e. within the due date of filing the return of income for Assessment year 2014-15 i.e. 30 November 2014 and accordingly, any levy of interest under section 234A of the Act is unjustified and unwarranted under the provisions of the Act.

3.6 Excess levy of interest under section 234B of the Act – INR 8,52,73,020

3.6.1 The learned AO has erred in computing interest under section 234B of the Act, which is consequential to the above grounds of appeal.

Brief facts of the case are as under:

2. Assessee is a company engaged in the business of providing information technology services. It filed its Return of income for year under consideration on 29/11/14 declaring total income at “nil”. The case was selected for scrutiny and notice under section 143 (2) was issued. Subsequently notice under section 142 (1) along with questionnaire was issued upon assessee in response to which representatives of assessee appeared before Ld.AO and filed requisite details as called for. Ld.AO observed that assessee had international transaction with associated enterprises exceeding Rs.15 crores, and accordingly case was referred to transfer pricing officer for determining arm’s length price of international transaction.

3. Upon receipt of reference, Ld.TPO called upon assessee to file economic details of international transaction in Form 3 CEB. Ld.TPO observed that, assessee is providing information technology services to global clientele to high technology, banking, healthcare, insurance, telecom manufacturing clients. It was observed that assessee has its operations in USA, Japan and India. In USA assessee operates through its subsidiaries.

4. Ld.TPO observed that, assessee had following transaction with associated enterprises:

Description	Payable (Rs.)	Receivable (Rs.)	MAM
Loan		64,21,010/-	CUP
Purchase of services and products	12,06,78,01,00/-		CUP
Third-party billing		1,83,38,86,422/-	CUP
Total	1,20,67,80,100/-	1,84,03,07,432/-	

5. It has been submitted by Ld.AR that Ld.TPO carried out analysis of international transaction without understanding business model of assessee.

6. Ld.TPO rejected analysis carried out by assessee and observed that functions of assessee was to develop software/providing software services, as was in previous year. Ld.TPO observed that in previous year, assessee chose TNMM as most appropriate method in transfer pricing analysis, whereas for current year, though there is no change in business scenario, and that assessee was providing same kind of services to both AE and non-AE, CUP has been used. Ld.TPO therefore rejected CUP, instead, considered TNMM for determining ALP of the transaction. Ld.TPO applied filters for determining set of following 8 comparables, with an average margin of 29.40%:

Sl. No.	Comparables selected	Margin
1.	Infosys Ltd	36.13%
2.	Larsen and Toubro Infotech Ltd	27.36%
3.	Mindtree Ltd	20.43%

4.	Persistent systems Ltd	35.10%
5.	R S software (India) Ltd	24.23%
6.	Cigniti technologies Ltd	27.62%
7.	SQS India BSFI Ltd	22.25%
8.	Thirardware solutions Ltd	50.45%
	Total	29.40%

7. Ld.TPO computed average margin of comparables at 29.48% as against 7.80% of assessee, thereby proposing an adjustment being shortfall amounting to Rs.41,00,84,082/-.

8. Ld.TPO also made following observations:

- that operational arrangement of assessee with its associated enterprise AE is of a routine contract software development service provider;
- Ld.TPO rejected TNMM as most appropriate method as against CUP, and disregarded submissions of assessee in this regard;
- Ld.TPO concluded that assessee operates on a cost-plus markup basis, and observed that turnover is not relevant, since there is no impact of turnover on cost plus margin earned by assessee;
- Ld.TPO rejected submissions of assessee regarding Infosys being functionally different and failing upper turnover filter;
- Ld.TPO rejected submissions of assessee regarding comparables alleged for exclusion on functional dissimilarity;
- Ld.TPO rejected companies having different financial year ending and rejected companies having software development service income less than 75% of the total turnover;

- Ld.TPO rejected assessee's contention treating provision for doubtful debts as operating expenses, instead, treated it non-operating item while calculating margins of comparable companies.
- Ld.TPO rejected certain comparables alleged for inclusion by assessee.

9. Ld.AO while passing draft assessment order computed disallowance under section 14 A at Rs.23,90,960/-, and also did not grant deduction under section 10AA of the Act to the extent of certain expenditure in foreign currency amounting to Rs.19,92,074/- in Chennai unit and Hydrabad unit from export turnover.

10. Aggrieved by additions made by Ld.AO/TPO in draft assessment order, assessee raised objections before DRP. DRP simply upheld findings of Ld.TPO in respect of transfer pricing issues, however excluded ICRA Techno Analytics Ltd. DRP also held that, since assessee did not have any provision for doubtful debts during the year under consideration, objection in relation to treating it as operating item in respect of comparables was rejected.

11. Upon receipt of directions from DRP, Ld.AO passed impugned assessment order, against which assessee is in appeal before us. Ld.AR submitted that assessee do not wish to press **Grounds 1, 2.1, 2.2., 2.3.**

Accordingly, these ground stands dismissed as not pressed.

12. At the outset, Ld.AR submitted that entire transfer pricing analysis carried out by Ld.TPO is without understanding the business model of assessee.

He narrated the business model of assessee as under:

13. At the outset, Ld.AR submitted that assessee is the holding company of its subsidiaries located in USA and Japan. For all part practical purposes, the subsidiary companies in USA and Japan entered into contracts with the 3rd parties for rendering services, and the revenue generated therein is remitted to India. Ld.AR submitted that, assessee entered into agreements with its subsidiaries in USA, wherein it is agreed that revenue generated from third-party customer contracts in USA for which work is done out of India will be paid to the assessee in entity. It is also submitted that the customer who are based in USA prefers to engage locally and hence the AE is enter into contracts with the customers for provision of services. He placed reliance on the agreements with its subsidiary AE's placed in paper book.

14. Ld.AR submitted that, observations of Ld.TPO regarding associated enterprises baring all risk related to services rendered and that assessee is working on cost plus mark-up basis is not in accordance with facts. Ld.AR submitted that, it is incorrect to say that assessee in preceding year used CUP as MAM in relation to income earned for rendition of software development services. He submitted that for assessment year 2013-14 TNMM was considered only in respect of services availed from U.S. associated enterprises and not for services rendered to subsidiary AE's. It has been submitted that in current year as well as in earlier year,

assessee used CUP for software services rendered to subsidiary AE's.

15. Ld.AR thus been submitted that, Ld.TPO on wrong assumption of facts, carried out transfer pricing analysis, and selected inappropriate comparables which do not match with the functional profile of assessee. He submitted that even DRP also failed to appreciate contentions of assessee, and simply upheld observations of Ld.TPO without dealing with objections raised.

16. Ld.CIT DR though referred to orders passed by authorities below, could not controvert functional profile of assessee, having regards to agreements entered into by assessee which is placed in the paper book.

We have perused submissions advanced by both sides and having regards to the records before us.

17. Admittedly, ongoing through agreements entered into by assessee at page 659 of paper book, it is clear that assessee has 2 segments being AE segment and non-AE segment. Associated enterprises are subsidiaries of assessee, and in order to have the ease of business, associated enterprises enter into contract with 3rd parties for providing services. From these agreements it is clear that assessee bares all risk related to services rendered, whereas subsidiary AE's only. On the contrary, authorities below assumed that assessee is working on a cost-plus model with associated enterprises and that associated enterprises undertakes all risk related to service provided by assessee.

18. We observe that, Ld.TPO considered assessee to be a contract service provider, assuming minimal risk, which is contrary to the

business model of assessee. We agree with contention of Ld.AR that Ld.TPO conducted TP analysis on erroneous understanding of business model of assessee, and comparables selected by Ld.TPO cannot be looked into.

19. We are therefore of opinion that, adjustment made by Ld.AO on the proposed adjustment by Ld.TPO should be revisited *de novo*. Accordingly, we set aside all issues raised by assessee on transfer pricing issues to Ld.AO/TPO. LD.AO/TPO is directed to carry out transfer pricing analysis having regard to the business model of assessee. It is also directed that comparables selected should be functionally similar with assessee, having similar business model like assessee.

20. Assessee is directed to produce all relevant documents to bring out its role in providing services to the parties situated outside India. Ld.TPO is also directed to grand working capital adjustments in comparables in actual where ever necessary, for computing correct margins of comparables.

Needless to say, that assessee shall be granted proper opportunity of being represented.

Accordingly, we set aside Grounds 2.4- 2.6 to Ld.AO/TPO for statistical purposes.

Corporate Tax issues:

21. Ld.AR submitted that, assessee do not wish to press **Ground no. 3.2** accordingly these ground with its sub grounds raised stands dismissed.

Ground no.3.3 along with its sub grounds are against 14 A disallowance.

22. It is submitted that assessee did not have any exempt income during the year under consideration. Only dividend earned by assessee is from investment in foreign banks, which are subjected to tax.

Ground no.3.4 is in respect of non-granting of carry forward and set off of unabsorbed depreciation.

It has been submitted that **Ground no. 3.5** is in respect of interest u/s. 234 A/B.

24. DRP had directed Ld.AO to verify submissions of assessee, which has not been done by Ld.AO. Both sides submit that these issues may be sent back to Ld.AO for due verification.

Based upon the submissions by both sides, we direct Ld.AO to call for necessary details for verifying the contentions of assessee, and if found correct to allow the claim as per law.

Needless to say, that assessee shall be granted proper opportunity of being heard in accordance with law.

Accordingly, corporate issues argued by Ld.AR are set aside to Ld.AO for statistical purposes.

In the result, appeal is set aside to Ld.AO/TPO partly for statistical purposes.

Order pronounced in the open court on 26th February, 2020.

Sd/-
(O. P. MEENA)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 26th February, 2020.
/MK/

Copy to:

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

By order

Assistant Registrar,
Income Tax Appellate Tribunal.
Bangalore.

		Date	Initial	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	10-02-2020		Sr.PS
3.	Draft proposed & placed before the second member			JM/AM
4.	Draft discussed/approved by Second Member.			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			Sr.PS/PS
6.	Kept for pronouncement on			Sr.PS
7.	Date of uploading the order on Website			Sr.PS
8.	If not uploaded, furnish the reason			Sr.PS
9.	File sent to the Bench Clerk			Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS