

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I-2', NEW DELHI**

Before Ms. Sushma Chowla, Vice President

Dr. B. R. R. Kumar, Accountant Member

ITA No. 1077/Bang./2012 : Asstt. Year : 2007-08

M/s BEA Systems India Technology Centre Pvt. Ltd., C/o Oracle India P. Ltd., Commerce @ Mantri, 12/1 & 12/2, N.S. Palya, Level 2, 4-8, Bannerghatta Road, Bangalore-560076	Vs	Dy. Commissioner of Income Tax, Circle-11(2), 5 th Floor, R.P. Bhavan, Nrupathunga Road, Bangalore
(APPELLANT)		(RESPONDENT)
PAN No. AACCB2736K		

ITA No. 1272/Bang./2012 : Asstt. Year : 2007-08

Dy. Commissioner of Income Tax, Circle-11(2), 5 th Floor, R.P. Bhavan, Nrupathunga Road, Bangalore	Vs	M/s BEA Systems India Technology Centre Pvt. Ltd., C/o Oracle India P. Ltd., Commerce @ Mantri, 12/1 & 12/2, N.S. Palya, Level 2, 4-8, Bannerghatta Road, Bangalore-560076
(APPELLANT)		(RESPONDENT)
PAN No. AACCB2736K		

Assessee by : Sh. Ravi Sharma, Adv.

Revenue by : Ms. Nidhi Sharma, Sr. DR

Date of Hearing: 12.03.2020

Date of Pronouncement: 30.04.2020

ORDER

Per Dr. B.R.R. Kumar, Accountant Member:

The present appeals have been filed by the assessee and revenue against the order of the Id. CIT (A)-IV, Bangalore dated 05.07.2012.

2. Following grounds have been raised by the revenue:

"1. The order of the Commissioner of Income Tax (Appeals)-I, Bangalore is opposed to law and facts of the case.

2. The Commissioner of Income Tax (Appeals) erred in stating that what is excluded from export turnover needs to be excluded from total turnover.

3. The Commissioner of Income Tax (Appeals) erred in relying on the decision in the case of Tata Elxsi Limited in the circumstance when the High Court decision is not accepted by Department and SLP is filed.

4. In the facts and circumstances of the case, the Id. CIT (A) erred in holding that M/s Celestial Labs and Flextronics Software Systems Ltd. being functionally different, cannot be taken as comparables on the transfer pricing issue."

3. Ground No.1 is general and does not require any adjudication.

4. The issue raised vide Ground No. 2 is against the direction of CIT(A) vide para 4.1.3 that the telecommunication expenses and other expenses incurred in foreign currency need to be excluded from "export turnover" as per clause (iv) of Explanation 2 to section 10A of the Act, however, they are also required to be excluded from the "total turnover". The CIT(A) held that the same are to be excluded in turn relying on the decision of Hon'ble Karnataka High Court in the case of CIT vs Tata Elxsi Ltd. and others (ITA No.70/2009 & Others).

5. Ground No. 3 of the revenue appeal relates reliance of the Id. CIT (A) on the order of the Hon'ble High Court in the case of Tata Elxi Ltd. which was not accepted by the department

and wherein SLP has been filed. At this juncture, we hold that reference to filing of SLP cannot be a reason not to accept the order of the Hon'ble jurisdictional High Court. No interference is called for in the order of the Id. CIT (A).

6. Ground No. 4 of the revenue appeal relates to accepting Celestial Labs and Flextronics Software Systems Ltd. We find from the record that the Id. CIT (A) has excluded Flextronics Software Systems Ltd. based on the RPT filter which has been applied to all 18 comparables. Similarly, in the case of Celestial Labs Ltd. the same has been excluded along with other companies as they do not have any onsite revenue. Hence, the decision of the Id. CIT (A) cannot be interfered with as these companies do not meet the required filters applied by the Id. CIT (A).

7. Following grounds have been raised by the assessee:

"1. That the order passed by the learned Commissioner of Income Tax (Appeals) - IV, Bangalore ('CIT (A)'), to the extent prejudicial to the Appellant, is bad in law and liable to be quashed, [corresponding to ground 1 of original grounds of appeal].

2. That the learned CIT (A) erred in upholding the rejection of Transfer Pricing ('TP') documentation by the learned Transfer Pricing Officer ('TPO')/ Assessing Officer ('AO') and in upholding adjustment to the transfer price of the Appellant in respect of its software development services by Rs. 4,86,03,466 and in the information technology enabled services by Rs.71,09,586. [corresponding to ground 2 of original grounds of appeal]

3. The learned CIT-(Appeals) has erred in upholding the rejection of comparability analysis of the Appellant in the TP documentation and accepting the

comparability analysis performed by the learned TPO in the TP Order; [corresponding to ground 3(a) of original grounds of appeal]

4. That the learned CIT(A) has erred in upholding the learned TPO's action of carrying out his own comparability analysis and modifying some of the filters applied by the Appellant (i.e. related party transaction ['RPT'] filter >0% applied by the learned CIT(A)), without providing an opportunity of being heard; [corresponding to ground 3(b) of original grounds of appeal]

5. That the learned CIT(A) erred in applying RPT>0% filter in excluding companies, whereas RPT> 15% filter should have been applied and accordingly should have excluded Accel Transmatic Ltd., Geometric Ltd., R Systems International Ltd and Ishir Infotech Ltd in the software development segment of the Appellant and Apollo Health Street Limited, Caliber Point Business Solutions Ltd., HCL Comnet Systems and Services Ltd. and Informed Technologies Ltd in the ITES segment of the Appellant; [corresponding to ground 3(b) of original grounds of appeal]

Software Development Services Segment

6. That, without prejudice, the learned CIT(A), while excluding Avani Cimcon Technologies Ltd. on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the software development segment of the Appellant, as it is a software product company that owns products like Exchange, Travel solutions, Insurance solutions, customer appreciation and relationship management application (CARMA), content management systems, etc, having no segmental information; [corresponding to ground 3(c) of original grounds of appeal]

7. That the learned AO/TPO have erred in considering e-Zest Solutions Ltd. as a functionally comparable company to the software development services of the Appellant, whereas this company is

functionally dissimilar as it is engaged in software product development and providing technical services coming under the category of KPO services; [corresponding to ground 5 of additional grounds]

8. That, without prejudice the learned CIT(A) while excluding Flextronics Software Systems Ltd only on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the software development segment of the Appellant, as it is engaged in both software services, products and BPO services, having no bifurcation between software services & products, undertakes R&D activities and has intangibles; [corresponding to ground 3(c) of original grounds of appeal]

9. That, without prejudice, the learned CIT(A) while excluding Ishir Infotech Ltd on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the software development segment of the Appellant, as it outsources its services for which it pays professional fees which constitutes significant portion of its total cost, fails employee cost filter of 25% applied by TPO and related party transactions are in excess of 15% of its sales ; [corresponding to ground 3(c) of original grounds of appeal]

10. That the learned CIT(A) erred in upholding the approach of the learned TPO in including KALS Information Systems Ltd as functionally comparable to the software development segment of the Appellant, whereas this company is functionally dissimilar, as it has significant revenue from software products and no segmentation is available; [corresponding to ground 3(c) of original grounds of appeal]

11. That the learned AO/TPO erred in not appreciating that Lucid Software Ltd is functionally not comparable to the software development segment of the Appellant, as it is a software product company which has incurred substantial product development expenditure; [corresponding to ground 3(c) of original grounds of appeal]

12. That the learned CIT (A) erred in excluding Mediasoft Solutions Ltd. on account of functional dissimilarity and low margin, whereas this company is functionally comparable to the software development segment of the Appellant; [corresponding to ground 6 (additional grounds)]

13. That, without prejudice, the learned CIT (A) while excluding Persistent Systems Ltd. on the ground of RPT>0%, has failed to appreciate that this company should have been excluded on the basis of it being functionally dissimilar to the software development services of the Appellant, as it is engaged in provision of software services and software product development with no segmental information available [corresponding to ground 5 of additional grounds)]

14. That, without prejudice, the learned CIT(A) while excluding Tata Elxsi Ltd on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the software development segment of the Appellant, as it is engaged in providing embedded product design services, industrial design & engineering and has visual computing labs wherein it provides animation & visual effects services and has engaged in R&D activities; [corresponding to ground 3(c) of original grounds of appeal]

15. That, without prejudice, the learned CIT (A) while excluding Thirdware Solutions Ltd. on the ground of RPT>0%, has failed to appreciate that this company should have been excluded on the basis of it being functionally dissimilar to the software development services of the Appellant, as it is engaged in sale of software licence, provision of product development & software services and sale of investments, having no segmental information; [corresponding to ground 5 (additional grounds)]

IT Enabled Services Segment

16. That the learned AO /TPO have erred in considering Accentia Technologies Ltd. as a functionally comparable company to the Appellant,

whereas this company is functionally dissimilar to the IT enabled services segment of the Appellant as it provides Medical transcription, billing, coding and software development & implementation services, having no segmental information and having extraordinary event like amalgamation contributing to extraordinary growth in revenues; [corresponding to ground 7 (additional grounds)]

17. That the learned CIT (A) erred in upholding the action of the learned TPO in including Bodhtree Consulting Ltd. as a functionally comparable company to the IT enabled services segment, whereas this company has fluctuating margins due to its revenue recognition model and has RPT > 15% of revenue; [corresponding to ground 7 (additional grounds)]

18. That, without prejudice, the learned CIT(A) while excluding Caliber Point Business Solutions Ltd on the ground of RPT>0%, has failed to appreciate that this company cannot be compared to the IT enabled segment of the Appellant as it is engaged in Research & development activities and has related party transactions exceeding 15% of its revenue; [corresponding to ground 3(c) of original grounds of appeal]

19. That, without prejudice, the learned CIT(A) while excluding Eclerx Services Ltd on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled segment of the Appellant, as it is engaged in providing specialized services like Data Analytics, Operations Management and Audits & Reconciliation services which are in the nature of nature of Knowledge Process Outsourcing ('KPO') service and cannot be compared to a support services company like Appellant; [corresponding to ground 3(c) of original grounds of appeal]

20. That, without prejudice, the learned CIT(A) while excluding HCL Comnet Systems and Services Ltd. (seg) on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled segment of the

Appellant, as it provides connectivity services, security services and IT infrastructure management services, has intangibles, has RPT >15% of sales and has a different accounting year; [corresponding to ground 3(c) of original grounds of appeal]

21. That, without prejudice, the learned CIT(A) while excluding Informed Technologies Ltd on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled segment of the Appellant, as it is knowledge based Back-office processing company which is engaged in collecting and analyzing the data on financial fundamentals, corporate governance, director executive compensation and capital market and also

has RPT>15%; [corresponding to ground 3(c) of original grounds of appeal]

22. That, without prejudice, the learned CIT (A) erred in excluding Infosys BPO Ltd. on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled services segment of the Appellant, as it is engaged in providing high-end services, has brand value, intangibles and has incurred selling & marketing expenses; [corresponding to ground 7 (additional grounds)]

23. That the learned AO/TPO have erred in considering I services India Ltd. as a functionally comparable company to the IT enabled services segment of the Appellant, whereas this company is functionally dissimilar as it provides Geographic Information System services, Insurance claim processing, mortgage loan processing, cheque processing services, that cannot be compared to support services of the Appellant; [corresponding to ground 7 (additional grounds)]

24. That the learned AO/ TPO have erred in considering Maple e-Solutions Ltd. as a functionally comparable company to the IT enabled services segment, whereas this company cannot be taken as a comparable due to a serious indictment on the Management/Board of the company, making its

financial information unreliable; [corresponding to ground 7 (additional grounds)]

25. That, without prejudice, the learned CIT (A) while excluding Mold-Tek Technologies Ltd on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled services segment of the Appellant, as it is engaged in providing high end engineering design and detailing that cannot be compared with the services of the Appellant, and having extraordinary event of amalgamation contributing to supernormal profits; [corresponding to ground 7 (additional grounds)]

26. That the learned AO/TPO have erred in considering Triton Corp Limited as a functionally comparable company to the IT enabled services segment of the Appellant, whereas this company cannot be taken as a comparable due to a serious indictment on the Management/Board of the company, making its financial information unreliable; [corresponding to ground 7 (additional grounds)]

27. That the learned CIT (A) erred in upholding the action of the learned TPO in including Vishal Information Technologies Ltd. as a functionally comparable company to the IT enabled services segment of the Appellant, whereas this company is functionally dissimilar as it has a different business model wherein it provides agency services by outsourcing services to third party vendors and acting as an intermediary between the final customer and the vendor and thereby having low employee cost of 2.3% of its revenue; [corresponding to ground 7 (additional grounds)]

28. That, without prejudice, the learned CIT (A) while excluding Wipro Ltd. only on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to the IT enabled services segment of the Appellant, as it is engaged in providing activities of various fields like technology innovation, process innovation & delivery

innovation, has brand value and is engaged in significant Research and development activities, unlike the Appellant; [corresponding to ground 3(c) of original grounds of appeal]

29. That, without prejudice, the learned CIT (A) erred in excluding Accurate Data Convertors Ltd. on the ground of RPT>0%, has failed to appreciate that this company is functionally dissimilar to IT enabled services segment of the Appellant as the company provides software development services ; [corresponding to ground 7 (additional grounds)]

30. That the learned CIT(A) has erred in upholding the approach of the learned TPO in disregarding application of multiple year/prior year data as used by the Appellant in the TP documentation and holding that current year (i.e. Financial year 2006-07) data for companies should be used for comparability; [corresponding to ground 3(d) of original grounds of appeal]

31. That the learned CIT(A) has erred in upholding the learned TPO's approach of using data as at the time of assessment proceedings, instead of that available as on the date of preparing the TP documentation for comparable companies while determining the arm's length price; [corresponding to ground 3(e) of original grounds of appeal]

32. That the learned CIT(A) has erred in upholding the approach adopted by the learned TPO of collecting selective information of the companies by exercising power granted to him under section 133(6) of the Income Tax Act, 1961 ('Act') that was not available to the Appellant in the public domain, [corresponding to ground 3(f) of original grounds of appeal]

33. That the learned CIT(A) has erred in not providing appropriate adjustment towards the risk differential/ between the Appellant and the entrepreneurial companies selected as comparables while determining the arm's length price,

[corresponding to ground 3(g) of original grounds of appeal.

34. That the learned CIT(A) has erred in upholding the consequential charging of interest under section 234B and 234D of the Act. [corresponding to ground 4 of original grounds of appeal]

35. That the learned AO/learned TPO erred in not including the amount of advances received from holding companies for the purpose of computing the working capital adjustment, [corresponding to ground 8 (additional grounds)]”

8. The grounds of the assessee appeal are being dealt issue wise as under.

9. The assessee excluded companies that have substantial transaction to the tune of more than 25% with related parties were excluded. The TPO held that it is an appropriate filter to eliminate the influence of the control transactions. The Id. CIT (A) held that even a one comparable without related party transaction is arrived on the comparability analysis, there is no rationale to retain the comparables which have related party transactions. The Id. CIT (A) is of the opinion that only if it is not possible to find out any comparable without the related party transaction, the TPO has to apply a suitable filter to identify such comparables, margins on which are not influenced by the related party transaction to make a purposive interpretation uncontrolled transaction. In the instant case, the Id. CIT (A) held that there is no need to include any comparable which has a related party transaction as there are a number of comparables available for the study which do not have any related party transactions. Holding this, he excluded Accel Transmatic Ltd., Geometric Ltd., R Systems

International Ltd and Ishir Infotech Ltd in the software development segment and Apollo Health Street Limited, Caliber Point Business Solutions Ltd., HCL Comnet Systems and Services Ltd. and Informed Technologies Ltd in the ITES segment.

10. We have gone through the arguments and facts on record. In the case of Ariba Technologies India (P.) Ltd. v. ITO 67 taxmann.com 265, the ITAT held that finding comparables having zero per cent RPT transaction is impossible and therefore a reasonable tolerance range has to be considered for selecting uncontrolled comparables. The tolerance range is dependent on the availability of comparables. Thus if comparables are easily available tolerance range of RPT should be restricted to minimum. The Hon'ble High Court of Delhi in the case of PCIT Vs Oracle (OFSS) BPO Services (P.) Ltd. 253 Taxman 498 held that the RPT filter is relevant and fits in with the overall scheme of a transfer pricing study which is premised primarily on comparing light entities having similar if not identical functions. Therefore, if a particular entity predominantly has transactions with its associate enterprise – in excess of a certain threshold percentage, its profit making capacity may resulted in a distorted picture, either way. The Hon'ble Court was of the opinion that the broad threshold figure of 25% RPT in the case of comparables was essential. We take into account, the RPT and find it correct to exclude certain comparables by applying a broad ballpark threshold of taken into account, the functioning and profits of comparable entities who is unrelated transactions were in excess of 75% of the business. Nil percentage criteria would result in selection

of very few companies which may not give sufficient base for comparable. If the related party transactions do not have material effect on the overall profit margins then still that company can be considered as a comparable. The Act does not provide directly as to what percentage of related party transactions can have material effect on the overall margins. But however guidance can be taken from definition of the Associated Enterprise from Section 92A(2)(e) where in it is prescribed that one enterprise holding 26% shares in the other enterprise can be considered as an associate enterprise. Similarly in the provisions of Section 40A(2)(b) the persons having substantial interest is described as a person carrying not less than 20% of voting power in that company. Thus it is found that 20% or 26% interest is considered as substantial interest. As the provisions of Section 92A(2)(a) are from the transfer pricing chapter itself, a limit of 25% is applied as the threshold limit for the related party transactions. If the limit is reduced further it would only result in eliminating more and more companies, on the other hand if the limit is relaxed then companies with predominantly related party transactions would get included which would not represent uncontrolled transactions. The companies having more than 25% related party transactions should therefore be rejected as comparables. Hence, keeping in view the entirety of the facts, we order that the decision of the Id. CIT (A) on the issue of RPT cannot be upheld. Accordingly, we direct the exclusion of concerns Accel Transmatic Ltd., Geometric Ltd., R.Systems International Ltd. and Ishir Infotech Ltd. in the software development segment of the appellant and Apollo Health Street Limited, Caliber

Point Business Solutions Ltd., HCL Comnet Systems and Services Ltd. and Informed Technologies Ltd. in the ITES segment.

11. The comparable Avani Cimcon Technologies Ltd., e-Zest Solutions Ltd., Flextronics Software Systems Ltd., Ishir Infotech Ltd., Mediasoft Solutions Ltd., Thirdware Solutions Ltd. cannot be functionally similar, hence cannot be taken as comparable. The details are as under:

S.No.	Name of the comparable	Reasons	Remarks
1.	Avani Cimcon Technologies Ltd.	<ul style="list-style-type: none"> Segmental details are not available The company is involved in provision of IT and related services and owns software products 	Since, functionally the company dissimilar and no segmental details are available, cannot be considered as a comparable.
2.	e-Zest Solutions Ltd.	<ul style="list-style-type: none"> Segmental details are not available The company diversified into customs software development, CRM ERP, knowledge management consultancy and legal solutions. 	Since, functionally the company dissimilar and no segmental details are available, cannot be considered as a comparable.
3.	Flextronics Software Systems Ltd.	<ul style="list-style-type: none"> Segmental details are not available Financials are available only for the period July 2006 to March 2007 Develop software products and provides software consultancy services and is also a product company 	Since, functions are different, financials are insufficient and in the absence of segmental details cannot be considered as a right comparable.

4.	Ishir Infotech Ltd.	Employees cost / sales filter is greater than 4%	Fails TPO's filter of employees cost / sales filter is greater than 25%
5.	Mediasoft Solutions Ltd.	<ul style="list-style-type: none"> • Low margin company • Not in IT sector 	Insufficient financials and does not meet FAR analysis.
6.	Thirdware Solutions Ltd.	<ul style="list-style-type: none"> • Segmental details are not available • Functionally derived revenue from sale of license software services and export from SEZ 	Since, functionally dissimilar and in the absence of segmental data cannot be considered as a correct comparable

12. Regarding the KALS Information Systems Ltd., we find that the company has got significant revenue from software products and as no segmental are available this needs to be excluded. Similarly, with the case of Lucid Software Ltd. which is predominantly product Development Company, hence the same cannot be taken as a comparable. Similarly Tata Elxsi Ltd. is a product company and the same cannot be taken as a comparable.

13. Regarding the Persistent Systems Ltd., the same is to be excluded owing to extra ordinary event with regard to restructuring during the relevant year wherein the subsidiary Control Net (India) Ltd. was merged with the comparable company.

14. The assessee pleaded for inclusion of the concern Media Soft Solutions Ltd. The TPO had excluded the same because of the low margins. The case of the assessee is that the same merits to be included. However, we find no merit in the same.

15. Now coming to the ITES segment wherein the assessee has chosen 15 comparables to benchmark its transaction. The TPO had finally selected 27 concerns as comparables. The CIT(A) excluded 18 concerns and the assessee before us is contesting the inclusion of 14 concerns. Accentia Technologies Ltd. is found to be functionally not comparable and also owing to the amalgamation of two companies namely, Iridium Technologies Ltd. and Geo Soft Technologies Ltd. Similarly, Bodhtree Consulting Ltd. is excluded; the comparable being mainly into software solutions. Similarly, we find Eclerx Services, Informed Technologies India Ltd. are KPO hence cannot be taken into consideration as a comparable. The concern Infosys BPO Ltd. is engaged in diversified activities and owns intangible and hence cannot be included as comparable. Owing to the reported fraud in the management Maple e-Solutions and Traton Corporation Ltd. cannot be considered as right comparables. The concern High Services Ltd. are providing high-end services and is engaged in web hosting which is not functionally comparable to the assessee. Similarly, Mold Tec Technologies Ltd. is to be excluded as it is providing KPO services. We find Vishal Information Technologies Ltd. has outsourced 43% of the sales and owing to low employee cost to sales ratio of 2.2 this will not be a correct comparable. Accurate Data Convertor is a development services company and Wipro Ltd. has invested in R&D activities for development of IP, hence not meeting the criteria of FAR.

16. Regarding the ground nos. 30, 31, 32 & 33, we find that the action of the TPO is in accordance with the established procedure laid down for TP study. Hence, these grounds may be treated as dismissed.

17. In the result, the appeal of the assessee is allowed and the appeal of the revenue is dismissed.

Order Pronounced in the Open Court on 30/04/2020.

Sd/-

(Sushma Chowla)
VICE PRESIDENT

Sd/-

(Dr. B.R.R. Kumar)
ACCOUNTANT MEMBER

Dated: 30/04/2020

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR