

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

BEFORE SHRI N V VASUDEVAN, VICE PRESIDENT
AND SHRI G MANJUNATHA, ACCOUNTANT MEMBER

IT(TP)A No.1700/Bang/2017
Assessment year: 2013-14

Tavant Technologies India Pvt. Ltd., # 12, CSRIE-II, Guava Garden, 5 th Block, Koramangala, Bangalore – 560 095. PAN: AABCT 3216E	Vs.	The Deputy Commissioner of Income Tax, Circle 7(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Ms. Tanmayee Rajkumar, Advocate
Respondent by	:	Shri Muzaffar Hussain, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	18.08.2020
Date of Pronouncement	:	21.08.2020

ORDER

Per N.V. Vasudevan, Vice President

This appeal by the assessee is directed against the order dated 13.6.2017 of the DCIT, Circle 7(1)(1), Bangalore (hereinafter referred to as the Assessing Officer, “AO” in short) passed u/s.143(3) read with Section 144C(13) of the Income Tax Act, 1961 (the Act) in relation to assessment year 2013-14.

2. The Assessee is engaged in the business of provision of Software Development Services (SWD services), to its wholly owned holding company. In terms of the provisions of Section 92A of the Act, the Assessee and its wholly owned holding company were Associated Enterprises ("AEs"). In terms of Sec.92B(1) of the Act, the transaction of

providing SWD Services and MSS were “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, the Any income arising from an international transaction shall be computed having regard to the arm's length price. In this appeal by the Assessee, the dispute is with regard to determination of Arms' Length Price (ALP) in respect of the aforesaid two international transaction of (i) rendering SWD services to the AE and (ii) rendering of MSS to the AE. We shall deal each of the international transactions separately.

3. As far as the provision of Software Development services are concerned, the Assessee filed a Transfer Pricing Study (TP Study) to justify the price paid in the international Transaction as at ALP by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) of determining ALP. The Assessee selected Operating Profit/Operating Cost (OP/OC) as the Profit Level Indicator (PLI) for the purpose of comparison. The OP/OC of the Assessee was arrived at 25.14% by the Assessee in its TP study. The operating income was Rs. 100,18,13,973 and the Operating Cost was Rs. 80,05,26,590. The Operating profit (Operating income – Operating cost) was Rs. 20,12,87,383. Thus the OP/TC was arrived at 25.14%. The Assessee chose companies who are engaged in providing similar services such as

the Assessee. The Assessee identified 9 companies whose average arithmetic mean of profit margin was comparable with the Operating margin of the Assessee. The Assessee therefore claimed that the price it charged in the international transaction should be considered as at Arm's Length.

4. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred to by the AO, accepted TNMM as the MAM and also used the same PLI for comparison i.e., OP/TC. He also selected comparable companies from database. The TPO accepted two companies chosen by the Assessee as comparable companies. The TPO on his own identified five companies as comparable with the Assessee company and worked out the average arithmetic mean of their profit margins as follows:-

Comparables selected by the TPO and their arithmetic mean

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)	Mark-up on Total Costs (WC-adj) (in %)
1	CG-VAK Software Exports Ltd.	20.54	31.42
2	ICRA Techno Analytics Ltd.	17.10	24.47
3	Larsen and Toubro Infotech Ltd.	26.06	37.15
4	Mindtree Ltd. (seg.)	18.19	30.81
5	Persistent Systems Ltd.	28.27	38.44
6	RS Software (India) Pvt. Ltd.	17.41	29.89
7	Tech Mahindra Ltd. (seg.)	18.72	29.69
AVERAGE MARK-UP		20.90	31.70

5. The TPO computed the Addition to total income on account of adjustment to ALP as follows:-

Computation of arm's length price by the TPO and adjustment made

Arm's Length Mean Mark-up	20.90%
Less: Working Capital Adjustment	-10.53%
Adjusted mean mark-up of the comparables	31.43%
Operating Cost	Rs. 80,05,26,590/-
Arm's Length Price – 125.15% of Operating Cost	Rs. 1,05,21,52,889/-
Price Received	Rs. 3,00,54,419/-
Shortfall being adjustment u/s. 92CA	Rs. 5,03,38,916/-

Thus a sum of **Rs. 5,03,38,916/-** was added to the total income of the Assessee on account of determination of ALP for provision of SWD services by the Assessee to its AE.

6. The Assessee filed objections before the Disputes Resolution Panel (DRP) against the draft assessment order passed by the AO wherein the addition suggested by the TPO as adjustment to ALP was added to the total income of the Assessee by the AO. The Assessee filed objections before the DRP and the DRP gave certain directions. Based on the directions of the DRP, the AO passed the final order of assessment. To the extent the Assessee did not get relief from the DRP, the Assessee has preferred appeal before the Tribunal.

7. At the time of hearing, the grounds that were pressed were grounds 5.1 to 5.4, 6.5 & 6.8, which read as under:-

“5. Comparability Analysis and Determination of Arm's Length Price

Ld. Panel and Ld. AO/TPO erred in computing a negative working capital adjustment on the margins of the comparable companies:

5.1 The Ld. TPO/ AO erred on facts and in law, in computing a negative working capital adjustment on the margins of the comparable companies without appreciating the fact that

Appellant is a risk insulated captive software development service provider and does not carry any working capital risk. The Ld. Panel further erred in upholding / confirming the action of the Ld. TPO/ AO.

Grounds of Appeal for rejection of comparables selected by the Ld. TPO in the order issued u/s 92CA of the Act

- 5.2 The Ld. AO/ TPO grossly erred on facts in confirming the benchmarking of transactions of software development services of the Appellant with companies operating as full-fledged entrepreneurs without considering the differences in the functions performed, assets employed and risk undertaken by the Appellant vis-à-vis comparable companies. The Ld. Panel erred in upholding the actions of the Ld. TPO/AO.
- 5.3 The Ld. TPO erred in selecting CG-VAK Software Exports Limited as comparable in the order u/s 92CA of the Act, despite the business of the company being functionally not comparable to the Software Development services rendered by the Appellant. CG-VAK Software Exports Limited is involved in niche areas of product development during the Financial Year (TY') 2012-13. It is also involved in the business of providing Software Development and BPO services and there is no segmentation available in respect of revenue earned by the said company on account of rendering of software development and BPO services. Accordingly, the said company cannot be compared to the Appellant.
- 5.4 The Ld. TPO erred in selecting Larsen & Toubro Infotech Limited, Mindtree Limited and Persistent Systems Limited as comparables in the order u/s 92CA of the Act, despite that the business of those companies was functionally not comparable to the software development services business of the Appellant. Persistent Systems Limited and Larsen & Toubro Infotech Limited have incurred expenditure on research and development, have significant onsite revenues, own intangibles, have huge turnover. Larsen & Toubro Infotech Limited and Persistent Systems Limited have significant related party transactions for the FY 2012-13.

Accordingly, the said companies cannot be compared to the Appellant, being a risk insulated captive software development service provider.

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6.5. The Ld. AO/ TPO erred on facts in arbitrarily accepting the companies without considering the turnover and size of the Appellant and comparables. The Ld. Panel also erred in confirming the same.

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6.8. The Ld. AO/ TPO erred on facts in wrongly computing the margins of the following companies identified as comparable by the TPO. The Ld. Panel also erred in confirming the same:

- i. CG-VAK Software Exports Limited; and
- ii. Persistent Systems Limited.”

8. As far as ground No.5.2 is concerned, it is general ground with regard to different parameters for choosing a comparable based on functions performed, assets employed and risk undertaken.

9. Ground No.5.3 relates to the assessee's plea for exclusion of CG Vak Software Exports Ltd. as a comparable by the TPO which action was confirmed by the DRP. The grounds on which the assessee sought exclusion of this company as a comparable by the TPO was that it was functionally different in the sense that it was engaged in software product development and absence of segmental data. The TPO & DRP took the view that product development was part of software development services.

10. The Id. counsel for the assessee brought to our notice a decision of ITAT Bangalore in the case of *NXP India P. Ltd. v. DCIT [2020] 116 taxmann.com 421 [Bang Trib.]* wherein in the case of an assessee for AY 2013-14 engaged in Software development services such as the assessee

it was held that CG Vak Software Exports Ltd. was not a good comparable. The following were the relevant observations of the Tribunal:-

“III. C G Vax Software & Exports Limited

24. The learned AR submitted that this company should be excluded for the reason that C G VAX Software & Exports Limited is engaged in software development and sale of products which involves high degree of R & D expenditure and to demonstrate the same, he drew our attention to the paper book page Nos.1018 and 1034 and submitted that the nature of the business of software development involves inbuilt, constant Research and Development as a part of its process of manufacturing (development). The company is developing applications engines, re-usable codes and libraries as a part of its R & D activities. Further, it has intangible assets as shown in the financial statement as on 31.03.2013 at Rs.3,03,83,536 and it is also engaged in outsource product development, as is evident from the attached notes forming part of the accounts. The learned AR also submitted that C G VAK Software & Exports Limited was not considered as a comparable in the case of M/s. EPAM Systems India Private Limited (ITA No.2122/Hyd/2017 for assessment year 20132014). Vide order dated 20-11-2018, the Tribunal held as under:-

"16. Having regard to the rival contentions and the material on record, we find that the assessee has raised its objections before 10 the TPO but he held that it is functionally similar. We have gone through the annual reports of CGVAK Software & Exports Ltd and find that the said company is having revenue from both software services and BPO services but there is no segmental data with regard to each of these transactions. Therefore, as held by the Coordinate Bench of the Tribunal in a number of cases (cited *supra*), we hold that this company cannot be taken as a comparable to the assessee-company. Accordingly, we direct the TPO to exclude this company from the final list of comparables. "

24.1 Similarly, in the case of *M/s.ION Trading India Private Limited v. ITO* (ITA No.1035/Del/2015 for the assessment year 2010-2011). The Tribunal vide its order dated 7-12-2015, held as under:-

"21. We have considered the submission of the Id. counsel for the assessee and have considered the argument of the Id. DR that the assessee is not producing any product, however, we find that CG-Vak Software and Exports Limited is not only into computer software but it is a product manufacturer too. Since assessee is not into product manufacturing and the segmental details cannot be bifurcated from the financial details, we find that the assessee and the CG-Vak Software and Exports Limited are not comparables. Therefore, we are inclined to uphold the orders of the authorities below in rejecting this company as a comparable. We direct accordingly. "

24.2 In our opinion, there is force in the argument of the learned AR. M/s. C G VAX Software & Exports Limited is not only engaged in the business of computer software development, but also engaged in product manufacturing process, whereas the present assessee is not in product manufacture activity. M/s. C G VAX Software & Exports Ltd. owns huge intangible assets and also engaged in outsourced product development. In view of the foregoing reasons, we hold that the said company cannot be considered for inclusion in the list of comparables. We, therefore, direct the TPO to exclude the said company from the list of comparables.”

11. Following the aforesaid decision, we direct the exclusion of CG Vak Software Exports Ltd. from the list of comparable companies.

12. As far as grounds 5.4 and 6.5 raised by the assessee is concerned, the assessee seeks exclusion of 3 companies viz., Laresen & Toubro Infotech Ltd.; Mindtree Ltd. & Persistent Systems Ltd. as comparable companies.

13. One of the arguments by the assessee before the TPO as well as DRP was that these companies had turnover which was in excess of Rs.200 crores and therefore these companies cannot be regarded as a comparable in the case of assessee whose turnover was only Rs.100 crores. The TPO as well as DRP took the view that the functional comparability of the companies were alone to be seen and turnover was not an important criterion. The other ground on which the assessee sought exclusion of the 3 companies were also rejected by the TPO as well as DRP. In ground No.5, the assessee has challenged the order of DRP in holding that higher turnover is not a relevant criterion for disregarding a company, when it is functionally found to be comparable. In ground No.5.4, exclusion of 3 companies are challenged on the basis of functional comparability, presence of significant onsite revenue and related party transaction. We deem it appropriate to consider the exclusion of the aforesaid 3 companies on the basis of turnover filter.

14. As far as ground No.6.5 is concerned, the question boils down on application of turnover filter in choosing comparable companies. As far as excluding the companies on the basis of turnover is concerned, the issue has been settled in several decisions of the Tribunal and has been elaborately discussed by this Tribunal in the case of *Autodesk India Pvt. Ltd. v. DCIT in IT(TP)A No.540 & 541/Bang/2013, order dated 06.07.2018*. The Tribunal in this decision after review of entire case laws on the subject, considered the question, whether companies having turnover more than 200 crores upto 500 crores has to be regarded as one category and those companies cannot be regarded as comparables with companies having turnover of less than 200 crores, the Tribunal held as follows:-

“17.7. We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of *Chryscapital Investment Advisors (India) Pvt. Ltd., (supra)* was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of *CIT Vs. Pentair Water India Pvt. Ltd. Tax Appeal No.18 of 2015 judgment dated 16.9.2015* has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5 companies from the list of comparable companies chosen by the TPO on the basis that the

5 companies turnover was much higher compared to that the Assessee.

17.8. In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys Integrating (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capgemini India Pvt. Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of M/S.NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time. Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra).”

15. In the light of the aforesaid decision of the Tribunal, ground No.6.5 raised by the assessee is allowed.

16. Since the 3 companies referred to in ground 5.4 are excluded on the application of turnover filter, the assessee's plea for exclusion on the basis of other filers set out in ground 5.4 is not taken up for consideration.

17. We are of the view that ground 6.9 is academic in view of acceptance of the grounds that are pressed for adjudication by the assessee and hence dismissed as academic.

18. The other ground that remains for adjudication is ground 5.1. The grievance of the assessee is with regard to negative working capital adjustment carried out by the TPO which was confirmed by the DRP. It is the plea of the assessee that though the TPO has observed that the Assessee has a healthy margin, the TPO has erred in making an adjustment towards working capital and the DRP further erred in upholding the same.

19. It was submitted that Working capital adjustment is made for the time value of money lost when credit time is given to the customers. The Assessee however does not bear any risk and has no working capital contingencies. The Assessee has not incurred any expenses for meeting the working capital requirement. The Assessee is running the business without any working capital risk as compared to the comparables. The Assessee does not bear any market risk as the services are provided only to Tavant US. Therefore, requirement for adjustment of negative working capital does not arise. Detailed submissions in this regard are placed at pages 136-141 and pages 628-633 of the paperbook.

20. The learned counsel for Assessee placed reliance on *Tivo Tech Private Limited v. DCIT* (order dated 12.06.2020 in IT(TP)A No.

1619/Bang/2017), *Lam Research India Pvt Ltd v. DCIT* (order dated 30.04.2015 in ITA No. 1473 & 1385/2014) and *DCIT v. Software AG Bangalore Technologies Pvt Ltd* (order dated 31.03.2016 in ITA No. 1628/2014) passed by this Hon'ble Tribunal, where it has been held that negative working capital adjustment shall not be made.

21. We have considered the rival submissions. We find that in the case of *Lam Research India Pvt Ltd. (supra)* and *Software AG Bangalore Technologies Pvt. Ltd. (supra)* passed by this Tribunal, it has been held that negative working capital adjustment shall not be made in case of a captive service provider as there is no risk and it is compensated on a total cost plus basis. Following these decisions, we allow ground No.5.1 raised by the assessee.

22. Thus the TPO is directed to compute the ALP in accordance with the directions contained in this order after affording assessee opportunity of being heard.

23. Another corporate tax issue that needs adjudication in this appeal is ground 7 which reads as follows:-

“7. MAT Credit not allowed.

An amount of Rs. 3,08,86,381/- being MAT Credit claimed by the assessee during the filing of Income Tax Returns was not allowed by the Learned Assessing officer on account of the assessment proceedings of A.Y 09-10, A.Y 10-11 & A.Y 11-12 are pending before the CIT (A) for 10A Exemption.

With respect the reduction made in the 10A Exemption for the A.Y 09-10, A.Y 10-11 & A.Y 11-12, by reducing Telecommunication, Insurance and Expenditure incurred in Foreign currency from export turnover only and not from Total Turnover, assessee has placed its reliance on the Hon'ble Karnataka High Court decision in the case of *Tata Elxsi Ltd & others* reported in 349 ITR 98 and the Order passed by the

Hon'ble Income Tax Appellate Tribunal in assessee's own case for the A.Y 2004-05, A.Y 2005-06 & A.Y 2006-07, for reducing the same from the Total turnover also.

Since the Hon'ble Karnataka High Court decision is directly applicable to the assessee, the demand raised due to such 10A adjustment would be nullified by the CIT(A) and the MAT credit will fully be eligible for set off.”

24. The submission made by the Id. counsel for the assessee on the above issue was that an amount of Rs. 3,08,86,381/- being MAT credit has been disallowed by the Respondent on the ground that the assessment proceedings for the assessment years 2009-10 to 2011-12 are pending before the CIT(A) for 10A exemption. In this regard, it is submitted that the Respondent has computed the exemption under Section 10A of the Act by reducing telecommunication, insurance and expenditure incurred in foreign currency from the export turnover only and not from the total turnover. The Appellant placing reliance on the decision of the Hon'ble High Court of Karnataka in *CIT v. Tata Elxsi* which was also upheld by the Hon'ble Supreme Court in *Commissioner of Income Tax, Central-III v. HCL Technologies Ltd [(2018) 93 taxmann.com 33 (SC)]* submits that the said expenses reduced from the export turnovers should also be correspondingly reduced from its total turnovers. Therefore, the demand raised due to such adjustment would be nullified by the CIT(A) and the MAT credit available to the Appellant would be eligible for set off.

25. At the time of hearing, the Id. counsel for the assessee submitted that the MAT credit would be consequential to the decision rendered in AY 2009-10 , 2010-11 & 2011-12 with regard to exemption u/s. 10A of the Act in those years. She prayed for a direction to the AO to give consequential effect as and when the decisions are rendered in those assessment years. We accept the prayer of the Id. counsel for the assessee and direct the AO to given consequential relief based on the outcome of the earlier

assessment years. Ground 7 is accordingly treated as allowed for statistical purposes.

26. In the result, the appeal by the assessee is treated as partly allowed.

Pronounced in the open court on this 21st day of August, 2020.

Sd/-

(G MANJUNATHA)
ACCOUNTANT MEMBER

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 21st August, 2020.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.