

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

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

IT(TP)A No.497/Bang/2016
Assessment year : 2011-12

Microchip Technology (India) Private Ltd., No.149 B, EPIP, I Phase, Industrial Area, Whitefield, Bangalore – 560 066. PAN: AABCM 9868J	Vs.	The Assistant Commissioner of Income Tax, Circle 4(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Darpan Kirpalani, Advocate
Respondent by	:	Shri Muzaffar Hussain, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	01.09.2020
Date of Pronouncement	:	04.09.2020

ORDER

Per N.V. Vasudevan, Vice President

This is an appeal by the Assessee against the order dated 28.01.2016 of ITO, Ward-4(1)(2), 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 (Act) in relation to assessment year 2011-12.

2. The Assessee is engaged in the business of provision of Software Development Services (SWD services), and Marketing and sales Support Services (MSS) to its wholly owned holding company. In terms of the provisions of Sec.92-A 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.

SOFTWARE DEVELOPMENT SERVICES SEGMENT

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/TC of the Assessee was arrived at 14.87% by the Assessee in its TP study. The operating income was Rs.46,30,16,681/- and the Operating Cost was Rs.40,31,58,812/-. The Operating profit (Operating income – Operating cost) was Rs.5,98,57,869/-.

Thus the OP/OC was arrived at 14.87%. The Assessee chose companies who are engaged in providing similar services such as the Assessee from the Prowess and Capitaline Plus Data Base. The Assessee identified 8 companies whose average arithmetic mean of profit margin was less than and comparable 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 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/OC. He also selected comparable companies from the same database from which the Assessee had chosen comparable companies, viz., Prowess and Capitaline Plus. The TPO rejected 6 out of the 8 companies chosen by the Assessee as comparable companies. The TPO on his own identified 11 companies as comparable with the Assessee company and worked out the average arithmetic mean of their profit margins as follows:-

A.6. Comparables selected by 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	Acropetal Technologies Ltd. (seg)	31.98	30.17
2	e-Zest Solutions Ltd.	21.03	20.43
3	E-Infochips Ltd.	56.44	57.63
4	Evoke Technologies Pvt. Ltd.	8.11	9.45
5	ICRA Techno Analytics Ltd.	24.83	24.30
6	Infosys Ltd.	43.39	44.95
7	Larsen & Toubro Infotech Ltd.	19.83	21.35
8	Mindtree Ltd. (seg)	10.66	10.70
9	Persistent Systems & Solutions Ltd.	22.12	22.66
10	Persistent Systems Ltd.	22.84	23.09
11	R S Software (India) Ltd.	16.37	17.68
12	Sasken Communication Technologies Ltd.	24.13	26.00
13	Tata Elxsi Ltd. (seg)	20.91	20.42
AVERAGE MARK-UP		24.82	25.29

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

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

Arm's Length Mean Margin on cost	24.82%
Less: Working Capital Adjustment	-2.71%
Adjusted mean margin of the comparables	27.53%
Operating Cost	Rs. 33,77,24,506/-
Arm's length Price (127.53% of Operating Cost)	Rs. 43,07,00,063/-
Price Received	Rs. 39,04,51,674/-
Short fall being adjustment u/s. 92CA	Rs.4,02,48,389/-

Thus a sum of Rs.4,02,48,389/- 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 DRP excluded 6 comparable companies viz.,(i) Infosys Ltd., (ii) Larsen & Toubro Ltd., (iii) Mindtree Ltd., (iv) Persistent Systems Ltd., (v) Sasken Communication Technologies Ltd., and (vi) Tata Elxsi Ltd., on the application of turnover filter of more than Rs.200 crores. The DRP did not agree to plea of the Assessee for exclusion of Acropetal Technologies Ltd., E-Infochips Ltd., ICRA techno Analytics Ltd., Persistent Systems & Solutions Ltd., and E-Zest Solutions Ltd., To the extent the Assessee did not get relief from the DRP, the Assessee has preferred appeal before the Tribunal. The specific grounds of challenge are contained in Grd.No.3(b) of the grounds of appeal filed before the Tribunal. The grounds relating to SWD services segment that were pressed for adjudication were Ground No. 3(b) in which the Assessee

has projected grievance with regard to non-exclusion of the following five companies by the DRP viz., of Acropetal Technologies Ltd., E-Infochips Ltd., ICRA techno Analytics Ltd., and E-Zest Solutions Ltd.

7. The learned counsel for the Assessee brought to our notice decision of Bangalore ITAT in the case of M/S. LG Soft India Pvt. Ltd. Vs. DCIT IT(TP)A o.52/Bang/2016 for AY 2011-12 order dated 5.8.2020. In the aforesaid decision the Assessee was also a SWD service provider and the very same comparable companies were chosen as comparable companies in that case. The Tribunal ruled on the comparability of 7 companies with a SWD service provider such as the Assessee in which the aforesaid 5 companies sought to be excluded in this appeal by the Assessee was also a part. The following were the relevant observations of the Tribunal for excluding the aforesaid 5 companies listed in paragraph-6 above :-

“10. With regard to the other 7 comparable companies, whose exclusion is challenged by the revenue in ground No.2 of its appeal, we find that exclusion of these comparables from the list of companies selected by the TPO had come up for consideration before the Bangalore ITAT in the case of *Electronic for Imaging (I) Pvt. Ltd. v. DCIT [2017] 85 taxmann.com 124 [Bang. Trib]. ; Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No.614/Mds/2016; DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137/Bang/2015; Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA No.696/Mum/2016* which are also decisions rendered in relation to AY 2011-12 in the case of a companies providing SWD services such as the assessee in the present appeal. It is also relevant to point out that the very same comparable companies chosen by the TPO in the present appeal had been chosen by the TPO as comparable companies in the case of *Electronic for Imaging (I) Pvt. Ltd. (supra)*. The Tribunal in its order dated 14.7.2017 in the aforesaid case dealt with the comparability of these companies.

11. As far as **Acropetal Technologies Ltd.** is concerned, vide para 8 of the order of Tribunal in *Electronics for Imaging (I) Pvt. Ltd. (supra)*, exclusion of Acropetal was upheld on the ground that this company was into development of computer products. The Tribunal also held that L&T Infotech Ltd. had RPT at 18.66% and since the RPT was beyond the threshold limit of 15%, this company was directed to be excluded from the list of comparable companies. The Tribunal further excluded **Tata Elxsi Ltd.** from the list of comparables on the ground that this company was engaged in diversified activities and was not a pure SWD services provider such as the assessee. In para 9 of the aforesaid order, the Tribunal held **e-Infochips Ltd.**, was earning revenue both from the software services and software products and though the break-up of revenue from the two segments were available, but the break-up of Operating Cost and Net Operating revenue and segmental details were not available.

12. As regards **e-Zest Solutions Ltd.**, in the case of *Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No.614/Mds/2016*, this company was held to be engaged in Knowledge Process Outsourcing (KPO) and cannot be regarded as a SWD services company.

13. The Tribunal in the case of *DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137/Bang/2015* excluded the company, **ICRA Techno Analytics Ltd.**, on the ground that it was engaged in engineering and consulting services, besides licensing and sub-licensing and no segmental information was available to compare the margins of SWD services segment.

14. The Mumbai Tribunal in the case of *Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA No.696/Mum/2016* held **Infosys Ltd.** to be not comparable for the reason that this company was engaged in manufacturing of software products and was a giant company assuming various risks. As far as **Larsen & Toubro Infotech Ltd.**, is concerned, vide paragraph-8 page-16 of the order in the case of *Electronics for imaging India Pvt. Ltd.*, (supra) this tribunal excluded this company on the ground of presence of onsite revenue of more than 50% and that the related party transaction was more than 15% (18.66%).

15. Respectfully following the aforesaid decisions, we uphold the exclusion of the aforesaid 7 companies from the list of comparable companies and ground No.2 raised by the assessee to this extent is dismissed. We may add that the other grounds raised by the revenue in its appeal are purely supportive of ground No.2 and are general grounds with no specific reference to instances of comparables excluded and hence dismissed.”

8. Respectfully following the aforesaid decision, we direct exclusion of the aforesaid 5 comparable companies from the list of comparable companies. No other specific grounds were argued or pressed.

9. The TPO is directed to compute the ALP in accordance with the directions contained in his order after affording Assessee opportunity of being heard.

MARKETING SUPPORT SERVICES SEGMENT (MSS)

10. As far as the provision of MSS is 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 Assessee was 10.90%. The Assessee chose a set of comparable companies whose average profit margin was 9.83%. Since the Assessee's profit margin was much more than that of the comparable companies, the Assessee claimed that the price charged in the international transaction was at Arm's Length. The 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/OC. The TPO rejected all companies chosen as comparable company by the Assessee and on his own chose

three companies and worked out the average arithmetic mean of their profit margins and adjustment to ALP as follows:

E.6. Comparables selected by TPO and their arithmetic mean:

Sl. No.	Name of the Company	Mark-up on Total Costs (in %)
1.	Asian Business Exhibition & Conferences Ltd.	19.51
2.	Cyber Media Research Ltd.	10.59
3.	ICC International Agencies Ltd.	24.66
AVERAGE MARGIN		18.25

11. The TPO computed ALP and consequent addition to the total income as follows:-

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

Arm's Length Mean Margin on cost		18.25%
Operating Cost	B	Rs. 6,54,34,308/-
Arm's length Price (118.25% of Operating Cost)	$C=B*118.25\%$	Rs. 7,73,76,069/-
Price Received	D	Rs. 7,25,65,007/-
Short fall being adjustment u/s. 92CA	E=C - D	Rs. 48,11,062/-

12. The Assessee filed objection before the DRP against the draft order of Assessment wherein the addition suggested by the TPO was added to the total income of the Assessee. The DRP however confirmed the order of the AO. Before the Tribunal, the Assessee seeks exclusion of two out of the three comparable companies chosen by the TPO viz., Asian Business

Exhibition & Conferences Ltd., and ICC International Agencies Ltd. in Gr.No.2.7 which reads as follows:-

13. At the time of hearing the learned counsel for the Assessee pressed for adjudication of exclusion of ICC International Agencies Ltd., alone. It was brought to our notice by the learned counsel for the Assessee that in the case of *AMD India Pvt. Ltd. Vs. ACIT* in IT(TP) A.No.1487 & 1496/Bang/2015 order dated 6.4.2017 ITAT Bangalore Bench for the very same segment for AY 2011-12 was pleased to hold that this company was with MS Services providing company. The relevant observations are as follows:-

“2. ICC International Agencies Ltd :

The assessee submitted before the DRP that this company is functionally not comparable since it is engaged in trading activity and thereby functionally different. The DRP rejected this company for the reason that this company is functionally dissimilar and for incorrect margin computation made by the TPO. The Revenue is on appeal . The assessee pleaded that this is functionally different and relies on this Tribunal decision in *ITO v Interwoven Software Services(India) P Ltd* [TS -723-ITAT - 2016 -Bang-TP ay 2010-11. The relevant portion of the order IT(TP)A.1487 & 1496/Bang/2015 Page - 36 from *ITO v Interwoven Software Services (India) P Ltd* [IT(TP)A.No.461/Bang/2015 dt 26.8.2016 for a y 2010-11 is extracted as under :

"28. For this segment, the assessee is seeking exclusion of two comparables i.e. M/s Acentia Technologies Ltd., and M/s ICC International Agencies Ltd., The claim of assessee regarding exclusion of M/s Acentia Technologies Ltd. is also covered in favour of the assessee by the same Tribunal order rendered in the case of *M/s Electronics for Imaging India (P)Ltd.,(Supra)* and respectfully following the same Tribunal order, we direct the AO/TPO to exclude this company from the list of final comparable because the ld. DR of the revenue could not point out any difference in facts.

29. Regarding exclusion of second company, it was submitted by the learned AR of the assessee that i.e. M/s ICC International Agencies Ltd., (Supra) this is the claim of the assessee that annual report of this company available on page-1100 & 1104 of the paper book. As per the same, we find that this company is deriving income from trading activity and also maintaining inventories. Both these arguments are supported by annual report of this company available on page-1100 & 1104 of the paper book. Since the assessee is not engaged in trading activity, in our considered opinion, this company cannot be considered as good comparable in the present case and hence, we direct the AO/TPO to exclude his company from the list of final comparable.”

14. Following the said decision, we direct exclusion of the aforesaid company ICC International Agencies Ltd., from the list of comparable companies. The learned DR submitted that ICC International Agencies Ltd., was accepted by Assessee himself as comparable before the TPO. We find that before the DRP in the objections the Assessee has objected to inclusion of ICC International Agencies Ltd., as comparable company on several counts at page-5 of the written submission filed before the DRP on 4.12.2015. The Special Bench of the Hon'ble Tribunal in the case of *DCIT v. Quark Systems (P.) Ltd. ([2010] 38 SOT 307 (CHD.) (SB))* has held that an Assessee cannot be precluded from seeking exclusion of a company selected by it in its TP study, when the company is otherwise not comparable to the Assessee. We therefore reject that argument of the learned DR in this regard.

15. We direct the TPO to compute the ALP in accordance with the directions contained in this order and allow working capital adjustment after examination of the claim of the Assessee in this regard in the TP Study and allow opportunity of being heard before deciding on the quantum of adjustment to be given on account of working capital adjustment.

16. No other grounds were pressed for adjudication in the MSS segment.

17. In the result, appeal by the Assessee is partly allowed.

Pronounced in the open court on this 4th day of September, 2020.

Sd/-

(B R BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 4th September, 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.