

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

**BEFORE SHRI B.R. BASKARAN, ACCOUNTANT MEMBER
AND
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER**

IT(TP)A No.3374/Bang/2018
(Assessment Year: 2014-15)

M/s.ARM Embedded Technologies Pvt. Ltd.,
Bagmane World Technology Pvt. Ltd.,
SEZ Citrine Block, 5th & 6th Floors,
Marathahalli, ORR, Doddanakundi Village,
Mahadevapura, Bangalore-560 048

....Appellant

Vs.

Income Tax Officer,
Ward 1(1)(1), Bangalore.

.....Respondent.

Assessee By:	Smt. Tanmayee Rajkumar, Advocate.
Revenue By:	Shri Muzaffar Hussain, CIT (D.R)

Date of Hearing :	05.08.2020.
Date of Pronouncement :	24.11 .2020.

ORDER

PER SHRI PAVAN KUMAR GADALE, JM :

The assessee company has filed an appeal against the order passed under Section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 ('the Act') in pursuance to the directions of the Dispute Resolution Panel (DRP) under Section 144C(5) of the Act Dt.14.09.2018.

2. At the time of hearing, the learned Authorized Representative submitted that effective grounds of appeal are Nos.2.9, 2.10 and 2.12 and other grounds of appeal are not pressed. Accordingly, except Ground of appeal Nos.2.9, 2.10 and 2.12, other grounds of appeal are treated as withdrawn and dismissed. The effective grounds of appeal are as under:

“ Ground No.2.9 Including the following comparable companies even though the functions performed, assets employed and risks assumed by the said companies are entirely different and incomparable to that of the Appellant :

- a) Infosys Limited*
- b) Persistent Systems Limited*
- c) Thirdware Solutions Limited*
- d) Larsen & Toubro Infotech Limited.*

Ground No.2.10 Excluding the following companies even though they are functionally comparable to the Appellant and pass all the filters applied by the learned TPO in its order :

- a) Sasken Communication Technologies Limited*
- b) Akshay Software Technologies Limited*
- c) E-Zest Solutions Limited - Not pressed.*
- d) Sankya Infotech Limited*
- e) I2T2 India Limited*
- f) Daffodil Software Limited - Not pressed.*
- g) Kireeti Soft Technologies Limited*
- h) Exilient Technologies Pvt. Ltd.*
- i) Celstream Technologies Limited*
- j) Maveric Ssystems Limited*
- k) Evoke Technologies Pvt. Ltd. – Not pressed.*

2.12 Not providing an adjustment for the differences in working capital of the Appellant and the comparable companies.”

3. The Brief facts of the case are that the assessee company is a subsidiary of ARM Limited UK engaged in Software Development Services and provides maintenance of service to ARM Limited, UK and ARM Inc, US and also sales and market services to ARM Ltd UK. The Assessee company has filed the Return of Income for the A.Y. 2014-15 with total income of Rs.25,41,46,430/-.Subsequently, the case was selected for scrutiny and Notice under Section 143(2) and 142(1) of the Act were issued. In compliance, the LdAR of the assessee appeared from time to time and the details were furnished and also case was discussed. The Assessing Officer verified the Books of Accounts, documents and evidences filed in respect of the claims made by the assessee and find that the assessee has international transactions exceeding Rs.15 Crores, therefore with the prior approval of the CIT, Bangalore, the case was referred to the Transfer Pricing Officer (TPO) for determination of Arm's Length Price (ALP) in relation to international transactions with Associated Enterprises (AEs). The TPO has perused the financial statements of (i)Software Development and maintenance services segment and (ii)marketing & sales support services segment at para 3.1 of the TPO order as under:

3.1. THE SEGMENTAL FINANCIALS AS GIVEN IN THE TP STUDY IS AS UNDER:

Particulars	Software Development and maintenance Services	Marketing and Sales Support Services	Total
Income			
Revenue from operation	17517,80,711	275,35,276	17793,15,987
Expenditure			
Operating & Administrative expenses	13814,59,336	254,29,556	14068,88,892
Forex loss/(Gain)			-
Depreciation Expenses	1412,80,837	66,111	1413,46,948
Total Operating Cost (TC)	15227,40,173	254,95,667	15482,35,840
Operating Profit (OP)	2290,40,538	20,39,609	2310,80,147
OP/TC	15.04%	8.00%	
Add: Income from resource augmentation services			17,33,190
Add: Interest Income			55,37,736
Less: Loss on sale of assets			5,47,489
Profit Before Tax			2378,03,584

The international transactions mentioned in the 3CEB report referred at page 3 para 3.4 of TPO order as under :

Particulars	Amount (in Rs.)
Receipts from provision of software development services	17517,80,711
Receipts from provision of marketing support services	275,35,276
Receipts from provision of resource augmentation services	17,33,190
Reimbursement of travel and communication expenses paid	13,25,226
Reimbursement of expenses received-resource augmentation services	277,01,467
Reimbursement of expenses received- others	80,49,551
Reimbursement of expenses received towards ESOP's RSU	1180,65,434
Remittance of behalf of employees towards ESOP's and ESPP's	611,17,125
Total	19973,07,980

4. The assessee company has applied TNMM as Most Appropriate Method (MAM) and operating margin of PLI i.e. OP/OC was calculated. The TPO has issued letter calling for documents required under Section 92C of the Act. along with financial and annual report and copies of agreements. The assessee has submitted the details and on perusal of the TP documents, the TPO find that the assessee has international transactions in respect of receipts for software development and maintenance services (SW Segment) and receipt for marketing and sales support Segment (MSS Segment).The TPO observed that the assessee company has selected 7 comparables for software development segment and 4 comparables for MSS Segment and applied the filters. The assessee has provided software development services to its AEs in the F.Y. 2013-14 aggregating to Rs.1,75,17,80,711/-.The TPO has rejected the TP Study and selected the comparables and applied filters.The final set of comparables in Software Development Services Segment selected by TPO after analysis at para 14 of the order are as under :

14. FINAL SET OF COMPARABLES CONSIDERED BY THE TPO:

After considering the objections of the taxpayer to the comparable proposed in the show-cause notice, perusal of relevant annual reports and examination of additional comparable suggested by the taxpayer on the touchstones of filters and functionality, the final set of comparable companies considered by the TPO, is as under

SWD Segment

S NO	NAME OF TAX PAYER	Amounts in Rs. Lakh			OP/OC (in %)
		OR/SALES	OC	OP	
1	Infosys Ltd.	46,91,700	32,77,700	11,84,200	36.13%
2	Larsen & Toubro Infotech Ltd.	4,54,360	3,64,619	89,741	24.61%
3	Mindtree Ltd.	2,99,010	2,48,290	5,072	20.43%
4	Persistent Systems Ltd.	1,18,412	87,649	3,07,625	35.10%
5	R S Software (India) Ltd.	35,188	28,321	6,867	24.25%
6	Cigniti Technologies Ltd.	5,563	4,359	1,204	27.62%
7	S Q S India B F S I Ltd.	20,061	16,394	3,667	22.37%
8	Thirdware Solution Ltd.	19,883	13,742	6,140	44.68%
	Average				29.40%

Further, the TPO has not granted Working Capital Adjustment and no risk adjustment and determined the PLI of the assessee OP/OC of comparables @ 29.40%.The TPO has computed the ALP in Software Development Services Segment referred at Para 16 as under :

16.. Computation of Arm's Length Price:

16.1 The arithmetic mean of the Profit Level indicators is taken as the arm's length margin. Please see Annexure 'A' for details of computation of PLI of the comparable. Based on this, the arm's length price of the services rendered by the taxpayer to its AE(s) is computed as under:

SWD Segment

Arm's Length Mean Margin on cost	29.40%
Operating Cost	67,77,74,386
Arm's Length Price(ALP) @ 129.40%	87,70,40,055
1.2940 of Operating Cost)	
Price Received	77,94,40,544
Variation in Price	9,75,99,511
3% of price received	2,33,83,216
<u>Shortfall being adjustment</u>	<u>9,75,99,511</u>

The TPO in the market support services segment has considered final set of comparables and determined PLI based on the comparables OP/OC @ 12.54%.

The TPO has computed the ALP of both the software development segment and MSS segment at Para 20 of the order as under :

Segment	Amount (Rs.)
SWD Services	9,75,99,511
Marketing Support Services	11,57,548
Total	9,87,57,059

The TPO has passed order under Section 92CA of the Act dt.25.10.2017.

5. The TPO has passed Rectification Order under Section 92CA(5) of the Act r.w. Rule 154 for rectifying the order dt.25.10.2017 and determined the computation in respect of Software Development Services segment at para 2.1 of rectification order as under :

2.1 On verification it is found that the operating cost and operating revenue has incorrectly considered in the said order u/s 92CA(3). As the same constitutes a mistake apparent from record, the revised computation in respect of SWD and the workings is as under.

Description	92CA	Vide instant order
Arm's Length Mean Margin on cost	29.40%	29.40%
Operating cost	67,77,74,386	1,52,27,40,173
ALP [operating cost x (100%+PLI{in%})]	87,70,40,055	1,97,04,25,784
Price received	77,94,40,544	1,75,17,80,711
Variation (ALP-Price received)	9,75,99,511	21,86,45,073
3% of price received	2,33,83,216	5,25,53,421
Adjustment[(ALP-Price received)>3% price received]	9,75,99,511	21,86,45,073

The TPO has passed order under Section 154 r.w.s. 94CA(5) Dt.31.10.2017, with summary of adjustments at para 3 as under :

3. Summary of adjustment

Segment	92CA (Rs.)	Vide instant order (Rs.)
SWD Services	9,75,99,511	21,86,45,073
Marketing Support Services	11,57,548	11,57,548
Total	9,87,57,059	21,98,02,621

6. The Draft assessment order was passed under Section 143(3) r.w.s.144C of the Act dt.23.12.2017 with TP Adjustments. The assessee has filed objections in Form 35A with DRP against the draft assessment order. The DRP after considering the objections and findings of the TPO has given certain directions to TPO in respect of comparables and partly allowed the objections and passed order under Section 143(3) r.w.s. 144C(5) of the Act dt.14.09.2018. In compliance to the directions of DRP, the final assessment order in respect of Software Development Services segment under Section 143(3) r.w.s. 144C(13) of the Act passed with Transfer Pricing Adjustment on 30.10.2018 determining the total income of Rs.47,27,91,500/-. Aggrieved by the final assessment order, the assessee has filed an appeal with the Tribunal.

7. At the time of hearing, the learned Authorized Representative has restricted her arguments to effective grounds of appeal only and supported the arguments with chart and paper book. The LdAR submitted that 4 comparables are to be excluded in Software Development Services segment and 8 comparables are to be

included for determining the ALP and further Working Capital Adjustment has to be granted. The learned Authorized Representative of the assessee has not pressed other grounds of appeal and are treated as not pressed and dismissed. The learned Departmental Representative supported the orders of the lower authorities.

8. We heard the rival contentions and perused the material on record. The assessee has adopted TNMM and determined the PLI i.e. OP/OC @ 15.04%. The LdAR submitted that (i) Infosys Ltd. (ii) Persistent Systems Limited, (iii) L & T Infotech Limited and (iv) Thirdware Solutions Ltd. are to be excluded on the turnover criteria and supported her submissions, relying on the catena of judicial decisions.

We find,

i) Infosys Technologies Ltd. - The Company is not functionally comparable as it has diversified operations and no segmental data is available, and does end to end business solutions like business consulting, technology, engineering and outsourcing services. Further, Lack of segmental details in respect of services and investment in products and focuses on immense brand building. The company owns significant brand value, significant amount of IPR and brand value, and involved in R & D activities and incurred significant expenditure. During the year the company has amalgamated its wholly owned subsidiary Infosys Consulting India Ltd. For the A.Y.2014-15, the company was excluded as comparable by the co-ordinate Bench of Tribunal in the case of M/S EMC Software and Services India Pvt. Ltd.

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(Bang)] at para 6(i) as under :

“ 6 (i) Infosys Limited : This company is functionally dissimilar and provides end to end business solutions like business consulting technology engineering and outsourcing services and no segmental details in respect of services are available and made investments and products to establish as a tradable IPO owner. Further the comparable owns significant brand value products and focus on brand building and incurred expenditure on R & D. The company owns 7 edge products / platforms and six other product based solutions. The company leverages on its premium banking solution and during the year the company merged with its wholly owned subsidiary Infosys Consulting India Limited. We found that the company was excluded from the final list of comparables in assessee's own case for the Assessment Year 2011-12 by the DRP and revenue has accepted. The learned Authorised Representative supported his arguments relying on the decisions in the case of CIT Vs. Agnity (India) Technologies Pvt. Ltd. (2013); CGI Systems and Management Ltd. Vs. ACIT (2015) 94 taxman.com The learned Authorised Representative also substantiated that for the Assessment Year 2014-15, the co-ordinate Bench of the Tribunal in the case of LG Soft India Pvt. Ltd. Vs. DCIT in IT(TP)A No.3122/Bang/2018 for the Assessment Year 2014-15 Dt.28.5.2019. We support our views relying on the LG Soft India Pvt. Ltd. Vs. DCIT (supra) where the Tribunal has observed at paras 6 and 6.1 as under :

“6. We notice that the co-ordinate bench has excluded M/s.Infosys Ltd in A.Y 2008-09 by following the decision rendered by another co-ordinate bench in the case of 3DPLM Software Solutions Ltd (IT(TP)A No.1303/Bang/2012 dated 28.11.2013, wherein the decision rendered in the case of Trilogy E Business Software India P Ltd. (ITA No.1054/Bang/2011) was followed and it was held that M/s. Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It was further observed that the break up of revenue from software services and software product is not available.

6.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in A.Y 2008-09, we direct exclusion of M/s. Infosys Ltd.”

We found that the Infosys Ltd. has significant intangibles and huge revenues from software products and was considered by the co-ordinate Bench of the Tribunal for

exclusion in the Assessment Year 2014-15. Accordingly, we direct the TPO to exclude the Infosys Ltd. from the final list of comparables for determination of ALP.”

In the present case also, we find that the comparable has significant intangibles, and therefore, we direct the TPO to exclude Infosys Technologies Ltd. from the final list of comparables in determination of ALP.

ii) L & T Infotech Limited - The company is not functionally comparable, as it has high brand value and market leader and also benefit from its parent brand. It has proprietary business and during the year extraordinary events like product engineering services business of the company was transferred to its subsidiary and has incurred expenses in foreign currency being 57.13% of its total expenditure. The company was excluded as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 6(ii) at page 592 & 593 of Paper Book as under :

“ 6 (ii) L & T Infotech Limited : The company has a margin of 24.61% and has high brand value and is a market leader, high presence and the intangible income in proprietary products. Significant expenditure in foreign currency to the extent of 57.13%. During the year the product engineering business service of the company was transferred to its subsidiary. The company segments are divided into service cluster, industrial cluster and telecom business. As per the Annual Report of the company, the company has a significant capital work-in-progress and the company has developmental products. The comparable was excluded from the final list of comparable in assessee's own case for the Assessment Year 2011-12 by the DRP and further the comparable company was excluded by the co-ordinate Bench of Delhi Tribunal in the case of Pitney Bowes Software India Pvt. Ltd. Vs. ACIT 101 Taxman.com 350. The learned Authorised Representative also relied on CGI Information Systems & Management Consultants (P) Ltd. Vs. ACIT (2018) 94 taxman.com 97 and DCIT Vs. Taxman India Pvt. Ltd. (2016) 74 Taxmann.com 88 (Del). We found that the co-ordinate Bench of Tribunal in M.P. No.95/Bang/2019 in IT(TP)A No.3122/Bang/2018 for the Assessment Year 2014-15 has dealt on the issue at page 2 para 4 as under :

“ 4. We heard Ld D.R and perused the record. We find merit in the miscellaneous petition filed by the assessee. Accordingly following paragraph is inserted after

paragraph 10 in the impugned order of the Tribunal, which will adjudicate the issue relating to “L & T Infotech Ltd”:-

“10A The assessee has sought exclusion of M/s L & T Infotech Ltd on the ground that there were extraordinary events during the year, it possesses brand and intangibles, it has not provided segmental information and it has got sub-contracting expenses. The Ld A.R submitted that the above said company has been excluded by the co-ordinate bench in the case of Metric Stream Infotech P Ltd (IT(TP)A No.1418 & 2735/Bang/2017) relating to AY 2013-14 and also in the case of Electronics for Imaging India P Ltd (IT(TP)A No.1506/Bang/2016 relating to AY 2011-12). The Ld A.R submitted that there is no change in facts in this year also and accordingly prayed for exclusion of the above said company.

10A.1 We heard Ld D.R and perused the record. We notice that M/s L & T Infotech Ltd has been excluded by the co-ordinate bench in the case of Metric Stream Infotech P Ltd (supra) for AY 2013-14 and also in the case of Electronics for Imaging India P Ltd (supra) for AY 2011-12. The Ld A.R submits that there is no change in facts prevailing in the current year vis-a-vis the years considered by the co-ordinate benches in the above said cases. Accordingly, following the above said decisions, we direct exclusion of M/s L & T Infotech Ltd.”

We considering the functional dissimilarity and judicial decisions and various facts which are not similar to the assessee functional profile, Accordingly, we direct the TPO to exclude M/s. L & T Infotech Limited from the final list of comparable in determining the ALP.

iii) Persistent Systems Ltd. - The company is not functionally comparable as it has diverse business operations including IP led business, extraordinary events and is engaged in R & D activities and large scale of operations. The company was excluded as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 6(iii) pages 593 of Paper Book as under :

“ 6 (iii) Persistent Systems Ltd. : The company is functionally different as it is engaged in rendering IT services and in the development of software products without there being support segmental information and engaged in IP led solutions and undertakes significant R & D activities, owns IP. During the year the company made acquisitions. The company has made significant investment in IP and their solutions and has a dedicated team for Research and IP development.

The learned Authorised Representative relied on decision of Tribunal in the case of CGI Information & Management Systems Pvt. Ltd. Vs. ACIT 94 Taxman.com 97 and PCIT Vs. Saxo India Pvt. Ltd. 74 taxmann.com 88 (Delhi). We relied on the decision of CGI Information Systems & Management Consultants Pvt. Ltd. (supra) at paras 28 to 30 as under :

28. The learned counsel for the Assessee submitted before us that the comparability of the 3 companies out of the aforesaid 4 companies which the Assessee seeks to exclude from the list of comparable companies chosen by the TPO viz., Infosys Ltd., Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd., were considered by the ITAT Delhi Bench in the case of *Agilis Information Technologies India (P.) Ltd. v. Asstt. CIT [2018] 89 taxmann.com 440 (Delhi - Trib.)* for the same AY 2012-13. In this regard it was submitted that the functional profile of the Assessee is same as that of the Assessee in the case of *Agilis Information Technologies India (P.) Ltd. (supra)*, is identical inasmuch as the said company was also involved in providing SWD services to its AE and the TPO had chosen 16 comparable companies out of which 6 companies chosen by the TPO in the case of the Assessee for the purpose of comparability were the same. His submission was that the decision rendered by the Tribunal in the case of *Agilis Information Technologies India (P.) Ltd. (supra)* would be equally applicable to the Assessee in the present case also. The learned DR. submitted that the DRP in its directions has merely accepted with the reasoning of the IPO and therefore the issue of exclusion of these companies should be directed to be examined afresh by the DRP.

29. We have considered the rival submissions. In the case of *Agilis Information Technologies India (P.) Ltd. (supra)*, this Tribunal considered the comparability of the 3 companies which the Assessee seeks to exclude from the final list of comparable companies chosen by the TPO. The functional profile of the Assessee and that of the Assessee in the case of *Agilis Information Technologies India (P.) Ltd. (supra)*, is identical inasmuch as the said company was also involved in providing SWD services to its AE and the TPO had chosen some comparable companies which were also chosen by the TPO in the case of the Assessee for the purpose of comparability. In the aforesaid decision the Tribunal held on the comparability of the 3 companies which the Assessee seeks to exclude as follows:

- (a) Infosys Ltd., was excluded from the list of comparable companies by following the decision of the Hon'ble Delhi High Court in the case of *CIT v. Agnity India Technologies (P.) Ltd.* [2013] 36 taxmann.com 289/219 Taxman 26 (Delhi). The discussion is contained in paragraphs 4.5 to 4.7 of the Tribunal's order. The Tribunal accepted that Infosys Ltd. is a giant risk taking company and engaged in development and sale of software products and also owns intangible assets and therefore not comparable with a software development service provider such as the Assessee in that case.
- (b) Larsent & Tourbro Infotech Ltd., was excluded from the list of comparable companies by relying on the decision of the Delhi Bench of ITAT in the case of *Saxo India (P.) Ltd. v. Asstt. CIT* [2016] 67 taxmann.com 155 (Delhi - Trib.). The discussion is contained in paragraphs 4.8 to 4.10 of the Tribunal's order. The Tribunal held that L & T Infotech Ltd., was a software product company and segmental information on SWD services was not available. The Tribunal also noticed that the appeal filed by the revenue against the tribunal's order was dismissed by the Hon'ble Delhi High Court in ITA No.682/2016.
- (c) Persistent Systems Ltd., was excluded from the list of comparable companies on the ground that this company was a software product company and segmental information on SWD services was not available. The Tribunal in coming to the above conclusion referred to the decision rendered by ITAT Delhi Bench in the case of *Cash Edge India (P.) Ltd. v. ITO* ITA No.64/Del/2015 order dated 23.9.2015 and the decision of Hon'ble Delhi High Court in the case of *Saxo India Pvt. Ltd. (supra)*. The findings in this regard are contained in Paragraphs 4.14 to 4.16 of its order.

30. Respectfully following the decision of the Tribunal we hold that the aforesaid 3 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins. In this regard we are also of the view that the plea of the learned DR for a remand of the issue to the DRP on the ground that the DRP has not given any reasons in its directions cannot be accepted. The DRP has endorsed the view of the TPO in its directions and therefore the reasons given by the TPO should be regarded as the conclusions of the DRP.

We rely on judicial decisions and facts in respect of comparable Persistent Systems Ltd. and direct the Assessing Officer to exclude from the final list of comparable for determination of ALP.”

We found there is a functional dissimilarity in comparison to assessee financial profile and accordingly, we direct the TPO to exclude the comparable from the final list for determination of ALP.

iv) Third ware Solutions Ltd. - The company is not functionally comparable as it has different diversified activities, and derives income from software development, income from subscription contract and from sale of user licenses. Further, no segmental details are available and has diverse services and also error in computation of margins. The company was excluded as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 6(iv) pages 594 & 595 of Paper Book as under :

“ 6 (iv) Thirdware Solutions Ltd. the company is functionally dissimilar and is engaged in rendering software development implementation and support services and engaged in the development of software products and earns revenue from sale of user licenses and purchase stock in trade during the year and has intangibles. Further the margins of the company fluctuate year on year basis due to different revenue recognition model which the company has adopted. The above comparable was excluded in assessee's own case on functional dissimilarity in the Assessment Years 2005-06 and 2007-08 and learned Authorised Representative also relied on Lime Labs (India) Pvt. Ltd. Vs. ITO 101 Taxman.com 201 (Delhi Trib.). We found the co-ordinate Bench of the Tribunal in the case of LG Software India Pvt. Ltd. Vs. DCIT in IT(TP)A No.3122/Bang/2018 dt.28.05.2019 for the Assessment Year 2014-15 has excluded the comparable as observed at paras 8 & 8.1 at page 4 as under :

“8. We also notice that in A.Y 2008-09, the co-ordinate bench has excluded M/s. Thirdware Solutions Ltd also by following the decision rendered in the case of 3DPLM Software Solutions Ltd (supra), where in it was held that M/s. Thirdware Solutions Ltd. is engaged in product development and earns revenue from sale of licenses and subscription. Further, the segmental details were not available.

8.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in A.Y 2008-09, we direct exclusion of M/s. Thirdware Solutions Ltd.”

The comparable Thirdware Solutions Ltd. has to be excluded as it is predominant in activity and segmental details are not available. Accordingly we direct the TPO/A.O to exclude this comparable from the list of comparables for determining the ALP.”

We found there is a functional dissimilarity in respect of assessee's financial profile and accordingly ,we direct the TPO to exclude the comparable from the final list for determination of ALP.

9. The learned Authorized Representative argued for inclusion of 8 comparables as per Ground of appeal No.2.10.

(i) Akshay Software Technologies Ltd. – The company is functionally comparable as it has majority of the revenue is from of software related services. The TPO did not apply the on-site development filter and foreign branch expenses are not the same as on-site development of software. There is no difference in the business model adopted by the company and the assessee. The company was included as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT 115 taxmann.com 293 (Bang – Tribunal) at para 7(i) page 595 of Paper Book as under :

“ 7 (i) Akshay Software Ltd. which has a margin of 8.13%. The income from commission on sale of software license constitute meager 0.5% of total revenue and TPO has not applied transfer development filter. The said company was rejected by the TPO for the reason that the company is engaged in providing provisional services, procurement installation, employment support of ERP products. The DRP has rejected the comparable without applying the filter and there is no difference in the business model adopted by the company and the assessee. We on perusal of the Annual Report at Page 1373 of Paper Book, found

that major revenues are from operations as per Note 19 being income from software services and commission received on sale of software licenses. The earnings as per Note 28 as per the financial statements, the company has earning from export of software and in the F.Y. 2013-14 which constitute more than 95% of income. Therefore we found these facts are not considered by the TPO or DRP and accordingly we restore this issue to the file of TPO for examination and verification.”

We found there is a functional comparability in respect of assessee profile and accordingly, we direct the TPO to include the comparable in the final list for determination of ALP.

(ii) Sasken Communication Technologies Ltd. – The Company is functionally comparable as it has engaged in rendering SWD services and software product development and has income from software products, which constitutes a meager 0.88% of total revenue. Such income would not have any impact on the profitability of the SWD services segment. There is no difference in the business model adopted by the company and the assessee. The company was included as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 7(ii) page 595 of Paper Book as under :

“ 7 (ii) Sasken Communication Technologies Ltd. : The company has a margin of 10.25% and was rejected by the TPO on the functional dissimilarity and was confirmed by the DRP observing that the company fails export turnover filter. The company earns revenue from licensing and software development and royalty and the company offers software products. The learned Authorised Representative submissions are that the company is functionally similar to the assessee's profile and services rendered are predominantly software development services and income from software products constitute a meager amount of total revenue shall not have any impact on the profitability of the company's software development

segment. The learned Authorised Representative referred to the profit and loss account at page 1455 where the abridged statement profit and loss account was disclosed and as on 31.3.2014, the revenue from the operations of software products is Rs.309.17 lakhs and software services are Rs.3508.49 lakhs. The learned Authorised Representative emphasizing that there is no impact on the profits. We are of the opinion that the assessee company has customers in US and Europe area and the export revenue filter test has to be applied by the TPO. Accordingly we restore this issue to the file of TPO for fresh consideration.”

We found there is a functional comparability in respect of assessee's profile and accordingly, we direct the TPO to include the comparable in the final list for determination of ALP.

(iii) I2T2 India Limited - The Company is functionally comparable and passes all the filters. The DRP erred in upholding the exclusion of the company without first putting the assessee to notice. There is no difference in the business model adopted by the company and the assessee. The company was included as comparable in the decision of co-ordinate Bench in the case of M/S LG Soft India Pvt. Ltd. Vs. DCIT in IT(TP)A No.3122/Bang/2018 Dt.28.05.2019 and in M.A. No.95/Bang/2019 Dt.27.09.2019 at para 3 page 705 of Paper Book as under :

“ 3. The assessee had sought inclusion of a comparable company named “I2T2 India Ltd.” The tribunal has adjudicated the same in paragraphs 11 & 12 of the order. However, the name of company has been erroneously mentioned as “T2T2 India Ltd.” Instead of “I2T2 India Ltd.” Accordingly he prayed that the above said mistake may also be corrected.”

We found there is a functional comparability in respect of assessee's profile and accordingly we direct the TPO to include the comparable in the final list for determination of ALP.

(iv) Kireeti Soft Technologies Ltd. - The company is functionally comparable as it passes export turnover filter. The company is operating in one segment which is software and information technology services. The company was included as comparable in the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 7(v) page 596 of Paper Book as under :

“ 7 (v) Keerthi Soft Technologies Ltd., where the margin of the company is 4.11%. The observations of the DRP that the TPO has rejected the company on the ground of functional dissimilarity. On perusal of Paper Book at page 1641 where statement of profit and loss account was disclosed, the revenue from sale of products is disclosed as NIL and at page 1635, there is no segmental reporting except domestic and export reporting available. We are of the opinion that the DRP has made observations on the functionality of the company. Therefore we consider it appropriate to restore this issue to the file of TPO for verification and examination.”

We found there is a functional comparability in respect of assessee's profile and accordingly, we direct the TPO to include the comparable in the final list for determination of ALP.

(v) & (vi) Exilant Technologies Pvt. Ltd. And Celstream Technologies Ltd. - These two companies are functionally comparable as it passes all the filters. The company was included as comparable in the decision of co-ordinate Bench in the

case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at paras 7 (vi) & (vii) page 596 of Paper Book as under :

“ 7 (vi) Excellent Technologies Pvt. Ltd. : The TPO has rejected this comparable as P & L Account is not available in the public domain and the DRP has confirmed the observations. Before us, the learned Authorised Representative relied page 1677 of Paper Book disclosed the financial summary of business for the relevant year. As this information is available, we consider it proper to restore this comparable to the file of TPO for examination and verification.

7 (vii) Celstream Technologies Limited - The TPO and DRP has rejected the comparable as profit and loss account is not available in public domain and the learned Authorised Representative referred to page 1755 to 1786 of Paper Book where the details of profit and loss account and Annual Report of the company are filed. Since the financial statements are available, we restore this issue to the file of the TPO to consider the financial statements, profit and loss account and Director's Report. Accordingly, we restore the comparable to the file of TPO for verification of the financial statements.”

We found there is a functional comparability in respect of assessee's profile and accordingly, we direct the TPO to include these two comparable companies in the final list for determination of ALP.

(vii) *Maveric Systems Ltd.* - The company is functionally comparable as it has engaged in software testing and integral part of software development. The DRP erred in upholding the exclusion of the company on the ground that it incurred R&D exp of 6% of turnover, when no filter was applied by the TPO to exclude companies incurring R&D expenses. The company was included as comparable in

the decision of co-ordinate Bench in the case of EMC Software and Services Pvt. Ltd. Vs. JCIT (supra) at para 7(iii) page 595 of Paper Book as under :

“ 7 (iii) Maveric Systems Limited : This comparable was rejected by the TPO and it was sought for inclusion by the assessee and whereas TPO has rejected without any basis and was excluded on the ground that the company was engaged in R & D activity and expenditure is 6% of total turnover. Similarly, the DRP has upheld the exclusion of the company. The learned Authorised Representative submitted that company's functional profile is comparable and applied the TPO filters. Whereas the DRP has observed that the company has incurred substantial expenses to the tune of 6% of turnover towards R & D and the tolerable limit is 3%. We found the observations of the DRP are without any basis. Accordingly we restore this issue to the file of TPO to give a logical conclusion and findings.”

We found there is a functional comparability in respect of assessee's profile and accordingly we direct the TPO to include the comparable in the final list for determination of ALP.

(viii) Sankya Infotech Ltd. - The company is functionally comparable as it passes the export turnover filter and revenue from products is merely 0.005% of service income and therefore the same cannot have any impact on the profit margin. The company segmental details are available. The company was included as comparable in the decision of co-ordinate Bench in the case of Brocade Communications Systems (P) Ltd. Vs. DCIT in IT(TP)A No.79/Bang/2019 Dt.19.06.2020 at paras 34 to 36 on pages 616 & 617 of Paper Book as under :

“ 34. This company was selected by the assessee in its TP study and came to be rejected by the TPO for the reason that it fails the export revenue filter. While the assessee demonstrated before the DRP that the company passes the filter and earned revenue from export of services comprising 96.53% of the total revenue, the DRP upheld the rejection of the company on an altogether new basis that the

company is engaged in development of software and products, and that it had incurred substantial R&D expenses to the tune of 5.9% of total operating revenue.

35. At the outset it was submitted that the company is functionally comparable and passes all the filters applied by the TPO. It was submitted that action of the DRP in upholding the exclusion of the company on an altogether new basis without first putting the assessee on notice of the same is wholly erroneous and unsustainable.

36. We are of the view that the comparability of the company should be considered afresh by the TPO both on the export revenue filter and the filters applied by the DRP, because admittedly the assessee was not confronted by the DRP on the new filter it applied nor did it give a finding one way or the other on the export turnover filter.”

We found there is a functional comparability in respect of assessee's profile and accordingly we direct the TPO to include the comparable in the final list for determination of ALP.

10. The contention of the learned Authorized Representative that the Working Capital Adjustment has to be applied in the order to adjust the difference of working capital of the tested parties. The LdAR relied on the decision of the coordinate Bench in the case of Brocade Communications Systems (P) Ltd. Vs. DCIT in IT(TP)A No.79/Bang/2019 dt.19.06.2020, where the Tribunal has directed the TPO to allow the Working Capital Adjustment after verification of the assessee computation and provide opportunity to the assessee to represent the case referred at Para 40 to 46 of the order as under :

“ 40. In ground no.4, the assessee has projected its grievance regarding non-grant of working capital adjustment (WCA) and risk adjustment. The assessee submits that that Rule 10B(3) of the Income-tax Rules, 1962 (“the Rules”), itself categorically provides that an adjustment ought to be provided for any differences in the economic factors between the tested party and the comparables. A working capital adjustment is one such adjustment which is to be applied in order to adjust for the differences between the working capital positions of the tested party and of the comparable.

41. Reliance was placed by the assessee on the decision of this Tribunal in the cases of Bearing Point Business Consulting (P.) Ltd. vs. DCIT [(2013) 33 taxmann.com 92]. Further in the assessee's own case for the AY 2010-11, this Tribunal held that working capital adjustment ought to be granted while computing the ALP. Further, in the assessee's own case for the AY 2009-10, this Tribunal upheld the action of the DRP in directing allowing working capital adjustment on actual basis without applying any restriction.

42. The Id. DR relied on the order of DRP.

43. We are of the view that it is now a settled proposition of law that necessary adjustments are to be made to the margins of comparables to give effect to the differences in the working capital positions of the tested party and of the comparables. The TPO ought to have given the assessee the benefit of the same. We hold and direct the TPO to allow working capital adjustment after verification of the assessee's computation and after affording opportunity of being heard to the assessee.

44. As regards risk adjustment, it was submitted that Rule 10B(2) of the Rules specifically state that comparability of an international transaction with an uncontrolled transaction shall be judged with reference to inter alia the risks assumed by the parties to the transaction. Coupled with Rule 10B(3) of the Rules, it becomes clear that adjustment towards differences in risk assumed by the parties in contemplated in the statute itself. In this regard it was submitted that the TPO and the DRP erred in holding that no such adjustment was warranted as it was not demonstrated that there was a difference in the risks assumed by the tested party and the comparable companies. In this regard it was submitted that since the Appellant is a captive service provider, the risks assumed by the Appellant are significantly low. The following chart sets out the levels of risk assumed by the assessee and its AE:

Risk	Appellant	AE
Market risk	0	4
Project Liability risk	1	3
R&D Risk	0	4
Credit risk	0	4
Foreign Exchange risk	2	2
Manpower risk	0	4
General business risk	2	2

Note:

- 0 indicates no responsibility,
- 1 indicates low risk,
- 2 indicates moderate risk,
- 3 indicates high risk,
- 4 indicates significant risk.

Detailed submissions in this regard are placed at pages 249-266 of the paperbook.

45. Reliance in this regard was placed on the decision of the Hon'ble Delhi Bench of the Tribunal in the case of Honeywell Turbo Technologies (India) (P.) Ltd. v. DCIT (reported in [2017] 78 taxmann.com 342 (Pune - Trib.)), wherein the Tribunal granted an adjustment to be granted for differences in risk assumed by the tested party and the comparable entities.

46. We are of the view that the question of allowing risk adjustment should be considered by the TPO afresh in the light of the submissions and after examining the computation of risk adjustment and affording opportunity of being heard to the assessee."

We respectfully follow, the decision and direct the TPO to grant Working Capital Adjustment after verification and examination of the assessee computation and allow the ground of appeal of the assessee for statistical purposes.

11. In the result, the assessee appeal is partly allowed for statistical purposes.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-

(B.R. BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Dated: 23.11.2020.

*Reddy GP

Copy to

1. The appellant
2. The Respondent
3. CIT (A)
4. Pr. CIT
5. DR, ITAT, Bangalore.
6. Guard File

By order

Assistant Registrar
Income-tax Appellate Tribunal Bangalore.