

IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE – VIRTUAL COURT

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

ITA No.173/PUN/2017
निर्धारण वर्ष / Assessment Year: 2012-13

M/s. Nethawk Networks India Private Limited, 1249/50, 1 st Floor, Lifestyle Building, F.C. Road, Deccan, Pune 411 004 PAN : AACCN0994P	Vs.	ACIT, Circle-2, Pune
Appellant		Respondent

Assessee by Shri Nikhil Pathak
Revenue by Smt. Aparna M. Agarwal

Date of hearing 16-06-2021
Date of pronouncement 17-06-2021

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 30-11-2016 passed by the Assessing Officer (AO) u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') in relation to the assessment year 2012-13.

2. The assessee has raised an additional ground, which is nothing but an elaboration of the grounds taken in the Memorandum of appeal. The additional ground specifically refers to the name of

the companies challenged, which were earlier, albeit not named, but assailed in the Memorandum on the basis of certain filters etc. The Id. DR did not raise any objection to the admission of the additional ground. As such, we admit the same for disposal on merits.

3. The only issue in this appeal is against the transfer pricing addition of Rs.1,35,74,804/- made by the AO. Briefly, the facts of the case are that the assessee is engaged in the business of rendering Software Development and testing services to its Associated Enterprise (AE). A return was filed declaring total income of Rs.3.03 crore. Certain international transactions were reported in Form No. 3CEB. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of the international transactions. Instantly, we are concerned only with the international transaction of 'Provision of Software Development services' with transacted value of Rs.25,32,80,385/-. The assessee applied the Transactional Net Margin Method (TNMM) as the most appropriate method for showing that the international transaction was at ALP. In doing so, it used Profit Level Indicator (PLI) of Operating profit/Operating

cost (OP/OC). Its own PLI was worked out at 13.24%. Ten comparables were chosen to show that the international transaction was at ALP. The TPO retained two companies from the assessee's list and added seven new companies and accordingly worked out the transfer pricing adjustment at Rs.3,24,94,980/-. The DRP excluded one and included one company already chosen by the assessee that was rejected by the TPO, thereby making total number of comparables at nine. This exercise by the DRP resulted in reducing the transfer pricing addition to Rs.1,35,74,804/-, against which the assessee has approached the Tribunal.

4. At the outset, it is stated that the dispute in the extant appeal revolves around certain companies chosen by the TPO as comparable. But for that, there is no quarrel over the adoption of the TNMM as the most appropriate method or the application or calculation of the PLI. Before analyzing comparability or otherwise of the companies challenged before us, we consider it expedient to first ascertain the nature of work carried out by the assessee under the international transaction. The TPO has simply reproduced from the assessee's depiction of the transaction as that of rendering Software Development services. There is no

independent evaluation of the nature of transaction w.r.t the relevant Agreement or the Transfer pricing study report. The Id. AR invited our attention towards the Computer Programming and Product Support Services Agreement (hereinafter also called 'the Agreement') dated 01-04-2007 under which the assessee rendered the Software services. As per clause 6, the Agreement shall commence on the effective date (01-04-2007) and remain in force until terminated by OYJ with three (3) months' prior notice written notice to NNIPL. From the above clause, it is clear that the Agreement is relevant to the year under consideration. Clause 1 of the Agreement provides the 'Description of the Deliverables regarding Computer Programming and Product Support services' as 'Deliverable(s) shall mean *computer programming and related services*, and product support services for OYJ, including all material in whatever form, which is generated. Deliverable may include, but is not limited to, the computer program or any part thereof. Source and Object Code, any enhancements thereof, all materials and documentation necessary for OYJ to use, modify, correct, adapt, and understand any computer program and related enhancements delivered by NNIPL to OYJ under this Agreement,

all materials and documentation that shall be prepared, written, developed or otherwise provided by NNIPL to OYJ under this Agreement.' Clause 3 of the Agreement states that the: *'Ownership and title to all intellectual Property Rights of whatsoever nature in or related to any work produced by NNIPL under this Agreement, including but not limited to the Deliverables and associated documentation, shall vest exclusively with OYJ.'* Thus, it is borne out from the Agreement that the assessee was supposed to render Software Development services to its AE, namely, NetHawk OYJ, Finland. The transfer pricing study report of the assessee also substantiates that the assessee rendered only Software Development services. With the above understanding of the character of services rendered by the assessee under the international transaction under review, we now proceed to examine the comparability or otherwise of the companies challenged before us.

(i) Infobeans Systems Pvt. Ltd. :

5. The TPO chose this company as comparable. The assessee objected to its inclusion by contending that there was a merger in this company effective from 26-09-2012 and hence should be

excluded because of this extra-ordinary financial event. The TPO did not find any merit in this argument because the effective date fell beyond the relevant previous year. The DRP observed that though the merger was sanctioned by the Hon'ble Madhya Pradesh High court on 26-09-2012, but the appointed date was only 01-04-2011 relevant to the year under consideration. It, however, went on to affirm the inclusion by holding that such merger had no impact on the financial results of the company. Aggrieved thereby, the assessee has approached the Tribunal.

6. We have heard both the sides through Virtual Court and gone through the relevant material on record. The only objection raised by the Id. AR against the inclusion of InfoBeans Systems Pvt. Ltd. is the factum of merger taking place during the relevant year. Except for that, its otherwise comparability is not assailed. We have examined the Annual report of this company, a copy of which has been provided at page 195 onwards of the paper book. The fact of demerger has been taken note of in para 2 of the Auditors report reading as under: -

“2. We state that “Software Business” of the InfoBeans Systems India Pvt. Ltd. (currently known as Seed Enterprises Private Limited) is demerged and transferred to the Company

in pursuance to the Scheme of Arrangement as approved by the Hon'ble Madhya Pradesh High Court dated 26/09/2012 vide Appointed date 1st April 2011. Accordingly these are the Revised financial statements including the Financial Statements of the said "Software Business" of Demerged Company."

7. On going through the above para, it is overt that demerger of the Software business of Seed Enterprises Private Limited took place effective from 01-04-2011 and the accounts of such company relating to the software business were transferred to the Infobeans Systems India Pvt. Ltd. from such date. Thus it is glaring that the merger took place on the first day of the relevant financial year only. By now, it is fairly settled that an extraordinary financial event, such as, merger or demerger or amalgamation render a company incomparable. However, our attention has been drawn towards a peculiar fact of this company, which is manifested on an examination of its Profit and loss account. All the figures of the Profit and loss account of the immediately preceding year relating to the business operations, such, 'Revenue from operations', 'Employee benefit expense', 'Financial costs' or 'Depreciation and amortization expenses' are Nil. There is only one figure of 'Other expenses' at Rs.10,068. Similar position follows on perusal of its

Balance sheet. All the figures having some relevance with the business operations, such as, Fixed assets, Trade Receivables or Payables are Nil at the close of the last year. Total of balance sheet items for the preceding year is only Rs.92,690, as against the total for the year under consideration at Rs.10,04,63,809. This indicates that the company had no business operations in the preceding year and started effective functioning only w.e.f. 01-04-2011, namely, the first day of the relevant financial year on taking over the Software business of Seed Enterprises Private Limited, which was earlier called as InfoBeans Systems India Pvt. Ltd., being, the comparable company itself.

8. The *raison d'être* for the exclusion of a company on account of extra-ordinary financial events is that the uninterrupted results of its hitherto continuously existing business get interrupted because of the abrupt infusion or diffusion on merger/demerger, thereby rendering it vulnerable for an effective comparison with an otherwise evenly poised company. *Au contraire*, if the company starts its operations *ab initio* by taking over business of another entity from the first day of the financial year, without having any pre-existing business, there can be no question of distortion of its

financial results because of merger. Such a panorama cannot justify exclusion of an otherwise comparable company.

9. Adverting to the facts of the instant case, we find that InfoBeans commenced its actual business operations from the very first day of the relevant financial year by taking over the Software business of Seed Enterprises Private Limited. It had no separate independent business before the merger. Thus, the financial results of InfoBeans for the relevant year were not jeopardized in any manner because of the merger of Software business of another company. They represented a true reflection of its seamless functioning throughout the year. The situation is akin to the standalone software business of the erstwhile Seed Enterprises Private Limited becoming a comparable indirectly. This distinguishing feature leads us to the inevitable conclusion that InfoBeans, which is otherwise admittedly similar, cannot be filtered out from the final list of comparables.

10. To bolster his argument of exclusion of InfoBeans, the Id. AR banked on a Pune Tribunal order dated 17-12-2020 passed in *eGain Communications Pvt. Ltd. Vs. DCIT* (ITA No.544/PUN/2017) for the same A.Y. 2012-13. That order was

passed by this very combination of the Members directing the exclusion of InfoBeans on account of the extra-ordinary financial event of merger *vis-à-vis* the assessee-company in that case engaged in rendering software services in the manner similar to that of the assessee under consideration. On going through that order, it is discernible that the afore-noted peculiar fact of InfoBeans commencing its actual business operations with the merger only, without there being any earlier continued business, were not highlighted before the Bench by either side. Once the correct position has been made graphically clear, no party should impress upon the Bench to follow suit. In the hue of the foregoing discussion, we are satisfied that InfoBeans cannot be excluded from the tally of comparables on account of extraordinary financial event of merger, more specifically, when the otherwise similarity of this company has not been challenged on behalf of the assessee. We, therefore, countenance the inclusion of this company.

(ii) Cybercom Datametics Information Solutions Ltd. :

11. This company was included by the TPO in the list of comparables. The assessee objected to the same by contending that it was functionally dissimilar. The DRP echoed the view of

the TPO, against which the assessee has come up in appeal before the Tribunal.

12. We have heard the rival submissions and scanned through the relevant material on record including the Annual report of this company, a copy of which has been placed at page 176 onwards of the paper book. Note 1A forming part of the Financial statements reads as under:

“About the Company

.....

The Principal object of the Company is *to act as consultants and advisors* on information/internet system and surveyors of information services, and to carry on the business of development, testing, implementation, migration of home grown and other applications, marketing and manufacturing of information technology products and services, software and hardware systems to enterprise and embedded technologies in the telecom and other industries.”

13. Profit and loss account of this company shows, “Sale of services” as the only item of Revenue from operations, except ‘Other income’. Note 23 forming part of the Financial statements gives details of ‘Segment Reporting’ as under :

“The principal business of the Company is of *providing of technical and software services*. All other activities of the Company revolve around its main business. Hence no additional disclosure under Accounting Standard-17. “Segment Reporting” are required in these financial statement.”

14. On going through the above material, it is manifest that the principal object of the company was to act as Consultants and Advisors of information/internet systems and Surveyors of information services and further that it was engaged in providing Technical and Software services. As against that, the assessee is engaged only in rendering Software Development services. It is neither providing any Technical services nor any Consultancy services. The Annual report of the company does not indicate any bifurcation of profits from Technical services and Software services. In other words, there is no segmental information available so as to cull out the figures relating to Software services. Since this comparable was chosen by the TPO, the primary onus of demonstrating its comparability, was upon him. Except for repeated accentuation of comparability in his order, the TPO has nowhere proved his point in the light of the Annual report of the company or any other relevant material. The ld. DR also could not point out from the Annual report of the company or any other material that it was rendering only Software services. Per contra, the Annual report of the company states that it is engaged in rendering Technical services in addition to Software services – a

situation, which does not match with the assessee on holistic basis. On the failure of the Revenue to establish the comparability of this company chosen by the TPO, we direct to exclude it from the list of comparables.

15. To sum up, we set-aside the impugned order and remit the matter to the file of AO/TPO for re-determining the ALP of the international transaction of Provision of Software Development services in the light of our above discussion. Needless to say, adequate opportunity of hearing will be provided to the assessee.

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

Order pronounced in the Open Court on 17th June, 2021.

Sd/-
(PARTHA SARATHI CHAUDHURY)
JUDICIAL MEMBER

Sd/-
(R.S.SYAL)
VICE PRESIDENT

पुणे Pune; दिनांक Dated : 17th June , 2021
Satish

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr.CIT-5, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे
“C” / DR ‘C’, ITAT, Pune
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	16-06-2021	Sr.PS
2.	Draft placed before author	16-06-2021	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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