

IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE
BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A No.458/Bang/2019
Assessment Year : 2007-08

Lam Research (India) Pvt. Ltd., (formerly known as Novellus Systems (India) Pvt. Ltd., Maruti Infotech Center, 2 nd Floor, A Block, 11/01 & 12/01, Amarjyothi Layout, Intermedite Ring Road, Bengaluru-560 071.	Vs.	The Dy. Commissioner of Income-Tax, Circle-4(1)(1), Bengaluru.
PAN - AABCN 2063 Q		
APPELLANT		RESPONDENT

Assessee by	:	Shri Darpankirpalani, Advocate
Revenue by	:	Shri Muzaffar Hussain, CIT(DR)

Date of Hearing	:	05-04-2021
Date of Pronouncement	:	23-06-2021

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

The present appeal has been filed by assessee against the final assessment order dated 27/12/2018, passed by the Ld.DCIT Circle- (1)(1), Bangalore, for assessment year 2006-07, on following revised grounds of appeal:

“Based on the facts and circumstances of the case and in law, Lam Research (India) Private Limited (hereinafter referred to as Appellant), respectfully craves leave to prefer an appeal against the assessment order passed by the learned Assessing Officer [hereinafter referred to as the learned AO] under section 143(3) read with section 144C of the Income-tax Act, 1961 (the Act) on the following grounds.

1. The impugned order of the learned AO pursuant to the directions of the Hon'ble DRIP, erred in assessing the total income at Rs. 1,44,71,721 as against the returned income of Rs. 29,240;

2. The learned AO I Transfer Pricing Officer (TPO) and the Honble DRP have erred, in making an addition of Rs 1,31,78,142 to the total income of the Appellant on pretext that price charged was lower than arm's length price determined for provision of software development services transaction rendered by Appellant to its AE(s);

3. The learned AO / TPO and the Hon'ble DRIP have erred, in law and in facts, by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Income Tax Rules, 1962 (the Rules'), and in conducting a fresh economic analysis for the determination of the arm's length price ('ALP') in connection with the impugned international transaction, and holding that the Appellant's international transaction is not at arm's length;

4. The learned AO / TPO and the Hon'ble DRIP have erred, in law and in facts, by determining the arm's length margin/ price using only FY 2006-07 data though the same was not available to the Appellant at the time of complying with the transfer pricing documentation requirements;

5. The learned AO / TPO and Hon'ble DRIP have erred, in law and in facts, by exercising his powers under section 133(6) of the Act to obtain information which was not available in public domain and relying on the same for comparability purposes;

6. The learned AO / TPO and the Hon'ble DRIP have erred, in law and facts by rejecting certain comparable companies considered by the Appellant in the comparability analysis by applying different quantitative and qualitative filters:

a) The learned AO / TPO and the Hon'ble DRP have erred, by rejecting certain comparable companies identified by the Appellant for having different accounting year (i.e. companies having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months);

b) The learned AO I TPO and the Hon'ble DRP have erred, by rejecting certain comparable companies identified by the Appellant using employee cost greater than 25% of the total revenues as a comparability criterion;

c) The learned AO / TPO and the Hon'ble DRP have erred, by rejecting certain comparable companies identified by the Appellant using export earnings greater than 75% of the sales as a comparability criterion;

d) *The learned AO / TPO and the Honble DRP have erred, in applying only the lower cap on the turnover filter of Rs.1 crore and not applying any upper cap for the comparability criterion;*

i. *The learned AO/ TPO and the Hon'ble DRIP has therefore erred in law and in facts, in considering the following as comparable companies:*

- a) *Flextronics Software Systems Limited (Seg.)*
- b) *Infosys Technologies Ltd.*
- c) *Tata Elxsi Ltd. (Seg.)*
- d) *Wipro Ltd. (Seg.)*
- e) *Persistent Systems Ltd.*
- f) *Sasken Communications Technologies Limited*
- g) *IGate Global Solutions Limited*
- h) *Mindtree Limited*

7. *The learned AO/ TPO and the Hon'ble DRP have erred, in law and in facts, by accepting / rejecting companies based on unreasonable comparability criteria;*

7.1 *The learned AO/DRPITPO has failed to appreciate the fact that the following companies are not functionally comparable to the software development segment of Appellant, therefore has erred in law and in facts in considering them as comparable companies:*

- a) *Accel Transmatic Limited (Seg)*
- b) *Avani Cimcon Technologies Limited*
- c) *Celestial Labs Limited*
- d) *E-Zest Solutions Limited*
- e) *Flextronics Software Systems Limited (Seg.)*
- f) *Ishir Infotech Limited*
- g) *KALS Information Systems Limited (Seg)*
- h) *Lucid Software Limited*
- i) *Tata Elxsi Limited Se*
- j) *Thirdware Solutions Limited*
- k) *Wipro Limited (Seg)*

7.2 *Without prejudice to transfer pricing documentation, the learned AO/DRP/TPO has failed to appreciate the fact that the following companies are not functionally comparable to the software development segment of Appellant, therefore, the learned AO/DRP/TPO has erred in law and in facts by considering them as comparable companies:*

- a) *Helios & Matheson Information Technology Limited*
- b) *Infosys Technologies Limited*

8. *The learned AO/DRP/TPO and the Hon'ble DRP have erred in wrongly computing the operating profit margin of the comparable companies identified in the TIP order;*

9. *The learned AG / TPO and the Hon'ble DRP have erred in not making suitable adjustments on account for differences in the risk profile of the*

Appellant vis-à-vis the comparables, while conducting comparability analysis;

10. The learned AO/TPO and the Hon'ble DRP erred in computing the arm's length price without giving the benefit of +/- 5 percent under the proviso to section 920 of the Act.

General Grounds

11. The learned AG has erred in levying interest of Rs.68,60,778 under section 234B of the Act and Rs. 2,45,722 under section 2340 of the Act;

12. The learned AG has erred, in law and in facts, by initiating penalty proceedings u/s 271(1)(c) of the Act.

The Appellant submits that each of the above grounds is independent and without prejudice to one another.

The Appellant craves leave to add, alter, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide on the appeal in accordance with the law.”

Brief facts of the case are as under:

2. The assessee filed its return of income for year under consideration on 30/10/2007 declaring income of Rs.29,420/-. The return was processed under section 143(1) and the case was selected for scrutiny. Subsequently notice under section 143(2) of the Act was issued, in response to which, representative of assessee appeared before Ld.AO and filed requisite details as called for the Ld.AO on perusal of the details filed observed that assessee had international transaction with associated enterprises exceeding Rs. 5 crores. The case was accordingly referred to the Transfer Pricing officer to compute the arm's length price of the transaction as per section 92C of the Act.

3. On receipt of reference, the Ld. TPO called upon assessee to file the economic details of the transaction entered into by assessee with its associated enterprises. From the details filed, the Ld.

TPO observed that, assessee had following international transaction:

Software Development services	Rs.12,67,55,785 /-
Fixed asset loan	Rs. 5,87,883/-
Interest payable on Loan	Rs. 4,67,183/-
Reimbursement of expenses (Received)	Rs.8,35,368/-

3. Assessee used TNMM as most appropriate method and OP/OC as the PLI. It computed its margin at 10.51%. Ld.TPO observed that assessee selected 28 comparables with an average margin of 14.53%. As margin was between 5% range the assessee held its transaction to be at arms length. The Ld.TPO rejected the Transfer Pricing analysis carried by assessee as according to Ld.AO it suffered certain defects. Applying various filters Ld.AO rejected the comparables selected by assessee. The Ld.TPO undertook fresh search and selected set of following 26 comparables with average margin of 25.14%:

Sl. No.	Comparables Margin	Margin
1.	Allsec Transmatic Ltd (SEG)	18.91%
2.	Avani Cincom Technologies Ltd	49.97%
3.	Celestial Labs Ltd	53.06%
4.	Datamatics Ltd	-1.81%
5.	e-Zest Solutions Ltd	34.85%
6.	Flextronics Software Systems Ltd (SEG)	23.85%
7.	Geometric Ltd (SEG)	8.42%
8.	Hello and Matheson Information Technology Ltd	33.23%
9.	iGate Global Solutions Ltd	4.42%
10.	Infosys Technologies Ltd	37.76%

11	Ishier Infotech Ltd	29.20%
12.	KALS Information Systems Ltd	22.22%
13.	LGS Global Ltd	13.95%
14.	Lucid Software Ltd	15.84%
15.	Mediasoft Solutions Ltd	0.39%
16.	Megasoft Ltd	0.12%
17.	Mindtree Ltd (TP study comparable)	4.16%
18.	Persistent Systems Ltd	2.23%
19.	Qtintengra Solutions Ltd	8.04%
20.	RS Software India Ltd	1.93%
21.	R Systems International Ltd (SEG)	2.04%
22.	SaskenCommunications Technologies Ltd (SEG)	9.88%
23.	SIP Technologies and Exports Ltd (TP study comparable)	9.50%
24.	Tata Elxsi Ltd (Seg.)	4.96%
25.	Thirdware Solutions Ltd	0.32%
26.	Wipro Ltd	3.27%
	Average Margin	21.95%

4. The Ld.TPO thus proposed adjustment being shortfall at Rs.1,44,85,721/-.

5. On receipt of draft assessment order, the Ld.AO also disallowed the telly/Internet charges incurred on delivery of software abroad, travelling expenses made in foreign currency etc from export turnover, thereby reducing the deduction claimed by assessee under section 10A at Rs.12,64,165/- .

6. Against the draft assessment order, assessee filed objections before DRP. The DRP passed its direction based on which assessment order under section 143 (3) read with sec.144C of the Act, was passed on 19/09/2011, determining the income in the

hands of assessee for year under consideration at Rs.1,57,79,300/-. Aggrieved by the order of the Ld.AO, assessee filed appeal before this *Tribunal* in ITA (TP) A No. 1087/B/2011 dated 12/07/2017. This *Tribunal* set aside the entire Transfer Pricing issue to the DRP, for comparing functional similarity/dissimilarity with the comparables selected by the Ld.TPO based on the FAR analysis, and also to pass an order in accordance with law, laid down by the *Hon'ble High Court* and this *Tribunal*.

7. Based on the directions of this *Tribunal*, the DRP gave its direction on 20/12/2018 and consequent to the DRP directions, the Ld. AO passed impugned order wherein the income assessed was revised to Rs.1,44,71,721/-.

8. Aggrieved by the order of the Ld.AO, assessee is in appeal before us now.

9. This is the 2nd round of appeal before this *Tribunal*.

At the outset, the Ld.AR submitted that, assessee wish to only argue grounds 6 (d), 7 (7.1)-(7.2). It is submitted that, apart from these grounds, no other grounds are pressed for arguments. Accordingly, we are restricting our opinion, only in respect of the grounds argued by the Ld.AR as referred to herein above.

It is submitted that, in these grounds, assessee seeks exclusion/inclusion of comparables selected by the Ld. TPO in the final list.

10. Before we undertake the comparability analysis it is *sine qua non* to understand the functions, assets and risk assumed by assessee under this segment as observed by the Ld TPO.

10.1 Functions

As per the taxpayer, there is no change in the functional profile of the taxpayer during the FY 2006-07. The taxpayer being a software development company, performs software development services on a contract basis to its AE, Novellus US .

10.2 Assets

As is common in the case of software service provider companies, the technical manpower employed and trained by a company is its most important asset. Assessee also deploys well qualified workforce in its business. Besides that, assessee also owns Computers etc., which are essential to the business of a software development company. The asset profile of the company is given as under in the TP Report

Sl No	Type of assets	Net Block Value (Rs.) as on 31.3.07
1	Computers	53,02,465
2	Office Equipment	50,81,436
3	Furniture & Fixture	36,73,214
4	Vehicles	1,50,206
5	Leasehold improvements	62,09,772
Total		2,04,17,093

10.3 Risks

It is claimed by assessee that, being a captive service provider and being compensated at cost plus 10%, the assessee does not bear the risks like market risk, financial risk, credit & collection risk and service liability risks which are normal in the case of independent entrepreneurs. The risk profile of the taxpayer vis-a-vis other comparables has been dealt with in later part of this order under the head "Risk Adjustment".

10.4 The Ld.TPO thus observed that the assessee is a captive service provider compensated at cost +10% and does not bear any risks associated with its services rendered to the associated enterprises.

Based on the above we shall undertake the comparability analysis of following comparables with that of assessee:

11. It has been submitted by the Ld.AR that all the comparables alleged by the assessee for inclusion/exclusion has been considered by coordinate bench of this *Tribunal* in case of *M/s Mphasis Ltd. vs ACIT in IT(TP)A No.14/B/2012 by order dated 19/05/2017 for assessment year 2007-08* and *M/s Net App India Pvt Ltd vs DCIT in IT(TP)A No.593/B/2012 and IT(TP)A No.687/B/2012 for assessment year 2007-08 by order dated 27/02/2020*.

12. We have perused these decisions and observed that they have also been categorised as a captive service provider rendering software development services to its associated enterprises with

minimum or no risk. Under such circumstances the comparability analysis carried out by coordinate bench of this *Tribunal* in these decisions could be applied in the present facts of the case:

Ground 6 (d):

13. In this ground assessee seeks exclusion of 8 comparables on turnover filter.

13.1 It has been submitted by the Ld.AR that Ld.TPO while applying the turnover filter failed to apply the upper turnover limit of Rs.200 crores. He thus submitted that, following comparables have more than 200 crores turnover and therefore deserves to be excluded:

- Flextronics Software Systems Ltd. (SEG)
- Infosys Technologies Ltd.
- Tata Elxsi Ltd. (SEG)
- Wipro Ltd. (SEG)
- Persistent Systems Ltd.
- Sasken Communications Technologies Ltd.
- iGate Global Solutions Ltd.
- Mindtree Ltd.

13.2 On the contrary learn CIT DR relied on orders passed by authorities below.

13.3 We have perused submissions advanced by both sides in light of records placed before us.

It has been submitted that, these comparables were considered for exclusion on failing turnover filter in assessee's own case by

coordinate bench of this Tribunal for assessment year 2013-14 in ITA No.2490/B/2017 by order dated 3/2/2021.

14. *One of the arguments by the assessee before the Ld.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 the assessee whose turnover was only Rs. 18 crores. The Ld.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. In ground No. 5(iv), 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. 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 (P.) Ltd. v. Dy. CIT [2018] 96 taxmann.com 263. This Tribunal in case of Autodesk India (P.) Ltd. v. Dy. CIT (supra) decision after review of entire case laws on the subject, considered the question, whether companies having turnover more than 200 crores to 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 v. Pentair Water India Put. 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 Capegemini India Pvt. Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding coordinate 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 bie 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, comparables sought for exclusion in Ground No.6.1 raised by the assessee is allowed."

13.4 In the light of the above, we uphold exclusion of these comparables raised by assessee in ground No. 6 (d).

Accordingly this ground raised by assessee stands allowed.

Ground No. 7 (7.1)

14. In this ground, assessee seeks exclusion of following comparables on functional dissimilarities:

- Accel transmatic Ltd. (SEG)
- Avani Cincom Technologies Ltd.
- Celestial Labs Ltd.
- e-Zest Solutions Ltd.
- Ishir Infotech Ltd.
- Kals Information Systems Ltd. (SEG)
- Lucid Software Ltd.
- Thirdware Solutions Ltd.

It has been submitted that identical set of 26 comparables were selected by the Ld.TPO for the very same assessment year in case of *M/s.Tektronix India Pvt.Ltd vs DCIT in IT(TP)A no.673/B/2017*. This *Tribunal* observed as under:

“5.2 *We note that identical set of 26 comparables were selected by Ld.TPO for very same assessment year in case of Meritor LVS India (P)Ltd., by this Tribunal reported in (2015) 64 Taxmann.com 136 and First Advantage Offshore Services Pvt Ltd vs DCIT in ITA (TP) No. 1086/B/2011. We also note that assessee before us and Meritor LVS, First Advantage Offshore Services Pvt. Ltd., renders software development services to associated enterprises under a contract services provider for very same assessment year. This Tribunal in these decisions have held following companies to be not comparable for year under consideration on identical functions which is risks mitigated being a contract service provider like assessee. We refer to observation made by this (Tribunal) in the case of (Meritor LVS, India Pvt. Ltd. (Supra)) in respect of following comparables.*

Celestial Labs Ltd.

42. As far as this company is concerned, the stand of the assessee is that it is absolutely a research & development company. In this regard, the following submissions were made:-

- *In the Director's Report (page 20 of PB-II), it is stated that "the company has applied for Income Tax concession for in-house R&D centre expenditure at Hyderabad under section 35(2AB) of the Income Tax Act."*
- *As per the Notes to Accounts - Schedule 15, under "Deferred Revenue Expenditure" (page 31 of PB-II), it is mentioned that, "Expenditure incurred on research and development of new products has been treated as deferred revenue expenditure and the same has been written off in 10 years equally yearly installments from the year in which it is incurred."*

An amount of Rs. 11,692,020/- has been debited to the Profit and Loss Account as "Deferred Revenue Expenditure" (page 30 of PB-II). This amounts to nearly 8.28 percent of the sales of this company.

It was therefore submitted that the acceptance of this company as a comparable for the reason that it is into pure software development activities and is not engaged in R&D activities is bad in law.

43. Further reference was also made to the decision of the Mumbai Bench of the Tribunal in the case of Teva Pharma Private Ltd. v. Addl. CIT - ITA No.6623/Mum/2011 (for AY 2007-08) in which the comparability of this company for clinical trial research segment. The relevant extract of discussion regarding this company is as follows:

"The learned D.R. however drew our attention to page-389 of the paper book which is an extract from the Directors report which reads as follows:

"The Company has developed a de novo drug design tool "CELSUITE" to drug discovery in, finding the lead molecules for drug discovery and protected the IPR by filing under the copy if sic (of) right/patent act. (Apprised and funded by Department of Science and Technology New Delhi) based on our insilico expertise (applying bio-informatics tools). The Company has developed a molecule to treat Leucoderma and multiple cancer and protected the IPR by filing the patent. The patent details have been discussed with Patent officials and the response is very favorable. The cloning and purification under wet lab procedures are under progress with our collaborative Institute, Department of Microbiology, Osmania University, Hyderabad. In the industrial biotechnology area, the company has signed the Technology transfer agreement with IMTECH CHANDIGARH (a very reputed CSIR organization) to manufacture and market initially two Enzymes, Alpha Amylase and Alkaline Protease in India and overseas. The company is planning to set up a biotechnology facility to manufacture industrial enzymes. This facility would also include the research laboratories for carrying out further R & D activities to develop new candidates' drug molecules and license them to Interested Pharma and Bio Companies across the GLOBE. The proposed Facility will be set up in Genome Valley at Hyderabad in Andhra Pradesh.'

According to the learned D.R. celestial labs is also in the field of research in pharmaceutical products and should be considered as comparable. As rightly submitted by the learned counsel for the Assessee, the discovery is in relation to a software discovery of new drugs. Moreover the company also is owner of the IPR. There is however a reference to development of a molecule to treat cancer using bio-informatics tools for which patenting process was also being pursued. As explained earlier it is a diversified company and therefore cannot be considered as comparable functionally with that of the Assessee. There has been no attempt made to identify and eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustment, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the Assessee in this regard."

44. It was submitted that the learned DR in the above case vehemently argued that this company is into research in pharmaceutical products. The ITAT concluded that this company is owner of IPR, it has software for discovery of new drugs and has developed molecule to treat cancer. In the ultimate analysis, the ITAT did not consider this company as a comparable in clinical trial segment, for the reason that this company has diverse business. It was submitted that, however, from the above extracts it is clear that this company is not into software development activities, accordingly, this company should be rejected as a comparable being functionally different.

45. From the material available on record, it transpires that the TPO has accepted that up to AY 06-07 this company was classified as a Research and Development company. According to the TPO in AY 07-08 this company has been classified as software development service provider in the Capitaline/Prowess database as well as in the annual report of this company. The TPO has relied on the response from this company to a notice u/s.133(6) of the Act in which it has said that it is in the business of providing software development services. The Assessee in reply to the proposal of the AO to treat this as a comparable has pointed out that this company provides software products/services as well as bioinformatics services and that the segmental data for each activity is not available and therefore this company should not be treated as comparable. Besides the above, the Assessee has point out to several references in the annual report for 31.3.2007 highlighting the fact that this company was develops biotechnology products and provides related software development services. The TPO called for segmental data at the entity level from this company. The TPO also called for description of software development process. In response to the request of the TPO this company in its reply dated 29.3.2010 has given details of employees working in software development but it is not clear as to whether any segmental data was

given or not. Besides the above there is no other detail in the TPO's order as to the nature of software development services performed by the Assessee. Celestial labs had come out with a public issue of shares and in that connection issued Draft Red Herring Prospectus (DRHP) in which the business of this company was explained as to clinical research. The TPO wanted to know as to whether the primary business of this company is software development services as indicated in the annual report for FY 06-07 or clinical research and manufacture of bio products and other products as stated in the DRHP. There is no reference to any reply by Celestial labs to the above clarification of the TPO. The TPO without any basis has however concluded that the business mentioned in the DRHP are the services or businesses that would be started by utilizing the funds garnered through the Initial Public Offer (IPO) and thus in no way connected with business operations of the company during FY 06-07. We are of the view that in the light of the submissions made by the Assessee and the fact that this company was basically/admittedly in clinical research and manufacture of bio products and other products, there is no clear basis on which the TPO concluded that this company was mainly in the business of providing software development services. We therefore accept the plea of the Assessee that this company ought not to have been considered as comparable."

E-Zest Solutions Ltd.

14.1 This company was selected by the TPO as a comparable. Before the TPO, the assessee had objected to the inclusion of this company as a comparable on the ground that it was functionally different from the assessee. The TPO had rejected the objections raised by the assessee on the ground that as per the information received in response to notice under section 133(6) of the Act, this company is engaged in software development services and satisfies all the filters.

14.2 Before us, the learned Authorised Representative contended that this company ought to be excluded from the list of comparables on the ground that it is functionally different to the assessee. It is submitted by the learned Authorised Representative that this company is engaged in 'e-Business Consulting Services', consisting of Web Strategy Services, I T design services and in Technology Consulting Services including product development consulting services. These services, the learned Authorised Representative contends, are high end ITES normally categorised as knowledge process Outsourcing ('KPO') services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorised Representative submits that since the Annual Report of the company does not contain detailed descriptive information on the business of the company, the assessee places reliance on the details available on the company's website which should be considered

while evaluating the company's functional profile. It is also submitted by the learned Authorised Representative that KPO services are not comparable to software development services and therefore companies rendering KPO services ought not to be considered as comparable to software development companies and relied on the decision of the co-ordinate bench in the case of Capital IQ Information Systems (India) (P) Ltd. in ITA No.1961(Hyd)/2011 dt.23.11.2012 and prayed that in view of the above reasons, this company i.e. e-Zest Solutions Ltd., ought to be omitted from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparables by the TPO.

14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of Capital I- Q Information Systems (India) (P) Ltd. Supra) that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company, i.e. e-Zest Solutions Ltd. be omitted from the set of comparables for the period under consideration in the case on hand. The A.O./TPO is accordingly directed."

KALS Information Systems Ltd.

"46. As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Q 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of Bindview India Private Limited Vs. DCI, ITA No. ITA No 1386/PN/10 wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

"16. Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of I T enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds."

Based on all the above, it was submitted on behalf of the assessee that KALS Information Systems Limited should be rejected as a comparable.

47. We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly software development service provider. We therefore accept the plea of the Assessee that this company is not comparable."

Thirdware Solutions Ltd. (Segment):

"15.1 This company was proposed for inclusion in the list of comparables by the TPO. Before the TPO, the assessee objected to the inclusion of this company in the list of comparables on the ground that its turnover was in excess of Rs. 500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable for the reason that apart from software development services, it is in the business of product development and trading in software and giving licenses for use of software. In this regard, the learned Authorised Representative submitted that :-

- (i) This company is engaged in product development and earns revenue from sale of licences and subscription. It has been pointed out from the Annual Report that the company has not provided any separate segmental profit and loss account for software development services and product development services.

- (ii) *In the case of E-Gain communications Pvt. Ltd. (2008-TII-04-ITAT-PUNE-TP), the Tribunal has directed that this company be omitted as a comparable for software service providers, as its income includes income from sale of licences which has increased the margins of the company.*

The learned A.R. prayed that in the light of the above facts and in view of the afore cited decision of the Tribunal (supra), this company ought to be omitted from the list of comparables.

15.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

15.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the material on record that the company is engaged in product development and earns revenue from sale of licenses and subscription. However, the segmental profit and loss accounts for software development services and product development are not given separately. Further, as pointed out by the learned Authorised Representative, the Pune Bench of the Tribunal in the case of E-Gain Communications Pvt. Ltd. (supra) has directed that since the income of this company includes income from sale of licenses, it ought to be rejected as a comparable for software development services.

In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the Pune Tribunal (supra), we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand."

5.3 Ishir Infotech Ltd

This comparable was included by Ld.TPO and objected by assessee for its functional dissimilarities. It has been submitted that, information of obtained under 133 (6) by Ld.AO is placed at page 1061-1064 of paper book wherein this company is involved in diversified activities like application development and maintenance,, testing services, Web development services, Internet based application, e-commerce application, consulting services. It is also been submitted that all these services have been categorised under one single ahead of software development services

5.4 *Ld.AR submitted that, this Tribunal in case Meritor LVS India (P)Ltd., by this Tribunal reported in (2015) 64 Taxmann.com 136*

for AY: 2007-08 held that, this company is not comparable in case of captive software development services provider like assessee.

5.5 The Ld.DR however objected to the exclusion of this company from the list of comparables.

5.6 On a careful perusal of material on record, and the reply received from this company under section 133 (6) we find that this company is involved in various activities as compared to captive software service provider like assessee. It is also observed that in the case of Meritor LVS India Pvt Ltd (supra) Ld.TPO used very same 26 comparables for computing arm's length margin of software development service segment direct. This Tribunal after considering the functions performed by this company was of the opinion that it is not comparable to ours captive software development service provider. For coming to this preposition this Tribunal relied upon decision of this Tribunal in case of First Advantage Offshore Services Pvt Ltd vs DCIT in ITA (TP) No. 1086/B/2011 for assessment year 2007-08.

Further in case of M/s Netapp India Pvt.Ltd vs DCIT (supra) this Tribunal in case of Lucid Software Ltd. observed as under:

Lucid Software Ltd

This comparable was included by Ld.TPO and objected by assessee for its functional dissimilarities. It has been submitted that, this company is involved in R & D with leading scientific institutions.

Ld.Counsel submitted that, this Tribunal in the case of First Advantage Offshore Services Pvt. Ltd., Vs. DCIT IT(TP)A No. 1 0861Bang1201 1 for AY: 2007 - 08 held that, this company is not comparable in case of software development services provider. The nature of services rendered by assessee in present appeal and the assessee in case of First Advantage Offshore Services Pvt. Ltd., (supra) are one and the same. This fact would be clear from the fact that very same 26 companies were chosen as comparables in case of the assessee as well as in case of First Advantage Offshore Services Put. Ltd., (supra).

Ld.Counsel submitted that, this company is to be excluded from the list of comparables on the basis of finding of this Tribunal in case of First Advantage Offshore Services Put. Ltd., (supra). He submitted that, facts of the case before us are similar and,

therefore, the said decision is applicable to the assessee's case also.

The Ld.DR however objected to the exclusion of this company from the list of comparables.

On a careful perusal of material on record, we find that this Tribunal in case of First Advantage Offshore Services Pvt. Ltd., A. Y: 2007 - 08 (supra) took note of dissimilarities between assessee therein and

Lucid software Ltd.,. As observed therein, this company was involved in development of software as compared to captive software service provider. As the facts of the case before us are similar, respectfully following the decision of the coordinate bench, we hold that these 2 companies are also to be exclude Respectfully following the decision of this Tribunal referred to above, we direct the Ld. AO/TPO to exclude this company from final list of comparable.”

14.1 There is nothing on record brought by authorities below that the factual observation by this *Tribunal* in the above decisions are incorrect. In all the above comparables, it has been observed that, it cannot be used as comparables to determined the ALP of risk mitigated contract service provider like that of assessee before us.

Accordingly, respectfully following the above observations of this *Tribunal* we direct exclusion of the comparables considered herein above for functional dissimilarities.

15. In respect of Helios & Matheson Information Technology Ltd., which has been considered by coordinate bench of this *Tribunal* in case of *M/s Emphasis Ltd. vs ACIT (supra)* as under:

“3. M/s Helios & Matheson Information Technologies Ltd was

directed to be excluded by the Co-ordinate Bench in MIs NXP Semiconductors India PvtLtd.(Supra) vide paragraph 28, which is reproduced here under:

28. As far as comparable chosen by the TPO at S1.No.8 of the final list of comparable Viz., M/S.Helios & Matheson Information Technology Ltd., we find that the said company has been held to be not comparable with a software service provider like the Assessee by the JTA T Pune Bench in the case of FTC Software 'india)Pvt.Ltd JTA. No.] 6051PN/201 I (Asstt. Year: 2007-08) order dated 30.4.2013. The following were the relevant observations of the Tribunal:

"76 The next point made out by the assessee is with regard to the inclusion of items at (9) and (ii) namely Helios & Matheson information Technology Ltd., and KALS information Solutions Ltd. (Seg) The primary plea raised by the assessee to assail the inclusion of the aforesaid two companies from the list of comparables is to be effect that they are functionally incomparable and therefore, are liable to be excluded. In sun and substance, the plea set up b% the the aforesaid concerns are engaged in development & and sale of software products which is functionally from the services undertaken by the assessee in its IT-services segment.

17. As per the discussion in para 6.3.2. of the order of The TPO, the reason advanced for including K4LS Information Systems Ltd., is to the effect that the said concern 's application software segment is engaged in the development of software which can be considered as comparable to the assessee company. The said concern is engaged in two segments namely application software segment and Training. As per the TPO, the application software segment is functionally comparable to the assessee as the said concern is engaged in software services. The stand of the assessee is that a perusal of the Annual Report of the said concern for P. Y. 2006-07 reveals that the application software segment is engaged in the business of sale of software products and software services. The assessee pointed out this to the TPO in its written submissions, copy of which is placed in the Paper book at page 420.3 to 420.4. The assessee further pointed out that there was no bifurcation available between the business of sale of software products and the business of software services, and therefore, it was not appropriate to adopt the application software segment of the said concern for the purposes of comparability with the assessee's Services Segment. The TPO however, noticed that though the application software segment of the said concern may be engaged in selling of some of the software products which are developed by it, however, the said concern was not into trading of software products as there were no cost of purchases debited in the Profit & Loss Account. Though the TIO agreed that the quantum of revenue from sale

of products was not available as per the financial statements of the said concerns but as the basic function of the said concern was software development, it was includible as it was functionally comparable to the assessee 's segment of ITES Services.

18. Before us, apart from reiterating he points raised before the TPO and the DRP, the Ld. Counsel submitted that in the immediately preceding assessment year of 2006-07 the said concern was evaluated by the assessee and was found functionally incomparable. For the said purpose, our reference has been invited to pages 421 to 542 of the Paper book, which is the CONY of the Transfer Pricing study undertaken by the assessee for the A. Y. 2006-07, and in particular, attention was invited to page 454 where the accept reject matrix undertaken by the assessee reflected KALS Information Solutions Ltd. (seg) as functionally incomparable. The Ld. Counsel pointed out that the aforesaid position has been accepted by the TPO in the earlier A. Y. 2006-07 and therefore, there was no justification for the TPO to consider the said concern as functionally comparable in the instant assessment year.

19. In our considered opinion, the point raised by the assessee is potent in as much as it is quite evident that the said concern has not been found to be functionally comparable with the assessee in the immediately preceding assessment year and in the present year also, on the basis of the Annual Report, referred to in the written submissions addressed to the lower authorities, the assessee has correctly asserted out that the said concern was inter qua engaged in sale of software products, which was quite distinct from the activity undertaken by the assessee in the IT Services segment. At the time of hearing, neither is there any argument put forth by the Revenue and nor is there any discussion emerging from the orders of the lower authorities as to in what manner the functional profile of the said concern has undergone a change from that in the immediately preceding year. Therefore, having regard to the factual aspects brought out by the assessee, it is correctly asserted that the application software segment of the said concern is not comparable to the assessee 's segment of IT services.

20. With regard to the inclusion of Hellos & Matheson Information Technology Ltd, the assessee has raised similar arguments as in the case of Y-4-LS Information Solutions Ltd. (Seg). We have perused the relevant para of the order of the TPO i.e., 6.3.21, in terms of which the said concern has been included as a comparable concern. The assessee pointed out that as in the case of KALS Information Solutions Ltd. (Seg), in the instant case also for A. Y. 2006-07 the said concern was found functionally incomparable by the assessee in its Transfer pricing study and the said position was not disturbed by the TPO. The relevant portion of the Transfer pricing study, placed at page 432 of the Paper book has been pointed out in support. Considered in the aforesaid light, on the basis of the discussion in relation to KALS Information Solutions Ltd. in

the instant case also we find that the said concern is liable to be excluded from the list of comparables."

29. Respectfully following the decision of the Tribunal referred to above, we direct the A O/TPO to exclude the aforesaid company from the final list of comparable companies for the purpose of determining ALP.

We therefore, direct exclusion of M/s Helios & Matheson. Information Technology Ltd also from the list of comparables."

16. There is nothing on record brought by authorities below that the factual observation by this *Tribunal* in the above decisions are incorrect. In all the above comparables, it has been observed that, it cannot be used as comparables to determined the ALP of risk mitigated contract service provider like that of assessee before us.

Accordingly, respectfully following the above observations of this *Tribunal* we direct exclusion of the comparables considered herein above for functional dissimilarities.

Accordingly, this ground raised by assessee stands allowed.

Accordingly this ground raised by assessee stands allowed.

In the result appeal filed by assessee stands partly allowed.

Order pronounced in the open court on 23rd June, 2021

Sd/-
(CHANDRA POOJARI)
Accountant Member
Bangalore,
Dated, the 23rd June, 2021.
/Vms/

Sd/-
(BEENA PILLAI)
Judicial Member

Copy to:

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

By order

Assistant Registrar, ITAT, Bangalore

		Date	Initial	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	-6-2021		Sr.PS
3.	Draft proposed & placed before the second member	-6-2021		JM/AM
4.	Draft discussed/approved by Second Member.	-6-2021		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	-6-2021		Sr.PS/PS
6.	Kept for pronouncement on	-6-2021		Sr.PS
7.	Date of uploading the order on Website	-6-2021		Sr.PS
8.	If not uploaded, furnish the reason	--		Sr.PS
9.	File sent to the Bench Clerk	-6-2021		Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS