

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

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER  
AND SHRI GEORGE GEORGE K., JUDICIAL MEMBER

ITA No.339/Bang/2019 & Assessment year : 2014-15		
M/s. Huawei Technologies India Private Ltd., SYNO 37, 46, 45/3, 45/4, ETC, KNO 1540, Divyashree Park, Near EPIP Industrial Area, Kundalahalli Village, Bangalore – 560 037. <b>PAN: AAACH 8599L</b>	Vs.	The Assistant Commissioner of Income Tax, Special Range 3, Bangalore.
APPELLANT		RESPONDENT

&

IT(TP)A No.370/Bang/2019 Assessment year : 2014-15		
The Joint Commissioner of Income Tax, Special Range 3, Bangalore.	Vs.	M/s. Huawei Technologies India Private Ltd., Bangalore – 560 037. <b>PAN: AAACH 8599L</b>
APPELLANT		RESPONDENT

Appellant by	:	Mr. Aliasger Rampurawala, Advocate
Respondent by	:	Mr. Muzaffar Hussain, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	14.07.2021
Date of Pronouncement	:	22.07.2021

**ORDER**

*Per Chandra Poojari, Accountant Member*

These are cross appeals by the assessee and the revenue against the order of the CIT(Appeals)-3, Bengaluru dated 24.12.2018 for the assessment year 2014-15.

2. The assessee has raised the following grounds:-

“Transfer Pricing Ground:

1. On the facts and in the circumstances of the case and in law, Learned Assistant Commissioner of Income-tax, circle 3(1)(2) (Ld. AO) / Learned Assistant Commissioner of Income-tax (Transfer Pricing)-1(3)(1) (Ld. TPO) in making an adjustment of Rs. 84,74,69,606 to the transfer price of the Appellant's international transactions in respect of software development services. Further, the Learned Commissioner of Income-tax (Appeals) -III, Bangalore (Ld. CIT(A)) erred in partially confirming the action of Ld. AO/TPO.

2. On the fact and in the circumstances of the case and in law, with respect to adjustment to the transfer price of the software development services, the Ld. CIT(A) erred in upholding the action of Ld. AO/ TPO in:

2.1. Rejecting the Transfer Pricing (TP) documentation maintained by the Appellant under Section 92D of the Act, in good faith and with due diligence.

2.2. Rejecting the comparability analysis carried out by the Appellant in the TP documentation and in conducting a fresh comparability analysis for the international transaction of software development services based on the application of additional filters for determining the arm's length price.

2.3. Using data, which was not contemporaneous and which was not available in the public domain at the time of preparing the TP documentation.

2.4. Not considering the multiple year/prior year data of comparable companies while determining the arm's length price in relation to the Appellant's international transactions with its AEs.

2.5. Using information under section 133(6) of the Act, which tantamount to choosing secret comparable companies whose information was not available in public domain while preparing the transfer pricing documentation for the relevant financial year.

2.6. Including the following comparable companies even though they are functionally different from operational profile of the Appellant:

a) Infosys Ltd.;

- b) Larsen & Toubro Infotech Ltd.;
- c) Mindtree Ltd.;
- d) Persistent Systems Ltd.; and
- e) Thirdware Solutions Ltd.

2.7. Excluding the following companies selected by the Appellant in its TP study report even though they were functionally comparable to the Appellant and passes all the filters applied by the Ld. TPO in its order:

- a) Akshay Software Technologies Ltd.;
- b) E-Zest Solutions Ltd.;
- c) Sasken Communications Technologies Ltd.

2.8 Not including following additional companies proposed as comparables to the Appellant during the course of TP assessment proceedings and which passes all the filters applied by the Ld. TPO in its order:

- a) Sankhya Infotech Limited;
- b) I2T2 India Limited;
- c) Daffodil Software Limited;
- d) Kireeti Soft Technologies Limited;
- e) Exilant Technologies Private Limited;
- f) Celestream Technologies Private Limited;
- g) Maveric Systems Limited; and
- h) Evoke Technologies Private Limited

2.9. Not providing adjustment for the differences in working capital of the Appellant and the comparable I companies.

2.10. Not providing suitable adjustment to account for differences in the risk profile of the Appellant vis-a-vis the comparable companies.

2.11. Computing incorrect operating mark-up of certain comparable companies.

Direct tax Ground:

3. On the facts and in the circumstances of the case and in law, the Ld. AO erred in levying interest under Section 234B of the Act of Rs. 16,13,16,690.

That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein above or produce further documents before or at the tune of hearing of this Appeal.”

3. The revenue has raised the following grounds:-

“1. The order of the learned CIT(A) is opposed to law and facts of the case.

2. Whether the CIT(A) erred in fact in rejecting Cigniti Technologies Ltd & SQS India BSFI Ltd(Thinksoft Global Services Ltd) as a comparable on the grounds that it is functionally different when the primary source of income of the comparables is from provision of software development services.

3. Whether while seeking the exact comparability mentioned above, the CIT(A) was right in fact and in law in imposing conditions beyond law whereas the requirement of law is to acknowledge only those differences that are likely to materially affect the margin.

4. Whether the CIT(A) is correct in fact and law in disregarding the position of law that there could be differences between the enterprises compared under the TNMM method that are not likely to materially affect the price or cost charged or the profits accruing to such enterprises.

5 In the facts and circumstances of the case, whether the CIT(A) erred in fact in directing the TPO to include CG-VAK Software & Exports Ltd as a comparable company without appreciating that the company is engaged into R&D activities and therefore has a different revenue model and therefore functionally not comparable to the tax payer.

6. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT(A) in so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.

7. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.”

4. The assessee, Huawei India, is the wholly subsidiary of Huawei Tech. Investment Company Limited, Hong Kong ("Huawei Hong Kong") which is in-turn a subsidiary of Huawei China. Huawei Technologies Company Limited ("Huawei China"), global telecom solutions provider based in China. Huawei China is engaged in the business of research, development, manufacturing and marketing of telecommunication equipment.

5. Huawei India renders software development services to its AEs in the field of telecommunications. Huawei China owns all the valuable intellectual property rights and other commercial or marketing intangibles and is involved in complex operations of developing proprietary technologies and marketing of the same.

6. The assessee company has entered into the following international transactions with its Associated Enterprises (AEs).

International Transaction	Amount (in Rs.)
Rendering software development services	5,064,293,224
Drawdown from ECB	1,256,256,730
Purchase of fixed assets	212,808,168
Purchase of consumable	2,644,170

7. The financial of assessee as per P&L Account are as under:-

Particulars	Total
Operating Income	5064293224
Operating Cost	4578857490
Operating Profit	485435734
OP/OC	10.60%

8. The segmental financials of assessee for FY 2013-14 as per TPO are as follows:-

<b>Particulars</b>	<b>Amount (INR)</b>
Revenue from operations	5,064,293,224
Other income	14,303,508
<b>Total Revenue (A)</b>	<b>5,078,596,732</b>
<b>Less: Non-Operating income</b>	
Interest income	0
Profit on sale of fixed assets (net)	1,024,746
<b>Total Non-operating income (B)</b>	<b>1,024,746</b>
<b>Total operating income (C=A-B)</b>	<b>5,077,571,986</b>
Employee benefits expense	2,960,266,267
Depreciation & amortisation expense	365,837,531
Other expenses	1,252,753,692
<b>Total Expenditure (D)</b>	<b>4,578,857,490</b>
Less: Non-operating expenditure	0
<b>Total non-operating expenditure (E)</b>	<b>0</b>
<b>Total operating expenses (F=D-E)</b>	<b>4,578,857,490</b>
<b>Operating Profit (G=C-F)</b>	<b>498,714,496</b>
<b>OP/OC</b>	<b>10.89 %</b>

9. The assessee selected the following comparables:-

Sl. No.	Name of the Company	Wt. Avg (%)
1.	Akshay Software Technologies Ltd.	7.46
2.	Bell Softech Ltd.	7.92
3.	Helios & Matheson Information Technology Ltd.	18.27
4.	Locuz Enterprise Solutions Ltd.	6.91
5.	CSS Corp Pvt Ltd.	20.01
6.	E-Zest Solutions Ltd.	12.60
7.	Sasken Communication	10.31
	<b>Arithmetic mean</b>	<b>11.93</b>

10. The TPO selected the following comparables:-

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 BFSI Ltd.	20,061	16,394	3,667	22.37%
8	Thirdware Solution Ltd.	19,883	13,742	6,140	44.68%
	<b>Average</b>				<b>29.40%</b>

11. Thus, the TPO made a TP adjustment of Rs.84,74,69,606 relating to SWD segment. Consequently the AO passed assessment order dated 2.2.2018 u/s. 143(3) r.w.s. 92 of the Act.

12. The assessee carried the matter before the CIT(Appeals) who directed exclusion of the companies viz., Cigniti Technologies Ltd. and SQS India BFSI Ltd. (Thinksoft Global Services Ltd.) and inclusion of CG Vak Software & Exports Ltd. Finally, the following companies remained in the comparables:-

- (1) Infosys Ltd.
- (2) Larsen & Toubro Ltd.
- (3) Mindtree Ltd.
- (4) Persistent Systems Ltd.
- (5) R S Software (India) Ltd.
- (6) Thirdware Solutions Ltd.
- (7) CG Vak Software & Exports Ltd.

13. Now the assessee and revenue are in cross appeals before us against the order of CIT(Appeals).

14. First we will take up the **assessee's appeal**. The assessee has not pressed ground Nos.2 to 2.5, 2.7, 2.8, 2.10 and 2.11. Accordingly these grounds are dismissed as not pressed.

15. Ground No.2.6 of the assessee is regarding exclusion of the following comparables:-

- (i) Infosys Ltd.
- (ii) Larsen & Toubro Infotech Ltd.
- (iii) Mindtree Ltd.
- (iv) Persistent Systems Ltd., an
- (v) Thirdware Solutions Ltd.

(i) Infosys Ltd.

16. The Id. AR submitted that Infosys Ltd. is functionally different from the assessee and has to be excluded from the comparables on account of:

- Heavily engaged in development of Software products
- Diversified operations and non-availability of segment data
- Significant amount of Brand value and IPR
- Significant Research and development expenses
- Business restructuring and Extraordinary event

17. In addition the margin of the company is wrongly computed by treating provision for bad and doubtful debt as non-operating expense. Infosys Limited was considered as comparable by the TPO for AY 2011-12 and AY 2012-13 but the same was not considered as proper comparable for AY 2013-14 by holding that segmental data was not available. It was submitted that during the year under consideration too the segmental data is not available and as such this company needs to be excluded from the list of comparables.

18. As regards wrong computation of margin, the Id. DR submitted that the issue of treating provision for bad and doubtful debt as non-operating expense has been discussed in the order of CIT(Appeals) and the action of the AO is to be upheld. So there is no error in computation of margin of this company.

19. On the next argument of the assessee that there was Business restructuring and Extraordinary event, the merger of Infosys Consulting India Limited (ICIL) had been accounted for under pooling of interest method, and that the assets and liabilities of ICIL had been transferred to Infosys Limited on a going concern basis, therefore, Infosys Ltd should be excluded from the list of comparables; the Id. DR submitted that a merger can be considered as extra ordinary event if it had a significant impact on the profits or margins of such other company. The assessee had not indicated that such a merger had impacted the revenue of Infosys Ltd. There is nothing to show that assessee is adversely impacted if this company is selected as a comparable. Therefore this company cannot be excluded on the reason of merger.

20. Another argument of the Id. AR is that Infosys Ltd. is engaged in diversified operations such as business consulting, engineering and outsourcing services and it offers software product and platforms. The annual report clearly specify income deriving from sale of products. Significant R&D, brand value, size and scale of operations of Infosys Ltd. made it functionally dissimilar to the assessee. There was no significant information on products and services segment as segmental data was not available.

21. The Id. AR next contended that Infosys Ltd. had huge brand value and contributed to its growth in revenue and hence not comparable. The Id. DR submitted that brand is not restricted to parent company but also

available to all associated companies if they are using brand name. In the case of assessee also, it was using the brand 'Huawei' in its products and assessee is expected to provide service commensurate with the brand image. Thus Infosys Ltd. cannot be excluded because of brand value and the assessee is also at the same footing.

22. The Id. DR submitted that as regards the reliance of the appellant on the order of TPO for AY 2013-14, each year needs to be looked into separately and the comparables need to be selected after examining the issue of filters applied and the functionality of the company based on the financials or the other data available with the TPO. So this argument was rejected.

23. The Id DR submitted that the platforms/products and solutions of the company are not off the shelf products as argued by the assessee. The company had revenue from software services of RS.42,531 crores and that from software products was only Rs.1,810 cores. As such, the product revenue constituted a meagre 4.08% of total operating revenue. It passed the filter of 'Revenue from Core services greater than 75% and functionally comparable to assessee. The meagre revenue from software products does not impact the margins of company from software development and segmental data is not required to be considered.

24. On the contention of the assessee that Infosys Ltd. has a huge R&D expenditure, the Id. DR submitted that company has incurred R&D expenditure of Rs.873 crore which is a meagre 1.96% of its total operating revenue. From the Note 1.1 of the Annual Report at page 50, the development of intangibles and its impact on the revenue and profitability can be inferred as meagre. The assessee has failed to establish that differences, if any, on account of R&D, brand and intangibles have material effect on the margin of the said company. Further the assessee itself

considered such companies as comparable which had R&D expenditure to sales ratio less than 3%. The reason given by assessee to apply such a filter was to select companies which do not own intangibles and are pure service providers. Thus this company cannot be rejected as a comparable because of R&D or intangibles.

25. We have heard both the parties and perused the material on record. The issue of comparability of Infosys Ltd. came up for consideration before the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. [IT(TP)A No.3131/Bang/2018 for the AY 2014-15]*. Vide order dated 05.02.2020 the Tribunal excluded this company from the comparables holding as follows:-

“(i) Infosys Limited : The turnover being rs.44,341 Crores and it is functionally not comparable as the turnover is more than 500 times of the assessee turnover of Rs.84.09 Crores. The company is engaged in developing software products Pinnacle and was rejected by the DRP in assessee own case for the Assessment Year 2011-12. Further has high brand value and incurred huge expenditure in R & D with exceptional areas of operation and earned super natural profits and is engaged in diversified activities. We found that the comparable was excluded by the co-ordinate Bench decision of the Tribunal in the case of *M/s. Marwell India P. Ltd. Vs. DCIT in IT(TP)A No.3082/Bang/2018 for the Assessment Year 2014- 15 Dt.23.10.2019 at page 20 para 4.2 (b)* which read as under:

“4.2 (b). Infosys Ltd:

It has been submitted by Ld.Counsel that this comparable has been included by Ld.TPO in finalist. It has been submitted that this comparable is not comparable due to high turnover and intangibles owned by this company. It has been submitted that Hon'ble Delhi High Court in case of *CIT vs Agnity India technologies* reported in (2013) 36 Taxmann.com 289 has held this company to be bad comparable to a company which is captive service provider under the segment. It has been submitted that this company provides end to end business solutions that leverage technology to enable clients to enhance business performance.

Ld. CIT DR placed reliance upon the order passed by authorities below.

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

Admittedly this company owns huge intangibles and is an entrepreneur in the field of software service development service segment. At page-1100 of paper book, Vol.III it is observed that this company primarily derives revenue from software development and related services and from licensing of products. In segmental details at page-1110, it is observed that revenue generated from software services is Rs.4253/- Crores which is much high and hence cannot be compared to a captive service provider like that of assessee.

Respectfully following decision of orderable Delhi High Court (supra) we direct Ld. AO/TPO to exclude this comparable from the final list.”

We considering the facts, functional profile and the decision of the co-ordinate Bench, direct the TPO to exclude the comparable from the final list of comparables for determination of ALP.”

26. Since the facts of the case are similar relating to SWD segment to the case of *Microsoft Research Lab India Pvt. Ltd. (supra)*, we direct exclusion of Infosys Ltd. from the comparables.

(ii) Laresen & Toubro Infotech Ltd.

27. The Id. AR submitted that Larsen and Toubro Infotech Limited (L&T) should be excluded from the list of the comparables as it is functionally different from the appellant on account of following:

- Significant amount of Intangible assets including IPR and business rights
- Significant Brand value
- Extraordinary events during the year
- Significant Overseas Staff costs and sub-contracting expenses.

28. Further on the assessee's submission that this company has subcontracting expenses, the Id. DR submitted that it is very common practice in the software development sector that personnel for the coding e.g. programmers are taken on contract by the companies for the duration of the project and they are just like employees of the developer as they function under control and direction of the developer. So sub-contracting expenses do not make L&T functionally different from the appellant. This is entirely different from the case where the software development work itself is outsourced to the software developer e.g. the AE of the appellant has outsourced its work to the appellant. So these arguments of the appellant are to be rejected.

29. The Id. DR submitted that the issue of brand of this company is similar to the contentions of the revenue in Infosys Ltd. As regards the argument that it was a product company, the Id. DR submitted that from the annuals of the company it is evident that the company is in software development. On perusal of the 'Director's Report' (as in the Annual Report), under the sub head 'Performance of the Company', it is observed that the company is operating in the sector of 'IT services'. The IT service sector revenue is categorized into three parts on the basis of the nature of business of the clients. Of the total IT services revenue, 43.5% comes from the clients from services sector, 48.6% from clients operating in manufacturing sector and 7.9% (for nine months) from clients operating in the Telecom sector. The basic work of L&T remains the same i.e. providing software development services to its clients operating in different business segments. Earnings in foreign currency (Notes forming part of accounts annual report) also shows the major earnings are from software export. The revenue recognition method in the 'Notes forming part of Accounts' also refers to services performed on 'fixed price basis' or 'time and material basis'. Thus the functional profile of the company is same as that of the

assessee company. The ALP in the case of the assessee has been determined by treating TNMM as the most appropriate method. This method requires broad comparability of the functionality of the comparables. So in case the company is in Software Development, it would not matter as to what kind of customer it serves as the broad range of services remain the same and that is the development of software. Further, it will not matter whether the comparable develops complete software for its client e.g. develops a final product as per demand of the client or develops only some software modules, as per the requirements of its client. The function remains same. A company can be considered in the business of Software Products only if it is itself developing and selling the products developed by it and not if its client is selling the products developed for it by such company. The appellant is also similarly placed as it is providing services to its AE, which uses the same in its own products. So these arguments of the appellant do not have any merit as the company is functionally similar to the appellant. As there is no revenue stream on account of product sales, there is no merit in the argument of the appellant that the company is engaged in product sales.

30. As regards the contention of assessee that the product engineering business segment of L&T was transferred to L&T Technology services Ltd and the same had an impact on the margins of this company, the Id. DR submitted that a perusal of the annual report of L&T shows that the company had three business segments — services cluster, industrials cluster and telecom cluster (product engineering services). W.e.f. Jan 1, 2014, the Product Engineering Services (PES) was transferred to L&T Technology services Limited, and accordingly only the nine month revenue results from Product Engineering Services (PES) were considered in the company's financial statement for the year. As such there wasn't any impact on functional comparability. The appellant has not pointed out any

impact on revenue which could have increased the margins of this company or impact on the functional comparability on account of such business transfer. In fact, on account of such transfer, the quantum of revenue will be less which will only lower the margins.

31. On the assessee's argument that L&T has substantial Overseas staff cost and sub-contracting expenses, the Id. DR submitted as in the case of Infosys, no such ground of appeal has been raised by the appellant that there should be filter relating to onsite work. No such filter was applied by the appellant itself in its TP study. So this argument of the appellant has to be rejected.

32. On the argument of the assessee that L&T has intangibles and so it should not be considered as an appropriate comparable in its case, the Id. DR submitted that on perusing the details of intangible assets of L&T, it is observed that the entire value of the gross block before depreciation is on account of software used for the development purposes. A meagre amount of Rs 9.8 crore is shown as business rights, which is not being developed year after year but is a right which has been amortized over last five years and the net block of the same as on 31.03.2014 shows Nil value. Intangible assets under development, as in the list of intangible assets, is shown as Nil. Further, even if there is any self-generated intangible, not being on account of normal purchase as in case of software, in the case of appellant too, while it is performing its functions of Software Development, substantial intangibles get generated as activity of software development inherently generates IPR. Considering above, this argument of the appellant cannot be accepted.

33. Further, L&T was considered to be functionally comparable to a software service provider company by the ITAT Bangalore in the case of *M/s. Advice America Software Development Centre Private Limited (in ITA*

(TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14. In the case of *DCIT Vs. Target Corporation of India Pvt. Ltd. IT(T.P.)A. No.343/Bang/2015 (Assessment Year : 2010-11)* too ITAT had observed that the said company was functionally comparable for software development services. Considering above, the Id. DR submitted that the ground of appeal in relation to Larsen and Toubro Infotech has to be rejected.

34. We have considered the rival submissions. Similar issue was decided by the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. (supra)* wherein it was observed as follows:-

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

It is observed that Delhi ITAT in case of *Aginity India Technologies India private limited (supra)* has held as follows:

“Larsen and Toubro Infotech Ltd was excluded from the list of comparable companies by relying on the decision of the Delhi bench ITAT in case of *Saxo India d vs ACIT*. The discussion is contained at para 4 .8 to 4.10 of tribunal’s order. The tribunal held that LMT Infotech Ltd was software product company and segmental information on SWT services was not available. The tribunal also noticed that appeal filed by revenue against rivals order was dismissed by orderable Delhi High Court in ITA No. 682/2016.

Respectfully following the same we are of considered opinion that this company deserves to be excluded from the final list.”

We rely on the coordinate bench decision and direct the TPO/A.O. to exclude the comparable from the final list for determination of ALP.”

35. In view of the above decision, we direct exclusion of Larsen & Toubro Infotech Ltd. from the comparables.

(iii) Mindtree Ltd.

36. The Id. AR submitted that Mindtree Ltd. should not be considered as a proper comparable for the following reasons:-

- TP adjustments have been made in the case of Mindtree.
- Ownership of Intangibles and Development of Intellectual property
- Product Business
- Diversified operations

37. The Id. DR submitted that TP adjustments in the case of Mindtree does not disturb its financials and as such the same does not make the company as functionally incomparable to the appellant. The contention of assessee that this company being functionally different has been discussed by the TPO and his findings has not been controverted by assessee. The basis of claim that the said company is into diversified business or product business is the website of this company. However this reference of appellant to website of the company is misplaced, as the annual report of the Mindtree is more reliable than the website as the latter is dynamic in nature and may represent the status at the time of accessing the same rather than the status during the relevant financial year. Further the purpose of website is to advertise and to attract more clients and thus it may reflect the capabilities of the company rather than the actual functioning during a specific year. So reliance cannot be placed on the website of the company. The ALP in the case of the assessee has been determined by treating TNMM as the most appropriate method. This method requires broad comparability of the functionality of the comparables. So in case the company is in Software Development, it would not matter as to what kind of customer it serves as the broad range of services remain the same and that is the development of software. So,

according to the Id. DR, these arguments of the appellant do not have any merit as the company is functionally similar to the appellant.

38. The Id. DR submitted that assessee has argued that MindTree is into development of Intellectual property and has intangibles. The issue has been discussed by the TPO which has not been controverted. The contention of assessee that as per the annual report of Mindtree, it has received long term funds from Council for Scientific and Research (CSIR) to develop a project under 'Development of Intelligent Video Surveillance Server System'. This argument does not carry any weight. Firstly page 109 of the annual report of Mindtree relates to consolidated financials of the group. Secondly the borrowing from CSIR is a meager Rs 2.70 crores as against the turnover of the company which is 3031.60 crore. Thirdly there is nothing to suggest in the annual that this has resulted in generation of IP for the company. The TPO has rightly pointed out that total intangibles of Mintree are of Rs 6.7 crore, which is just 1% of the total non-current assets and there is nothing to suggest that these intangibles have driven the revenue of this company. The remaining intangibles of Rs 69.80 crore are the software used for development. Further, even if there is any self-generated intangible, not being on account of normal purchase as in case of software, in the case of appellant too, while it is performing its functions of Software Development, substantial intangibles are generated. Considering above, the argument of the appellant cannot not be accepted.

39. This issue came up for consideration before the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. (supra)* wherein this company was excluded from comparables observing as under:-

“4.2(f) We found for the Assessment Year 2014-15, the company was excluded by the co- ordinate Bench decision in the case of *Marwell India Pvt. Ltd. Vs. DCIT (supra)* at page 24 para 4.2 (f) of the order as under :

“4.2 (f). Mindtree Ltd

This comparable has been included by Ld.TPO the final list. Ld. counsel submitted that it is functionally not similar with that of assessee. It is submitted that assessee engaged in providing services such as Agile, analytics and information management, application development and maintenance, business process management, business technology consulting, Cloud, Digital business, independent testing, infrastructure management services, mobility, product engineering and SAP services. Ld.AR referred to page 1088 in support. It is further been submitted that this company does not have segmental information on the basis of which revenue earned from different verticals could be identified. This company also owns huge intangibles and therefore deserves to be excluded.

On the contrary Ld. CIT DR placed reliance upon orders passed by authorities below.

We have examined the annual reports of this company and it is observed that this company carries out research and development activities and has created large intangibles. Under such circumstances we do not find this company to be comparable with that of a captive service provider like assessee.

We therefore direct the Ld. AO/TPO to exclude this comparable from the final list.”

Considering the functional dissimilarity and High turnover criteria and judicial decision, we direct the TPO/A.O. to exclude the comparable from the final list of comparables for determination of ALP.”

(iv) Persistent Systems Ltd.

40. The Id. AR submitted that Mindtree should not be considered as a proper comparable for the following reasons:-

- Engaged in Product Development
- Engaged in Diversified business including Intellectual property

- Extraordinary events
- Engaged in R&D activities
- Large scale of operation

41. The Id. DR submitted that the reference of assessee to website of the company is misplaced, as the same relates to entire group of Persistent Systems. Further, the annual report of the company is more reliable than the website as the latter is dynamic in nature and may represent the status at the time of accessing the same rather than the status during the relevant financial year. Further the purpose of website is to advertise and to attract more clients and thus it may reflect the capabilities of the group rather than the actual functioning during a specific year. On perusal of the annual report of this company, it is observed that at page 158 [clause (iv)] of the unconsolidated annual report, it is mentioned that the activities of the company do not involve purchase of inventory and sale of goods, and its nature of business was rendering of services. The reference of appellant to pages 59, 60, 77 and 105 of annual report is also misplaced, as the same relate to entire group of Persistent Systems and unconsolidated report starts from page 155 of the annual report. The revenue recognition method in the 'Notes forming part of financial statements' on page 166 of the Annual Report also refers to 'income from software services'. It refers to services performed on 'fixed price basis or 'time and material basis'. As per page 181, Note 21 of the Annual Report, the revenue from operations is stated to be on account of sale of software services amounting Rs.11,841.16 million. As per page 195 of the annual report, the earnings in foreign currency of Rs.10,606.23 million, (constituting 89.57%) was from sale of software; and there is no reference to sale of products. Thus it is evident that this company's revenue from operation was predominantly on account of services rendered. There is no mention of any revenue stream

from sale of products in the P& L account or balance sheet. At page 183 of the Annual Report, it is given that the company's operations predominantly relate to providing software products services and technology innovation covering full life cycle of products to its customers. The primary reporting segments are identified based on review of market and business dynamics based on risk and returns affected by the type of class of customers for the services provided. As per page 164 (Note 1) of the Annual Report, the company is specializing in software products services and technology innovation and offers complete product life cycle services. This indicates that the company is developing software for its customers, who in turn are in business of software product development and outsourcing the work of software development to this company. Thus the appellant has wrongly inferred that M/s Persistent Systems Ltd itself is in software product development. In fact, the appellant itself is similarly placed as it is developing software for its AE, which in turn is finally using it in its own products. Although the 'Nature of operations ' of the company use the words 'specializing in software products', 'services and technology innovation', 'complete product life cycle services' etc., however as brought out by the TPO in his order, the company is developing products for its customers and not itself selling the products. This is also confirmed by the company in the information provided under Section 133(6) of the Act. In fact, the business strategy of the entire group is to provide services to the clients, which are software product companies. Thus the functional profile of the company is same as that of the appellant. The ALP in the case of the appellant has been determined by treating TNMM as the most appropriate method. This method requires broad comparability of the functionality of the comparables. So in case the company is in Software Development, it would not matter as to what kind of customer it serves as the broad range of services remain the same and that is the development of software. Further,

it will not matter whether the comparable develops complete software for its client e.g. develops a final product as per demand of the client or develops only some software modules for as per the requirements of its client. The function remains same. Thus, a company can be considered in the business of Software Products only if it is itself developing and selling the products developed by it and not if its client is selling the products developed for it by such company. The appellant is also similarly placed as it is also into software development for the products for its AE. So these arguments of the appellant do not have any merit as 'the company is functionally similar to the appellant. In *Agnity India Technologies Pvt. (supra)* the ITAT held Persistent Systems Ltd to be a proper comparable for software development activities.

42. As regards expenditure incurred towards R&D, the Id. DR submitted that as per page 195 of the annual report the same was Rs.39.61 million, which constitute meager 0.33% of operating revenue. As discussed supra while dealing with Infosys Ltd as a proper comparable, in its TP study the appellant has itself acknowledged that R&D expenditure which is less than 3% of the sales is an appropriate filter to reject companies which are in R&D or in development of intangibles. So as per appellant's own yard stick this company cannot be rejected on account of R&D or intangibles. Further the value of intangible assets of Persistent systems was only Rs.162.85 million constituting 1.36% of operating revenue. There is no reference to any intangible assets or patent owned or developed by the company, in the stand alone annual report. There is also no acquisition of intangibles during the year. Thus, it can be inferred that the R&D and intangible assets do not have impact on the revenue and profitability of the company. On perusing the 'summary of significant accounting policies' in the annual report (page 164 of annual report) of Persistent Systems, it is observed that intangible assets are primarily the

software licenses purchased and contractual rights acquired' and are valued on the basis of 'purchase price and attributable cost of bringing the asset to its working condition for intended use'. Nowhere there is reference to the IPR generated by the company itself and its valuation. Thus the intangibles in the fixed assets schedule are on account of software/contractual rights purchased and used for the development purposes. Further, even if there is any self-generated intangible, not being on account of normal purchase as in case of software, as discussed supra, in the case of appellant too, while it is performing its functions of Software Development, substantial intangibles are generated. The appellant has failed to establish that differences, if any, on account of R&D, brand and IRPs have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B, which provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences, if any, between enterprises entering into business transactions or likely to materially affect the profit arising from such transactions in the open market.

43. The contention of assessee is that there was occurrence of extraordinary events during the year under consideration in the case of this company and so it should not be considered as a comparable. The Id. DR submitted that page 27 of annual report relates to the consolidated financials of the group and the extra ordinary event relates to acquisition by Persistent Systems Inc (PSI) and not by the Indian entity namely Persistent Systems Limited which has been considered as a comparable by the TPO. The appellant has not explained as to how these acts of subsidiaries have impacted the profit margins of Mis Persistent Systems. So this argument of the appellant is to be rejected.

44. On the scale of operations, the Id. DR submitted that the TPO has used employee cost filter of 25% to exclude the companies not in the Software Development segment. The appellant has not explained as to how more number of employees affects the margins of this company.

45. The Id. DR further submitted that this company was upheld to be functionally comparable to a software service provider company by the Hon'ble ITAT Bangalore in the case of *M/s. Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 (A.Y. 2013-14)*. In *Agnity India Technologies Pvt. Ltd. (supra)* also the ITAT had held Persistent Systems Ltd to be a proper comparable for software development activities.

46. Considering above, the Id. DR submitted that the ground relating to this comparable has to be dismissed.

47. This comparable i.e., Persistent Systems Ltd. came up for consideration before the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. (supra)* wherein this company was excluded from comparables observing as under:-

“We have perused submissions advanced by both sides in the light of the records placed before us. At page-1432, it is observed that companies operations predominantly relates to providing software products services and technology, innovation covering full life cycle of product to its customers.

It is observed that Delhi ITAT in case of *Agnity India Technologies India private limited (supra)* has held as follows:

“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 decisions rendered by ITAT Delhi Benches in case of *cash edge India private limited vs ITU in ITA No. 64/del/2015*

vide order dated 23/09/15 and the details of orderable Delhi High Court in case of sexual India private limited (supra). The findings in this regard are contained in paragraph 4.14 to 4.16 of its order.” Respectfully following the same we are of considered opinion that this company deserves to be excluded from the final list.”

We, respectfully follow the coordinate Bench decision, and direct the TPO to exclude the comparable from the final list of comparable for determination of ALP.”

48. Following the aforesaid decision, we direct to exclude Persistent Systems Ltd. from the list of comparables.

(v) Thirdware Solutions Ltd.

49. The Id. AR on the basis of detailed submissions stated that this company is engaged in sale of products and has to be excluded.

50. The Id. DR, on the other hand, submitted that a perusal of the financials of this company shows that the revenue of this company is only from sale of software development services and not from sale of any products. As per page 16 of the financials, the company is engaged in the business of software development and consultancy service and that the operation of the company comprises of software, development, implementation and support services. Though at page 2 of the P&L A/c statement the company has mentioned revenue from sale of products at Rs.20675/- lakhs, however it is clearly mentioned that the revenue was on account of export of software services to the tune of Rs.20,194.37/- lakhs, from software services from local unit Rs.414.07/-lakhs, from subscription and training Rs.59.32/- lakhs, from sale of licenses 7.98 lakhs. The revenue from software licence constitutes a meager 0.03% of total operating revenue. Thus it is very clear that this company is predominantly into sale of software services and hence can be safely taken as a comparable. Further at page 7 of annual report it is mentioned that the company has

acquired intangible asset relating to software purchased for company's internal use which was capitalized as the cost of acquisition. Thus this company is a proper comparable.

51. On the contention of assessee that the TPO has erroneously considered forex loss as non-operating expense, the Id. DR submitted that the TPO has considered forex gain/loss as operating in nature. The CIT(Appeals) directed the TPO to reverify this aspect in relation to this comparable also and if the forex loss is not considered as operating in nature then he should treat it as operating and recompute the margin of this company.

52. We have heard both the sides and perused the material on record. Similar issue came up for consideration before the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. (supra)* wherein the Tribunal held as under:-

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

On perusal of the annual reports placed at page 573 of paper book volume 2, it is observed that this company has developed its own product by the name “PAPA”. It is observed that this company has incurred huge expenses towards import of software services evidencing outsourcing of software services unlike that of assessee. It is also observed that this company is into production of software product and therefore cannot be functionally held similar to a contract service provider under this segment like that of assessee. Ld.Counsel placed reliance upon decision of coordinate bench of this Tribunal in case of *Nomura Research Institute Financial Tech (India) Pvt. Ltd., vs DCIT in ITA No. 284/Kol/2016* vide order dated 26/10/2018.

Respectfully following the same we direct Ld. AO/TPO to exclude this comparable from the finalist.”

Accordingly, we rely on the tribunal and direct the TPO to exclude this comparable from the final list selected in determining the ALP.”

53. Following the above decision of the Tribunal, this company is directed to be excluded from the comparables.

54. The assessee has also sought inclusion of the following comparables:-

- (i) Sankhya Infotech Ltd.
- (ii) I2T2 India Ltd.
- (iii) Evoke Technologies Pvt. Ltd.

(i) Sankhya Infotech Ltd.

55. This company was not part of assessee's own comparables in its TP study and the same was proposed as additional comparable before TPO. The TPO considered it as functionally different by holding that the same is engaged in diversified activities.

56. The Id. AR made detailed submissions that the company is functionally similar to assessee and passes all the filters applied by the TPO.

57. The Id. DR submitted that the company has an In-House Research and Development Centre involved in the development activities of new products in the field of simulation and Training. The company is mainly into software product development and related R&D activities. During the year under consideration the company has debited an expense of Rs 8.17 crores on account of R&D, and of this Rs 7.99 crore constitutes employee cost. That the company is in research and development and thus developing its own intangibles also becomes evident from the fact that its tangible fixed assets are valued at only Rs 53.48 lacs as against intangible

assets of Rs 4848.47 lacs. These intangibles include learning management products, training management products, simulator products, knowledge based content, optimization products etc. as against normal intangible of "software purchased" in case of routine software developer. This makes it evident that the company is mainly in the business of technical training and R&D rather than software development. Nowhere in the annual report there is any reference to the software development activities of the company and it is observed that the company categorizes its activities as software services and software products. Nature of software services has not been indicated specifically and thus has to be interpreted on the basis of information available in the annual report. Although in the annual report the company repeatedly refers to revenue from its software products and solutions only, however in the segmental data it has shown entire revenue from software services, without explaining the nature of software services. Since complete segmental data relating to revenue from multiple streams and the expenses on the same is not available, so this company is functionally different from the appellant company. The assessee has just relied on the segmental details of "Software Services" and "Software Products" as given in the annual report without explaining as to how software services constitute software development services only and the details indicated in the annual report are irrelevant. Further, this company has already been rejected as a proper comparable for the Software Development segment by the ITAT in several cases as under:-

- Sysarris Software (P.) Ltd. v. Deputy Commissioner of Income-tax, Circle- 12 (3), Bangalore[2016] 67 taxmann.com 243 (Bangalore)
- Dy. CIT v. Kodiak Networks India (P.) Ltd. [IT (TP) Appeal No. 532 (Bang.) of 2013, dated 30-7-2013], and
- ITO v. Sunquest Information Systems (India) (P.) Ltd. [2015] 61 taxmann.com 81 (Bang. - Trib.).

The ITAT held that this company is engaged in the business of development of Software Products & Services and training. Considering above, this company cannot be considered as a proper comparable.

58. We have heard both the parties and perused the material on record. In this case, all comparable segment details are available. This company was considered by the Tribunal in the case of *Brocade Communications Systems Pvt. Ltd., IT(TP)A No.79/Bang/2019* dated 19.6.2020 wherein the issue was remitted back to TPO for fresh consideration observing as follows:-

“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.”

59. Being so, we remit the issue to the TPO for fresh consideration with a direction to consider the segment data.

(ii) i2T2 India Ltd.

60. The Id. AR submitted that this company was rendering software development services and consulting activities and hence comparable to it, however the same had wrongly been not accepted by the TPO by holding that RPT information was not available. It was submitted that the company satisfied all the filters adopted by the TPO and hence should not be rejected as comparable only because RPT information is not available in the financials of this company.

61. The Id. DR submitted that perusal of the annual report of this company (Directors report- Acknowledgements) shows that the company is in the ITES industry and has done transaction processing work, which is not functionally comparable. Further RPT information is an important aspect in selection of comparables and in absence of such data a company cannot be considered as a proper comparable.

62. This issue was considered by the Tribunal in the case of *LSI India Research & Development Pvt. Ltd. in IT(TP)A No.3170/Bang/2018 dated 7.10.2020* wherein it was held as follows:-

“27. As far as inclusion of I2T2 India Ltd. is concerned, we find that in the case of *LG Soft India (P.) Ltd. (supra)* this company was directed to be included. The Tribunal in para 11 of its order held that the TPO excluded this company for the reason that the Related Party Transaction (RPT) had not been disclosed in the annual report. The Tribunal held that if there is no disclosure of RPT in the annual report, it has to be concluded that there was no RPT and therefore this company should be included as a comparable company. Following the aforesaid decision, we direct inclusion of I2T2 India Ltd. as comparable company.”

63. Following the aforesaid decision, we direct for inclusion of this company i.e., i2T2 India Ltd.

(iii) Evoke Technologies Ltd.

64. The Id. AR submitted that this company was not accepted by the TPO on the ground that standalone financials of this company included unaudited revenue and expenditure of a branch located outside India. The company is mainly in software development and hence the same is functionally similar to it and unaudited financial of the branch office cannot be a reason to reject this company as a comparable.

65. The Id. DR submitted that a perusal of the statutory auditor's report shows that the financial statements include branch revenue of Rs. 9,24,86,670/- and profit of Rs. 1,41,11,040/- based on unaudited financial statement of the Branch outside India. So the data of this company cannot be considered as reliable. As such this company cannot be considered as a proper comparable. Further, as per the geographic segmentation information, the revenue from India was given to be Rs. 3621.72 lakhs and that the revenue from US was given to be Rs. 924.87 lakhs. Thus it can be seen that the export revenue constitute only 20.34% of the total revenue. Therefore this company cannot be considered as comparable.

66. This company was considered by the Tribunal in the case of *Citrix R&D India Pvt. Ltd. in IT(TP)A No.3134/Bang/2018 dated 29.01.2020* wherein it was held as follows:-

“15. The assessee seeks inclusion of Evoke Technologies Pvt. Ltd. which was rejected by the TPO as a comparable company for the reason that data relating to this company was not available in the public domain and that it had a different financial year ending. Before the DRP also, the assessee did not challenge the action of the TPO in excluding the aforesaid company because the assessee did not have a data relating to this company. The assessee is now seeking inclusion of this company on the basis of decision rendered by the Hyderabad Bench of ITAT in the case of *Infor (India) Pvt. Ltd. ITA No.2307/Hyd/2018 for AY 2014-15.*

In the aforesaid decision, the Hyderabad Bench took the following view :-

“3. As regards Evoke Technologies is concerned, the contentions of the assessee are that this company is functionally similar to the assessee, whereas the TPO & DRP have held that the financials of this company include the revenue of one branch outside India which are unaudited and hence are not reliable. The learned Counsel for the assessee however, drew our attention to page 963 of the Paper Book, which is part of the Annual Report of Evoke Technologies Ltd wherein the revenue of Indian Branch of assessee is separately shown. Taking the same into consideration, we direct the AO/TPO to reconsider the comparability of this company by taking the revenue from Indian Branch only. Thus, the ground for Maveric Systems Ltd is rejected and for Evoke Technologies Ltd is allowed for statistical purposes.”

16. We are of the view that it would be appropriate to direct the TPO/AO to consider this issue afresh, after opportunity to the assessee and in the light of facts brought to our notice as above.”

67. Following the aforesaid decision, we remit the issue to the AO/TPO for fresh consideration and decision on similar lines.

68. The next ground of the assessee is with regard to working capital adjustment (WCA). The Id. AR submitted WCA ought to have been allowed by the TPO and also relied upon the decision of ITAT in its own case for AY 2012-13 where enhancement made by the CIT(A) by disallowing the WCA as granted by the AO was deleted.

69. The Id. DR submitted that the AO has given detailed reasoning for not allowing the WCA to the appellant. The appellant has relied upon decision of ITAT in its own case for AY 2012-13. A perusal of the order of ITAT (*para 15*) shows that in that case the TPO had allowed WCA to the appellant by accepting the calculation given by it. The ITAT observed (*para 17*) that the CIT(A) had not found any error in the TPO's working of WCA and so the WCA as worked out by the TPO needed to be allowed. However

the facts of the present case are different. The TPO has not allowed any WCA. It was submitted that before the CIT(A) assessee has not furnished any calculations relating to the WCA so that accuracy of its claim could have been examined. A perusal of the TP study of the appellant also shows that assessee has just given a theoretical discussion on the issue, without quantifying the amount of WCA and as such no such WCA has been claimed by the appellant in its own TP study. The appellant has not brought on record any details to show that the relevant data for computation of WCA was produced by it before the AO or it had made a specific request to the AO to collect such data and provide such an adjustment. The appellant's reliance on the decision in the case of *Mobis India ITA No 2112/Mds/2011(AY: 2007-08) [2013] 38 taxmann.com* is not applicable to it. However, as discussed supra, the appellant has not given any calculation of WCA. This is important to note that the facts were not so in appellant's case for AY 2012-13, as the ITAT had observed that such calculations were provided by the appellant and as such decision in the case of *Mobis India(Supra)* could not be applied. However on the facts of the present case, when no such details have been provided by the appellant the above decision in the case of *Mobis India (Supra)* gets squarely applied. In the case *W M Global Technology Services (India) (P.) Ltd. v. Assistant Commissioner of Income-tax, Circle - 7(1)(2), Bengaluru of [2018J 91 taxmann.com 403 (Bengaluru — Trib) dt 28.02.2018*, the ITAT held as follows:-

“24. We have gone through the records and perused the orders passed by the DRP as well as the TPO. In our view, it is for the assessee to prove as to how the working capital had an impact on its profit and is required to follow the analysis cis mentioned in para 12.1 of the DRP order. Needful has not been done despite opportunity granted by the DRP. However considering the totality of the circumstances, we are remitting back six companies for consideration by the TPO. We deem it fit to

remand this issue afresh. Needless to say that the TPO shall be bound by the decision of the ITAT, Chennai Benches in *Mobis India Dd. v. Dy. CIT* [2013] 38 [taxmann.com](#) 231/[2014] 61 SOT

40. Accordingly this ground is allowed for statistical purpose."

70. The Id. DR submitted thus ITAT held that it was for the assessee to prove as to how the working capital had an impact on its profit. In the present case also, the appellant has not produced any details to show the same. So the decision in the case of *Mobis India(Supra)* gets applied to the facts of the present case. Similarly in the case of *Same Deutz Fahr India (P.) Ltd. v. CIT* [2017] 81 [taxmann.com](#) 68 (Chennai - Trib.), the ITAT held that in absence of terms and conditions relating to payments/recoveries of the comparables and assessee, working capital adjustment cannot be granted. This was also observed by the ITAT that such details were not furnished by the assessee in the said case. In the case under consideration too, as discussed supra, the relevant details were not produced by the appellant and there is no merit in the ground of the assessee.

71. We have heard both the parties and perused the material on record. Similar issue came up for consideration in assessee's own case for AY 2012-13 in *IT(TP)A No.1939/Bang/2017 dated 31.10.2018* wherein it was held as under:-

"15. In the present case the TPO allowed working capital adjustment accepting the calculation given by the Assessee. The CIT(A) in exercise of his powers of enhancement held that no adjustment should be made to the profit margins on account of working capital differences between the tested party and the comparable companies for the following reasons:

(i) The daily working capital levels of the tested party and the comparables was the only reliable basis of determining adjustment to be made on account of working capital because that would be on the basis of working capital deployed throughout the year.

(ii) Segmental working capital is not disclosed in the annual reports of companies engaged in different segments and therefore proper comparison cannot be made.

(iii) Disclose in the balance sheet does not contain break up of trade and non-trade debtors and creditors and therefore working capital adjustment done without such break up would result in computation being skewed.

(iv) Cost of capital would be different for different companies and therefore working capital adjustment made disregarding this different based on broad approximations, estimations and assumptions may not lead to reliable results.

16. The CIT(A) also placed reliance on a decision of Chennai ITAT in the case of Mobis India ITA No.2112/Mds/2011 (2013) 38 taxmann.com. That decision was based on the factual aspect that the Assessee was not able to demonstrate how working capital adjustment was arrived at by the Assessee. Therefore nothing turns on the decision relied upon by the CIT(A) in the impugned order. In the matter of determination of Arm's Length Price, it cannot be said that the burden is on the Assessee or the Department to show what is the Arm's Length Price. The data available with the Assessee and the Department would be the starting point and depending on the facts and circumstances of a case further details can be called for. As far as the Assessee is concerned, the facts and figures with regard to his business has to be furnished. Regarding comparable companies, one has to fall back upon only on the information available in the public domain. If that information is insufficient, it is beyond the power of the Assessee to produce the correct information about the comparable companies. The Revenue has on the other hand powers to compel production of the required details from the comparable companies. If that power is not exercised to find out the truth then it is no defence to say that the Assessee has not furnished the required details and on that score deny adjustment on account of working capital differences. Regarding applying the daily balances of inventory, receivables and payables for computing working capital adjustment, the Delhi Bench of ITAT in the case of ITO Vs. E Value Serve.com (2016) 75 taxmann.com 195(Del-Trib) has held that insisting on daily

balances of working capital requirements to compute working capital adjustment is not proper as it will be impossible to carry out such exercise and that working capital adjustment has to be based on the opening and closing working capital deployed. The Bench has also observed that that in Transfer Pricing Analysis there is always an element of estimation because it is not an exact science. One has to see that reasonable adjustment is being made so as to bring both comparable and test party on same footing. Therefore there is little merit in CIT(A)'s objection on working adjustment based on unavailable daily working capital requirements data. There is also no merit in the objection of the CIT(A) regarding absence of segmental details available of working capital requirements of comparable companies chosen and absence of details of trade and non-trade debtors of comparable companies as these details are beyond the power of the Assessee to obtain, unless these details are available in public domain. Regarding absence of cost of working capital funds, the OECD guidelines clearly advocates adopting rate(s) of interest applicable to a commercial enterprise operating in the same market as the tested party. Therefore this objection of the CIT(A) is also not sustainable.

17. In the light of the above discussion we are of the view that the CIT(A) was not justified in denying adjustment on account of working capital adjustment. Since, the CIT(A) has not found any error in the TPO's working of working capital adjustment, the working capital adjustment as worked out by the TPO has to be allowed. We may also add that the complete working capital adjustment working has been given by the Assessee and a copy of the same is at page 173 & 192 of the Assessee's paper book. No defect whatsoever has been pointed out in these working by the CIT(A). We may also further add that in terms of Rule 10B(1)(e) (iii) of the Rules, the net profit margin arising in comparable uncontrolled transactions should be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions which could materially affect the amount of net profit margin in the open market. It is not the case of the CIT(A) that differences in working capital requirements of the international transaction and the uncontrolled comparable transactions is not a difference which will materially

affect the amount of net profit margin in the open market. If for reasons given by CIT(A) working capital adjustment cannot be allowed to the profit margins, then the comparable uncontrolled transactions chosen for the purpose of comparison will have to be treated as not comparable in terms of Rule 10B(3) of the Rules, which provides as follows:

“(3) An uncontrolled transaction shall be comparable to an international transaction if—

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged to paid in, or the profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.”

18. In such a scenario there would remain no comparable uncontrolled transactions for the purpose of comparison. The transfer pricing exercise would therefore fail. Therefore in keeping with the OECD guidelines, endeavor should be made to bring in comparable companies for the purpose of broad comparison. Therefore the working capital adjustment as claimed by the Assessee should be allowed. We hold and direct accordingly.”

72. After considering the rival submissions and the material on record, we are of the opinion that this issue has to be remitted back to the file of AO/TPO for fresh consideration in accordance with the above order of the Tribunal in assessee’s own case for AY 2012-13

### **Revenue’s appeal**

73. The first ground is regarding exclusion of the comparables viz., Cigniti Technologies Ltd. and SQS India BSFI Ltd. (Thinksoft Global Services Ltd.) by the CIT(Appeals).

Cigniti Technologies Ltd.

74. The Id. DR submitted that the TPO noted that this company is into development of computer software & services and therefore functionally similar to the assessee. The contention of the assessee was that this company had acquired to companies i.e. Gallop Solutions Inc and Gallop Solutions P. Ltd. which are extra ordinary events. The TPO observed that these two companies were shown as 100% owned subsidiary of this company and were not merged. In other words, these two companies still remained as separate legal entities and do not impact the standalone profit margin of the company. Whereas the assessee had erroneously compared and considered the consolidated figures of this company.

75. This issue was considered by the Tribunal in the case of *Microsoft Research Lab India Pvt. Ltd. (supra)* wherein this company was excluded from comparables observing as under:-

“ We found this comparable was excluded by the co-ordinate Bench of the Tribunal in the case of *Marwell India Pvt. Ltd. Vs. DCIT (supra)* at page 18 para 4.2 (a) of the order as under :

“We have perused submissions advanced by both sides in the light of the records placed before us. We have also perused the annual report very carefully and is observed that this company is involved exclusively into software testing and has created innovations in the software testing. It is also observed that this company is acquired hundred percent shares in a U.S.-based software testing service company called Gallop Solutions Inc based in Texas USA. It is also observed that this company has been listed on Bombay stock exchange, Bangalore stock exchange and maybe Madras stock exchange with a paid-up capital of Rs. 22.92 crores. It is an undisputed fact that entire revenue has been generated by this company from software testing services rendered to its independent clients as against simple testing carried out by assessee of

integrated circuits along with designing, customer support of integrated circuits related ancillary services provided by assessee only to its AE. Considering the holistic approach having regards to the annual reports of this company and the specialised services provided by this company to its own clients in the field of software testing as against captive service provided by assessee exclusively to its AE, we are of considered opinion that this company cannot be held as a good comparable with that of assessee.

Therefore we direct Ld. AO/TPO to exclude this company from the final list of comparables.”

Following the judicial precedence, we found the company is in specialized area and has to be excluded. Accordingly, we direct the TPO/A.O. to exclude from the final list of comparables”.

76. In view of the above decision of the Tribunal, we find no infirmity in the order of the CIT(Appeals) in exclusion of this company from the comparables.

SQS India BSFI Ltd. (Thinksoft Global Services Ltd.

77. The Id. DR relied on the findings of the TPO.

78. The Id. AR submitted that this company fails the RPT filter of 25% as applied by the TPO. M/s Thinksoft Global Solutions Ltd has been acquired by S Q S Software Quality Systems AG and its name has been changed to S Q S India B F S I Ltd. This was an extra ordinary event and as such this company was rightly excluded by the CIT(Appeals) as a comparable.

79. The CIT(Appeals) has observed that a perusal of the annual report of this company shows that it is engaged primarily in delivering software validation and verification services. So for the reasons as discussed for Cigniti Technologies, this company cannot be considered as a comparable as it is functionally different, according to the CIT(Appeals).

80. We have considered the rival submissions. As per annual report, this company is in the pure play independent software testing space., provides software validation and verification services to the Banking and Financial Services Industry (BFSI) worldwide. The Company is an India based software service provider primarily delivering software validation and verification services to the banking and financial services industry worldwide. According to assessee, this company is not comparable to the Assessee on account of Extra ordinary events, it Fails RPT filter and Margin computation. The company has acquired majority stakes in Thinksoft Global Services Ltd. by acquiring 53.35% of its shares during the year. It pertains to change in majority stake of the company (shareholding pattern). The assessee has not demonstrated as to how the above information has had any materialistic impact on the revenue or the profits earned by the company during the year. The assessee has summed up all the related party transactions (i.e. both on revenue side as well as expense side) and computed its percentage over sales. In the formula adopted, while the numerator contains both revenue and expenditure, the denominator contains only revenue. Hence, there is no parity between the denominator and numerator. In case of the revenue based related party transactions. net sales can be used as a base (i.e.  $\sum(\text{RPT})\text{revenue}/\text{sales}$ ). Conversely, for the related party transactions on the expense side, then total expenditure should be considered as a base. (i.e.  $\sum(\text{RPT})\text{expenses}/\text{Total expenditure}$ ). Thus, the assessee's practice of combining both revenue and expenses items of related party transactions and comparing it against net sales, would distort the application of the proposed RPT filter. In the case of the assessee and that of the comparable, significant revenue party transactions are on revenue side and hence (RPT)revenue/Net sales was taken as the appropriate filter. Accordingly, the RPT/Sales for this comparable works out to 5.8% (i.e. Rs. 1164Lakhs/

Rs. 20060.8 Lakhs). Hence, the revenue's ground is allowed and this company is directed to be included in the comparables.

81. The next grievance of the revenue is regarding inclusion of CG Vak Software & Exports Ltd. as comparable.

82. The Id. DR supported the findings of the TPO. The Id. AR submitted the company satisfies all the filters adopted by the TPO and that its major share of revenue was from software development services. The appellant submitted that revenue from BPO services was a meager 1.88% and as such the company passes filter of '75% revenue from Software development' as applied by the TPO. The appellant submitted that the company was considered as functionally comparable by the TPO in its own case for AY 2013-14 and the functional profile of the company remains the same.

83. The CIT(Appeals) observed that this company was treated as a proper comparable by the TPO in assessee's own case for AY 2013-14. During appellate proceedings for AY 2013-14, the appellant had argued for exclusion of this company from the list of comparables, however this ground of appeal of the appellant was dismissed by the CIT(A). A perusal of the annual report of this company for the year under consideration shows that this company had revenue from IT & ITES services, and the revenue from ITES was meager 1.8% of total operating revenue. So as such no segmental data is required to be considered. He therefore directed the TPO to include this company as a comparable if it satisfies all the other filters applied by the TPO. After hearing both the parties and perusing the material on record, we confirm the order of the CIT(Appeals) as he has remitted the issue for fresh consideration. Accordingly, the TPO will re-examine the issue in the light of fresh study to be considered by him.

84. In the result, both the appeals by the assessee and revenue are partly allowed.

Pronounced in the open court on this 22<sup>nd</sup> day of July, 2021.

Sd/-

( GEORGE GEORGE K. )  
JUDICIAL MEMBER

Sd/-

( CHANDRA POOJARI )  
ACCOUNTANT MEMBER

Bangalore,  
Dated, the 22nd July, 2021.

*/Desai S Murthy /*

Copy to:

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

By order

Assistant Registrar  
ITAT, Bangalore.