

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH 'I-1', NEW DELHI**

**Before Sh. Amit Shukla, Judicial Member**

**Dr. B. R. R. Kumar, Accountant Member**

**ITA No. 5553/Del/2011: Asstt. Year: 2007-08**

Alcatel Lucent India Ltd., (Erstwhile Alcatel Lucent Technologies India Pvt. Ltd.), 15 <sup>th</sup> Floor, Tower-C, DLF Cyber Greens, DLF City, Phase-III, Gurgaon-122002	Vs	DCIT, Circle-1(1), New Delhi
<b>(APPELLANTT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AACCA8667N</b>		

**ITA No. 5554/Del/2011 : Asstt. Year: 2007-08**

Alcatel Lucent India Ltd., (Erstwhile Alcatel Development India Pvt. Ltd.), 15 <sup>th</sup> Floor, Tower-C, DLF Cyber Greens, DLF City, Phase-III, Gurgaon-122002	Vs	DCIT, Circle-1(1), New Delhi
<b>(APPELLANTT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AACCA8667N</b>		

**Assessee by : Sh. Nageshwar Rao, Adv.**

**Revenue by : Sh. Surenderpal, CIT DR**

**Date of Hearing: 27.07.2021**

**Date of Pronouncement: 16.08.2021**

**ORDER**

**Per Dr. B. R. R. Kumar, Accountant Member:**

The present appeals have been filed by the assessee against the orders dated 31.10.2011 passed by the AO u/s 143(3) r.w.s. 144C of the Income Tax Act, 1961.

2. In ITA No. 5553/Del/2011, following grounds have been raised by the assessee:

*"1. The Ld. Dispute Resolution Panel ('DRP') erred both on facts and in law in confirming the Ld. AO/ TPO's action of making an adjustment of Rs. 57,29,49,678 to the income of the appellant by holding that the international transactions undertaken by the appellant in do not satisfy the arm's length principle envisaged under the Income-tax Act 1961 ('Act'). In doing so the Ld. DRP has grossly erred in agreeing with the Ld. TPO's action of;*

*1.1. not appreciating that none of the conditions set out in section 920(3) of the Act are satisfied in the present case;*

*1.2. ignoring the fact that the appellant is entitled to tax holiday under section 10A of the Act on its profits and therefore would not have any untoward motive of deriving a tax advantage by manipulating transfer prices of its international transactions;*

*1.3. disregarding the ALP as determined by the Appellant in the Transfer Pricing ('TP') documentation maintained by it in terms of section 92D of the Act read with Rule 10D of the Income-tax Rules, 1962 ('Rules') as well as fresh search; and in particular modifying/ rejecting the filters applied by the Appellant;*

*1.4. disregarding multiple year/ prior years' data as used by the Appellant in the TP documentation and holding that current year (i.e. FY 2006-07) data for comparable companies should be used despite the fact that the same was not necessarily available to the Appellant at the time of preparing its TP documentation;*

*1.5. collecting selective information of the companies by exercising power granted to him under section 133(6) of the Act that was not available to the Appellant in the public domain and relying on the same for comparability purposes (and to the extent of*

*completely ignoring reliable data available in public domain/ annual reports in numerous cases);*

*1.5.1. and in doing so violating the fundamental principles of natural justice by relying on the information sourced under section 133(6); and also by*

*1.5.2. not sharing with the Appellant, in case of a number of comparables, the information/ reply received by the TPO/ AO u/s 133(6).*

*1.6. rejecting comparability analysis in the TP documentation/ Appellant's fresh search and in conducting a fresh comparability analysis based on application of the following additional/ revised filters in determining the ALP for the international transactions;*

*1.6.1. exclusion of companies having different financial year ending (i.e. not March 31, 2007)*

*1.6.2. exclusion of companies with export sales that are less than 25% of their total revenue;*

*1.6.3. exclusion of companies with diminishing revenues/ persistent losses for last three years up to and including FY 2006-07;*

*1.6.4. retaining companies with related party transactions upto 25% of their sales;*

*1.6.5. adopting employee cost to revenues greater than 25% of their total revenues as a search criteria for short listing and evaluating comparables for software development services;*

*1.6.6. exclusion of companies with onsite revenues greater than 75% of their export revenues for selecting comparables for contract software development services;*

*and rejecting, in particular, the following filters applied by the Appellant in its TP documentation/ fresh search:*

*1.6.7. companies having other operating income (i.e. income other than manufacturing and trading income) to sales greater than 50% were accepted;*

*1.6.8. companies with net worth less than zero were rejected;*

*1.6.9. companies having research & development costs to sales less than 3% were accepted; and*

*1.6.10. companies having advertising, marketing and distribution costs to sales less than 3% were accepted.*

*1.7. including high-profit making companies in the final comparables' set for benchmarking a low risk captive unit such as the Appellant (disregarding judicial pronouncements on the issue), thus demonstrating an intention to arrive at a pre-formulated opinion without complete and adequate application of mind with the single-minded intention of making an addition to the returned income of the Appellant;*

*1.8. including certain companies that are not comparable to the Appellant in term of functions performed, assets employed and risks assumed;*

*1.9. resorting to arbitrary rejection of low-profit/loss making companies based on erroneous and inconsistent reasons;*

*1.10. excluding certain companies on arbitrary/frivolous grounds even though they are comparable to the Appellant in terms of functions performed, assets employed and risks assumed;*

*1.11. ignoring the business/ commercial reality that since the Assesee is remunerated on an arm's length cost plus basis, i.e. it is compensated for all its operating costs plus a pre-agreed mark-up based on a benchmarking analysis, the Appellant undertakes minimal business risks as against comparable companies that are full fledged risk taking*

*entrepreneurs, and by not allowing a risk adjustment to the Appellant on account of this fact;*

*1.12. committing a number of factual errors in accept-reject of comparable companies included in/excluded from the final set of companies.;*

*1.13. by following an inconsistent approach while computing the OP/ TC margin of the appellant by treating foreign exchange loss as operating whereas treating the same as non-operating in some cases and operating in others in case of comparables; and*

*1.14. disregarding judicial pronouncements in India in undertaking the TP adjustment.*

*2. The Id. AO erred in facts and in law in initiating the penalty u/s 271(1)(c)."*

3. In ITA No. 5554/Del/2011, following grounds have been raised by the assessee:

*"1. The Ld. Dispute Resolution Panel ('DRP') erred both on facts and in law in confirming the Ld. AO/ TPO's action of making an adjustment of Rs. 24,34,79,416 to the income of the appellant by holding that the international transactions undertaken by the appellant in do not satisfy the arm's length principle envisaged under the Income-tax Act 1961 ('Act'). In doing so the Ld. DRP has grossly erred in:*

*1.1. not appreciating that none of the conditions set out in section 92C(3) of the Act are satisfied in the present case;*

*1.2. ignoring the fact that the Appellant is entitled to tax holiday under section 10A of the Act on its profits and therefore would not have any untoward motive of deriving a tax advantage by manipulating transfer prices of its international transactions;*

*1.3. disregarding the ALP as determined by the Appellant in the Transfer Pricing ('TP') documentation maintained by it in terms of section 92D of the Act*

*read with Rule 10D of the Income-tax Rules, 1962 ('Rules') and in particular modifying/ rejecting the filters applied by the Appellant;*

*1.4. committing certain factual errors in accept-reject of comparables included in/ excluded from in the final set of companies;*

*1.5. disregarding multiple year/ prior years' data as used by the Appellant in the TP documentation and holding that current year (i.e. FY 2006-07) data for comparable companies should be used despite the fact that the same was not necessarily available to the Appellant at the time of preparing its TP documentation;*

*1.5.1. without prejudice, in case the current year data is used, the appellant should be allowed to submit a fresh search so that all companies (for whom data for FY 2006-07 is now available, but which was not necessarily available at the time of preparing TP documentation, including companies now reported in the databases, but which were not reported in the databases at the time of preparing TP documentation) are appropriately considered.*

*1.6. collecting selective information of the companies by exercising power granted to him under section 133(6) of the Act that was not available to the Appellant in the public domain and relying on the same for comparability purposes (and to the extent of completely ignoring reliable data available in public domain/ annual reports in numerous cases);*

*1.6.1. and in doing so violating the fundamental principles of natural justice by relying on the information sourced under section 133(6); and also by not sharing with the Appellant, the information/ reply received by the TPO/ AO u/s 133(6).*

*1.7. rejecting comparability analysis in the TP documentation and in conducting a fresh comparability analysis based on application of the following filters in determining the ALP for the international transactions;*

*1.7.1. exclusion of companies having different financial year ending (i.e. not March 31, 2007);*

*1.7.2. exclusion of companies with export sales that are less than 25% of their total revenue;*

*1.7.3. retaining companies with related party transactions upto 25% of their sales;*

*1.7.4. adopting employee cost to revenues greater than 25% of their total revenues as a search criteria for short listing and evaluating comparables for software development services;*

*1.7.5. exclusion of companies with onsite revenues greater than 75% of their export revenues for selecting comparables for contract software development services; and*

*rejecting, in particular, the following filters applied by the Appellant in its fresh search:*

*1.7.6. Service income (i.e. income other than manufacturing and trading income) to sales greater than 50% filter were accepted;*

*1.7.7. companies with net worth less than zero were rejected;*

*1.7.8. companies having research & development costs to sales less than 3% were accepted; and*

*1.7.9. companies having advertising, marketing and distribution costs to sales less than 3% were accepted.*

*1.8. including high-profit making companies in the final comparables' set for benchmarking a low risk captive unit such as the Appellant (disregarding judicial pronouncements on the issue), thus demonstrating an intention to arrive at a pre-formulated opinion without complete and adequate application of mind with the single-minded intention of making an addition to the returned income of the Appellant;*

1.9. including certain companies that are not comparable to the Appellant in terms of functions performed, assets employed and risks assumed;

1.10. resorting to arbitrary rejection of low-profit/loss making companies based on erroneous and inconsistent reasons;

1.11. excluding certain companies on arbitrary/frivolous grounds even though they are comparable to the Appellant in terms of functions performed, assets employed and risks assumed;

1.12. ignoring the business/ commercial reality that since the Assesee is remunerated on an arm's length cost plus basis, i.e. it is compensated for all its operating costs plus a pre-agreed mark-up based on a benchmarking analysis, the Appellant undertakes minimal business risks as against comparable companies that are full fledged risk taking entrepreneurs,

1.12.1. that due to the fact that the appellant is a captive contract software development services provider undertaking minimal risks, adjustments such as risk adjustment is imperative in appellant's case;

1.13. disregarding judicial pronouncements in India in undertaking the TP adjustment.

## **2. Capitalization of Software Expenses**

2.1. The DRP and AO both on facts and in law erred in not appreciating the fact that the software acquired is of revenue in nature.

2.2. The DRP and AO both on facts and in law erred in not appreciating the fact that the nature of software acquired is primarily application software which has no enduring benefit.

## **3. Exclusion of communication charges from Export Turnover in computing deduction under section 10A**

*3.1. The DRP and AO both on facts and in law erred in not appreciating the fact the definition of export turnover does not intend to exclude expenditure incurred in domestic currency from export turnover.*

**4. Exclusion of expenditure incurred in foreign currency from Export Turnover in computing deduction under section 10A**

*4.1. The DRP and AO failed to appreciate the nature of business of the appellant and erred in presuming that the appellant is engaged in providing the technical services and thereby erred in reducing expenses in foreign exchange from export turnover.*

**5. Exclusion of Total Turnover**

*5.1. Without prejudice to ground 3 and 4 above, the DRP and AO erred in not excluding amounts excluded from export turnover (i.e. communication charges and expenditure in foreign currency) from total turnover as well.*

*5.2. The DRP and AO erred in not following order of Hon'ble Tribunal in Appellant's own case for the Assessment Year 2005-06 & 2006-07.*

*6. The Ld. AO erred in facts and in law in initiating the penalty u/s 271(1)(c)."*

4. Alcatel Development India Private Limited ("ADIPL") was originally incorporated as a private limited company in the name of Alcatel Development Center Chennai Private Limited on 3<sup>rd</sup> March 1998. Until the financial year 2002-03, ADIPL had only one captive business unit under fixed communication group, Alcatel's Indian Development Centers, located in Gurgaon & Chennai, have established a strong process capability; in order to deliver reliable software packages. The Software Centre at Gurgaon is completely focused on development of application software with a significant number

of dedicated software professionals working with partner organizations all over India.

5. The details of Associated Enterprises and the International Transactions carried out by the assessed are as under:

S. No.	International transaction	Associated Enterprise	Amount
1	Service Income	Alcatel-Lucent, Belgium	50,88,95.804
2		Alcatel-Lucent, Germany	48,04,71,130
3		Alcatel CIT, France	54,61,55.950
4		Alcatel, USA	5,40,28.616
5		Alcatel USA Sourcing Inc	28,13,11,368
6		Genesis Telecommunications	6,58,87,719
7		Alcatel, Australia	8,87,83,545
8		Alcatel, China	81,16,793
9		Alcatel, Spain	20,20,71,314
10		Alcatel Italy	99,57,597
11		Alcatel, Denmark	20,42,740
12	Connectivity and band width charges	Alcatel, France	6,37,63,934
13	Reimbursement of Expenses	Alcatel, Belgium	2,46,667
14	Purchase of fixed	Alcatel, France	1,51,14,683
15		Alcatel Germany	10,67,206
16		Alcatel Spain	1,78,013
17		Alcatel, USA Sourcing Inc.	3,09,48,774
18		Alcatel, France	1,55,18,964
19		Alcatel, Belgium	4,21,22,311
20		Alcatel, Canada	6,74,922
21		Alcatel, China	82,74,424
22		Alcatel, China(HK)	534
23		Alca Net, France	1,64,48,080
24	Reimbursement of	Alcatel, France	87,73,882

## 6. Functions, Assets and Risk Analysis of the assessee

### Functions:

ADIPL is a dedicated captive software development facility centre for Alcatel-Lucent Group Companies. It develops the software, based on the core R&D provided by the European and the US R&D centers, which is integrated into the exchange network products. ADIPL is a routine software development company, which carries out routine functions and assumes less than normal risks associated with carrying out such business,

- The ADIPL's Fixed Solution Division (FSD) consists of Local Competence Area Managers (LCAM) under implementations, Industrialization, Development, Testing, Project Office and Customer Satisfaction & Quality (CSQ) teams.
- The Local Competence Area Manager (LCAM) for the Implementation and industrialization teams are responsible for managing resources in each of these teams, training them in the skill sets required for each project. When a software development project comes up, the concerned project leader requests for resources from LCAMs of the Implementation and Industrialization teams. The LCAM of the implementation and industrialization teams allocate their resources to these projects based on estimated time required for each project.
- **Implementation team:** The implementation team of each project is responsible for design, development, coding and testing functions based on the functional specifications received from the product management team of the

respective country of the customer, The employees In the implementation team are expected to have sound knowledge in the telecom field, besides their expertise In the field of software. ADIPL usually recruits Engineers with expertise in networks and communications.

- (a) **Design:** The first step in the software development life cycle for ADIPL begins with the technical design based on the functional specifications received. The technical design process translates the functional requirements into a representation of the software which ultimately is to be coded into machine readable form.
  - (b) **Coding:** The next step is to write the code. ADIPL uses the Chill programming language to write the code on the UNIX operating system.
  - (c) **Testing:** The implementation team does unit testing at the workstation level, Unit testing involves the developer to test his module independently.
- **Industrialization team:** A telephone exchange deals with an enormous volume of data, especially relating to details of their subscribers, like numbers, features available to each subscriber, etc. The entire operations of a telephone exchange are data driven. The industrialization team Is Involved with everything associated with the data. It is the new data created by this team which will drive the new features built by the Implementations team.
  - The customer, i.e. telephone exchanges, provides the data in a specific format, which the product management team

hands over to ADIPL. The industrialization team is responsible for conversion of this data into required format, so that this could be integrated with the code developed by the implementation team, for delivery to the customer. The data relating to each exchange would be .unique with respect to that market. The industrialization team uses some specific tools to carry out their tasks, and require knowledge in programming languages like C, C++, etc. to manipulate the data received. The final new set of data produced is called a data package.

- **Integration:** The Build Manager (BM) integrates the code and the data package to generate a System Load Package (SLP). The BM generates different SLPs at different stages for testing purposes. Integration Testing: There are 2 levels of testing which takes place –
  - (a) **Feature Integration Test:** The new features and data may have an Impact on different other modules. This test ensures that the desired results are obtained at the area level.
  - (b) **Feature Test:** The feature test is done by testers In each Implementation team. ADIPL has a scale down version of 3 telephone exchanges for testing purposes. The feature test Is done at the exchange level. Most of the bugs at the functional level are resolved at this stage.
- **Delivery and Final Testing:** At this stage, the final package is delivered to an Independent Qualification Test (IQT) team in Stuttgart, Germany or in Belgium. The IQT

team performs comprehensive tests on the final product. This stage aims to test performance related issues like number of lines it could handle, etc. The final product is then delivered to the exchange in the form of an optical disk. A pilot testing takes place in one exchange before it is fully implemented. Minimum shutdown time of the exchanges is planned for updation of the new features.

- **Quality:** The Customer Satisfaction and Quality team (CSQ) does quality checks at all levels to ensure that internal standards and protocols are met. ADIPL has obtained Capability Maturity Model (CMM) Level 3 certification.
- **Maintenance. & Support:** As per its Software Development and License Agreement dated May 25th 1998, ADIPL provides technical assistance, maintenance & support through its Technical Assistance Centre (TAC). ADIPL provides these services to Alcatel Bell NV without additional charge for the warranty period mentioned in the agreement to correct any errors, defects or malfunctions in the software it has delivered. In case of support beyond the warranty period or not related to the warranty performance, ADIPL bills at the normal rates.

The TAC provides Routine Telephone Assistance in investigating, diagnosing and troubleshooting problems in the covered software product. ADIPL also provides "Remote Console Intervention" using a modem connection to directly operate the system and software, in cases where the problem cannot be resolved through the Routine Telephone Assistance. Emergency Telephone Assistance is

also provided by the TAC personnel on a 24/7 basis. ADIPL's response time is based on a category of faults it produces depending on the criticality of the bugs. The delivery of the maintenance release is through tire product management operations team in the respective market.

### **General Management Functions**

The functions addressed below are common functions that are carried out by any business irrespective of their size and type. These functions are drivers of every business and are Indispensable In the economic environment.

**(a) Corporate Strategy Determination:** Generally, all policies within ADIPL are determined by its own management who continuously monitor the economic environment surrounding the Indian entity, assess their strategic position within the industry and target to achieve its corporate objective with guidance from the Alcatel- Lucent Group.

**(b) Finance, Accounting, Treasury and Legal Function:** The management of ADIPL is responsible for managing the finance, treasury, legal and accounting functions. In certain areas, wherever necessary, ADIPL is guided by the Alcatel-Lucent Group, ADIPL is also responsible for all local statutory compliance.

**(c) Human Resource Management Function:** The HR function at ADIPL is coordinated by its management, which is responsible for recruitment, development and training of the personnel

including the emolument structure. In this respect, where appropriate, it is guided by Alcatel-Lucent Group policies.

**Assets:**

ADIPL deploys assets necessary for carrying out the software development function. However, ADIPL does not own any valuable non-routine intangibles. ADIPL does not spend any significant amount on research and development on its account that leads to the development of non-routine intangibles. ADIPL uses the trademark, process, know-how, technical data software, operating / quality standards etc. developed / owned by Alcatel-Lucent Group. All companies of the Alcatel-Lucent Group leverage from these intangibles for continued growth in revenues and profits. Accordingly, ADIPL does not own any significant non-routine intangibles.

**Risks:**

The various risks associated with this international transaction are as under:

**Market Risk:**

ADIPL does not have any significant exposure to this risk because it renders services exclusively for Alcatel-Lucent Group and therefore can forecast its revenues with fair degree of certainty.

All market risks with respect to the product including customer acceptance are borne by Alcatel-Lucent Group. It is exposed to

the intensely competitive conditions in the telecom industry and impact of technological advances.

**Product liability risk:**

ADIPL's risk is minimal as it does not have any interface with the ultimate customer. However, it would provide technical support and maintenance under the warranty period to Alcatel Bell NV for the software it has developed.

All risks with respect to product warranty, claims suffered or damages awarded in favour of end customers arising from any infringement of Intellectual Property Rights of any third party in consequence of the use of its products are borne by Alcatel-Lucent Group, as the owner of the intellectual property rights.

**Technology obsolescence risk:**

ADIPL as a contract service provider does not bear any risk in this regard because the services are performed as per Alcatel-Lucent Group's specifications. It uses certain technology of the Alcatel-Lucent Group to undertake its development work.

Alcatel-Lucent Group as the owner of the product and solutions and the associated technology, bears the risks of obsolescence of its products.

**Research and development risk:**

ADIPL does not carry on any core R&D activity. It develops software as per specifications provided by the Alcatel-Lucent Group.

Alcatel- Lucent Group engages in significant R&D on their own account for developing new products and introducing new technologies. All Research and development related work are collated and owned by Alcatel-Lucent Group. Accordingly, it has significant exposure to this risk.

**Credit risk:**

As ADIPL regularly receives its payments from Alcatel-Lucent Group irrespective of collections made by the Group Companies from the ultimate customers, its credit risk is mitigated.

Alcatel-Lucent Group bears the risk of bad debts as it sells its products to a number of customers worldwide on varying payment terms.

**Manpower risk:**

ADIPL bears the manpower risk of recruiting and retaining the right personnel and all the associated costs and obligations. ADIPL's success does depend on the quality of its personnel and its ability to retain such trained personnel to meet the group's internal quality standards.

Alcatel-Lucent Group ultimately bears the cost of under utilization of manpower resources.

**Foreign exchange fluctuation risk:**

ADIPL invoices its associated enterprises in Euros. Therefore, foreign exchange fluctuation risk is borne by ADIPL as its

revenues are in foreign currency whereas its expenses are in Indian rupees.

Further, those associated enterprises who deal in currency other than Euro also bear the foreign exchange risk in respect of this transaction.

### **Inventory risk:**

ADIPL develops modules of the software which form part of the final product / service delivered to the final customer by the Alcatel-Lucent Group. Being only a service provider, ADIPL does not carry any inventory.

Alcatel-Lucent Group bears the responsibility for the security, maintenance and inventory of all its products, both hardware and software, and bears the full cost of maintaining the storage of the Inventory.

In effect, ADIPL is insulated from most of the risks in respect of its international transaction entered with its associated enterprises.

### **Payment for Bandwidth and Connectivity Charges**

#### **Function:**

ADIPL has entered into a Master Contract with Alcatel France, for bandwidth, connectivity, hosting, data network and conferencing services. As per the agreement ADIPL should place all resources, premises and energy and connection means,

documentation and all elements necessary for performance of the services by Alcatel France.

**Risk Analysis:**

There are no inherent external risks involved in this international transaction except foreign exchange fluctuation risk which is borne by ADIPL as it has made the payment for bandwidth and connectivity charges in foreign currency.

**Purchase of Fixed Assets****Function:**

ADIPL purchases fixed assets like servers, modems, etc. from associated enterprises to perform testing functions of the code developed in-house. ADIPL even employs used assets apart from hiring these assets. Used assets are employed as the specification of the asset is impracticable to obtain at a reasonable cost. These are supported by an independent valuer's report. The Alcatel-Lucent Group companies identify the assets requirement of ADIPL and procure it if required and pass it to ADIPL.

Further, ADIPL has also obtained fixed assets from its associated enterprises on loan basis. However, based on our discussion with the Company Management, we understand that obtaining these fixed assets on loan basis will not have any bearing on ADIPL's profit.

**Risk Analysis:**

The following are the various risks associated with this international transaction: Obsolescence Risk ADIPL bears all the risk relating to these fixed assets becoming obsolete as a result of development of new technology requiring more sophisticated/new equipment for testing purposes.

**Foreign Exchange Fluctuation Risk**

ADIPL bears the foreign exchange fluctuation risk in relation to this transaction as it makes the payment for purchasing of fixed assets in foreign currency.

**Payment of Training Expenses****Function:**

During the year under consideration, ADIPL has paid certain operating expenses to its associated enterprises. These are In the nature of training expenses.

**Risk:**

There are no inherent external risks Involved in this international transaction except foreign exchange fluctuation risk which is borne by ADIPL as it has made the payment for these expenses in foreign currency.

## 7. Brief Description of the Method Adopted by the assessee for TP study:

For all the transactions given above, the assessee has adopted the TNMM as the method for bench marking its transactions with it's A.E's. The final lists of comparable chosen by the company are as follows:

Sl. No.	Name of the company	NCP 2004-05 (%)	NCP 2005-06 (%)	NCP 2006-07 (%)	Weighted Average (%)
1.	Intertec Communications Ltd.	8.54	5.62	NA	6.68
2.	PSI Data Systems Ltd.	0.05	1.64	5.97	3.01
3	Prithvi Information Solutions Ltd.	10.49	13.68	14.11	13.24
4	R Systems international Ltd.	5.16	22.35	7.35	11.28
5	SQL Star International Ltd.	1.28	-16.18	-1.86	-3.32
6	Sasken Communication Technologies Ltd.	11.41	7.58	11.47	10.22
7	Sonata Software Ltd.	15.59	5.66	19.99	13.63
8	Visesh Infotecnics Ltd.	9.12	21.10	18.86	17.76
	Arithmetic Mean	<b>7.70</b>	7.68	10.84	9.06

8. As per this list the average OP to cost of the comparable companies is 9.06%, as against this, the consolidated P & L Account given in the Annual Report for the financial year 2006-07 in the case of Assessee Company shows an OP to cost of 10.57%. A separate search was conducted by the TPO which yielded 28 comparable companies and the OP margin of the comparables is 27.96% as against the assessee's margin of 10.57%.

**Action of TPO:**

9. The search resulted in 28 comparable companies and the average OP margin of comparables is 27.96% as against the company's margin of 10.57%. The list of comparables and the search process and the filters adopted by the TPO are furnished below:

Sl. No.	Company Name	Sales (Rs.cr.)	OP to Total Cost %
1.	Accel Transmatlc Ltd (Seg.)	9.68	21.11%
2..	Avani Clmcon Technologies Ltd	3.55	52.59%
3	Bodhtree Consulting Ltd (Seg.)	7.40	109.79%
4	Celestial Labs Ltd.	14.13	58.35%
5	Datamatlcs Ltd.	54.51	7.27%
6	E-Zest Solutions Ltd.	6.26	38.12%
7	Flextronics Software Systems Ltd (Seg.)	848.66	25.31%
8	Geometric Ltd. (Seg.)	158.38	10.71%
9	Hellos & Matheson Information Technology Ltd.	183.51	40.35%
10	IGate Global Solutions Ltd.	747.27	7.49%
11	Infosys Technologies Ltd.	13149	40.30%
12	Ishir Infotech Ltd.	<b>7.42</b>	30.12%
13	KALS Information Systems Ltd. (Seg.)	2.00	30.55%
14	LGS Global Ltd. (Lanco Global Solutions Ltd.)	45.39	15.75%
15	Lucid Software Ltd.	1.70	54.85%
16	Mediasoft Solutions Ltd.	1.85	3.66%
17	Megasoft Ltd. (Seg.)	63.71	23.11%
18	Mindtree Ltd.	590.35	16.90%
19	Persistent Systems Ltd.	293.75	24.52%
20	Quintegra Solutions Ltd.	62.72	12.56%
21	R S Software (India) Ltd.	101.04	13.47%
22	R Systems International Ltd. (Seg.)	112.01	15.07%
23	Sasken Communication Technologies Ltd. (Seg.)	343.57	22.16%
24	SIP Technologies & Exports Ltd.	3.80	13.90%

25	<i>Tata Elxi Ltd. (Seg.)</i>	262.58	26.51%
26	<i>Thirdware Solutions Ltd.</i>	36.08	25.12%
27	<i>TVS Infotech Ltd.</i>	7.24	11.61%
28	<i>Wipro Ltd. (Seg.)</i>	9616.09	33.65%
			27.96%

10. Before us, the Id. AR objected to the selection of comparables relied upon by the TPO.

**Avani Cincome Technologies Ltd.**

11. The TPO held that the comparable is engaged in provision of software development services and clears all the filters. The Id. DRP agreed to observation of the TPO and found that the company has stated that it is dealing purely in software development. The Id. AR argued that the comparable is functionally different and there was no segmental data available for the revenue from the sale of software development services and the software products. We find that this was not allowed as a comparable for the similarly placed companies owing to high operating margins and different asset base with regard to Motorola Solutions India Pvt. Ltd. During the year with regard to the assessee, we find that the comparable has replied that they are into software development only. We find that 97% of the revenue of the comparable is from software development which is similar to the functions of the assessee who is also having a software development facility centre. Hence, the contention of the Id. AR that in the absence of segmental data, the Avani CT Ltd. is not a right comparable, cannot be accepted.

**Celestial Labs Ltd.**

12. The TPO selected the comparable based on the reply received in response to the notice u/s 133(6) that the company is engaged in provision of software development which is affirmed by the Id. DRP. The Id. AR has taken objection on two grounds namely, the comparable is functionally different and as per the DRHP the company is engaged in the areas of IT /Bio-Informatics and consultancy work. He relied on the case of Infogains Pvt. Ltd.

13. The part of the annual report reads as under:

*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 right/patent act. (Apprised and funded by Department of Science and Technology, New Delhi).*

*"Based on our in silico 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."*

From the above, we find that the above comparable is dissimilar to the functions performed by the assessee company.

**E-Zest Solutions Ltd.**

14. We have gone through the order of the Tribunal in assessee's own case in ITA No. 1112/Del/2007 for the assessment year 2012-13. The relevant portion of the order is as under:

*"The Ld. AR submits that this company fails the service income filter applied by the TPO i.e. Service Income / Total Income 75%. This company is engaged in providing diverse services like BPO, product engineering, software product development and KPO. The segmental data is also not available. The inventory ratio to total revenue is 19.90%, whereas the assessee company does not hold any inventory. Besides this, E-zest is into professional services and full risk bearing entrepreneur, whereas the assessed company is limited risk capital company dealing in software development and is performing limited functions like coding, testing.*

*10.14 The Ld. DR submitted that the TPO has rightly selected this comparable and relied upon the order of the TPO.*

*10.15 We heard both the parties and perused the records. The functions of both the companies are different. There is no segmental data available in the annual report of the company. The service income filter which was applied by the TPO clearly has not been followed by the TPO in this company while*

*selecting as comparable. Therefore, this company has to be excluded. We, therefore, direct TPO to exclude this company from comparable."*

15. Hence, we hold that this may not be considered as a right comparable.

**Flextronics Software Systems Ltd.**

16. On going through the record, we find that this is not a correct comparable owing to the diversified segment of software services and products are grouped together.

**Helios and Motherson (IT) Ltd.**

17. We find that this comparable fails the employee cost filter implied by the TPO himself and also the fact that the company is engaged in the services like ITES/BPO/off-shore delivery/project management and maritime practices makes it functionally dissimilar to be a right comparable.

**KALS Information Systems Ltd.**

18. The reply of the company that "the use of readymade object laboratories is only to the tune of about (0.33 to 3) % in the year 2005-06 and 2006-07" has been examined by the Tribunal and came to the conclusion that "what has been written is that the company's use the readymade object laboratories is only to the tune of maximum 3% and it doesn't convey that the software products' revenue stands at 3%". On examination of the reply in detail, the Tribunal rejected the comparable

hitherto. Hence, we direct that this comparable needs to be excluded.

**Persistent Systems Ltd.**

19. This company was directed to be deleted from the list of comparable in the case of Infogains India Pvt. Ltd. (ITA5870/Del/2011) owing to amalgamation of the company. Since, the facts remain undisputed, owing to the incidence of the extraordinary event, the same cannot be considered as a right comparable.

**Infosys Technologies Ltd.**

20. This company has set up a network of research labs and granted patents which are intangible assets on which revenue is generated. Infosys is a giant risk taking company. Besides that, it is engaged in development & sale of Software Products and also owns intangible assets. The assessee company is engaged in the business of digital switching equipment and related software, cellular exchange / transmission equipment and provides related services, intelligent network and broadband solutions, equipment and related services. Thus, the functions of both the companies are different. There is no segmental bifurcation available of Infosys Limited. Hence, the comparable may be scored through the list of comparable. Similar observation is applicable to Wipro Ltd.

**Thirdware Solutions Ltd.**

21. The company is engaged in product development and earns revenue from trading of software licenses and subscription.

Further, the segmental information of different streams of revenue is not available.

**Megasoft Ltd.**

22. The TPO while determining the ALP used the entity wise margins instead of segmental margins. Hence, needs to be obliterated.

23. With regard to the Akshay Software Technologies Ltd. and SQL Star International Ltd., the same cannot be considered as the revenue filter and the export turnover filter have not been met.

**Ishir Infotech Ltd.**

24. The assessee contended that the comparable fails the employee cost filter as per annual report. However, the information provided u/s 133(6) clears the employee filter.

**Lucid Software Ltd.**

25. The company submitted that it is a pure software development company and does not have any revenue from sale of products or license. Hence, the appellant's contention on the similarity of the functions is over ruled. Similarly, the contention that amount incurred in product development and owing of the software product doesn't influence the profit levels on annual basis. Hence, we decline to interfere with this comparable.

**Ground No. 2: Capitalization of Software Expenses:**

26. The assessee debited software expenses to its P&L account whereas the AO altered the expenses to capital expenditure. The rationale given by AO and the reliance on the different judgments is as under:

*"i. Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business or for a substantial replacement of equipment.*

*ii. Expenditure may be treated as properly attributable to capital when it is made not once and for all, but with a view to bringing into existence as asset or an advantage for the enduring benefit or a trade. The enduring benefits or the permanent character means acquisition of the assets or the right having enough durability to justify its being treated as capital assets.*

*iii. Whether the expenditure incurred was a part of fixed capital of the business or a part of its circulating capital.*

*AO held that the enduring benefit or the permanent character means acquisition of the assets or the right having enough durability. A division Bench of the Madras High Court in CIT Vs Ashok Leyland Ltd. (1969) 72 ITR 137 has ruled that the word capital connotes permanency and capital expenditure and capital expenditure includes securing tangible and intangible property, so long as there is lasting or enduring benefit, as against a revenue expenditure which is operational in its perspective and is solely intended for furtherance of the*

*enterprise. Following the Hon'ble Supreme Court decision in M/s Assam Bengal Cement Co. Ltd. Vs CIT (1955) 27 ITP 34, the enduring benefit or the permanent character means acquisition of the assets or the right having enough durability."*

27. Before us, during the arguments, the Id. AR relied on the following judgments:

- *CIT Vs Southern Roadways Ltd. 288 ITR 15 (Madras)*
- *L&T Ramboll Consulting Engineers Ltd. Vs ACIT in ITA No.886/Mds/2006 (Chennai ITAT)*
- *CIT Vs G.E. Capital Services Ltd. (2007) 164 Taxman 46 (Del.)*
- *Amway India Enterprises Vs DCIT & SQL Star International Ltd. Vs ACIT (2008) 111 ITD (Delhi -SB)*
- *IBM India Ltd. Vs CIT (2006) 290 ITR 183 (Bang.)*
- *CIT Vs K & Co. (2003) 181 CTR 378 (Del.)*
- *Addl. CIT Vs Asahi India Safety Glass (2006) 6 SOT 656 (Del.)*
- *ITO Vs Shivani Locks Ltd. (2008) 22 SOT 122 (Del.)*

28. Heard the arguments of both the parties and perused the material available on record.

29. We have gone through the various judgments relied upon by both the parties. We have also gone the judgment of Hon'ble Apex Court in the case of Empire Jute Co. Ltd. 1980 AIR 1946. From the facts, relevant to the instant case, we find that the assessee has not acquired any capital asset of enduring in nature with regard to the software purchases. It is the user rights which has been purchased by the assessee and requires updation and modification at regular intervals. Hence, it cannot be said that the assessee has acquired any asset capital in nature by way of payment of software expenses. Hence, the addition made by the AO is directed to be deleted.

**Computation of Deduction u/s 10A:**

30. The assessee has raised grounds with regard to computation of deduction u/s 10A pertaining to exclusion of communication charges, expenditure incurred in foreign exchange from the export turnover. The issue of computation of deduction u/s 10A has reached a finality in view of the judgment of Hon'ble Supreme Court in the case of CIT Vs HCL Technologies Ltd. 404 ITR 719. The relevant portion of the said order dealing with the similar issues raised by the assessee in the present appeal is reproduced for the sake of ready reference:

*"5. The only point for consideration before this Court is whether in the facts and circumstances of the case, the software development charges are to be excluded while working out the deduction admissible under Section 10A of the IT Act on the ground that such charges are relatable towards expenses incurred on providing technical services outside India?"*

***Rival contentions:-***

*6. At the outset, learned senior counsel for the Revenue submitted that when the total turnover is not defined under Section 10A of the IT Act, the ordinary meaning of the words is to be adopted. As it was a technical term, the technical meaning of total turnover, which does not envisage the reduction of any expense from the total amount, was to be taken into consideration for computing deduction under Section 10A of the IT Act. Hence, the fact that the Respondent has claimed expenses like freight, telecommunication and insurance attributable to the delivery of software outside India total turnover also, while calculating deduction under Section 10A of the IT Act, despite the fact that there is no such provision in Section 10A of the IT Act, is not sustainable in the eyes of law. Therefore, the impugned decision of the High Court is liable to be set aside.*

*7. On the other hand, learned senior counsel appearing for the Respondent submitted that the export turnover is the numerator whereas the total turnover is the denominator in the formula for computing profit from exports. The export turnover as defined in Section 10A of the IT Act would not include freight, telecommunication charges or insurance attributable to the delivery of goods outside India and the expenses incurred in foreign exchange for providing technical services outside India. The same cannot be included in the total turnover as if numerator included the aforesaid amount, which the denominator doesn't include, the formula would render undesirable results. Therefore, the Respondent is legally entitled to exclude the above said expenses from the total turnover as well. Hence, these appeals deserve to be dismissed at the outset.*

**Discussion:-**

*8. The whole controversy revolves around the claim of certain expenses attributable to the delivery of software outside India or in providing technical services from 'total turnover' by the Respondent under Section 10A of the IT Act. It is an undisputed fact that neither Section 10A nor Section 2 of the IT Act define the term 'total turnover'. However, the term 'total turnover' is given in clause (ba) of the Explanation to Section 80 HHC of the IT Act which defines the meaning of total turnover as follows:*

*"(ba) 'total turnover' shall not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs stations as defined in the Customs Act, 1962 (52 of 1962).*

**Provided** *that in relation to any assessment year commencing on or after the 1<sup>st</sup> day of April, 1991, the expression "total turnover" shall have effect as if it also included any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of section 28;"*

*9. It is also pertinent to mention here the relevant terminologies which are as under:*

**'Export Turnover:**

*Explanation 2(iv) of Section 10A of the IT Act defines "export turnover" to mean the consideration that has been received for export of articles/things/computer software. Normally the*

*consideration will include the freight/telecommunication charges/insurance which had been incurred to deliver the article/things/computer software outside India. However, the Explanation 2(iv) specifically seeks to exclude these three categories of expenditure incurred for delivering the export of articles/things/computer software. It also seeks to exclude expenses for providing technical service, etc. outside India. Therefore, where an Indian technician goes abroad and receives fees for service, the foreign client will normally be required to reimburse the expenses as well. Therefore, out of the consideration received, the portion representing reimbursement of expenditure has to be excluded.*

***Export Turnover and Total turnover:***

*The "total turnover" has been defined in sections 80HHC and 80HHE only to exclude additional items given under section 28. But for this additional exclusion, there was no need to define "total turnover".*

*Export turnover is a component of total turnover. If the entire turnover represents export proceeds, then the export turnover and the total turnover are identical. It is clear that any exclusion in the export turnover in the numerator will automatically imply exclusion in the denominator as well because export turnover is always a component of total turnover.*

***Export Turnover/Total Turnover/Business:***

*Form 56F prescribes the report under Section 10A for and Annexure-A thereto refers to "export proceeds" and "sale proceeds". Both together form the total turnover of the undertaking.'*

**10.** *The question arises here that when the particular term has not been defined in any particular Section, is it allowed to import the meaning of such term from the other provisions of the same Act? Section 10A of the IT Act is a special beneficial provision and the purpose of deduction under such Section is to encourage and boost the new business undertakings situated in the free trade zone of this Nation by providing suitable deductions to such business entities. Sometimes, while calculating the deduction, disputes arise regarding the methodology of deduction which ought to be followed. Undisputedly, it is a matter of record that the Respondent is engaged in the activity of trading of generic software and providing*

*customized software development services for domestic as well as for foreign clients through its two units situated in Software Technology Park, Gurgaon (Now Gurugram) which falls under the definition of the Section 10A of the IT Act. The contention of the Respondent is that it incurred expenditure in foreign exchange in sending professionals abroad as per the agreements with the foreign constituents.*

**11.** *On an analysis of the Respondent's activity taken from its website, Assessing Officer arrived at a conclusion that Respondent has been rendering technical services outside India and, therefore, expenses incurred on such activity are required to be excluded from the export turnover while working out the deduction admissible under Section 10A of the IT Act. The Assessing Officer estimated 60% of the software development charges required to be attributed towards expenses incurred for providing technical services outside India. On appeal, learned CIT (Appeals) again made a detailed analysis of the activity of the Respondent and arrived at a conclusion that the Assessing Officer failed to bring any evidence which can indicate that Respondent was providing technical services outside India and it has incurred expenses towards salary etc. on rendering such services. In spite that, learned CIT (Appeals), estimated 10% of software development charge as charges incurred for technical services provided outside India.*

**12.** *It is undisputed fact that the Respondent was engaged in the business of software development for its customers engaged in different activities at software development centres of the Respondent. However, in the process of such customized software development, certain activities were required to be carried out at the sight of customers on site, located outside India for which the employees of the branches of the Respondent located in the country of the customers are deployed. It is true that it is not defined that which activity will be termed as providing technical services outside India. Moreover, after delivery of such softwares as per requirement, in order to make it fully functional and hasslefree functioning subsequent to the delivery of softwares in many cases, there can be requirement of technical personnel to visit the client on site. The Assessing Officer could not bring any evidence that the Respondent was engaged in providing simply technical services independent to software development for the client for which the expenditures were incurred outside India in foreign currency.*

**13.** *The Respondent company has claimed deduction under Section 10A as per certificates filed on Form No. 56F. The Respondent, while computing the deduction, has taken the same figure of export turnover as of total turnover. The Respondent cited various judicial cases but all these cases pertain to deduction under Section 80HHC. Further, the definition of total turnover has been defined in Section 80HHC and 80HHE of the IT Act. As discussed earlier, the definition of total turnover has not been defined under Section 10A of the IT Act.*

**14.** *In the above backdrop, we are of the opinion that the definition of total turnover given under Sections 80HHC and 80HHE cannot be adopted for the purpose of Section 10A as the technical meaning of total turnover, which does not envisage the reduction of any expenses from the total amount, is to be taken into consideration for computing the deduction under Section 10A. When the meaning is clear, there is no necessity of importing the meaning of total turnover from the other provisions. If a term is defined under Section 2 of the IT Act, then the definition would be applicable to all the provisions wherein the same term appears. As the term 'total turnover' has been defined in the Explanation to Section 80HHC and 80HHE, wherein it has been clearly stated that "for the purposes of this Section only", it would be applicable only for the purposes of that Sections and not for the purpose of Section 10A. If denominator includes certain amount of certain type which numerator does not include, the formula would render undesirable results.*

**15.** *A Statute is the intention of the legislature who enacts it after having regard to various facts and circumstances. It is a cardinal principle of law that the interpretation by the Court shall be done in such a way that the intention of the legislature shall prevail and no injustice occurred with the parties. The rule of harmonious construction is the thumb rule to interpretation of any statute. An interpretation which makes the enactment a consistent whole, should be the aim of the Courts and a construction which avoids inconsistency or repugnancy between the various sections or parts of the statue should be adopted.*

**16.** *In CIT v. **J.H. Gotla** [\[1985\] 23 Taxman 14J/156 ITR 323 \(SC\)](#) this Court has held as under:*

*"46. Where the plain literal interpretation of a statutory provision produces a manifestly unjust result which could never have been intended by the Legislature, the Court might modify the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational construction. The task of interpretation of statutory provision is an attempt to discover the intention of the Legislature from the language used...."*

*47 ....If the purpose of a particular provision is easily discernible from the whole scheme of the Act which, in the present case, was to counteract, the effect of the transfer of assets so far as computation of income of the Respondent was concerned, then bearing that purpose in mind, the intention should be found out from the language used by the Legislature and if strict literal, construction leads to an absurd result, i.e. result not intended to be subserved by the object of the legislation found out in the manner indicated above, then if other construction is possible apart from strict literal construction, then that construction should be preferred to the strict literal construction. Though equity and taxation are often strangers, attempt should be made that these do not remain so always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction. Furthermore, in the instant case, we are dealing with an artificial liability created for counteracting the effect only of attempts by the assessee to reduce tax liability by transfer...."*

**17.** *The similar nature of controversy, akin this case, arose before the Karnataka High Court in **CIT v. Tata Elxsi Ltd.** [\[2012\] 204 Taxman 321/17/taxmann.com 100/349 ITR 98](#). The issue before the Karnataka High Court was whether the Tribunal was correct in holding that while computing relief under Section 10A of the IT Act, the amount of communication expenses should be excluded from the total turnover if the same are reduced from the export turnover? While giving the answer to the issue, the High Court, inter-alia, held that when a particular word is not defined by the legislature and an ordinary meaning is to be attributed to it, the said ordinary meaning is to be in conformity with the context in which it is used. Hence, what is excluded from 'export turnover' must also be excluded from 'total turnover', since one of the components of 'total turnover' is export turnover. Any other interpretation would run counter to the legislative intent and would be impermissible.*

**18.** Accordingly, the formula for computation of the deduction under Section 10A of the Act would be as follows:

$$\text{Export Profit} = \frac{\text{total Profit of the Business} \times \text{Export turnover as defined in Explanation 2 (IV) of Section 10A of IT Act}}{\text{Export turnover as defined in Explanation 2(IV) of Section 10A of the IT Act} + \text{domestic sale proceeds}}$$

**19.** In the instant case, if the deductions on freight, telecommunication and insurance attributable to the delivery of computer software under Section 10A of the IT Act are allowed only in Export Turnover but not from the Total Turnover then, it would give rise to inadvertent, unlawful, meaningless and illogical result which would cause grave injustice to the Respondent which could have never been the intention of the legislature.

**20.** Even in common parlance, when the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover also. Otherwise, any other interpretation makes the formula unworkable and absurd. Hence, we are satisfied that such deduction shall be allowed from the total turnover in same proportion as well.

**21.** On the issue of expenses on technical services provided outside, we have to follow the same principle of interpretation as followed in the case of expenses of freight, telecommunication etc., otherwise the formula of calculation would be futile. Hence, in the same way, expenses incurred in foreign exchange for providing the technical services outside shall be allowed to exclude from the total turnover."

31. Hence, following the judgment of Hon'ble Apex Court, we hereby allow the appeal of the assessee on ground nos. 3 & 4.

32. In the result, both the appeals of the assessee are allowed.

Order Pronounced in the Open Court on 16/08/2021.

Sd/-

**(Amit Shukla)**  
**Judicial Member**

**Dated: 16/08/2021**

\*Subodh Kumar, Sr. PS\*

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

**(Dr. B. R. R. Kumar)**  
**Accountant Member**

**ASSISTANT REGISTRAR**