

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE**

Before Shri George George K, JM & Shri B.R.Baskaran, AM

IT(TP)A No.2498/Bang/2019 :Asst.Year2015-2016

M/s.EIT Services India Pvt.Ltd. Digital Park, 39/40, Electronic City, Phase II, Hosur Road Bangalore - 560 100. PAN :AAACD4078L.	v.	The Asst.Commissioner of Income-tax, Special Range-2 Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.Padamchand Khincha

Respondent by : Sri.Muzaffar Hussain, CIT-DR

Date of Hearing : 10.08.2021	Date of Pronouncement : 03.09.2021
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ORDER

Per B R BASKARAN, AM :

This appeal filed by the assessee is directed against final assessment order dated 10.10.2019 passed u/s 143(3) r.w.s. 144C(13) of the I.T.Act for assessment year 2015-16 in pursuance of directions given by Ld Dispute Resolution panel (DRP).

2. Several grounds are raised with regard to Transfer Pricing Adjustment, both with regard to software development segment and I.T.enabled services. The learned AR, during the course of hearing, submitted that as regards I.T.enabled services, revised order u/s 92CA of the I.T.Act has been passed accepting the international transactions to be at Arm's Length. As regards software development segment is concerned, the learned AR confined his submission to the exclusion of four comparable companies and inclusion of

three comparable companies, which were urged in the grounds of appeal. The learned AR also pressed ground No.6.a. with regard to the grant of working capital adjustment. The assessee has also filed an additional ground contending that the transfer pricing adjustment should be restricted to the value of international transactions only.

3. Brief facts of the case are as follow:

The assessee is a company engaged in the business of rendering software development services, software maintenance and technical call centre services primarily to its Associate Enterprises (AEs). The assessee had undertaken several international transactions with its AEs. As regards the software development segment, the final list of comparable considered by the TPO are as follows:-

Sr. No.	Name of the company
1.	Kals Information Systems Limited
2.	E-Zest Solutions Limited
3.	CG-VAK Software & Exports Limited
4.	Tata Elxsi Limited (Seg.)
5.	Rheal Software Private Limited
6.	Mindtree Limited
7.	Larsen & Toubro Infotech Limited
8.	R S Software (India) Limited
9.	Infobeans Technologies Limited
10.	Persistent Systems Limited
11.	Nihilent Technologies Limited
12.	Aspire Systems (India) Private Limited
13.	Inteq Software Private Limited
14.	Infosys Limited
15.	Thirdware Solutions Limited
16.	Cybage Software Private Limited

4. Draft assessment order was passed on receipt of the TPO's order passed u/s 92CA of the I.T.Act. Against the draft assessment order, the assessee filed objections before the DRP. The DRP confirmed the comparable list considered by the TPO except for Thirdware Solutions Limited. Instead of Thirdware Solutions Limited, the DRP included Sasken Communication Technologies Limited. Subsequent to the DRP's order, final assessment order was passed.

5. The assessee being aggrieved, has filed this appeal before the Tribunal. The limited prayer of the assessee, insofar as the software development services is that the assessee wants exclusion of four comparables selected by the TPO and affirmed by the DRP and inclusion of three comparables. The details of the companies sought to be excluded are

- (i) Larsen & Toubro Infotech Limited,
- (ii) Infobeans Technologies Limited,
- (iii) Persistent Systems Limited, and
- (iv) Infosys Limited.

The details of the companies sought to be included by the assessee in the comparable list are

- (i) I2T2 India Limited,
- (ii) Evoke Technologies Limited, and
- (iii) Melstar Information Technologies Limited.

6. We have heard rival submissions and perused the material on record. Before us the Ld A.R placed his reliance on the order dated 28.2.2020 passed by the coordinate bench in the case of M/s. Yahoo Software Development India Pvt.

Ltd. (IT (TP)A No.2365/Bang/2018) relating to assessment year 2015-16, wherein M/s. Persistent Systems Ltd., L&T Infotech Ltd. and Infosys Ltd. have been held to be not good comparable companies. He submitted that M/s. Info Beans Technologies Ltd. has been held to be not a good comparable in the case of Metric Stream Infotech (India) Pvt. Ltd. in ITA No.2347/Bang/2019 dated 24.4.2020.

7. We notice that the coordinate bench in the case of Yahoo Software Development India Pvt. Ltd. (supra) has excluded following 3 companies holding them as not good comparable companies.

(A) Persistent Systems Ltd:-

33. We have considered the rival submissions. We find that on the question of application of RPT filter, the assessee had made the following submission before the DRP:-

4. Fails the Related Party Transaction to Sales filter applied by the learned TPO

In the show-cause notice issued, the learned TPO has excluded companies for which the ratio of RPT to sales exceeds 25% during the current year i.e., during FY 2014-15. The relevant extract from the show-cause notice is reproduced below for ease of reference:

e) Companies who have more than 25% related party transactions of the sales were excluded.

Companies having related party transactions of more than 25% are proposed to be excluded. A threshold of 25% is being applied following the provisions of Section 92A(2)(a) which provides a limit of 26% of the equity capital carrying voting rights for treating an enterprise as Associated Enterprise. If the limit is reduced further it would only result in eliminating more and more companies, on the other hand if the limit is relaxed then companies with predominantly related party transactions would get included which would not represent uncontrolled transactions. Therefore, on a balancing note, 25% is a proper threshold limit for related party transactions. The companies having more than 25% related party transactions should therefore be rejected as comparables.

The Hon'ble ITAT has upheld the application of this filter by the TPO in its order in the case of M/s. Supporisoft India Pvt. Ltd for AY 2005-

G6 in IT (TP)A 1372/B/11 & 20/2012 dated 28.03.2013 following its own decision in the case of M/s. Actis Advertisers Pvt. Ltd vide ITA No.5277/De1/2011 dated 12.10.2012.

On perusal of the Annual Report of Persistent, we observe that the company has RPT in excess of 25% of the sales. The calculation of the same has been provided below for your ease of reference:

RPT to Sales ratio for FY 2014-15	Amount
Particulars	(INR Million)
Sale of services	2,410.02
Commission received	10.26
Purchase of software	1.49
Cost of technical professional	1,339.1
Commission paid on sales	111.79
Traveling and conveyance	19.27
Total related party transactions (A)	3,891.93
Total Sales (B)	12,424.98
RPT % of Sales (A/B)	31.32%

From the above computation, it is clear that the **controlled transactions of Persistent constitutes 31.32% of sales**. Based on the above, it can be seen that Persistent fails the 'RPT to sales ratio' filter applied by the learned TPO and should therefore not be considered as a comparable.”

34. This argument has been addressed by the DRP in its order as follows:-

“4.4.9 We note that the approach of the TPO in treatment of related party transaction into two sets, are for revenue transactions and other for expense transaction is logical and correct. We also note that the RPT filter was adopted by the TPO was with the above conditions and has adopted consistently. Hence, we do not find any infirmity the approach. Hence, we reject the assessee's plea. We hold that onsite expenses do not adversely affect comparability and hence, such plea is rejected.”

35. Further, the assessee had also raised plea with regard to onsite revenue filter by pointing out that onsite revenue is substantial and therefore this company should not be regarded as a comparable company with a company which does not have any onsite revenue. In this regard, the ld. counsel for the assessee placed reliance on the decision of the ITAT Bangalore Bench in the case of Trilogly e-business Software India P. Ltd. v. DCIT, ITA No.1054/Bang/2011 for AY 2007-08 dated 23.11.2012 wherein this Tribunal took the following view:-

“64. The next objection of the Assessee is that when the most appropriate method selected for determining ALP is the TNMM there is no reason as to why one should look at price difference in offshore software development and onsite software development. It is no doubt true that in TNMM it is only the margins in an uncontrolled transaction that is tested with reference to the controlled transaction but it is not possible to ignore the fact that pricing will have an effect on the margins obtained in a transaction. The argument that if pricing structure were to be considered as criteria, then it will have to be seen as to what is the pricing structure of all the comparable for various projects cannot be accepted because the TPO has not chosen any other

onsite software service provider with a revenue composition of more than 75% from onsite software services as comparable. As rightly observed by the TPO, the pricing is different in onsite when compared to offshore operations. The further observations of the TPO that the reasons for the same lie in the fact that while in the case of OFFSHORE projects most of the costs are incurred in India; an ONSITE project has to be carried out abroad significantly increasing the employee cost and other costs.

65. The next objection of the Assessee is with regard to Assets employed. The companies, which predominantly generate revenues from onsite activity, do not have significant assets as most of the work is carried on the site of customer outside India. The argument that the TPO has himself observed that software service providers do not require much assets cannot be basis to accept the Assessee's plea. Those observations are made by the TPO in the context of application of turnover filter and have been quoted out of context by the Assessee.

66. The next argument of the Assessee is that TPO has held that margins are lower in onsite software services and that margin is not a criteria to select or reject a comparable under Rule 10B(2) of the I.T. Rules. We are of the view that this argument again ignores the fact that the approach of the TPO has been to highlight the fact that there can be no functional comparability, if the assets employed and risks assumed are taken into consideration. It is in that context the TPO has referred to the margins.

67. The companies who generate more than 75% of the export revenues from onsite operations outside India are effectively companies working outside India having their own geographical markets, cost of labour etc., and also return commensurate with the economic conditions in those countries. Thus assets and risk profile, pricing as well as prevailing market conditions are different in predominantly onsite companies from predominantly offshore companies like the taxpayer. Since, the entire operations of the tax payer are taking place offshore i.e. in India; it is but natural that it should be compared with companies with major operations offshore, due to the reason that the economics and profitability of onsite operations are different from that of offshore business model. As already stated the Assessee has limited its analysis only to functions but not to the assets, risks as well as prevailing market conditions in which both the buyer and seller of services located. Hence, the companies in which more than 75% of their export revenues come from onsite operations are to be excluded from the comparability study as they are not functioning in similar economic circumstances to that of the tax payer. Hence, it is held that this filter is appropriately applied by the TPO.

68. Admittedly the onsite revenue in the case of the following comparable companies identified by the Assessee was more than 75% of its export revenues viz., a) Visu International Ltd. b) Maars Software International Ltd. c) Akshay Software Technologies Ltd. d) VJIL Consulting Ltd. e) Synfosys Business Solutions Ltd. The above companies were therefore rightly not considered as comparable by the TPO. We hold accordingly."

36. It is seen that the TPO in coming to the conclusion that the onsite revenue filter is not applicable has placed reliance on the decision of the ITAT Mumbai Bench in

the case of Capegemini as quoted in para 16 in para 14 of the TPO's order, but that decision does not deal with a case of onsite revenue filter and the decision was rendered on the facts of its own case.

*37. On the issue of RPT filter, we notice that the TPO in para 16 has accepted that the RPT filter should be @ 25%. In the case of Persistent Systems Ltd., the RPT is at 31.32% as extracted in the earlier part of this order and therefore this company should be excluded by application of RPT filter. In view of the above, we do not wish to go into other grounds on which this company is sought to be excluded viz., that it is a product company and there is no segmental data between product and services segment, presence of onsite activity and the impact of extra-ordinary event of acquisition during the relevant previous year. **Therefore, this company is directed to be excluded from the list of comparable company.***

(B) LARSEN & TOUBRO INFOTECH LTD:-

*38. As far as L&T Infotech Ltd. is concerned, the ld. counsel for the assessee brought to our notice the decision of ITAT Delhi Bench in the case of Saxo India Pvt. Ltd. v. ACIT, ITA No.6148/Del/2015 for AY 2011-12, order dated 5.2.2016, wherein the Tribunal took note of the fact that this company was also trading in software and owned insignificant intangible assets. **The company was excluded from the list of comparable companies with reference to SWD services provider such as the assessee.** The ld. Counsel pointed out that though this decision was rendered with reference to AY 2011-12, the same reasoning would apply to AY 2015-16 also and in this regard, he drew our attention to page 696 of assessee's PB, which gives the details of the revenue generated by this company without any segmental break-up. Our attention was also drawn to page 682 of PB which shows that there is substantial onsite revenue activity as well as cost incurred on onsite software development. We notice from page 676 of assessee's PB that this company as part of its operating profit in Schedule-O of profit & loss account contains expenditure for 'cost of bought out items for resale' and this is a significant part of the operating expenditure. When we see the revenue in Schedule M of the profit & loss account, there is no break-up of the revenue with regard to software services and software product. In our opinion, this distinction is enough to exclude this company from the list of comparable companies as held by the Hon'ble Delhi ITAT in the case of Saxo India Pvt. Ltd. (supra) which decision was also confirmed by the Hon'ble Delhi High Court*

(C) INFOSYS LTD.

39. The next company which the assessee seeks to exclude is Infosys Ltd. As far as this company is concerned, it is seen that the following are the functional dissimilarities brought to our notice:-

"Functionally dissimilar - owns intellectual properties, incurs significant R&D costs & onsite activity.

- Engaged in diversified business activities.*
- Involved in development of software products in addition to software services.*
- Owns intellectual property rights.*
- Incurs significant research and development costs.*

- Carries out significant activities based on onsite business.
- Owns products such as Finacle, Edge Verve and other product based solutions.

Extra-ordinary event of merger with Infosys Consulting India Ltd.

Segmental profit & loss account not available.

Commands substantial brand value.

40. *The DRP, however, has not thought it fit to exclude this company by observing that this company has substantial pre-dominant revenue from software services and the growth was not attributable to any brand value. Presence of onsite activity and the expenses on R&D have all been brushed aside. **In our view, the difference pointed out by the ld. counsel for the assessee before us show that this company cannot be compared with that of the assessee** basically because of its business model, presence of onsite revenue generation and other reasons cited before us. Besides, the reason that turnover of this company is huge and more than 10 times that of the assessee.”*

8. We notice that M/s. Infobeans Technologies Ltd. have been directed to be excluded by the coordinate bench in the case of Metric Stream Infotech (India) Pvt. Ltd. with the following observations:

“14.3. Infobeans Technologies Ltd.,

Ld.AR submitted that this comparable was selected by authorities below as it passes all filters, based upon response received from this company under section 133 (6) of the act. He submitted that this observation is contrary to the facts and figures appearing in annual report. Referring to page 1015 Ld.AR submitted that this company is operating at CMMI Level 3 and is a software service company specialising in business application development for web and mobile. In the company overview this company has been stated to be primarily engaged in providing custom developed services to offshore clients and it provides software engineering services primarily in custom application development, content management systems, enterprise mobility, Big Data analytics. Ld.AR thus submitted that this company is functionally not at all similar with a captive service provider like assessee that this providing Ltd services to its associated enterprises.

14.3.1. On the contrary Ld. CIT DR, referring observations of DRP in para 3.6.1 submitted that the activities of company fall under the gamut of software development has categorised by company itself and that the information obtained under section 133 (6) is sufficient enough to come to such conclusions. However he submitted that this comparable also may be sent back to learnt AO/TPO for verification.

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

It is observed that the annual report of this company categorises the diversify services provided by this company under software development segment. We also note that this company is basically into application development for web and mobile and provides customised services to its offshore clients comprising. Entire revenue received by this comparable ease under one single segment of sale of software. This company also owns software licenses.

14.3.3. *In our considered opinion this comparable cannot be considered to be functioning in 100% risk mitigated environment and is a full-fledged enterprise. Such a comparable cannot be compared with a captive service provider like assessee.*

Accordingly we direct this comparable to be excluded from finalist.”

9. Following the above said decisions rendered by coordinate benches, we direct exclusion of Persistent Systems Ltd., Larsen & Toubro Infotech Ltd. and Infosys Ltd. & Infobeans Technologies Ltd. from the final list of comparables.

10. With regard to the prayer of the assessee to include 3 comparable companies, we notice that the coordinate bench in the case of Goldman Sachs Services Pvt. Ltd. (IT(TP)A No.2355/Bang/2019 dated 15.6.2020) has restored all the 3 companies to the file of the A.O./TPO for examining the claim of assessee with the following directions.

10. The learned Authorized Representative argued for inclusion of three comparables (i) I2T2 India Limited, (ii) Evoke Technologies Limited and (iii) Melstar Information Technologies Limited and made submissions on comparables and substantiated with chart and Paper Book.

(i) I2T2 India Limited – The LdAr submitted that the comparable company margin is 3.67%. The comparable has to be included as the RPT details are available in the Annual Report and referred to page no 2385 of the Paper Book. We are of the opinion that the Assessing Officer could have called for the information under Section 133(6) of the Act to confirm the details in the proceedings. Accordingly, we restore this comparable to the file of the TPO/A.O. for examination and verification of facts.

(ii) Evoke Technologies Limited – has margin of 0.53%. The LdAr submitted that the company is functionally comparable and passes all the TPO's filters. The branch is a sub-set of an entity and the results of the branch are

included in the audited financial statements of the entity and qualify export revenue, as the company is in the business of software development services and implement services. The LdAr has supported his arguments with the Paper Book at page no 2452 and Profit and Loss Account. Whereas the DRP has commented that unaudited accounts cannot be relied. The learned Authorized Representative relied on the decision of Nokia Seimens Networks India (P) Ltd. Vs. ACIT 70 taxmann.com 236 (Del), with observations at page 5 as under :

■ Undisputedly the TPO has used segmental data of this comparable company relating to software development profit segment provided to him under section 133(6), which cannot be doubted without any cogent material brought on record by the assessee-company. Profit & loss account of this comparable company apparently proves the profitability of software development services segment. Segmental data obtained by the TPO though not audited but to controvert this data, the assessee had not produced any material on record and as such, this company is a valid comparable for TP adjustment in this case. [Para 55]

Considering the facts and submissions, we restore the comparable to the file of Assessing Officer for examination and verification of the facts and material.

(iii) Mel star Information Technology Limited margin is 5.29%. The company has made profit in the current year and not a loss making company. Whereas the DRP has rejected the company, which has incurred loss in two years out of three years. But for all the past years, the TPO had applied benchmark of rejecting companies with losses for all three years.

11. The learned Authorised Representative relied on the decision of CIT Vs. Goldman Sachs (2016) 69 Taxmann.com 19 and Star International Limited Vs. DCIT (2019) 112 Taxman.com 258. In the case of CIT Vs. Goldman Sachs India Securities (P) Limited (Supra) in paras 4(a) and 4(b) the observations are read as under :

4. (a) The Respondent-Assessee urged before the Tribunal that the upward adjustment of Rs.1.60 Crores by the TPO pertaining to Business Support Services rendered to its AE was, inter alia, on the basis of having rejected one of the comparable namely Capital Trust Limited, chosen by the Respondent-Assessee. This was rejected on account of the fact that Capital Trust Limited is a loss making unit. Before the Tribunal, the Respondent-Assessee contended that the nature of business as carried out by the Capital Trust Ltd., and that carried out by the Respondent-Assessee are similar. Therefore it ought to have been included in as comparable to arrive at the ALP;

(b) The Revenue on the other hand contended that Capital Trust Limited is a persistent loss making unit and, thus, cannot be used as a comparable for the purpose of determining the ALP. The Tribunal by the impugned order held on a finding of fact that for the Assessment Year 2005-06 - Capital Trust Ltd. has made a profit although it made a loss for the subsequent two years namely Assessment Year 2006-07 and 2007-08. However, the impugned order of the Tribunal inter alia relies upon its order in the case of *Brigade Global Services (P) Ltd. v. ITO* [2013] 33 taxmann.com 618 (Hyd. - Trib.) rendered by the coordinate Bench at Hyderabad- wherein it is held that only persistently loss making unit cannot be said as comparable. In this case, the impugned order holds on facts that Capital Trust Ltd. it is not a persistent loss making unit. Therefore, Capital Trust Ltd. is comparable; and

12. We, considering the facts, circumstances and judicial decisions are of the opinion that the disputed issue in respect of losses of continuous three years has to be verified/ tested by the Assessing Officer. Accordingly we remit this matter to the file of TPO/A.O for examination.

11. Following above decision, we restore I2T2 India Limited, Evoke Technologies Limited and Melstar Information

Technologies Limited to the file of AO/TPO for examining it afresh.

12. The assessee has submitted that the claim of working capital adjustment was rejected by TPO and Ld DRP. He submitted that the Tribunal is consistently holding that the working capital adjustment is permissible and in many cases; the TPO has also allowed the same. Accordingly, he submitted that the assessee may be granted working capital adjustment.

13. We find merit in the submissions made by Ld A.R. Accordingly, we restore this issue to the file of AO/TPO with the direction to grant working capital adjustment.

14. In the additional ground, the assessee is contending that the transfer pricing adjustment should be restricted to the value of international transactions only. There is merit in the said contention as the whole purpose of transfer pricing exercise is to determine the Arms length price of international transactions. Accordingly we direct the AO/TPO to restrict the transfer pricing adjustment to the value of international transactions only.

15. All other grounds have not been pressed by Ld A.R and accordingly, all of them are dismissed as Not Pressed.

16. In the result, the appeal filed by the assessee is treated as partly allowed.

Order pronounced on this day of 3rd September, 2021.

Sd/-
(George George K)
JUDICIAL MEMBER

Sd/-
(B R BASKARAN)
ACCOUNTANT MEMBER

Dated :3rd September, 2021.
Bangalore;
VG/SPS

Copy to :

1. The Appellant.
2. The Respondent.
3. The DRP-1, Bangalore
4. The Pr.CIT-2, Bangalore.
5. The DR, ITAT, Bengaluru.
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Asst. Registrar
ITAT, Bangalore