

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT  
AND SHRI CHANDRA POOJARI ACCOUNTANT MEMBER**

<b>IT(TP)A Nos. &amp; Assessment Years</b>	<b>Appellant</b>	<b>Respondent</b>
405/Bang/2016 2011-12	M/s. Lam Research India Pvt. Ltd., A-Block-11/1 and 12/1, Amrajyothi Layout Intermediate Ring Road, Bengaluru – 560 071. <b>PAN : AABCN 2063 Q</b>	DCIT, Circle – 4(1)(1), Bengaluru.
468/Bang/2016 2011-12	DCIT, Circle – 4(1)(1), Bengaluru.	M/s. Lam Research India Pvt. Ltd., Bengaluru – 560 071. <b>PAN : AABCN 2063 Q</b>

Appellant by	:	Shri. Darpan Kirpalani, Advocate
Respondent by	:	Ms. Neera Malhotra, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	16.09.2021
Date of Pronouncement	:	17.09.2021

**ORDER**

*Per N.V. Vasudevan, Vice President*

IT(TP)A No.468/Bang/2016 is an appeal by the Revenue, while IT(TP)A No.405/Bang/2016 is an appeal by the assessee. Both these appeals are directed against

the order dated 31.12.2016 of the DCIT, Circle-4(1)(1), Bangalore passed u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 [the Act] in relation to AY 2011-12.

2. The grounds of appeal raised by the Revenue in its appeal reads as follows:-

1. *The directions of the Dispute Resolution Panel are opposed to law and facts of the case.*
2. *The Hon'ble DRP erred in directing the AO to reduce the expenses both from the Export Turnover as well as Total Turnover when there is no provision in section 10A which requires the said expenses to be reduced from the Total turnover?*
3. *The Hon'ble DRP erred in holding that foreign exchange loss or gain is a part of operating expense or operating income, as the case may be, when the TPO has excluded this data from that of the comparables.*
4. *Whether the DRP is correct in foreign exchange fluctuation as operating in nature, while treating foreign exchange fluctuation non-operating in nature as applied by the TPO.*
5. *Whether the DRP is correct in holding that the foreign exchange transaction are to be considered as operating in nature, when the Rule 10B(2)(d) stipulates that the net profit margin realized by the taxpayer in the international transactions shall alone be computed for comparability analysis under TNMM.*
6. *The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.*

3. The assessee in its appeal has raised several grounds, but at the time of hearing, the Id. counsel for the assessee prayed that ground No.1(e)(i) and 1(i) (i) of the revised grounds of appeal alone be adjudicated and other grounds were not pressed. The relevant grounds read as follows:-

e) The learned AO/ TPO and the learned DRP have erred, in law and in facts, by accepting / rejecting the companies based on unreasonable comparability criteria

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

- a. Acropetal Technologies Limited*
- b. E-Infochips Limited*
- c. ICRA Techno Analytics Limited*
- d. Persistent Systems and Solutions Limited*

i) The learned AO/ TPO and the learned DRP have erred, in law and in facts, by accepting / rejecting companies based on unreasonable comparability criteria;

i. The learned AO/DRP/TPO has failed to appreciate the fact that the following companies are not functionally comparable to the IT enabled service segment of Appellant, therefore has erred in law and in facts in considering them as comparable companies:

- a. Accentia Technologies Limited*
- b. Acropetal Technologies Limited(seg)*
- c. ICRA Online Limited*
- d. Jeevan Scientific Technologies Limited*

4. We shall first identify the issues to be decided in these cross appeals. The issues that arise in these cross appeals are with regard to determination of Arm's Length Price (ALP) in respect of two international transactions between the Assessee and it's Associated Enterprise (AE) under the provisions of Sec.92 of the Income Tax Act, 1961 (Act) viz., (i) International Transaction of rendering of Software Development Services (SWD services) by the Assessee to its AE and (ii) rendering of Information technology enabled services (ITeS) by the Assessee to it's AE. As far as the appeal of the Revenue is concerned,

ground No.2 to 4 raised by the Revenue relates to the action of the DRP in directing the TPO/AO to consider foreign exchange gain as part of operating profits of the Assessee for comparing the Assessee's profit margin with the comparable companies. Gr.No.1 relates to the directions of the DRP to exclude from the total turnover whatever is excluded from the Export Turnover while computing deduction u/s.10A of the Act.

5. As far as the appeal of the Assessee is concerned, they relate to exclusion of comparable companies in the SWD services and ITeS segments. We shall deal with each of the segments of ITeS and SWD segment separately.

6. The Assessee is a wholly owned subsidiary of Novellus System International Inc., USA which in turn is a subsidiary of Novelleus Systems Inc., USA. During the previous year relevant to the assessment year 2011-12, two of the international transactions that took place between the Assessee and its AEs were the provision of software development ("SWD") services by the Assessee at a price of Rs.15,21,40,773/- and the provision of IT-enabled Services ("ITeS") by the Assessee at a price of Rs. 10,25,41,366. In terms of the provisions of Sec.92-A of the Act, the Assessee and its wholly owned holding company were Associated Enterprises ("AEs"). In terms of Sec.92B(1) of the Act, the transaction of providing SWD Services and ITeS "international transaction" i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more

of such enterprises. In terms of Sec.92(1) of the Act, the Any income arising from an international transaction shall be computed having regard to the arm's length price.

**SOFTWARE DEVELOPMENT SERVICES SEGMENT:**

7. It is not in dispute between the Assessee and the Revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for determination of ALP and that the profit level indicator to be adopted for comparison of the Assessee's profit with that of comparable companies was Operating Profit/Total Cost (OP/TC). The OP/TC of the Assessee was 14%. The Assessee in its TP study selected comparable companies whose arithmetic mean profit margin was comparable with the profit margins of the Assessee. Since the profit margin of the Assessee was comparable with the arithmetic mean of OP/TC of the comparables selected by the Assessee, it was claimed by the Assessee that the price charged by it in the international transaction was at Arm's Length. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred by the AO, accepted some of the comparable companies suggested in the TP study by the Assessee as comparable with the Assessee. The TPO on his own selected other companies as comparable companies with the Assessee. Thus a final set of 13 comparable companies was chosen by the TPO as comparable companies. The arithmetic mean of profit margin of these companies after and before adjustment towards working capital adjustment was as follows:

**Comparables selected by TPO and their arithmetic mean:**

<b>Sl. No.</b>	<b>Name of the Company</b>	<b>Mark-up on Total Costs (WC-unadj) (in %)</b>
1	Acropetal Technologies Ltd. (seg)	31.98

2	e-Zest Solutions Ltd.	21.03
3	E-Infochips Ltd.	56.44
4	Evoke Technologies Pvt. Ltd.	8.11
5	ICRA Techno Analytics Ltd.	24.83
6	Infosys Ltd.	43.39
7	Larsen & Toubro Infotech Ltd.	19.83
8	Mindtree Ltd. (seg)	10.66
9	Persistent Systems & Solutions Ltd.	22.12
10	Persistent Systems Ltd.	22.84
11	R S Software (India) Ltd.	16.37
12	Sasken Communication Technologies Ltd.	24.13
13	Tata Elxsi Ltd. (seg)	20.91
<b>AVERAGE MARK-UP</b>		<b>24.82</b>

**Computation of arm's length price by the TPO and the adjustment made:**

Arm's Length Mean Mark-up	24.82%
Less: Working Capital Adjustment	0.17%
Adjusted mean mark-up of the comparables	24.65%
Operating Cost	133,456,818
Arm's Length Price – 127.03% of Operating Cost	166,353,924
Price Received	152,140,773
<b>Shortfall being adjustment u/s. 92CA</b>	<b>14,213,151</b>

8. The AO incorporated the addition to the total income by way of shortfall being adjustment u/s.92CA of the Act, in his draft order of Assessment. Against the said addition in the draft assessment order, the Assessee filed objections u/s.144C of the Act before the DRP. The DRP accepted some of the contentions of the Assessee.

9. Aggrieved by the order of DRP not accepting some of the contentions raised by the Assessee for exclusion of 5 comparable companies, the Assessee has raised Grd.No.1(e) (i) before the Tribunal.

10. As far as exclusion of **Acropetal Technologies Ltd. from the list of comparable companies is concerned**, after hearing the rival submission for exclusion of Acropetal from the list of comparable companies, we find that plea for exclusion of this company from the list of comparable companies should be upheld because this company fails the employee cost filter of employee cost being equal to atleast 25% of the total operating revenue. From the annual report of the company it can be seen that the employee costs incurred by the company is 11.51% of the total operating revenue. Apart from the above, the Company also fails the TPO's filter of service revenue is excess of 75% as the income from software development activity is Rs. 81.40 Crores out of total operating revenue of Rs. 141 Crores. As it is clear that the company fails TPO's own filters of employee cost in excess of 25% and service revenue is excess of 75%, the company ought to remain excluded from the final list of comparables. We also find that this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT* [IT(TP)A Nos. 17 & 39/Bang/2016 ] at paras 16.1 to 16.4 at pages 1606-1607]; *Finastra Software Solutions (India) (P.) Ltd. v. ACIT* [[2018] 93 taxmann.com 460 (Bangalore - Trib.) at para 15 at page 1744]; *Electronic Imaging India P. Ltd v. DCIT* [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 8 at pages 1725-1726] and *Commscope Networks (I) Pvt. Ltd. v. ITO* [TS-161-ITAT-2017(Bang)-TP at para 9 on pages 1639-1640] held that this company should be excluded from the list of comparable companies in the case of companies engaged in rendering SWD services such as the Assessee. We therefore direct exclusion of this company from the list of comparable companies.

11. As far as plea for exclusion of **E-Infochips Ltd.** on the ground that it failed the software service income filter at 75%. We find that the company's software development

service revenue for FY 2010-11 was less than 75% of its total operating revenue for that year. Thus, the above action of the DRP in not rejecting the above company is incorrect. The DRP has also not appreciated that the above company is engaged in diverse activities such as product development and the provision of IT enabled services for which no separate segmental information is available in its Annual Report. On the contrary, the diverse activities of software development and the IT enabled services are considered and reported together in one segment. Thus, in the absence of such segmental details, the company was functionally not comparable to the Assessee which is a captive software development service provider. Further, the company also has presence of inventory and is, therefore, incomparable to the Assessee. We also find that this Tribunal in *Electronic Imaging India P. Ltd v. DCIT* [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 9 at pages 1726-1727]; *Saxo India Pvt. Ltd. v. ACIT* [2016] 67 taxmann.com 155 (Delhi - Trib.) (paras 10.1 and 10.2 at pages 1656-1657)] (which came to be upheld by the Hon'ble Delhi High Court); *Finastra Software Solutions (India) (P.) Ltd. v. ACIT* [[2018] 93 taxmann.com 460 (Bangalore - Trib.) at para 17 at page 1744]; *Cypress Semi-conductor Technology India Pvt. Ltd. v. DCIT* [IT(TP)A No.356/Bang/2016 at paras 19-20 at pages 1773-1775]; and *Commscope Networks (I) Pvt. Ltd. v. ITO* [TS-161-ITAT-2017(Bang)-TP at para 9 on pages 1639-1640] held that this company ought to be excluded from list of comparable companies in the case of companies rendering SWD services similar to that of the Assessee. Consequently, for the above reasons, we direct exclusion of **E-Infochips Ltd.** is upheld and the ground is dismissed.

12. As far as **ICRA Techno Analytics Ltd.**, this company ought to have been rejected by the DRP for the reason that the entire revenue of the company has been reported under one segment, and in the absence of segmental information regarding the same, the company

could not be held as a comparable to the Assessee. We find that this company is engaged in diversified activities of software development and consultancy, licensing and sub-licensing, annual maintenance for software support, web development & hosting and revenue from all the activities are reported under one segment, without any segmental information regarding the same made available. Therefore, in the absence of segmental information, it cannot be ascertained whether the company passes all the filters applied by the TPO and therefore ought to stand excluded from the final list of comparables. We also find that this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT* [IT(TP)A Nos. 17 & 39/Bang/2016] at paras 17.1 to 17.2 at pages 1607-1609]; *Finastra Software Solutions (India) (P.) Ltd. v. ACIT* [[2018] 93 taxmann.com 460 (Bangalore - Trib.) at para 17 at page 1744]; and *Electronics Imaging India P. Ltd v. DCIT* [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 10 at pages 1727] excluded this company from the list of comparables in the case of companies that were engaged in rendering SWD services similar to that of the Assessee. We therefore direct exclusion of this company from the list of comparable companies.

13. As far as exclusion e-Zest Solution Ltd. is concerned, this company was directed to be excluded by this Tribunal in the case of a SWD service provider such as the Assessee as functionally not comparable and absence of segmental information of its products and software development segments and also in the light of presence of inventory showing that this company is a product company. The decision in this regard is *Autodesk India Pvt.Ltd., IT(TP)A No.220/Bang/2016* (Paragraph-17). We therefore direct exclusion of this company from the list of comparable companies.

14. As far as exclusion of Persistent Systems and Solutions Ltd., is concerned, we find that this company was again excluded in the decision in the case of *Autodesk India*

Pvt.Ltd.(supra) for the very same reasons for exclusion of e-Zest solutions Ltd. We therefore direct exclusion of this company from the list of comparable companies.

15. As far as Grd.No.2 raised by the Revenue is concerned, the same is with regard to exclusion of telecommunication expenses and expenses incurred in foreign currency for rendering technical services outside India, both from the export turnover and total turnover for the purpose of computation of deduction u/s. 10A of the Act. It is not in dispute before us that the Hon'ble High Court of Karnataka in the case of CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn) has held that charges/expenses relating to telecommunication, and expenses in connection with rendering technical services outside India, should be excluded both from export turnover and total turnover while computing deduction u/s.10A of the Act i.e., whatever is removed from the numerator should also be excluded from the denominator while working total turnover and export turnover for allowing deduction u/s.10A of the Act. The aforesaid decision of the jurisdictional High Court has been upheld by the Hon'ble Supreme Court in the case of CIT v. HCL Technologies Ltd. in Civil Appeal No.8489-98490 of 2013 &Ors. dated 24.04.2018. In view of the above, we are of the view that the telecommunication charges should be excluded both from the export turnover as well as total turnover while computing deduction u/s.10A of the Act. The order of the DRP is therefore upheld.

16. As far as Gr.No.3 to 5 raised by the Revenue is concerned, the Revenue has challenged the action of the DRP in directing the AO to consider the gains/loss arising from fluctuation of foreign currency as being operating in nature. In this regard it was submitted that the gains on account of fluctuation in foreign currency has arisen from the international transaction of provision of ITE services and SWD services. The gains are inextricably related to rendering of the main services and are not derived independently.

As the gains relate to the rendering of the main service, the same ought to be treated as operating in nature. Reliance in this regard was placed on the following decisions:

- SAP LABS India (P.) Ltd. v. ACIT ([2011] 44 SOT 156 (Bangalore) at para 42);
- PCIT v. B.C. Management Services (P.) Ltd. ([2018] 89 taxmann.com 68 (Delhi), at paras 7 and 8);
- PCIT v. Ameriprise India Pvt. Ltd. (Order dated 23.03.2016 passed in ITA No. 206/2016 at paras 3 and 4)

The learned DR reiterated the stand of the Revenue as reflected in the grounds of appeal raised by the Revenue in this regard.

17. We have carefully considered the rival contentions. The Hon'ble Delhi High Court in the case of PCIT Vs. B.C. Management Services (P) Ltd., (supra) held that foreign exchange gain has to be regarded as part of operating income by following its own order in *Pr. CIT v. Cashedge India (P.) Ltd.* [IT Appeal No. 279 of 2016, dated 4-5-2016]. Respectfully following the said decision, we uphold the directions of the DRP and dismiss Gr.No.3 to 5 raised by the Revenue.

#### **INFORMATION TECHNOLOGY ENABLED SERVICES SEGMENT:**

18. It is not in dispute between the Assessee and the Revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for determination of ALP and that the profit level indicator to be adopted for comparison of the Assessee's profit with that of comparable companies was Operating Profit/Total Cost (OP/TC). The OP/TC of the Assessee was 18%. The Transfer Pricing Officer (TPO) to whom the

determination of ALP was referred by the AO, chose a final set of 10 comparable companies comparable companies. The arithmetic mean of profit margin of these companies after and before adjustment towards working capital adjustment was as follows:

**Comparables selected by TPO and their arithmetic mean:**

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)
1	Accentia Technologies Ltd.	28.89
2	Acropetal Technologies	26.86
3	Cosmic Global Ltd.	9.81
4	e4e Healthcare Business Services Pvt. Ltd.	12.38
5	ICRA Online Ltd. (seg.)	34.21
6	Jeevan Scientific Technology Ltd.	70.66
7	Infosys BPO Ltd.	17.89
8	Jindal Intellicom Pvt. Ltd.	11.13
9	Mindtree Ltd. (seg.)	10.76
10	iGate Global Solutions Ltd.	25.07
<b>AVERAGE MARK-UP</b>		<b>24.77</b>

**Computation of arm's length price by the TPO and the adjustment made:**

Arm's Length Mean Mark-up	24.77%
Less: Working Capital Adjustment	-0.21%
Adjusted mean mark-up of the comparables	24.98%
Operating Cost ('OC')	86,899,463
Arm's Length Price ('ALP') = 127.16% of OC	108,606,949
Price Received	102,541,366
<b>Shortfall being adjustment u/S. 92CA</b>	<b>6,065,583</b>

19. The AO incorporated the addition to the total income by way of shortfall being adjustment u/s.92CA of the Act, in his draft order of Assessment. Against the said addition in the draft assessment order, the Assessee filed objections u/s.144C of the Act before the DRP. Aggrieved by the directions of the DRP which were incorporated in the final order of Assessment, the Assessee has raised Grd.No.1(i)(i) in its appeal seeking exclusion of 4 comparable companies.

20. We have heard the rival submissions of the parties. The Assessee is seeking the exclusion of Acropetal Technologies Ltd., Jeevan Scientific Technology Ltd., and ICRA Online Ltd. We find that the above companies ought to have been rejected by the DRP and the same requires interference from this Hon'ble Tribunal. We find that **Acropetal Technologies Ltd.**, is engaged in the business of software development and services, contract centre service and IT enabled services and the same are reported together as one segment. In the absence of segmental details made available, the company could not be treated as a comparable. The TPO, while choosing the company as a comparable, has selected its Engineering Design Segment ('EDS' for short) which is in the nature of high end IT enabled services which are in the nature of Knowledge Process outsourcing ("KPO"). The high end services provided by the company cannot be compared with the routine services provided by the Assessee. This is a settled position and reliance can be placed on the decision of this Hon'ble Tribunal's in the case of *Symphony Marketing Solutions India Pvt. Ltd.*(ITA No. 1316/Bang/2012) where it was held that Acropetal cannot be considered as a comparable to assessee performing routine low end IT enabled services function. This company is therefore to be excluded from the list of comparable companies. As far as exclusion of company **Jeevan Scientific Technology Ltd.**, we find that this company is engaged in diverse functions and the same were reported under one

segment without segmental details regarding the same being made available. Without segmental details, the comparability of the company cannot be determined. In any event, the ERP segment of the company is not comparable to the assessee, the BPO segment of the company fails the filter of service income being greater than 75% of total revenue, and the company suffers from huge fluctuations which indicate that certain peculiar circumstances influencing the profit margin of the company exist, for which appropriate adjustments cannot be made to balance the effect. This company is therefore excluded as comparable company. As far as exclusion of **Accentia Technologies Ltd.**, is concerned, we find that details regarding its diverse functions were reported under one segment, without segmental details regarding the same being made available. In the absence of segmental details being made available, the comparability of the company with that of the assessee cannot be determined. In any event, Accentia is engaged in providing high end services in the nature of Knowledge Process Outsourcing ('KPO') which is evident from its annual report, whereas, the assessee is engaged in rendering routine low end information technology enabled services. Further, the said company not only does medical transcriptions, but has also ventured into healthcare receivables cycle management and high end consultancy to start-ups requiring field experts. As can be seen from the annual report, coding income is contributing 15% of the total income which activities are akin to software development activity while the assessee is a mere provider of IT enabled services. The company has invested huge sums in the development of EMR software. Segmental details of its various activities are unavailable. The company further owns significant intangibles. This Tribunal in the case of *Swiss Re Shared India Pvt. Ltd. v. ACIT* [TS-598-ITAT-2016(Bang)-TP at paras 9-20 on pages 7-21] where, in similar circumstances and for the same assessment year, this Hon'ble Tribunal directed the exclusion of this company from the list of comparables. **Accentia Technologies Ltd.** is, therefore, not comparable to

the Assessee and rejected as a comparable. As far as the company **ICRA Online Ltd.**, is concerned, the details regarding its diverse functions are reported under one segment without segmental details regarding the same being made available. Therefore, the comparability of the company cannot be determined. In any event, this company is functionally dissimilar for the reason that the outsourced services segment of the company is engaged in the provision of high end consultancy services which cannot be compared to the assessee who is into provision of low end IT enabled services which are routine in nature. Further, the company fails the TPO's own filter of export turnover in excess of 75% of total sales as the export turnover of the company amount to only 61.88% of its sales. Therefore, the company cannot be held as a comparable to the assessee.

21. The TPO is directed to compute ALP in accordance with the directions contained in this order after affording Assessee opportunity of being heard.

22. In the result appeal by the Assessee is partly allowed and the appeal by the Revenue is dismissed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-  
**(CHANDRA POOJARI )**  
**ACCOUNTANT MEMBER**

Sd/-  
**(N V VASUDEVAN)**  
**VICE PRESIDENT**

Bangalore,  
Dated: 17.09.2021.  
/NS/\*

Copy to:

Page 16 of 16

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

By order

Assistant Registrar  
ITAT, Bangalore.