

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

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

IT(TP)A No.128/Bang/2018 : Asst.Year 2013-2014

M/s.GXS India Technology Centre Private Limited Prestige Emerald, 2 nd 3 rd & 4 th Floor, Municipal No.2, Madras Bank Road, Lavelle Road Junction Bangalore – 560 001. PAN : AABCG7972P.	v.	The Assistant Commissioner of Income-tax, Circle 3(1)(2) Bangalore.
(Appellant)		(Respondent)

IT(TP)A No.331/Bang/2018 : Asst.Year 2013-2014

The Assistant Commissioner of Income-tax, Circle 3(1)(2) Bangalore.	v.	M/s.GXS India Technology Centre Private Limited Bangalore – 560 001.
(Appellant)		(Respondent)

Assessee by : Smt.Rashmi R. Advocate
Revenue by : Sri.Sankar Ganesh K, JCIT-DR

Date of Hearing : 11.11.2021	Date of Pronouncement : 16.11.2021
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ORDER

Per George George K, JM

These are cross appeals directed against CIT(A)'s order dated 13.11.2017. The relevant assessment year is 2013-2014. We shall first adjudicate the assessee's appeal.

IT(TP)A No.128/Bang/2018 (Assessee's appeal)

2. During the course of hearing, the assessee had pressed only one issue, namely, exclusion of two companies, i.e. (i) Larsen & Toubro Infotech Limited, and (ii) Persistent Systems Limited on account of application of upper turnover filter.

3. The brief facts of the case are as follows:

The assessee is a 100% export oriented unit. It is providing Software Development (SWD) services to its Associate Enterprises (AEs). As per the Transfer Pricing (TP) study, the assessee had entered into various international transactions with its AEs. The only international transfer which has subjected to Transfer Pricing Adjustment by the TPO was provision for SWD services of Rs.55,50,63,134. The financials of the assessee as per the TP study and financials for computing Arm's Length Price (ALP) as per the TPO are as follows:-

Particulars	Provisions of SWD and support services
Operating income	55,50,63,134
Operating Cost	47,28,45,313
Operating Profit	8,22,17,821
OP/OC	17.39%

Income			56,41,23,715
Other Income	Exclude	9060581	
Add : Forex gain	Include	8816977	
Operating Revenue / Income			56,38,80,111
Total Expenditure			47,44,88,315
Interest & finance expense	Exclude	1643002	
Operating expenses			47,28,45,313
Operating profit			9,10,34,798
OP/OC			19.3%
OP/OR			16.14%

4. In the TP study of the assessee, the ALP of the international transaction representing SWD services provided to the AEs is determined by applying Transaction Net Margin Method (TNMM) stated to be the Most Appropriate Method (MAM). The operating profits to total cost ratio is taken as a Profit Level Indicator (PLI) in TNMM analysis. The assessee by applying various filters, selected 11 companies as

comparables at arithmetical means of 12.45%. Thus, the assessee sought to justify the price of of the SWD segment at arm's length since the assessee's margin was 17.39%. However, the Transfer Pricing Officer (TPO) rejected the TP study of the assessee. The TPO rejected some of the filters of the assessee and included some others. The TPO selected seven companies as comparables at the average margin of 20.90%. By adopting arithmetical means margin on cost at 20.90% and after providing for negative working capital adjustment of minus 3.02%, the TPO proposed ALP adjustment of Rs.2,20,43,503. The companies selected by the TPO, the average margin and computation of ALP are as follows:-

Sl. No.	Name of tax payer	OP/OC (in%)
1.	CG-VAK Software & Exports Ltd.	20.54%
2.	ICRA Techno Analytics Limited	17.10%
3.	Larsen & Toubro Infotech Limited	26.06%
4.	Mindtree Limited (Seg.)	18.19%
5.	Persistent Systems Limited (Seg.)	28.27%
6.	R S Software (India) Limited	17.41%
7	Tech Mahindra Limited (Seg.)	18.72%
	Average	20.90%

SWD

Arm's Length Mean Margin on cost	20.90%
Less : Working capital adjustment (As per Annexure A)	-3.02%
Adjusted Margin	23.91%
Operating cost	47,28,45,313
Arm's Length Price (ALP)	58,59,23,619
123.91% of operating cost	
Price received	56,38,80,111
Variation in price	2,20,43,508
3% of price received	1,69,16,403
Shortfall being adjustment	2,20,43,508

5. Aggrieved by the TP adjustment of Rs.2,20,43,506, the assessee preferred an appeal to the first appellate authority. The CIT(A) partly allowed the appeal of the assessee. The CIT(A) accepted the assessee's contention for exclusion of two companies from the comparable list and also with regard to the negative working capital adjustment.

6. Aggrieved by the order of the CIT(A), the assessee has filed this appeal before the Tribunal. The limited submission of the assessee is to exclude two companies from the list of comparables, namely, Larsen & Toubro Infotech Limited and Persistent Systems Limited on application of turnover filter (Grounds 9 to 11). The learned AR submitted that the turnover of the assessee is only Rs.56.38 crore whereas the turnover of L&T Infotech Limited is Rs.3609.32 crore and Persistent Systems Limited is Rs.965.75 crore. The learned AR relied on the following orders of the Bangalore Bench of the Tribunal for exclusion of the above companies on account of application of upper turnover filter:-

- (i) Autodesk India Pvt. Ltd. (2018) 96 taxmann.com 263 (Bangalore)
- (ii) IGEFI Software India Pvt. Ltd. v. ACIT [IT(TP)A No.2614/Bang/2017 (order dated 04.09.2019)]

7. The learned Departmental Representative, on the other hand, supported the orders of the TPO / CIT(A).

8. We have heard rival submissions and perused the material on record. The AO / TPO had excluded companies

having turnover of less than Rs.1 crore, however, the AO / TPO has not put upper limit to turnover for exclusion of companies having high turnover. The company having very high turnover cannot be compared to the company like the assessee, whose turnover is only Rs.56.38 crore. This proposition has been accepted by the Hon'ble Bombay High Court in the case of CIT v. Pentair Water Private Limited in ITA No.18/2018 (judgment dated 16.09.2015). The recent orders of the Bangalore Bench of the Tribunal in the case of M/s.Zynga Game Network India Private Limited v. DCIT in ITA No.2573/Bang/2018 (order dated 23.03.2021) and Pearson India Support Services Private Limited v. DCIT in ITA No.3171/Bang/2018 (order dated 28.06.2019) had followed the judgement of the Hon'ble Bombay High Court in the case of CIT v. Pentair Water Private Limited (supra) and directed the AO / TPO to exclude from the list of comparables, the companies having turnover of more than Rs.200 crore. The relevant finding of the ITAT in the case of Zynga Game Network India Private Limited v. DCIT (supra), reads as follows:-

“38. We note that Ld.AO/TPO has applied filter of more than Rs.1 crore, but did not put an upper limit to the filter. This Tribunal in case of Genesis Integrating Systems India Pvt Ltd vs DCIT reported in (2012) 53 SOT 159 and various other decisions have held that, companies having turnover in excess of Rs.200 crores cannot be compared with companies having turnover less than Rs.200 crore. This proposition has been accepted by Hon'ble Bombay High Court in case of CIT vs Pentair Water Pvt.Ltd., by order dated 16/09/2015 in ITA No. 18/2015. Hon'ble Court upheld rejection of companies having turnover holding that turnover is a relevant factor in considering comparability of companies.

39. Objection raised by Ld.CIT.DR has been dealt with by this Tribunal in case of Autodesk India Pvt.Ltd. vs DCIT in (2018) 96 taxmann.com 263 for assessment year 2005-06. This Tribunal reviewed gamut of case laws to consider, whether companies having turnover more than Rs.200 crores

should be regarded as comparable with a company having turnover less than 200 crore. This Tribunal held as under:

“17.7 We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt. Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a nonjurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of Pentair Water India (P.) Ltd. (supra) has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5 companies from the list of comparable companies chosen by the TPO on the basis that the 5 companies turnover was much higher compared to that the Assessee.

17.8 In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capegemini India (P.) Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time.

Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra).”

40. Ld.AR submitted that though this decision was rendered with reference to AY 2005-06 and 2006-07, same reasoning would apply to AY 2015-16 also and in this regard. Based upon above discussions and the decision relied by Ld.AR herein above. We are of opinion that objection raised by revenue cannot withstand the test of law.

Accordingly we direct Ld. AO/TPO to exclude Tata Elxi Ltd (Seg.), Mindtree Ltd., Larsen and Toubro Infotech Ltd., RS Software (India) Ltd., Persistent Systems Ltd., Nihilent Technologies Ltd., Infosys Ltd., Cybage software Pvt.Ltd. for having high turnover as compared to a captive service provider like assessee.”

8.1 As mentioned earlier, the turnover of the assessee is Rs.56.38 crore whereas the turnover of L&T Infotech Limited is Rs.3609.32 crore and the turnover of Persistent Systems Limited is Rs.965.75 crore. Therefore, in view of the aforesaid reasoning, we direct the AO / TPO to exclude L&T Infotech Limited and Persistent Systems Limited from the list of comparables.

8.2 In the result, ground No.11 is partly allowed.

IT(TP)A No.331/Bang/2018 (Revenue's appeal)

9. Two issues are raised in this appeal, namely exclusion of two companies, i.e., (i) ICRA Techno Analytics, (ii) Tech

Mahindra Limited, and Negative Working Capital Adjustment.
We shall adjudicate the above issues as under:

Tech Mahindra Limited

10. The above company has been excluded by the CIT(A) after detailed analysis of the annual report. The relevant observation of the CIT(A) reads as follows:-

“9.1 Tech Mahindra Limited : The appellant has made detailed submission to support its ground of appeal that this company should not be considered as a comparable in its case for determination of ALP. The argument of the appellant are in substance same as made before the TPO. The submissions of the appellant have duly been considered. The main argument of the appellant is that the company is functionally different as it is operating in multiple segments and segmental details are not available. The issue has been discussed by the TPO on pages 18 and 19 of his order. The TPO has used consolidated segmental data of the group to work out the profit margins of this company as no segmental details were available in the unconsolidated report. On perusal of the segmental details in the consolidated report, it is observed that the segmental details are not strictly as per the functionality i.e. software development, ITES etc but it indicates three segments viz., Telecom Service Provider, Telecom Equipment Manufacturer and Business Process Outsourcing. Nowhere in the report is it indicated that services provider in relation to first two segments fall only in the category of Software Development and not any other services. Strangely, while selecting Tech Mahindra as a comparable, the TPO has discussed the functionality of only this company and not the group as a whole, the filters have been applied on the unconsolidated results of this company rather than group as a whole, but while working out the profit margin, the TPO has chosen the segmental of the group, without showing how all the filters applied by it are satisfied for the group as whole. Anyhow, as discussed above, since for this group there is not any material available in the annual report or information got by TPO under section 133(6) that the same relate to the software development alone, this company cannot be considered as a proper comparable. So the ground of appeal of the appellant in relation to this company is allowed and the TPO / AO should exclude this company from the list of comparables.”

11. The above discussion of the CIT(A) clearly explains that Tech Mahindra Limited is functionally dissimilar to that of the assessee. Tech Mahindra Limited has got multiple segments and on perusal of the segmental details in the consolidated report, it can be seen that the said company is strictly not into software development services, ITES etc. Moreover Tech Mahindra Limited is having turnover far exceeding Rs.200 crore. Therefore, this company gets excluded by application of upper turnover limit also. Hence, we see no reason to interfere with the order of the CIT(A) in excluding the above company from the list of comparables. It is ordered accordingly.

ICRA Techno Analytics

12. The CIT(A) has excluded this company by holding that it is functionally not similar after detailed analysis of the annual report. The relevant finding of the CIT(A) in this regard reads as follow:-

“9.1 ICRA Techno Analytics: The appellant has argued against inclusion of ICRA Techno Analytics.Ltd in the list of comparables by the TPO. The appellant has made detailed submissions to support Its ground of appeal that this company should not be considered as a comparable in its case for determination of ALP. The submission of the appellant is that the said company is functionally different as it is engaged in software development & consultancy, engineering services, web development & hosting as well as business analytics and business process outsourcing but segmental data is not available. the appellant has also submitted that the company falls the RPT filter of 25% as applied by the TPO. The submissions of the appellant have duly been considered. From the annual report of the company it is observed that the functional profile of the company has under gone a change w.e.f.FY 2011-12 due to certain mergers in the year. As per annual report of the year under consideration (page 22 of annual Report, Background- Significant Accounting Policies)

the company it is observed in software development and consultancy, engineering services web development and hoisting services, business analytics and business process outsourcing As per Revenue recognition (page 22 of annual report) tile revenue from services consists of revenue earned from services performed for software development & consultancy, licensing and sub-licensing Fee; annual maintenance charges for software support, web development and hosting; revenue from sales is recognized as and when delivery of the branded software is made-and is booked net of trade discount. Thus the company is operating in Software development (IT) segment as well as IT-Enabled Services segment In fact, during financial year 2011-12, there was a merger of an ITES company into this company, however no separate income from ITES segment is being. shown in the segmental data although the annual report states otherwise. So claim of the appellant that the company is not functionally similar to it for Software Development segment is found to be correct. Considering above this company should have been excluded by the TPO from the list of comparables as no/ segmental details were available. The AO/TPO is therefore directed to remove this company from the list of comparables. Considering above, this ground of the appeal of the appellant is allowed.”

13. The annual report of ICRA Techno Analytics is placed in paper book (refer page 1 to 146 of the paper book). On perusal of the same, it is clear that the CIT(A) is justified in excluding the company from the final list of comparables on account of functional dissimilarity. The said company is engaged in multifarious activities such as web development and engineering services etc. and the segmental details of the company is not available. Therefore, we hold that the CIT(A) is justified in excluding the above company from the list of comparables.

Negative Working Capital

14. The CIT(A) has given a finding that the assessee is captive service provider and is operating on cost plus basis.

Since the entire revenue of assessee was from its AE's, the CIT(A) held that negative working capital adjustment is not appropriate by relying on the order of the Bangalore Bench of the Tribunal in the case of Lam Research India Pvt. Ltd. v. DCIT in IT(TP)A No.1437 & 1385/Bang/2014 (order dated 30.04.2015). The relevant observation of the CIT(A) reads as follows:-

“11.1 In relation to working capital adjustment, it is observed that the appellant is a captive service provider in the Software Development Segment. It is operating on cost plus basis and the entire revenue in this segment is from AE. So the decision of Bangalore Bench of ITAT in the case of Lam Research India Private Limited (supra) is squarely applicable to its case. This ground of appeal of the appellant is allowed.”

15. Revenue being aggrieved, has raised this issue before the Tribunal. The learned DR had submitted that the financials of the assessee had mentioned borrowing during the year and therefore no working capital adjustment should be allowed. In this context, the learned DR referred to the order of the Tribunal in the case of ACIT vs. e4e Business Solutions India Pvt. Ltd. in IT(TPA) No.2900/Bang/2018 (order dated 08.12.2020). The learned AR, on the other hand, submitted that the assessee does not have any borrowing / loan for working capital and is a captive service provider providing software development services only to its AEs. It was submitted that the long term borrowings of Rs.99,74,434 that is mentioned in the notes of the financial statement is to secure hypothecation of vehicles acquired on financial lease.

16. We have heard rival submissions and perused the material on record. The CIT(A) has given a categorical finding that the assessee is a captive service provider and is operating on cost plus basis. It was held by the CIT(A) that since the entire revenue of the assessee was from its AEs, negative working capital is not appropriate by relying on the Co-ordinate Bench order of the Tribunal in the case of Lam Research India Pvt. Ltd. (supra). In the notes to financial statement under the head long term borrowing an amount of Rs.99,74,436 is mentioned. This amount is secured against hypothecation of vehicles on financial lease. In the financials an amount of Rs.16,43,002 has been mentioned under the heading interest expenses. This interest is against the amount taken for financial lease as mentioned earlier. Therefore, the assessee does not have borrowings / loans for working capital and is purely a captive service provider providing software development services only to its AEs. Therefore, in such circumstances, there is no working capital risk since the assessee is working on a cost plus model. The co-ordinate Bench of the Tribunal in the case of e4e Business Solutions India Private Limited (supra) had in detailed discussed the entire concept of negative working capital adjustment and why it should not be made. The said order of the Tribunal has also discussed in detail, the case of Technotree Convergence relied on by the learned DR (para 9 of e4e Business Solutions India Private Limited). Since the assessee in this case does not have working capital loans / borrowings and entails no working capital risks, the ratio decidendi in the case of e4e

Business Solutions India Private Limited (supra) directly applies to the assessee and no working capital adjustment should be made. Therefore, the CIT(A)'s conclusion that no negative working capital adjustment is to be made by placing reliance on the order of the Bangalore Bench of the Tribunal in the case of Lam Research India Private Limited (supra) is correct and no interference is called for. It is ordered accordingly.

17. In the result, the appeal filed by the assessee is partly allowed and the appeal filed by the Revenue is dismissed.

Order pronounced on this 16th day of November, 2021.

Sd/-
(B.R.Baskaran)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 16th November, 2021.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT(A)-2, Bengaluru.
4. The Pr.CIT-3, Bengaluru.
5. The DR, ITAT, Bengaluru.
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Asst.Registrar/ITAT, Bangalore