

**IN THE INCOME TAX APPELLATE TRIBUNAL  
BANGALORE BENCHES “B”, BANGALORE**

**Before Shri Chandra Poojari, AM & Shri George George K, JM**

IT(TP)A No.34/Bang/2020 : Asst.Year 2010-2011

M/s.ESI Software (India) Pvt.Ltd. 24-25, 27 <sup>th</sup> Cross, Banashankari 2 <sup>nd</sup> State, Bangalore – 560 070. <b>PAN : AABCE2943C.</b>	v.	The Income Tax Officer Ward 11(1) Bengaluru.
(Appellant)		(Respondent)

Appellant by : Smt.Tanmayee Rajkumar, Advocate  
Respondent by : Smt.Priyadarshini Besaganni, JCIT-DR

<b>Date of Hearing : 24.11.2021</b>	<b>Date of Pronouncement : 25.11.2021</b>
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**ORDER**

**Per George George K, JM**

This appeal at the instance of the assessee is directed against CIT(A)'s order dated 10.10.2019. The relevant assessment year is 2010-2011.

2. The assessee has raised several grounds and sub-grounds. However, during the course of hearing, the learned AR had only pressed grounds 4.5 and 4.12. The grounds 4.5 and 4.12 read as follows:-

*“4.5 Computation of mark-up without considering the excess depreciation of earlier years amounting Rs.20,55,416 that was reversed during F.Y. 2009-2010.*

*4.12 Including the following companies even though they fail the test of comparability:*

- (a) ICRA Techno Analytics Limited*
- (b) Infosys Limited*
- (c) Kals Information Systems Limited*
- (d) Persistent Systems Limited*
- (e) Tata Elxsi Limited.”*

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

The assessee is a company engaged in rendering software development services (SWD) to its Associate Enterprises (AEs). The assessee is a captive service provider and is compensated on cost plus mark-up basis. For the relevant assessment year, the return of income was filed declaring income of Rs.6,370 after claiming deduction u/s 10A of the I.T.Act amounting to Rs.3,22,90,336. The assessment was selected for scrutiny by issuing notice u/s 143(2) of the I.T.Act. During the course of assessment proceedings, the case was referred to the Transfer Pricing Officer (TPO) to determine Arm's Length Price (ALP) of the international transactions entered by the assessee with its AEs. The TPO passed order u/s 92CA of the I.T.Act on 30.01.2014 making TP adjustment of Rs.1,72,20,521 in respect of SWD segments. The operating profit to operating cost of the assessee in the TP analysis was determined at 13.28%, which was re-worked to 11.82% in the TPO's order. The assessee by adopting various filters and Transaction Net Margin Method (TNMM), arrived at 16 comparables with arithmetical mean of 13%. Accordingly, the assessee sought to justify the ALP of the SWD segments since the assessee's margin was higher than that of the comparables.

4. The TPO, however, rejected the TP study of the assessee. The TPO adopted TNMM and by applying various filters, arrived at 11 companies as comparables at arithmetical mean of 22.71%. The TPO after providing for the working capital adjustment of 0.13%, arrived at arithmetical mean of 22.58%

for the comparables and made TP adjustment of Rs.1,72,20,521 in the SWD segment. The details of the comparables selected by the TPO, the arithmetical mean, computation of ALP and TP adjustment made by the TPO are detailed in two tables given below:-

Comparables selected by TPO and their arithmetic mean:

Sl. No.	Comparables selected by TPO	Mark-up on total costs (Unadj)	Mark-up on total costs (Adj)
1.	ICRA Techno Analytics Ltd.	24.94	26.05
2.	Infosys Limited	44.98	46.15
3.	Kals Information Systems Ltd.	34.41	31.82
4.	Larsen & Toubro Infotech Ltd.	19.33	20.80
5.	Mindtree Limited	14.83	14.09
6.	Persistent Systems & Solutions Ltd.	15.38	16.51
7.	Persistent Systems Limited	30.35	29.47
8.	RS Software (India) Limited	10.29	11.81
9.	Sasken Communication Technologies Ltd.	17.36	17.78
10	Tata Elxsi Limited	20.93	18.56
11	Thinksoft Global Services Limited	17.05	15.32
	Arithmetic Mean	22.71%	22.58%

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

Arm's length mean margin	22.71%
Less : WC adjustment (restricted to 1.98%)	0.13%
Adjusted margin	22.58%
Operating cost	Rs.16,00,57,352
Arm's length price : 122.58% of operating cost	Rs.19,61,98,302
Price Received	Rs.17,89,77,781
Shortfall being adjusted u/s 92CA	Rs.1,72,20,521

5. Aggrieved by the transfer pricing adjustment of Rs.1,72,20,521 made by the TPO in the SWD segment, the assessee preferred an appeal to the first appellate authority.

The CIT(A) rejected the contention of the assessee and upheld the order of the TPO in its entirety.

6. The assessee being aggrieved by the order of the CIT(A) has filed this appeal before the Tribunal.

We shall adjudicate the grounds argued before us as under:

**Ground 4.1**

7. By this ground, the assessee is challenging the action of the TPO in computing the operating profit margin of the assessee without reducing the excess depreciation of the earlier year, which was reversed during the relevant assessment year amounting to Rs.20,55,416. The learned AR submitted that during the relevant assessment, the assessee reversed excess depreciation of the previous year amounting to Rs.20,55,416. It was stated that the excess depreciation reversed during the year under consideration is no longer an expenditure and therefore, cannot form part of the operating base. It was submitted that the TPO has erred in taking the same into consideration while computing the operating margin of the assessee.

7.1 The learned Departmental Representative was duly heard.

7.2 We have heard rival submissions and perused the material on record. The assessee had contended before the TPO and the CIT(A) that the operating profit on total cost was erroneously computed at 11.8% without considering the

excess depreciation of the earlier years that was reversed during the relevant assessment year, which amounted to Rs.20,55,416. The submission of the assessee in this regard before the TPO is placed at page 257 of the paper book. The submission of the assessee before the CIT(A) is at page 108 of the paper book submitted by the assessee. On perusal of the TPO's order and the CIT(A)'s order, we find that there is no discussion on the objections raised by the assessee. The assessee had computed the margin in the TP study as under:-

Particulars	Amount (Rs.)
Operating Income	17,89,77,781
Operating expenses	
Operating and other expenses	15,13,09,622
Depreciation	66,92,314
Total Operating cost	15,80,01,936
Operating profit	2,09,75,845
Add : Other income	6,370
Less : Exchange Loss	44,41,781
Profit before tax	1,65,40,434
OP/TC	13.27%

7.3 As rightly pointed out by the assessee that the excess depreciation form part of the cost base for computing mark-up in the previous year. Accordingly, the said excess depreciation once its reversed in the current assessment year cannot form part of the operating base. Since the issue raised by the assessee was not adjudicated by the TPO nor the CIT(A), we deem it appropriate to restore the matter to the AO / TPO. The AO / TPO is directed to verify whether the assessee has reversed in the current assessment year the excess depreciation claimed in the past years. If it is found that there is reversal of excess depreciation in the current assessment year to the extent of Rs.20,55,416, the same

cannot form part of the operating cost base. Therefore, the AO / TPO is directed to re-work the operating profit on the total cost keeping in view the above observations of us. It is ordered accordingly.

7.4 In the result, ground 4.5 is allowed for statistical purposes.

#### **Ground 4.12**

8. By this ground, the assessee is seeking to exclude the following five companies from the list of comparables.

- (i) ICRA Techno Analytics Limited
- (ii) Infosys Limited
- (iii) Kals Information Systems Limited
- (iv) Persistent Systems Limited
- (v) Tata Elxsi Limited

8.1 Each of above companies whether it is functionally comparable to assessee or not, we shall adjudicate as under.

#### **ICRA Techno Analytics Limited**

9. The assessee challenged the inclusion of above company before the CIT(A). The CIT(A) upheld the TPO's order.

9.1 Aggrieved, the learned AR submitted before the Tribunal that ICRA Techno Analytics Limited is functionally dissimilar as it is engaged in rendering diverse services. It was further stated that the said company lacks segmental information and the TPO has erroneously computed the margin of the company. The learned AR, therefore, prayed for exclusion of

ICRA Techno Analytics Limited from the list of comparable companies.

9.2 The learned DR was duly heard.

9.3 We have heard rival submissions and perused the material on record. We find that ICRA Techno Analytics Limited is engaged in a diverse range of IT solution service. Further, this company is not a full-fledged software development company. It provides such services like IT solution services like business analytics, IT engineering and business process outsourcing. We find that the services segment considered by the TPO contains revenues from all other business activities of the company such as engineering services, web development and hosting, business analytics and BPO services performed by ICRA Techno Analytics Limited and is not confined to SWD services. Hence, this company cannot be compared with the assessee. The Bangalore Bench of the Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. reported in [(2016) 70 taxmann.com 299 (Bang-Trib.)] on identical facts has excluded ICRA Techno Analytics Limited from the list of comparables. The relevant finding of the Tribunal reads as follow:-

*"14. At the outset, we note that apart from having the related party revenue at 20.94% of the total revenue, this company was also found to be functionally not comparable with software development services segment of the assessee. The DRP has given its finding at pages 13 to 14 as under:-*

*"Having heard the contention, on perusal of the annual report, it is noticed. by us that the segmental information is available for two segments i.e., services and sales. However, it is evident from the annual report that the service segment comprises of software development, software consultancy, engineering services, web development, web hosting, etc. for which no segmental information is available and therefore, the objection of the*

assessee is found acceptable. Accordingly, Assessing Officer is directed to exclude the above company from the comparables."

*15. We find that the facts recorded by the DRP in respect of business activity of this company are not in dispute. Therefore, when this company is engaged in diversified activities of software development and consultancy, engineering services, web development & hosting and substantially diversified itself into domain of business analysis and business process outsourcing, then the same cannot be regarded as functionally comparable with that of the assessee who is rendering software development services to its*

*16. In view of the above facts, we do not find any error or illegality in the findings of the DRP that this company is functionally not comparable with that of a pure software development service provider."*

9.4 In view of the foregoing reasons and also respectfully following order of the Co-ordinate Bench of the Bangalore Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra) (The profile of the assessee in case of Electronics for Imaging India Pvt. Ltd. and in this case is identical, so as the A.Y., namely A.Y. 2010-2011), we direct the AO / TPO to exclude ICRA Techno Analytics Limited from the final list of comparable companies. It is ordered accordingly.

### **Infosys Limited**

10. The assessee had challenged the inclusion of the above company in the comparable list before the CIT(A). The CIT(A) upheld the inclusion of Infosys Limited in the comparable list.

10.1 The learned AR submitted before the Tribunal that Infosys Limited has huge scale of operating and ownership of significant intangibles and brand profits. Further, it was submitted that the said company has product development, sales & marketing expenses and significant R&D expenses. Accordingly, the learned AR submitted that Infosys Limited cannot be compared with the assessee-company, and thus,

prayed for exclusion of this company from the list of comparables.

10.2 After hearing both the parties and perusing the material on record, we find that Infosys Limited has high brand value and focuses on brand building which occasions the high profits. Further, this company incurs sales and marketing expenses amounting to 4.6% of its sales and it focuses heavily on R&D having its own applied research division. Additionally, the turnover of this company for the year ended 31<sup>st</sup> March, 2010 was Rs.21,140 crore which is far higher than the turnover of the assessee. We also find that Infosys Limited is a giant in the software development space and owns products and leverages on its premium banking solution Finacle as evident from its annual report placed on record. Thus, Infosys Limited cannot be compared with the assessee-company and we direct exclusion of this company from the list of comparables. On similar circumstances, the Bangalore Bench of the Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra) excluded Infosys Limited from the final list of comparables. The relevant finding of the Tribunal reads as follow:-

*“17. The assessee objected against the selection of this company on the ground that this company has a big name and brand value and therefore it has a bargaining power. It also contended that the turnover of this company is Rs. 21,140 crores, which is 442 times higher than the assessee.*

*18. The DRP accepted the objections of the assessee and by following the decision of the Delhi Benches of the Tribunal in the case of Agnity India Technologies (P.) Ltd.v. ITO [2015] 58 taxmann.com 167/154 ITD 293 (Delhi - Trib.), directed the TPO to exclude this company from the list of comparables.*

*19. We have heard the ld. DR as well as ld. AR and considered the relevant material on record. We note that in the case of Agnity India Technologies (P.) Ltd. (supra), the Delhi Bench of the Tribunal has considered the comparability of this company and the findings of the Delhi Bench of the Tribunal has been confirmed by the*

*Hon'ble Delhi High Court. The Hon'ble Delhi High Court has observed that this company having brand value as well as intangible assets cannot be compared with an ordinary entity provide captive service. We further note that this company provides end to end business solutions that leverage cutting edge technology thereby enabling clients to enhance business performance. This company also provides solutions that span the entire software lifecycle encompassing technical consulting, design, development, re-engineering, maintenance, systems integration, package evaluation and implementation, testing and infrastructure management service. In addition, the company offers software product for banking industry. Thus, this company is engaged in diversified services including design as well as technical consultancy, consulting, re-engineering, maintenance, systems integration as well as products for banking industry.*

*20. In view of the above facts that Tnfosys Ltd. having a huge brand value and intangibles as well as having bargaining power, the same cannot be compared with the assessee who is providing services to its AE.”*

10.3 For the aforesaid reasoning, we direct the AO / TPO to exclude Infosys Limited from the final list of comparable companies. It is ordered accordingly.

### **KALS Information Systems Limited**

11. The above company was selected by the TPO and was challenged by the assessee before the CIT(A). The CIT(A) upheld the inclusion of the company.

11.1 The learned AR submitted before the Tribunal that KALS Information Systems Limited is functionally different from the assessee-company, as the said company is engaged in development of products and provision of related services and also it is having significant inventory.

11.2 The learned DR supported the orders of the Income Tax Authorities.

11.3 We have heard rival submissions and perused the material on record. We find that KALS Information Systems Limited is engaged in the development of software products

and providing related services. It also provides implementation and maintenance of software products. Further, this company has developed a range of products such as Shine ERP software, docuflow, Dac4Cast, CMSS, La Vision, Virtual Insure and Aldon. Further, KALS Information Systems Limited holds significant inventories which account for 27% of the total current assets which demonstrates that it is a product development company. Therefore, due to the functional dissimilarity between KALS Information Systems Limited and the assessee-company, KALS Information Systems Limited cannot be compared to the assessee-company. The Bangalore Bench of the Tribunal in the case of DCIT v. Electronics for Imaging India P. Ltd. (supra), on similar circumstances, excluded KALS Information Systems Limited from the comparable companies. The relevant finding of the Tribunal reads as follows:-

*“21. The assessee raised objections against this company on the ground that this company is engaged in the development of software and software products. Further, this company consists of STPI unit and also having a training centre engaged in training of software professionals on online products. Thus, when this company is having revenue from software services as well as software product, the same cannot be considered as comparable with software development service providing company.*

*22. The DRP has directed the AO to exclude this company from the list of comparables by taking note of the fact that there were inventories in the books of accounts of this company which shows that this company is in the software product business. Further, by following the decision of this Tribunal in the case of Trilogly E-Business Software India (P.) Lid. v. Dy.CIT 120 13) 140 ITD 540/29 taxmann.com 310 (Bang. - Trib.), this company was found to be not comparable with that of the assessee.*

*23. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. The Id. DR has not disputed the fact that comparability of this company has been examined by this Tribunal in a series of decisions including in the case of Trilogly e-business Software India (P.) Lid. (supra). We further note that in the balance sheet of this company as on 31.3.2010, there are inventories of Rs.60,47,977. Therefore, when this company is in the business of software products, the same cannot be compared with a pure software development services provider. Accordingly, we do not find any error or illegality in the impugned findings of the DRP.”*

11.4 Therefore, by relying on the order of the Coordinate Bench order of the Tribunal, cited supra, we direct the AO / TPO to exclude KALS Information Systems Limited from the list of comparables. It is ordered accordingly.

### **Persistent Systems Limited**

12. The assessee challenged the inclusion of the above company in the list of comparables before the CIT(A). The CIT(A), however, rejected the prayer of the assessee.

12.1 The learned AR before the Tribunal submitted that Persistent Systems Limited is functionally dissimilar to that of the assessee, because this company is engaged in product development and lacks segmental details. Therefore, it was submitted that Persistent Systems Limited may be excluded from the list of comparables.

12.2 The learned DR supported the orders of the Income Tax Authorities.

12.3 We have heard rival submissions and perused the material on record. We find that Persistent Systems Limited is engaged in rendering outsourced product development as against software development services. Further, as per the annual report of Persistent Systems Limited, the income is shown as sale of software services and products and no break-up is available between sale of software services and sale of products. We also noticed that in any event during F.Y. 2009-2010, the said company acquired assets in Paxonic Inc and has been involved in merger / demerger activities and on

account of this peculiar economic circumstance too, the said company cannot be considered as a comparable company. On identical situation, the Bangalore Bench of the Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra) has excluded Persistent Systems Limited from the list of comparables. The relevant finding of the Tribunal reads as follows:-

*“24. We have heard the ld. DR as well as ld. AR and considered the relevant material on record. The assessee raised objections against selection of this company on the ground that this company is functionally not comparable as engaged in the product development. The segmental information for services and product is not available. Further, the assessee has also pointed out that there was an acquisition and restructuring during the year under consideration.*

*25. The DRP has noted the fact that this company has reported the entire receipt from sales and software services and product. Therefore, no segmental information was found to be available for sale of software services and product. Further, the DRP has noted that as per Note I of Schedule 15, this company is predominantly engaged in outsource software development service. Apart from the revenue from software services, it also earns income from licence of products, royalty on sale of products, income from maintenance contract, etc. These facts recorded by the DRP has not been disputed before us.*

*26. Therefore, when this company is engaged in diversified activities and earning revenue from various activities including licencing of products, royalty on sale of products as well as income from maintenance contract, etc., the same cannot be considered as functionally comparable with the assessee. Further, this company also earns income from outsource product development. In the absence of any segmental data of this company, we do not find any error or illegality in the findings of the DRP that this company cannot be compared with the assessee and the same is directed to be excluded from the set of comparables.”*

12.4 In view of the foregoing reasons and by following the order of the Co-ordinate Bench of the Tribunal (supra), we direct the AO / TPO to exclude Persistent Systems Limited from the final list of comparable companies.

### **Tata Elxsi Limited**

13. The learned AR submitted before the TPO that Tata Elxsi Limited is functionally dissimilar to that of the assessee as the said company is having niche products and services,

engaged in R&D activities and it is having incorrect margin computation. The TPO, however, rejected the contention of the assessee and included Tata Elxsi Limited in the list of comparables. The CIT(A) upheld the inclusion of Tata Elxsi Limited in the list of comparables.

13.1 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR reiterated the submission that Tata Elxsi Limited is functionally not comparable to the assessee. In this context, the learned AR relied on the Bangalore Bench orders in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra).

13.2 The learned DR supported the orders of the Income Tax Authorities.

13.3 We have heard rival submissions and perused the material on record. Tata Elxsi Limited provides niche services which are not comparable to the low-end software development services rendered by the assessee. Further, Tata Elxsi Limited invested heavily in R&D activities and has expenses amounting to nearly 3% of its sales which demonstrates that the company is engaged in innovation of products and services such as animation, content creation for advertisements as well as hardware related activities such as network management, engineering services capabilities for broadcast technology players, products for wireless communication etc. On identical situation, the Co-ordinate Bench of the Bangalore Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra), excluded Tata

Elxsi Limited from the final list of comparables. The relevant finding of the Tribunal reads as follows:-

*30. The assessee has raised objections against this company on the ground that the company is functionally different from the assessee. Though the TPO has considered the software development and services segment of this company as comparable to that of assessee, however, the assessee contended that even within the software segment, this company is engaged in diverse activities. The assessee placed reliance on the information in the annual report under the Directors Report and submitted before the DRP that even under the software development services segment, this company is engaged in various diversified activities including product design service, innovation design, engineering service, visual computing labs, etc. The assessee also placed reliance on the decision of Mumbai Bench of the Tribunal in the case of Telcordia Technologies India (P.) Ltd. v. Asstt. eIT [2012] 137 ITD 1122 taxmann.com 96.*

*31. The DRP found that this company is not functionally comparable with assessee company as it is engaged in diversified activities even in the software development services. The DRP has followed the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India (P.) Ltd. (supra).*

*32. We have heard the ld. DR as well as ld. AR and considered the relevant material on record. We find that this company even in the software development segment is engaged in diversified activities of product design services, innovation design, engineering services, visual computing labs, etc. We further note that in the case of Telcordia Technologies India (P.) Ltd. (supra), the Mumbai Bench of the Tribunal vide its order dated 11.5.2012 in para 9.7 has held as under:-*

*"7.7 From the facts and material on record and submissions made by the learned AR, it is seen that the Tata Elxsi is engaged in development of niche product and development services which is entirely different from the assessee company. We agree with the contention of the learned AR that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable parties."*

*33. No contrary view has been brought to our notice regarding comparability of this company with that of a pure software development service provider. Accordingly, in view of the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India (P.) Ltd. (supra), we do not find any reason to interfere with the finding of the DRP."*

13.4 For the aforesaid reasons, and respectfully following the order of the Tribunal in the case of DCIT v. Electronics for Imaging India Pvt. Ltd. (supra), we direct the

AO / TPO to exclude Tata Elxsi Limited from the final list of comparable companies. It is ordered accordingly.

13.5 Therefore, ground 4.12 is allowed.

14. Consequent to our direction to exclude the five companies, the remaining comparables will be as follows:-

Sl. No.	Comparables
1.	Larsen & Toubro Infotech Limited
2.	Mindtree Limited
3.	Persistent Systems & Solutions Limited
4.	R S Software (India) Limited
5.	Sasken Communication Technologies
6.	Thinksoft Global Services Private Limited

The A.O. is directed to recomputed the arithmetical mean of the margin of the above comparables and re-determine the ALP of the international transactions the assessee undertook with its AEs in respect of SWD segments. It is ordered accordingly.

15. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on this 25<sup>th</sup> day of November, 2021.

**Sd/-**  
**(Chandra Poojari)**  
**ACCOUNTANT MEMBER**

**Sd/-**  
**(George George K)**  
**JUDICIAL MEMBER**

Bangalore; Dated : 25<sup>th</sup> November, 2021.  
Devadas G\*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT(A)-2, Bengaluru.
4. The Pr.CIT-2, Bengaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore