

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

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

IT(TP)A No.666/Bang/2016
Assessment Year : 2011-12

M/s. Tektronix (India) Pvt. Ltd. (formerly known as Tektronix Engineering Development (India) Pvt. Ltd.) Survey No.16, Salarpuria Premia Kadubeesana Halli Varthur Hobli, Sarjapur, Outer Ring Road Bangalore 560 103 PAN NO : AAAC7289F	Vs.	Deputy Commissioner of Income-tax Circle-7(1)(1) Bangalore
APPELLANT		RESPONDENT

Appellant by	:	Shri Sharath Rao, A.R.
Respondent by	:	Dr. Manjunath Karkihalli, D.R.

Date of Hearing	:	21.10.2021
Date of Pronouncement	:	29.11.2021

ORDER

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed this appeal challenging the assessment order dated 27-01-2016 passed by the assessing officer for AY 2011-12 u/s 143(3) r.w.s 144C(13) of the Income-tax Act,1961 [‘the Act’ for short] in pursuance of directions given by Ld Dispute Resolution Panel (DRP).

2. The assessee has raised many grounds and additional grounds. The assessee has filed "revised concise grounds of appeal". We were requested to refer to the above said revised concise grounds and additional grounds. At the time of hearing, the Ld AR pressed grounds relating to the following issues only out of the above said grounds:-

- (a) Addition relating to transfer pricing adjustment
- (b) Addition on account of carried forward balance of accrued expenses
- (c) Disallowance of miscellaneous expenses
- (d) Addition on account of reimbursement of expenses
- (e) Addition made u/s 14A of the Act
- (f) Depreciation on capitalised amount of customs duty
- (g) Deduction of education cess claimed

3. The first issue relates to the Transfer pricing adjustment made. The assessee is engaged in the business of rendering Software Development Services to its Associated Enterprises. During the year under consideration it reported turnover of Rs.36.80 crores and Operating profit to Operating cost rate of 15.82%. Rejecting the TP Study of the assessee, the TPO selected following 13 comparable companies. The average margin of these companies 24.82%.

Sl. No.	Name	Sales	Cost	PLI
1	Acropetal Technologies Ltd. (seg)	81,40,16,893	61,67,54,876	31.98%
2	e-zest solutions (from Capitaline)	11,28,66,098	9,32,55,341	21.03%
3	E-Infochips Ltd.	26,03,84,251	167,64,47,527	56.44%
4	Evoke (from Capitaline)	14,48,69,912	13,39,96,568	8.11%
5	ICRA Techno Analytics Ltd. (in 000)	15,84,01,000	12,68,94,000	24.83%
6	Infosys Ltd	25385000000	177,030,000,000	43.39%
7	Larsen & Toubro Infotech Ltd.	23318122096	19,764,861,289	19.83%

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8	Mindtree Ltd. (seg)	8,783,000,000	7,937,143,242	10.66%
9	Persistent Systems & Solutions Ltd.	189,490,457	155,172,089	22.12%
10	Persistent Systems Ltd.	6,101,270,000	4,971,860,000	22.84%
11	R S Software (India) Ltd.	1,882,638,471	1,617,804,170	16.37%
12	Sasken Communication Technologies Ltd.	3,941,962,000	3,175,616,000	24.13%
13	Tata Elxsi Ltd. (seg)	3,581,985,000	2,962,533,352	20.91%
	AVERAGE MARGIN			24.82%

The working capital adjustment came to be worked out at a negative ratio of (-) 1.31%. Accordingly, the TPO worked out adjusted negative margin at 26.13% and accordingly made Transfer pricing adjustment of Rs.3,27,40,970/-. Ld DRP also confirmed the same.

4. In respect of addition made on account of transfer pricing adjustment, the assessee is contesting on the following grounds:-

- (a) Assessee seeks exclusion of 8 comparable companies
- (b) It seeks inclusion of one comparable company.
- (c) It seeks correction of arithmetical errors
- (d) It seeks working capital adjustment on actual basis, if it is a positive one. No negative working capital adjustment should have been made.

4.1 The assessee seeks exclusion of following eight companies:-

1. Acropetal Technologies Ltd. (seg)
2. e-Zest Solutions
3. e-Info Chips Ltd.
4. ICRA Techno Analytics Ltd.
5. Infosys Ltd.
6. Persistent Systems & Solutions Ltd.
7. Persistent Systems Ltd.
8. Sasken Communication Technologies Ltd.

4.2 We notice that the co-ordinate bench has rendered its decision in the case of Maxim India Integrated Circuit Design P Ltd, Bangalore (IT(TP)A No.411/Bang/2016) in respect of following companies.

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1. Acropetal Technologies Ltd. (seg)
2. e-Zest Solutions
3. e-Info Chips Ltd.
4. ICRA Techno Analytics Ltd.
5. Persistent Systems & Solutions Ltd

The decision of the co-ordinate bench in the above said case is extracted below:-

11. The Ld D.R, however, made detailed arguments in respect of the above said four comparable companies. The Ld A.R rebutted to the contentions of Ld D.R. The rival contentions in respect of each of the four companies and the decision taken thereon are discussed below:-

(A) Acropetal Technologies Ltd:-

11.1 The Ld D.R invited our attention to page 9 of TPO's order and submitted that the assessee has sought exclusion of this company by submitting that it fails employees cost filter, i.e., its employee cost was only 11.51%. However, the TPO has noticed that this company has passed employee cost filter, since its employee cost was 49.36%. The Ld D.R submitted that the Tribunal, in the case of Commscope Networks (India) Private Ltd (supra) has followed the decision rendered by the Tribunal in the case of M/s Applied Materials India P Ltd (IT(TP)A No.17 & 39/Bang/2016 dated 21.9.2016). In the case of Applied Materials India P Ltd (supra), the Tribunal has excluded Acropetal Technologies Ltd by applying the filter that "revenue from Software development segment" was less than 75%. Adverting our attention to page 863 of the paper book, wherein the Profit and Loss account of M/s Acropetal Technologies Ltd is placed, the Ld D.R submitted that the segmental revenue details are not available. Accordingly, the Ld D.R submitted that the decision rendered in the case of Applied Materials India P Ltd should not be followed.

11.2 The Ld A.R, on the contrary, submitted that the TPO has issued a show cause notice dated 10.09.2014 to the assessee during the course of proceedings before him. He submitted that the copy of said letter is placed at pages 251 to 265 of the paper book. The Ld A.R invited our attention to page 260 of the paper book and submitted that the TPO has collected segmental details of Software Development activity from M/s Acropetal Technologies Ltd. According to the information so collected by the TPO, the turnover of Software development segment was Rs.81.40 crores, while its total turnover was Rs.140.55 crores. The Ld A.R invited our attention to page 7 of the TPO's order and submitted that the TPO has applied following filter for selecting comparable companies:-

"Companies whose Software Development Service and related services is less than 75% of the total operating revenues were excluded"

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Applying the above filter, this company is required to be excluded, since its revenue from software development services was less than 75% of the total revenue. The Ld A.R further submitted that the assessee had advanced arguments before the Tribunal in the case of Applied Materials India P Ltd (supra) both on employee filter and revenue filter. However, the Tribunal chose to exclude this company by applying revenue filter.

11.3 We heard rival contentions on this comparable company and perused the record. We notice that the co-ordinate bench has excluded this company in the case of M/s Applied Materials India P Ltd (supra) with the following observations:-

"15. The revenue is also seeking inclusion of some of the companies in the list of comparables which were reflected by the DRP. We will deal with the issues one by one as under :

(i) Acropetal Technologies Ltd.(Seg.)

16.1 The DRP rejected this company on the ground of employee cost filter. The ld. DR has submitted that the TPO has applied the employee cost filter and this company satisfies the same.

16.2 On the other hand, the learned Authorised Representative of the assessee has submitted that the total employee cost of this company is 11.51% of the total operating revenue therefore it fails the employee cost filter of 25%. Further he has pointed out that this company also fails the software development services revenue filter of 75%. He has referred the details at page Nos.39 and 53 of the Annual Report and submitted that the income from software development is Rs.81.40 Crores out of total revenue of Rs.141 Crores. Therefore this company fails this filter.

16.3 In a rejoinder the ld. DR has submitted that the TPO has considered only Information Technology transactions segment and therefore it satisfies software development services income filter as well as employee cost filter.

16.4 We have considered the rival submissions as well as the relevant material on record. As per the segmental reporting at page 53 of the Annual Report the income from Information Technology Services is Rs.81.40 Crores out of the total income of Rs.141 Crores. Therefore the revenue from Information Technology transactions services is less than 75% and consequently this company does not satisfy the filter of information technology revenue applied by the TPO itself. Accordingly, we do not find any reason to interfere with the order of the DRP for this issue."

11.4 We notice that the Tribunal chose to exclude this M/s Acropetal Technologies Ltd (seg.) applying revenue filter, even though the assessee has advanced arguments both on employee filter and revenue filter. We also notice that the TPO has considered segmental details only. Admittedly, this

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company fails on revenue filter. Accordingly, following the above said decision, we direct exclusion of M/s Acropetal Technologies Ltd.

(B) E-Zest Solutions Ltd:-

11.5 The Ld A.R submitted that this company has been excluded in the cases relied upon by him. On the contrary, the Ld D.R submitted that this company was remanded to the file of AO/TPO in the case of Applied Materials India P Ltd. He further brought to our notice certain inconsistencies in various decisions rendered by the co-ordinate benches.

11.6 We heard the parties on this comparable company. We notice that the co-ordinate benches have rendered diverse decisions as under:-

(a) In the case of Applied Materials India (P) Ltd (IT(TP)A 17 & 39/Bang/2016 dated 21.09.2016, it was remanded to the file of AO/TPO.

(b) In the case of Saxo India P Ltd (2016)(67 Taxmann.com 155), the Delhi bench of Tribunal has held that M/s E Zest Solutions Ltd is good comparable and accordingly retained the same.

(c) In the case of [Symantech Software & Services \(I\) Pvt. Ltd. v. DCIT, ITA No.614/Mds/2016](#), this company was held to be engaged in Knowledge Process Outsourcing (KPO) and cannot be regarded as a SWD services company. However, in the case of Applied Materials India P Ltd (supra), the co-ordinate bench has expressed the view that the question of BPO and KPO is relevant only in ITES segment and not for software development services segment.

(d) In the case of AMD India P Ltd vs. ACIT (IT(TP)A 1487 & 1496/Bang/2015 dated 06-04-2017), the Tribunal apparently followed the decision rendered in the case of Saxo India P Ltd (supra), but finally it excluded E Zest Solutions Ltd. We noticed earlier that the Tribunal has retained this company in the case of Saxo India P Ltd. Hence, there is an error in the order passed in the case of AMD India P Ltd (supra).

(e) In the case of Electronic Imaging India P Ltd (supra), the decision rendered in the case of AMD India P Ltd (supra) was followed.

In view of diverse of opinions expressed in various cases, we are of the view that comparability of this company requires fresh examination as held in the case of Applied Materials India (P) Ltd. Accordingly, we restore this company to the file of AO/TPO for examining it afresh.

(c) E-infochips Ltd:-

11.7 We heard the parties on this comparable company. We notice that the co-ordinate bench, in the case of M/s Commscope Networks (India) Private Ltd (supra) has excluded this company by following the decision rendered by the Delhi bench of Tribunal in the case of Saxo India P Ltd (ITA

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No.6148/Del/2015 dated 05-02-2016). In the case of Saxo India P Ltd (supra), this company was excluded with the following observations:-

"(i) E-Infochips Limited:

10.1. The Transfer Pricing Officer included this company in the list of comparables. On being called upon to explain as to why it should not be considered as a comparable, the assessee contended that there was functional dissimilarity inasmuch as this company was engaged in software development and IT enabled services and also Products. The Transfer Pricing Officer observed that the revenues of this company from Products was only 15% of total revenue and hence the same qualified to be eligible for comparison. The DRP did not allow any relief.

10.2. After considering the rival submissions and perusing the relevant material on record, we find that the Annual report of this company is available in the paper book with its Profit and loss account at page 1025. Schedule of Income indicates its operating revenue from software development, hardware maintenance, information technology, consultancy etc. Revenue from hardware maintenance stands at Rs. 3.92 crore, which has been considered by the Transfer Pricing Officer himself as sale of products. Such sale of products constitutes 15% of total revenue. There is no segmental information available as regards the revenue from sale of products and revenue from software development segment. As the assessee is simply engaged in rendering software development services and there is no sale of IT(TP)A No.411/Bang/2016 Maxim India Integrated Circuit Design Pvt. Ltd., Bangalore any software products, this company, in our considered opinion, ceases to be comparable. It is obvious that from the common pool of income from both the streams of software products and software services, one cannot deduce the revenue from software services and no one knows the impact of revenue from Products on the overall kitty of profit, which may be significant. Since no segmental data of this company is available indicating operating profit from software development services, we order to exclude this company from the list of comparables."

Following the decision rendered in the case of Saxo India P Ltd (supra), we direct exclusion of the above said comparable company.

(d) ICRA Techno Analytics Ltd:-

11.8 The Ld D.R submitted that the TPO has applied Related Party Transactions (RPT Filter) of more than 25%. In the case of Applied Materials India P Ltd (supra), the Tribunal has applied RPT filter of 15%.

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11.9 The Ld A.R invited our attention to page 879 of the paper book and submitted that this company is having Related Party Transactions to the tune of 22.38%. He further submitted that the Tribunal in the case of Applied Materials India P Ltd (supra) has excluded this company on both RPT filter and functionality difference.

11.10 We heard the parties on this issue and perused the record. We notice that the co-ordinate bench has excluded M/s ICRA Techno Analytics Ltd in the case of Applied Materials India P Ltd (supra) with the following observations:-

"(ii) ICRA Techno Analytic Ltd.

17.1 We have heard the learned D.R. as well as learned A.R. and considered the relevant material on record. The DRP has rejected this company by recording the fact as under : We examined the annual report from which it is evident that the entire revenue has been shown under service segment which indicates that the revenue from software development, consultancy, licensing and sub-licensing, annual maintenance charges for software support. WEB development and hosting has been reported in one segment, thus in absence of segmental information, we concur with the view of the DRP in preceding year and accordingly direct the Assessing Officer to exclude this company from comparables.

17.2 We further note that the Tribunal in the case of DCIT Vs. Electronics for Imaging India Pvt. Ltd. (supra) has considered the comparability of this company in paras 14 to 16 as under :

"(1) ICRA Techno Analytics Ltd. (seg)

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 IT(TP)A No.411/Bang/2016 Maxim India Integrated Circuit Design Pvt. Ltd., Bangalore 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

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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 AE.

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."

Nothing has been brought before us to show that the facts recorded by the DRP as well as by the co-ordinate bench of this Tribunal are not IT(T.P)A Nos.17 & 39/Bang/2016 correct. Accordingly, in view of the decision of the co-ordinate bench of this Tribunal in the case of DCIT Vs. Electronics for Imaging India Pvt. Ltd. (supra), we do not find any error or illegality in the order of the DRP on this issue."

11.11 We find merit in the submissions made by Ld A.R. Accordingly, following the decision rendered by the co-ordinate bench in the case of Applied Materials India P Ltd (supra), we direct exclusion of this company.

*12. With regard to the prayer of the Ld A.R for exclusion of **M/s Persistent Systems and Solutions Ltd**, the Ld D.R supported the order passed Ld DRP. On the contrary, the Ld A.R relied upon the case laws in support of his contention that this company is not a good comparable company.*

12.1 We heard the parties on this comparable company. We notice that this company has been excluded by the co-ordinate bench in the case of [DCIT vs. Electronics for Imaging India P Ltd \(IT\(TP\)A Nos. 227 & 285/Del/2013\)](#). For the sake of convenience, we extract below the observations made by the Tribunal in respect of this comparable company:-

"Persistent Systems & Solutions Ltd.

60. The assessee has the grievance against rejection of this company by the DRP. The ld. AR has submitted that assessee did not raise any objection against this company, however, the DRP has rejected the said company. Therefore, the said company should be retained in the list of comparables.

61. Having considered the rival submissions as well as relevant material on record, at the outset, we note that the DRP has examined the functional comparability of this company by considering the relevant details as given in the annual report of this company. The DRP has given the finding that the entire revenue has been earned by this company from the sale of software services and products and in the absence of segmental details, it cannot be considered as comparable with software services segment. We find that this

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company has shown the income from sale of software services and products to the tune of Rs.6.67 crores. We further note that as per Schedule 11, the entire revenue has been shown under one segment i.e., sale of software services and products. Therefore, no separate segment has been given in respect of software services. Accordingly, the composite data of revenue as well as margins of this company pertaining to the sale of software services and products cannot be considered as comparable with the software IT(TP)A No.411/Bang/2016 Maxim India Integrated Circuit Design Pvt. Ltd., Bangalore development services segment of the assessee. In view of the above facts and circumstances, we do not find any error or illegality in the directions of the DRP in excluding this company from the list of comparables. This ground of CO is dismissed."

We notice that the co-ordinate bench has excluded this company in the case of Applied Materials India Private Limited (supra) by following the decision rendered in the case of Electronics for Imaging India P Ltd (supra). Consistent with the view taken in the above said cases, we direct exclusion of this comparable company.

Following the above said decision, we restore M/s E-zest Solutions to the file of AO/TPO for fresh examination and direct exclusion of Acropetal Technologies Ltd (seg.), e-infochips Ltd, ICRA Techno Analytics Ltd and Persistent Systems & Solutions Ltd.

4.3 With regard to **Infosys Ltd**, the Ld A.R submitted that it is a giant company and hence it cannot be compared with the assessee. We notice this company has huge turnover of Rs.25,385 Crores as against the assessee's turnover of Rs.36.81 Crores. Further the company has high brand value and hence we are of the view that it cannot be considered as comparable company with that of the assessee. We also notice that the co-ordinate Bench of this Tribunal in the case of Applied Materials India Pvt. Ltd. Vs. ACIT In IT(TP)A No.17/Bang/2016 for the Asst. Year 2011-12 vide order dt.21.09.2016 has excluded the company. Accordingly, we direct exclusion of this company.

4.4 With regard to **Persistent Systems Ltd and Sasken Communication Technologies Ltd**, we notice that these two companies have been held to be not good comparables in the case of Electronics for Imaging India P Ltd (2017)(85 taxmann.com 124)(Bangalore Trib). The relevant observations made by the Tribunal in respect of these two companies are extracted below. It can be noticed that the comparability of M/s Persistent Systems Ltd has been discussed along with another company viz., M/s Persistent Systems and Solutions Ltd as under:-

(A) Persistent Systems Ltd:-

(ii) *Persistent Systems and Solutions Ltd.*

(iii) *Persistent Systems Ltd.*

9.2.1 These two companies were part of the TP Study analysis however the assessee raised objections against these companies before the TPO as well as DRP.

9.2.2 Before us, the learned Authorised Representative of the assessee has submitted that these companies are functionally not comparable to the assessee as these are engaged in diversified activity i.e. rendering of software development services and licensing, royalty of software products. Thus without having the separate segmental details and data these diversified activities cannot be compared with the assessee. He has further pointed out that the company Persistent Systems Ltd. also engaged in developing products and therefore the activities are not comparable with that of the assessee. In support of his contention, he has relied upon the decision of this Tribunal dt. 24.2.2016 in the case of DCIT v. Electronics for Imaging India (P.) Ltd. (supra) and submitted that this company was found to be not comparable with the software development services provider. He has further pointed out that in assessee's own case for the Assessment Year 2010-11, the DRP vide its order dt. 24.11.2014 has excluded Persistent Systems and Solutions Ltd. from the list of comparables by holding that this company is not comparable to the assessee.

9.2.3 On the other hand, the ld. DR has submitted that the TPO as well as DRP has examined the functional comparability of these companies and found that these companies are comparable with the assessee. These two companies have satisfied all the filters applied by the TPO and DRP therefore the minor variation in the activity would not render these companies non-comparable when a comparable price is considered under TNMM.

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9.2.4 We have considered the rival submissions as well as the relevant material on record. At the outset we note that the functional comparability of these two companies have examined by the co-ordinate bench of this Tribunal in the case of DCIT v. Electronics for Imaging India (P.) Ltd. (IT(TP)A Nos. 227 & 285/Del/2013) in paras 60 and 61 & paras 24 to 26 as under:

" Persistent Systems & Solutions Ltd.

60. The assessee has the grievance against rejection of this company by the DRP. The ld. AR has submitted that assessee did not raise any objection against this company, however, the DRP has rejected the said company. Therefore, the said company should be retained in the list of comparables.

61. Having considered the rival submissions as well as relevant material on record, at the outset, we note that the DRP has examined the functional comparability of this company by considering the relevant details as given in the annual report of this company. The DRP has given the finding that the entire revenue has been earned by this company from the sale of software services and products and in the absence of segmental details, it cannot be considered as comparable with software services segment. We find that this company has shown the income from sale of software services and products to the tune of Rs.6.67 crores. We further note that as per Schedule 11, the entire revenue has been shown under one segment i.e., sale of software services and products. Therefore, no separate segment has been given in respect of software services. Accordingly, the composite data of revenue as well as margins of this company pertaining to the sale of software services and products cannot be considered as comparable with the software development services segment of the assessee. In view of the above facts and circumstances, we do not find any error or illegality in the directions of the DRP in excluding this company from the list of comparables. This ground of CO is dismissed.

(4) Persistent Systems Ltd.

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 1 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

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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."

(B) Sasken Communication Technologies Ltd,

9. The functional comparability of these two companies have been examined by the Delhi Bench of ITAT in the case of Saxo India (P.) Ltd. (supra) in paras 10.1 to 10.2 and 15.1 to 15.2 as under:

" (i) E-Infochips Limited:

10.1 The Transfer Pricing Officer included this company in the list of comparables. On being called upon to explain as to why it should not be considered as a comparable, the assessee contended that there was functional dissimilarity inasmuch as this company was engaged in software development and IT enabled services and also Products. The Transfer Pricing Officer observed that the revenues of this company from Products was only 15% of total revenue and hence the same qualified to be eligible for comparison. The DRP did not allow any relief.

10.2 After considering the rival submissions and perusing the relevant material on record, we find that the Annual report of this company is available in the paper book with its Profit and loss account at page 1025. Schedule of Income indicates its operating revenue from software development, hardware maintenance, information technology, consultancy etc. Revenue from hardware maintenance stands at Rs. 3.92 crore, which has been considered by the Transfer Pricing Officer himself as sale of products. Such sale of products constitutes 15% of total revenue. There is no segmental information available as regards the revenue from sale of products and revenue from software development segment. As the assessee is simply engaged in rendering software development services and there is no sale of any software products, this company, in our considered opinion, ceases to be comparable. It is obvious that from the common pool of income from both the streams of software products and software services, one cannot deduce the revenue from software services and no one knows the impact of revenue from Products on the overall kitty of profit, which may be significant. Since no segmental data of this company is available indicating operating profit from software development services, we order to exclude this company from the list of comparables."

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" (vi) Sasken Communications Technologies Ltd.

15.1 The TPO included this company in the set of comparables despite the assessee's objection that it was functionally different and also had Product portfolio.

15.2 After considering the rival submissions, we find from page 58 of the TPO's order that he has recognized sale of software products to the tune of Rs. 37 crore and odd. Though the break-up of revenue from software services and software products is available, but, the break-up of operating costs and net operating revenues from these two segments have not been given. It is further observed that the TPO has taken entity level figures for the purposes of making comparison. Since such entity level figures contain revenue from both software services and software products, as against the assessee only providing software services, we are disinclined to treat this company as comparable. The assessee's contention is accepted on this issue."

We further note that the Hon'ble High Court vide its decision dt.28.09.2016 has confirmed the decision of the Delhi Bench of ITAT. We are aware that the co-ordinate bench of this Tribunal in the case of Applied Materials India (P.) Ltd. (supra) has remitted the issue of functional comparability of Sasken Communication Technologies Ltd. that in the said case the DRP did not adjudicate the objections of the assessee. Therefore in view of the decision of the Delhi Bench of the Tribunal in the case of Saxo India (P.) Ltd. (Supra) which has been confirmed by the Hon'ble Delhi High Court, we direct the TPO/AO to exclude these two companies from the set of comparables.

Accordingly, we direct exclusion of M/s Persistent Systems Ltd and M/s Sasken Communications Technologies Ltd. In the earlier paragraphs, we had already directed exclusion of M/s Persistent Systems & Solutions Ltd and M/s E-info chips Ltd. Since the Tribunal has rendered its decision in the case of Electronics for Imaging India P Ltd (supra) combining above said two companies also, relevant part of the decision of the Tribunal covering the above said two companies are also extracted.

4.5 The Ld A.R submitted that the TPO has committed arithmetical errors in computation of net profit margin of M/s Tata Elxsi Ltd and Larsen & Toubro Ltd. Accordingly, we restore this issue to the file of AO/TPO for examining the claim of the assessee.

5. The assessee seeks inclusion of certain companies in Ground No.8. However, at the time of hearing, the Ld A.R sought inclusion

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of M/s FCS Software Solutions Ltd only and did not press other companies. This company has been held to be a good comparable in the case of Marvell India Private Ltd (IT(TP)A Bo.384 & 471/Bang/2016 (2017)(84 taxmann.com 212)(Bangalore Trib). The relevant observations made by the Tribunal are extracted below:-

“18.FCS Software Solutions Ltd.:—

18.1 This company was first proposed as a comparable by the TPO in the show cause notice. The TPO however excluded the same from the final set of comparables on the ground of the working capital adjustment being high and effecting the profit margin. According to the ld. AR for the assessee, a similar stand taken by the TPO in excluding this company as a comparable for the year under consideration i.e. Assessment Year 2011-12 was considered by a co-ordinate bench in the case of Informatica Business (P.) Ltd. and its order in [IT Appeal Nos. 1285 & 1294 (Bang.) of 2014, dated 17-3-2017] the Tribunal had directed the TPO/AO to include this company as a comparable to the assessee who is a provider of software development services. It is prayed that this company be included in the final set of comparables.

18.2 Per contra, the ld. DR for revenue supported the orders of the authorities below in rejecting this company as a comparable to the assessee.

18.3.1 We have heard the rival contentions and perused and carefully considered the material on record; including the judicial pronouncements cited. It is seen from a careful appreciation of the material on record that this company i.e. FCS Software Solutions Ltd., though into providing software development services, as is the assessee in the case on hand, was rejected by the TPO on the ground of its working capital adjustment being high, it would affect the profit margin and hence rendered as not comparable to the assessee in the case on hand. We find that similar case of rejection of this company as a comparable on grounds of high working capital adjustment affecting profits was considered by a co-ordinate bench in the case of Informatica Business (P.) Ltd. (supra) the bench had directed the TPO/AO to include this company in the set of comparables as it was found to be functionally comparable to a provider of software development services, as in the assessee in the case on hand. At para 26.2 of its order the co-ordinate bench held as under:—

"26.2 we have heard the ld. DR as well as carefully perused the orders of the authorities below. We find that the TPO has rejected these two companies which were part of the initial proposal/show cause notice of the TPO but subsequently, the TPO decided not to include these two companies in the final set of comparables on the ground that if the working capital of these two companies is considered the profit margin get distorted. After giving our thought on this issue we are of the opinion that the limit of working capital is relevant for adjustment in the price and cannot be taken as a

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comparable for rejection or selection of the comparable company. Therefore, the TPO was not justified in excluding these two companies from the set of comparables merely because these companies were having borrowed fund and the working capital impact is more than 4% on the profit of the company. Accordingly we direct the AO/TPO to include these two companies in the set of comparables when the TPO itself found functionally comparable with the assessee."

18.3.2 *Following the decision of the co-ordinate bench of this Tribunal in the case of Informatica Business (P.) Ltd. (supra), we direct the TPO/AO to include this company in the final set of comparables for computing the ALP of the assessee's international transactions in software development services."*

Following the above said decision, we direct inclusion of FCS Software solutions Ltd.

6. The assessee also seeks that working capital adjustment should be allowed on actual basis. In the case of Marvell India (P) Ltd (supra), this issue has been decided as under:—

“19.Ground Nos. 9 & 10 - Working capital Adjustment:—

19.1 *In these grounds, the assessee contends that it has not been granted appropriate working capital adjustment by the TPO and the DRP, by not granting appropriate adjustment to those of the comparable companies to remove differences between them and the assessee. It is further contended that the TPO has erred in restricting the working capital adjustment to 1.63% as such a restriction is not justified as the adjustment seeks to remove differences in the working capital position between the assessee and the comparable companies. In this regard reliance was placed on the decision of the co-ordinate bench in the case of Moog Controls (India) (P.) Ltd. v. Dy. CIT [IT(TP) Appeal No. 551(Bang.) of 2015, dated 27-11-2015].*

19.2 *Per contra, the ld. DR for revenue supported the orders of the authorities below on this issue.*

19.3.1 *We have heard the rival contentions and perused and carefully considered the material on record. On the appreciation of the facts on record on this issue, it is seen that the TPO has restricted the working capital adjustment to 1.63%. According to the assessee such a restriction is not justified as the adjustment seeks to remove the differences in working capital position between the assessee and the comparable companies. We find that this issue of restriction of working capital adjustment was considered by a co-ordinate bench of this Tribunal in the case of Moog Controls (India) (P.) Ltd. (supra) and the co-ordinate bench directed the AO/TPO to allow actual adjustments towards the differences in working capital position between the*

assessee and the companies selected as comparables. At paras 24 to 29 thereof, the co-ordinate bench held as under:—

- 24. The next contention of the assessee is that the working capital adjustment should not have an upper limit. It was submitted that the average cost of capital cannot be used as a upper threshold for working capital adjustment.*
- 25. The TPO in the order has stated that the profit margin computed in TNMM is a composite figure which includes two components. They are the profit margin on account of operating profit and profit margin on account of cost of capital recovered. Therefore, when the arithmetical average of net profit margins computed in the case of uncontrolled comparables is considered as arm's length profit margin in transfer pricing that arise from operating business, then the average cost of capital computed in the case of uncontrolled comparables should also be considered as arm's length price of the cost of capital in transfer pricing exercise. Accordingly, the average cost of capital computed in the case of the uncontrolled comparables should be an upper cap for the purpose of allowing working capital adjustment.*
- 26. It was submitted that the TPO in the order has advocated limiting the working capital adjustment contending that the adjustment would be negative for the assessee/tested party, since it does not have significant debtors/inventory and generally, the assessee/tested party receives the money in advance for the services from the AEs. Whereas, the entrepreneurial companies selected as comparable will have debtors, inventory and the creditors.*
- 27. The ld. counsel for the assessee submitted that in advocating this principle the TPO has ignored the characterisation of the assessee as a low risk captive services provider that does not perform entrepreneurial functions and consequently does not bear related risks. The assessee, being part of the larger group has the advantage of healthy working capital position, whereas, entrepreneurial companies cannot have that advantage and therefore, need to adjust their prices for the services accordingly to account for working capital related functions, costs and risks. The objective of a benchmarking analysis is to neutralise these differences and bring about an appropriate comparison as far as possible. According to the ld. counsel for the assessee, even. Rule 10B says that reasonable and appropriate adjustment needs to be made for a better comparability between the transactions being compared.*
- 28. It was further submitted that the TPO ignored the above principles of comparability and contested that the transfer price of uncontrolled independent companies have component of return for functions and return for working capital, it was submitted that though the assessee is not denying this fact, but the return for working capital position between the assessee and the companies selected as comparable vary due to their characterisation and there exists a methodology which is also well accepted Internationally to nullify these differences. Therefore, it was submitted that such an*

adjustment should be carried out to bring in appropriate comparability between the tested party and the companies selected as comparable without any upper cap, which is not based on any sound rationale. The ld. counsel for the assessee relied on the decision of the Mumbai Bench of the Tribunal in the case of Dresser-Rand India Pvt. Ltd. v. ACIT (ITA No. 8753/Mum/2010) has held that "The soul of an order is in its reasoning, and unless the reasons for coming to a conclusion in the order are not set out, it is not possible to do a meaningful scrutiny of the order." The Mumbai Bench in the above case has referred to the observations made by Hon'ble Supreme Court in the case of Union of India v. Mohan Lal Capoor (AIR 1974 SC 87) wherein Their Lordships have, inter alia, observed as follows:—

"If the statute requires recording of reasons, then it is the statutory requirement and, therefore, there is no scope for further inquiry. But even when the statute does not impose such an obligation it is necessary for the quasi-judicial authorities to record reason as it is only visible safeguard against possible injustice and arbitrariness and affords protection to the person adversely affected. Reasons are the links between the material on which certain conclusions are based and the actual conclusions. They disclose how the mind is applied to the subject-matter for a decision, whether it is purely administrative or quasi-judicial. They should reveal rational nexus between the facts considered and the conclusion reached. Only in this way can opinions or decisions recorded be shown to be manifestly just and reasonable."

29. *In view of the decision in the case of Dresser-Rand India Pvt. Ltd. (supra) rendered by the Mumbai Bench of the Tribunal, the restriction placed by the TPO in providing the working capital adjustment was not justified. The AO/TPO is directed to allow the actual adjustment towards the differences in the working capital position between the assessee and the entrepreneurial companies selected as comparable.'*

19.3.2 Following the decision of the co-ordinate bench of this Tribunal in the case of Moog Controls (India) (P.) Ltd. (supra), we direct the TPO/AO to allow the actual adjustment towards the differences in working capital position between the assessee and the companies in the final set of comparables."

The Ld A.R also submitted that the working capital adjustment, if turns out to be negative, the same has to be ignored as held by the Tribunal in many cases. He submitted that the ld DRP has given similar directions, but the TPO has not followed the same. Since we have restored the issue of making working capital adjustment, we restore this contention of the assessee to the file of AO/TPO. Needless to mention, the AO/TPO should follow the directions given by Ld DRP on this aspect.

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7. The next issue urged by the assessee relates to the addition on account of carried forward balance of accrued expenses. The AO noticed that the provision for accrued expenses account disclosed a balance of Rs.25,61,564/-. The AO disallowed the same u/s 40(a)(ia) holding that the assessee has not deducted tax at source from the above said provision. The Ld DRP directed the AO examine this issue afresh explaining the principles relating to this issue.

7.1 The Ld A.R submitted that the above said amount of Rs.25,61,564/- is a Balance Sheet item and the said balance has been accumulated over the years. Hence the tax authorities are not correct in considering the same to represent current year's provision. Further, the assessee had suo motu disallowed a sum of Rs.11,20,185/- u/s 40(a)(ia) of the Act in the current year. However, the tax authorities have not considered the same and it has resulted in double disallowance.

7.2 We heard Ld D.R on this issue. Since the contention of the assessee requires verification, we restore this issue to the file of the AO for examining the same in accordance with law.

8. The next issue urged by the assessee relates to the disallowance of miscellaneous expenses of Rs.23,21,816/- u/s 40(a)(ia) of the Act for non-deduction of tax at source. During the course of assessment proceedings, the assessing officer asked for ledger account copies of expenses and also the details of TDS deducted thereon. Since the details were not furnished, the AO disallowed the above said claim u/s 40(a)(ia) of the Act. The Ld DRP directed the AO to examine this claim afresh explaining principles relating thereto.

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8.1 The Ld A.R submitted that the assessee has deducted tax at source, wherever required and further, TDS is not required to be deducted from certain payments. He submitted that the assessee may be provided with an opportunity to furnish the details before the AO.

8.2 We heard Ld D.R on this issue. We are of the view that, in the interest of natural justice, the assessee may be provided with an opportunity to present relevant facts before the AO. Accordingly, we restore this issue to the file of AO for examining the same in accordance with law.

9. The next issue relates to the disallowance of Rs.92,63,531/- representing reimbursement of expenses made to the AE. The facts are that the AO asked for details of tax deduction at source from the above said payment. However, the assessee contended that TDS is not required to be deducted, since the reimbursement is on cost to cost basis. Further, the assessee did not also furnish details as to whether AE has deducted tax at source while making payment to the payees. In the absence of relevant details, the AO disallowed the above said claim. The Ld DRP also noticed that the TPO has determined ALP of transactions at NIL. However, Ld DRP directed the TPO to verify the same again on the basis of evidences that may be produced and disallow only those expenses which are not explained satisfactorily. Ld DRP also observed that the applicability of TDS provisions is also required to be examined.

9.1 The Ld D.R submitted that the assessee has deducted TDS on payment of Rs.48,10,003/- made towards software purchases. The balance amount represents expenses in the nature of employee rewards, purchase of hardware and fixed assets, property insurance,

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travel, webex and intercall charges, training etc. He submitted that there is no requirement of making TDS from these payments. Accordingly the ld A.R submitted that this matter may be restored to the file of AO for examining the same again.

9.2 Since the contention of the assessee in this regard requires verification, we restore this issue to the file of AO/TPO for examining it in accordance with law.

10. The next issue relates to the disallowance made u/s 14A of the Act. The AO disallowed a sum of Rs.2,03,336/- under Rule 8D(2)(iii) read with section 14A of the Act. The Ld DRP also confirmed the same.

10.1 The Ld A.R submitted that the assessee did not earn any exempt income and hence there was no requirement to make any disallowance u/s 14A of the Act. We notice that the above said contention of the assessee finds support from the decision rendered by Hon'ble Delhi High Court in the case of PCIT vs. IL & FS Energy Development Company Ltd (2017) (84 taxmann.com 186). Accordingly, we direct the AO to delete this disallowance.

11. The next issue urged by the assessee in the additional ground is that the consequential depreciation should be allowed on amount of customs duty disallowed by the AO holding the same as capital in nature. We restore this issue to the file of AO with the direction to examine this claim of the assessee and allow depreciation at appropriate rates, if the customs duty are capitalised to any asset.

12. The last issue urged by the assessee in the additional ground relates to the claim for deduction of education cess and secondary

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and higher education cess paid during the year as deduction. The Ld A.R submitted that the claim of the assessee gets support from the decision rendered by Hon'ble Bombay High Court in the case of Sesa Goa Limited vs. JCIT (2020)(117 taxmann.com 96)(Bom) and also the decision rendered by the co-ordinate bench in the case of Wipro Limited (IT(TP)A No.99/Bang/2014. Since this issue is urged for the first time before us, we restore this issue to the file of AO for examining the claim of the assessee in accordance with the decisions referred above.

13. In the result, the appeal of the assessee is treated as partly allowed.

Order pronounced in the open court on 29th Nov, 2021

Sd/-
(George George K.)
Judicial Member

Sd/-
(B.R. Baskaran)
Accountant Member

Bangalore,
Dated 29th Nov, 2021.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.