

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

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER**

ITA No.1360/Bang/2018
Assessment Year : 2013-14

M/s. Nvidia Graphics Private Limited, C1-“Jacaranda”, Wing A, Manyata Embassy Business Park, Outer Ring Road, Bengaluru-560 045. PAN:AABCN 9200 H	Vs.	The Assistant Commissioner of Income Tax, Circle - 5(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. Chavali Narayanan, CA
Respondent by	:	Shri. Sumer Singh Meena, CIT(DR)(OSD)(ITAT), Bengaluru

Date of hearing	:	25.11.2021
Date of Pronouncement	:	29.11.2021

ORDER

Per N. V. VASUDEVAN, Vice President:

This appeal by the Assessee is directed against the order dated 28.2.2018 of CIT(A)-5, Bengaluru, (hereinafter referred to as the Assessing Officer, “AO” in short) in relation to AY 2013-14.

2. The Assessee is engaged in the business of provision of Software Development Services (SWD services), to its wholly owned holding company. In terms of the provisions of Sec.92-A of the Income Tax Act, 1961 (Act), the Assessee and its wholly owned holding company were Associated Enterprises (“AEs”). In terms of Sec.92B(1) of the Act, the

transaction of providing SWD Services was an “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, the any income arising from an international transaction shall be computed having regard to the arm’s length price. In this appeal by the Assessee, the dispute is with regard to determination of Arms’ Length Price (ALP) in respect of the international transaction of rendering SWD services to the AE.

3. As far as the provision of Software Development services are concerned, the Assessee filed a Transfer Pricing Study (TP Study) to justify the price paid in the international Transaction as at ALP by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) of determining ALP. The Assessee selected Operating Profit/Operating Cost (OP/OC) as the Profit Level Indicator (PLI) for the purpose of comparison. The OP/OC of the Assessee was arrived at 13.40% by the Assessee in its TP study. The operating income was Rs. 421,73,74,663/- and the Operating Cost was Rs.371,88,77,368/-. The Operating profit (Operating income – Operating cost was Rs.49,84,97,295/-. The Assessee chose companies who are engaged in providing similar

services such as the Assessee. The Assessee identified 26 companies whose average arithmetic mean of profit margin was comparable with the Operating margin of the Assessee. The Assessee therefore claimed that the price it charged in the international transaction should be considered as at Arm's Length.

4. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred to by the AO, accepted TNMM as the MAM and also used the same PLI for comparison i.e., OP/TC. He also selected comparable companies from database. The TPO accepted 5 companies chosen by the Assessee as comparable companies i.e., CG Vak Software & Exports Ltd., Larsen & Toubro Infotech Ltd., Mindtree Ltd., Persistent Systems Ltd., and R.S. Software (I) Ltd. The TPO on his own identified 2 more companies as comparable with the Assessee company and worked out the average arithmetic mean of their profit margins as follows:

Comparables selected by TPO and their arithmetic mean:

SI No.	Comparable	Margin (Unadjusted)	Margin (adjusted)*
1.	CG-VAK Software & Exports Limited (Segmental)	20.54%	18.74%
2.	ICRA Techno Analytics Limited	17.10%	11.67%
3.	Larsen & Toubro Infotech Limited	26.06%	24.29%
4.	Mindtree Limited (Segmental)	18.19%	16.09%
5.	Persistent Systems Limited	28.27%	25.67%
6.	R S Software (India) Limited	17.41%	17.07%
7.	Tech Mahindra Limited (Seg)	18.72%	16.75%
Arithmetic Mean		20.90%	18.61%

5. The TPO computed the Addition to total income on account of adjustment to ALP as follows:

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

Arm's Length Mean Margin	20.90%
Less: Working Capital Adjustment	2.29%
Adjusted mean margin of the comparables	18.61%
Operating Cost ('OC')	Rs. 3,718,877,368/-
Arm's Length Price (ALP) = 118.61% of OC	Rs. 4,411,038,744/-
Price Received	Rs. 4,217,374,663/-
Short fall being adjustment u/S. 92CA	Rs. 193,664,081/-

Thus a sum of Rs.19,36,64,081/- was added to the total income of the Assessee on account of determination of ALP for provision of SWD services by the Assessee to its AE.

6. The Assessee filed objections before the Disputes Resolution Panel (DRP) against the draft assessment order passed by the AO wherein the addition suggested by the TPO as adjustment to ALP was added to the total income of the Assessee by the AO. The Assessee filed objections before the DRP and the DRP gave certain directions. Based on the directions of the DRP, the AO passed the final order of assessment. To the extent the Assessee did not get relief from the DRP, the Assessee has preferred appeal before the Tribunal.

7. At the time of hearing, the learned counsel for the Assessee pressed for adjudication of only Gr.No.9(a) for adjudication in which the Assessee seeks exclusion of three comparable companies viz., Larsen & Toubro Infotech Ltd., Persistent Systems Ltd., and Tech Mahindra Limited.

8. The Learned counsel sought exclusion of the aforesaid 3 comparable companies from the list of comparable companies chosen by the TPO. In this regard he relied on decision of the ITAT Bangalore Bench in the case of M/S.Metricstream Infotech (India) Ltd., Vs. DCIT IT(TP) A.No.1418 & 2735/Bang/2016 for AY 2013-14 order dated 27.2.2019. In the aforesaid decision, the 3 comparables referred to in Grd.No.6(a) were excluded. It is not in dispute that the functional profile of the Assessee and the Assessee in the case cited by the learned counsel for the Assessee are identical. In fact the very same 7 comparables had been chosen in the case of the Assessee in the decision cited by the learned counsel for the Assessee before us. Though two out of the three companies were chosen by the Assessee in its TP study, before CIT(A), the Assessee has challenged its inclusion. The Special Bench of the ITAT Chandigarh Bench in the case of DCIT v. Quark Systems Pvt. Ltd. 38 SOT 207(SB)(Chd.) has taken the view that it is open to the parties in Transfer Pricing cases to take a stand contrary to their TP study, if they contend that the stand taken in the TP study is contrary to facts or was erroneous. Such a claim cannot be disregarded only on the basis that it is contrary to Assessee's own stand in the TP study.

9. Before we refer to the decision cited by the learned AR, we may look at the relevant provisions of the Act in so far as comparability of international transaction with a transaction of similar nature entered into between unrelated parties, provides as follows:

Determination of arm's length price under section 92C .

10B . (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction [*or a specified domestic transaction*] shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a) to (d).....

(e) transactional net margin method, by which,—

- (i) the net profit margin realised by the enterprise from an international transaction [*or a specified domestic transaction*] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) the net profit margin referred to in sub-clause (i) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction [*or the specified domestic transaction*] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);
- (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction [*or the specified domestic transaction*];

(f).....

(2) For the purposes of sub-rule (1), the comparability of an international transaction [*or a specified domestic transaction*] with an uncontrolled transaction shall be judged with reference to the following, namely:—

- (a) the specific characteristics of the property transferred or services provided in either transaction;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction [*or a specified domestic transaction*] if—

- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
- (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

10. A reading of Rule 10B(1)(e)(iii) of the Rules read with Sec.92CA of the Act, would clearly shows that the net profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any, between the international transaction and the

comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.

11. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the “TPG”) contain extensive guidance on comparability analyses for transfer pricing purposes. Guidance on comparability adjustments is found in paragraphs 3.47-3.54 and in the Annex to Chapter III of the TPG. A revised version of this guidance was approved by the Council of the OECD on 22 July 2010. In paragraph 2 of these guidelines it has been explained as to what is comparability adjustment. The guideline explains that when applying the arm’s length principle, the conditions of a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are generally compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that:

- None of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or
- Reasonably accurate adjustments can be made to eliminate the effect of any such differences. These are called “comparability adjustments.”

12. In the light as laid down in the relevant statutory provisions as explained in decided cases, we shall proceed to examine the claim of the Assessee for exclusion of 3 comparable companies. In the case of Metristream Infotech (supra), the Tribunal held on the comparability of the aforeasaid companies, as follows:

“11. As far as L&T Infotech Ltd. and Persistent Systems Ltd. are concerned, our attention was drawn to the decision of ITAT

Hyderabad Bench in the case of M/s. EPAM Systems (I) P. Ltd. v. ACIT, ITA No.2122/Hyd/2017 for AY 2013-14, order dated 20.11.2017. Vide para 12 of the decision, the Tribunal took the view that Persistent Systems Ltd. was into software products and software solutions and no segmental details were available and therefore the profit margin in the software development services segment could not be compared with the assessee's profit margin. As far as L&T Infotech Ltd. is concerned, the Tribunal vide para 17 of the aforesaid order came to a similar conclusion to hold that L&T Infotech should not be regarded as a comparable company. In the light of judicial precedents which remain uncontroverted, we are of the view that the aforesaid two comparable companies should be excluded from the list of comparable companies.

12. *As far as Tech Mahindra Ltd. is concerned, the assessee made a specific prayer before the DRP that the related party transaction (RPT) of this company was more than 25%. Our attention was drawn to page 641 of the assessee's PB, which is objections filed by the assessee before the DRP wherein the following submission was made:-*

"The assessee would like to submit that Tech Mahindra fails the RPT filter applied by your good self. The working for the same is provided below for your reference:

*ITA Nos. IT(TP)A Nos.1418 & 2735/Bang/2017
 Related Party Net Sales Related Party Transaction
 Transaction /Net Sales 25,739,000,000 60,019,000,000
 42.88% (Source: AR 2012-13 o pg. 69, 70 & 71)
 Hence, the company fails the RPT filter applied by the
 TPO and hence should be rejected."*

13. *The DRP, however, has not considered this submission, but has confirmed the order of TPO. We are of the view that it would be just and proper to set aside the order of DRP on this issue and remand the issue to AO/TPO for consideration of the content' n of the assessee with regard to the exclusion of this company by application of RPT filter."*

13. Respectfully following the aforesaid decision, we direct exclusion of the 3 comparable companies set out in Grd.No.9 (a) of the Assessee's appeal.

14. No other grounds were pressed for adjudication. We direct the TPO to compute the ALP of the international transaction in accordance with the directions given in this order after affording the Assessee opportunity of being heard.

15. In the result, appeal of the Assessee is partly allowed.

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

Sd/-

(B. R. BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(N. V. VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated : 29.11.2021.
/NS/*

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.