

**IN THE INCOME TAX APPELLATE TRIBUNAL,  
MUMBAI BENCH “J”, MUMBAI**

**BEFORE SHRI PRAMOD KUMAR, VICE PRESIDENT  
AND  
SHRI KULDIP SINGH, JUDICIAL MEMBER**

**ITA No.1379/M/2021  
Assessment Year: 2016-17**

M/s. Red Hat India Private Limited, A-201, Supreme Business Park, Supreme City, Hiranandani Gardens, Powai, Mumbai – 400 076 <b>PAN: AABCR7097N</b>	Vs.	Additional/Joint/Deputy/Assistant Commissioner of Income-Tax/ Income Tax Officer, National Faceless Assessment Centre, Delhi
(Appellant)		(Respondent)

**Present for:**

Assessee by : Shri Ajit Jain, A.R. &  
Shri Siddesh Chaugule, A.R.

Revenue by : Ms. Vatsala Jha, D.R.

Date of Hearing : 29.11.2021

Date of Pronouncement : 25.02.2022

**O R D E R**

**Per Kuldip Singh, Judicial Member:**

The appellant, M/s. Red Hat India Pvt. Ltd. (hereinafter referred to as ‘the assessee’) by filing the present appeal, sought to set aside the impugned order dated 26.03.2021 passed by Ld. CIT(DRP-2), Mumbai-2 [hereinafter referred to as the DRP] qua the assessment year 2016-17 on the grounds inter alia that :-

***“On the facts, and in the circumstances of the case, and in law, the Appellant craves to prefer an appeal against order dated 4 June 2021 passed by the Additional/ Joint/ Deputy/ Assistant Commissioner of Income tax/ Income-tax Officer, National Faceless Assessment Centre, Delhi (hereinafter referred to as the ‘Ld. AO’), under Section 143(3) r.w.s 144C(13) read with Section 144B of the Income-tax Act, 1961 (‘the Act’), on the grounds as set out herein:***

***The following grounds are independent of, and without prejudice to, one another:***

**Transfer Pricing**

***Adjustment relating to international transaction pertaining to payment of royalty and service fee (subscription segment) — INR 171,407,494***

***1. The Ld. AO [along with the Learned Transfer Pricing Officer (‘Ld. TPO’)] under the directions of Hon’ble Dispute Resolution Panel (‘DRP’) erred on facts and in law, in determining the arm’s length price for payment of royalty and service fees under subscription segment and thereby making an adjustment of INR 171,407,494 to the taxable income of the Assessee. In doing so, having grossly erred in:***

***1.1 modifying the economic analysis carried out by the Assessee in the Transfer Pricing Documentation (‘TP Documentation’) and arbitrary applying incorrect quantitative filters without providing any cogent reasons;***

***1.2 rejecting various comparable companies selected by the Assessee in the TP Documentation basis the provisions of Rule 10B(2) of the Rules;***

***1.3 introducing additional companies without appreciating that such companies are functionally dissimilar to the Assessee and violating the provisions of Rule 10B(2) of the Rules;***

***1.4 not allowing relevant adjustments as per the provisions of Rule 10B(1) and Rule 10B(3) of the Rules;***

*1.5 arbitrarily disregarding the submissions made before the Ld. TPO to give effect to DRP directions, for computation of profitability margins of various comparables;*

*1.6 confirming the incorrect value of adjustment disregarding the draft Assessment order and rectification application filed before the Ld. TPO/AO; and*

*1.7 not granting proportionate adjustment for the value of international transactions, thereby extending the quantum of transfer pricing adjustment to transactions with the non-associated enterprises also.*

*Adjustment relating to international transaction pertaining to payment of royalty and service fees (services segment) — INR 27,451,259*

*2. The Ld. AO (along with the Ld. TPO) under the directions of Hon'ble DRP erred on facts and in law, in determining the arm's length price for payment of royalty and service fees under service segment and thereby making an adjustment of INR 27,451,259 to the taxable income of the Assessee. In doing so, having grossly erred in:*

*2.1 modifying the economic analysis carried out by the Assessee in the TP Documentation and & arbitrarily applying incorrect quantitative filters without providing any cogent reasons;*

*2.2 rejecting various comparable companies selected by the Assessee in the TP Documentation basis the provisions of Rule 10B(2) of the Rules;*

*2.3 introducing additional companies without appreciating that such companies are functionally dissimilar to the Assessee and violating the provisions of Rule 10B(2) of the Rules;*

*2.4 not allowing relevant adjustments as per the provisions of Rule 10B(1) and Rule 10B(3);*

*2.5 arbitrarily disregarding the submissions made before the Ld. TPO to give effect to DRP directions, for*

*computation of profitability margins of various comparables;*

*2.6 confirming the incorrect value of adjustment disregarding the draft Assessment order and rectification application filed before the Ld. TPO/AO; and*

*2.7 not granting proportionate adjustment for the value of international transactions, thereby extending the quantum of transfer pricing adjustment to transactions with the non-associated enterprises also.*

*Adjustment relating to international transactions pertaining to provision of software support services — INR 68,493,639*

*3. The Ld. AO (along with the Ld. TPO) under the directions of Hon'ble DRP erred on facts and in law, in determining the arm's length price for provision of software support services and thereby making an adjustment of INR 68,493,639 to the taxable income of the Assessee In doing so, having grossly erred in:*

*3.1. modifying the economic analysis carried out by the Assessee in the TP Documentation and arbitrarily applying incorrect quantitative filters without providing any cogent reasons;*

*3.2. rejecting various comparable companies selected by the Assessee in the TP Documentation basis the provisions of Rule 10B(2) of the Rules;*

*3.3. introducing additional companies without appreciating that such companies are functionally dissimilar to the Assessee and violating the provisions of Rule 10B(2) of the Rules*

*3.4. considering fresh comparable companies without appreciating that such companies are functionally dissimilar to the Assessee;*

*3.5. not allowing relevant adjustments as per the provisions of Rule 10B(1) and Rule 108(3) and*

***3.6. arbitrarily disregarding the submissions made before the Ld. TPO to give effect to DRP directions, for computation of profitability margins of various comparables.***

***Adjustment relating to international transactions pertaining to provision of IT enabled support services - INR 42,159,003***

***4. The Ld. AO (along with the Ld. TPO) under the directions of Hon'ble DRP erred on facts and in law, in determining the arm's length price for provision of IT enabled support services and thereby making an adjustment of INR 42,159,003 to the taxable income of the Assessee. In doing so, having grossly erred in:***

***4.1. modifying the economic analysis carried out by the Assessee in the TP Documentation and arbitrarily applying incorrect quantitative filters without providing any cogent reasons;***

***4.2. rejecting various comparable companies selected by the Assessee in the TP Documentation basis the provisions of Rule 10B(2) of the Rules;***

***4.3. introducing additional companies without appreciating that such companies are functionally dissimilar to the Assessee and violating the provisions of Rule 10B(2) of the Rules***

***4.4. considering fresh comparable companies without appreciating that such companies are functionally dissimilar to the Assessee;***

***4.5. not allowing relevant adjustments as per the provisions of Rule 10B(1) and Rule 10B(3); and***

***4.6. arbitrarily disregarding the submissions made before the Ld. TPO to give effect to DRP directions, for computation of profitability margins of various comparables.***

**Corporate tax*****Additions on account of unearned revenue from subscription services — INR 280,190,592***

***5.1. The Ld. AO and Hon'ble DRP erred in not following the binding order of this Hon'ble Income Tax Appellate Tribunal ('ITAT') vide order dated 10 April 2019 for AY 2012-13 and AY 2013-14 wherein on same set of facts, the Hon'ble ITAT has upheld the revenue recognition policy adopted by the Appellant in relation to revenue from subscription services;***

***5.2 The Ld. AO and Hon'ble DRP erred on facts and in law in making an addition of INR 280,190,592 pertaining to subscription services and forming part of the 'unearned revenue', disclosed in the liabilities side of balance sheet of the Appellant, as income of the current year, without appreciating the fact that the impugned amount is in the nature of receipt of advance and is not chargeable to tax in the current year;***

***5.3. The Ld. AO and Hon'ble DRP erred on facts and in law in preponing the income to the current C year, without appreciating that the books of accounts are duly audited and unqualified by the auditor, and the said income is offered to tax in the respective year in which it is accounted, thereby, it is revenue neutral;***

***5.4 Without prejudice to the above, the Ld. AO and Hon'ble DRP erred in not granting a corresponding deduction/relief of INR 276,267,924 on the preponement of income, for a corresponding increase in expenses in the nature of 'royalty' and 'service fees' payment as per the terms of the 'License and Service' agreement entered into by the Appellant with the AE and in view of the matching concept of accounting.***

***Additions on account of Employee Stock Option Plan ('ESOP') expenses – INR 259,721,357***

***6.1 The Ld. AO and Hon'ble DRP erred on the facts and in law, in disallowing INR 259,721,357 on account of payments made by the Appellant for ESOPs granted to its***

*employees by its associate enterprise i.e. Red Hat Inc., USA. While doing so:*

*6.2 The Ld. AO and Hon'ble DRP failed to appreciate the factual evidences filed by the Appellant which demonstrate that the payments were made pursuant to ESOPs issued to its employees and hence an allowable business expenditure incurred in the ordinary course of business. The Ld. AO and Hon'ble DRP failed to verify the additional evidences submitted by the Appellant on account of paucity of time and technical issues on the NeAC portal.*

*6.3 The Hon'ble DRP erred in law in ignoring the judicial precedents supporting the position that payments made to group entities for ESOPs is an allowable expenditure.*

*6.4 The Ld. AO and Hon'ble DRP erred in facts and in law in holding that expenditure incurred in respect of ESOP is capital in nature since it is akin to purchase of investments by the Appellant, without appreciating the fact that ESOPs are granted to the employees of the Appellant.*

*Deduction for education and secondary and higher education cess*

*7.1 That on the facts and circumstances of the case and in law, the Ld. AO ought to have allowed deduction for education and secondary and higher education cess paid by the appellant of INR 3,467,380.*

*Deduction for contribution made to Prime Minister's National Relief Fund*

*8.1 That on the facts and circumstances of the case and in law, the Ld. AO erred in not granting deduction under Section 80G of the Act with respect to contribution made to Prime Minister's National Relief Fund by the appellant of INR 1,18,85,969.*

*Other grounds*

*9.1 The Ld. AO erred on facts and in law in levying interest under Section 234B of the Act.*

**9.2 The Ld. AO erred on facts and in law in initiating penalty proceedings under Section 274 read with Section 271(1)(c) of the Act.**

***The Appellant craves leave to add to, or alter, by deletion, substitution, modification or otherwise, the above grounds of appeal, either before or during the hearing of the appeal.”***

2. Briefly stated facts necessary for adjudication of the controversy at hand are : Red Hat India Pvt. Ltd. is a subsidiary of Red Hat Ltd., head quartered in USA, which offers the subscription to enable the customers to file and access various features including modifications, additions, enhancement or support in relation to such open source software. During the year under assessment the assessee has four business segments viz. Subscription Segment, Services Segment, Software Support Service Segment & IT Enabled Support Services.

3. The assessee reported to have entered into international transactions during the year under assessment as under:

S. No.	Associate Enterprise	Nature of International Transaction	Payment/Receipt by assessee	Amount (in Rs.)	Method used for determining ALP by the assessee
1	Red Hat Inc., USA	Royalty as per Lincese and Services Agreement	Payment	5,35,86,135/-	TNMM
2	Red Hat Inc., USA	Provision of ITeS	Receipt	83,76,55,778/-	TNMM

3	Red Hat Limited, Ireland	Provision of ITeS	Receipt	20,94,13,945/-	TNMM
4	Red Hat Inc., USA	Provision of Software Development Services	Receipt	55,82,40,145/-	TNMM
5	Red Hat Inc., USA	Service Fees as per License and Service Agreement	Payment	90,65,99,563/-	TNMM

4. The assessee in order to benchmark its international transactions qua subscription segment proceeded on the premise that the assessee is engaged purely in resale activities for these subscriptions and Red Hat US service segment by using its global support centers around the world directly provides maintenance, development and production support to the customer during the subscription period. The assessee in order to bench mark its international transactions chosen Transactional Net Margin Method (TNMM) with OP/OR as the Profit Level Indicator (PLI) for a subscription segment, selected 9 comparables with weighted average operating margin in the range of -0.51% to 20.78% with a margin of 0.68% after making a working capital adjustment (0.05% to 1.94% without working capital adjustment) and found its operating margin of 1.4% on operating revenue within arm's length range.

5. In order to benchmark its service segment transactions assessee chosen 6 comparables with weighed average operating profit on operating revenue in the range of 6.86% to 13.23% with a margin of 10.05% after making working capital adjustment of (15.45% to 15.54% without working capital adjustment) and found its operating margin of 13.50% on operating revenue within arms level range and treated its international transactions at arm's length.

6. The assessee in order to benchmark its international transactions qua software development services again used TNMM as the most appropriate method as OP/OC as the PLI chosen 16 comparables with margin of 12.19% as against its own margin of 15% and found its transaction at arm's length and found its margin within range.

7. The assessee in order to benchmark its international transaction qua Information Technology Enabled Services (ITES), assessee again used TNMM as the most appropriate method, chosen 14 comparables with margin of 10.83% as against operating margin of the assessee at 15.24% and found its international transactions at arm's length.

8. The Assessing Officer (AO) / Disputes Resolution Panel (DRP) made addition of Rs.28,01,90,592/- and Rs.25,97,21,357/-

on account of unearned revenue and on account of disallowance of Employee Stock Option Plan (ESOP) respectively. The AO also denied the deduction claim made by the assessee under section 80G of the Income Tax Act (for short 'the Act').

9. The assessee carried the matter before the Ld. DRP by way of filing objections who has disposed of the same. Pursuant to the adjustment proposed by the Transfer Pricing Officer (TPO) and directed by the Ld. DRP, the AO proceeded to frame the assessment order at total income of Rs.119,34,09,434/- under section 143(3) read with section 144C(13) read with section 144B of the Act. Feeling aggrieved, the assessee has approached the Tribunal by way of filing the present appeal.

10. We have heard the Ld. Authorised Representatives of the parties to the appeal, perused the orders passed by the Ld. Lower Revenue Authorities and documents available on record in the light of the facts and circumstances of the case and law applicable thereto.

11. The Ld. A.R. for the assessee challenging the impugned order relied upon its transfer pricing study and has also filed ground-wise chart, the copy of which was also supplied to Ld. D.R.

However, on the other hand, the Ld. D.R. relied upon the order passed by the Ld. TPO/DRP/AO.

### **Transfer Pricing Grounds**

**Ground No.1 & Grounds No.1.1, 1.2, 1.3, 1.4, 1.5 1.6 & 1.7;**  
**Ground No.2 & Grounds No.2.1, 2.2, 2.3, 2.4, 2.5, 2.6 & 2.7;**  
**Ground No.3 & Grounds No.3.1, 3.2, 3.3, 3.4, 3.5 & 3.6;**  
**Ground No.4 & Grounds No.4.1, 4.2, 4.3, 4.4, 4.5 & 4.6**

12. The Ld. TPO proposed adjustment of Rs.17,14,07,494/- and Rs.2,74,51,259/- qua international transactions pertaining to payment of royalty and service fee (subscription segment) on account of payment of royalty and service fee (service segment) respectively by modifying the economic analysis made by the assessee by rejecting the comparables and introducing new comparable and thereby determined the arm's length margin at 11.86% and 21.53% for subscription segment and service segment respectively.

13. Undisputedly, the assessee is into the sales and distribution of Red Hat Group's subscription in the Indian subcontinent region for which it pays a royalty and service fee to Red Hat US in respect of the subscription sold by it. The assessee's business model, analyzed in its transfer pricing documentation for the year under assessment, available at page 963 – 1640, paper book A, has been

accepted by the Tribunal in earlier years vide order dated 14.02.2019 in ITA No.1456 and 7271/M/2017 for A.Y. 2012-13 and 2013-14 and found the assessee functioning as a limited risk reseller as it is into selling the Red Hat subscriptions and the maintenance support services are provided by Red Hat US support service center as the assessee doesn't have the know-how to provide such support services. Red Hat US, the Associate Enterprise (AE) grants the assessee the right to use its intangible properties (trade marks, trade names and domain names) for which the assessee is liable to pay royalty at 3% of its revenue from subscription segment to the AE as per license and service segment dated 01.04.2011.

14. The AE, Red Hat US also provides services to the customers and users who purchase its subscription from the assessee, for which the AE charges the assessee service fee which is an amount equal to the entire revenue of the assessee from this segment -1.4% of its revenue from this segment and accordingly paid the amounts to its AE, Red Hat USA qua subscription segment as under:

1. Royalty – Rs.4,33,30,373/- (i.e. 3% of the assessee's revenue from subscription segment)
2. Service Fee – Rs.90,65,99,563/- (i.e. revenue of the assessee from subscription segment minus 1.4% of its revenue from subscription segment)

15. So the assessee has paid the entire revenue it earns from the sale of Red Hat subscription in India to its AE after retaining only 1.4% of it.

16. So similarly in service segment also the assessee pays its AE a royalty @ 3% of its revenue and a service fees equal to entire revenue of the assessee from this segment -13.50, the detail of which is as under:

1. Royalty – Rs.1,02,55,763/- (i.e. 3% of the assessee's revenue from service segment)
2. Service Fee – Rs.(89,12,059/- (i.e. revenue of the assessee from subscription segment minus 13.50% of its revenue from subscription segment)

17. At the same time, under this plan the assessee is assured a margin of 1.4% of revenue earned from subscription segment and 13.50% of revenue earned from service segment.

18. The Ld. TPO aggregated transaction under the head 'Royalty and service fees' in each segment and considered the same as single transaction under the head 'software distribution activity and computer training/education activity' for the subscription segment and service segment respectively.

19. The Ld. TPO modified the economic analysis of the assessee by rejecting comparables chosen by the assessee by introducing

new comparables and determined the arm's length margin of 11.8% in subscription segment and 21.53% in service segment.

20. The Ld. TPO after rejecting the benchmarking made by the assessee, however, accepted the TNMM with OP/OR as PLIs and finally selected three comparables and computed the margin in subscription segment as under:

S. No.	Name of the Comparable Company	Weighted average operating margin on operating revenue (OP/OR)(%)
1	K7 Computing Private Limited	11.69
2	Innovana Thinklabs Limited	12.54
3	Virtual Galaxy Infotech Private Limited	11.35
	<b>Mean</b>	11.86

21. The Ld. TPO accordingly determined the arm's length price of assessee qua provision of "subscription segment" as under:

Particulars	Amount
Operating Revenue of the Assessee	Rs.144,43,45,751/-
Operating Profit/Operating Revenue (OP/OR) of the assessee	1.40%
Operating Profit/Operating Revenue (OP/OR) of the comparables	11.86%
Operating Cost of the Assessee	Rs.142,41,24,910/-
Arm's length Operating Revenue	Rs.161,57,53,245/-
<b>Shortfall in the Revenue</b>	<b>Rs.17,14,07,494/-</b>

And proposed the amount of Rs.17,14,07,494/- to be adjusted under section 92CA(3) of the Act.

22. In “service segment”, the Ld. TPO selected 7 comparables after rejecting the objections raised by the assessee and accordingly computed the margin as under:

S.No.	Name of the Comparable Company	Weighted average operating margin on operating revenue (OP/OR) (%)
1	Lakshya Educare Pvt. Ltd.	13.61
2	MT Education Services Pvt. Ltd.	16.63
3	G D Goenka Pvt. Ltd.	19.77
4	Sarla Holdings Pvt. Ltd.	21.53
5	Career Mosaic Pvt. Ltd.	21.71
6	People Combine Educational Initiatives Ltd.	29.63
7	Merittrac Services Pvt. Ltd.	30.07
	<b>35<sup>th</sup> Percentile</b>	<b>19.77</b>
	<b>Median</b>	<b>21.53</b>
	<b>65<sup>th</sup> Percentile</b>	<b>21.71</b>

23. By determining the margin of the comparable @ 21.53% the Ld. TPO determined the arm’s length price qua service segment as under:

Particulars	Amount
Operating Revenue of the Assessee	Rs.34,18,58,758/-
Operating Profit/Operating Revenue (OP/OR) of the assessee	13.50%
Operating Profit/Operating Revenue (OP/OR) of the comparables	21.04%
Operating Cost of the Assessee	Rs.29,57,07,826/-
Arm’s length Operating Revenue	Rs.26,82,56,567/-
<b>Shortfall in the Revenue</b>	<b>Rs.2,74,51,259/-</b>

24. The Ld. A.R. for the assessee challenging the impugned adjustment made by the TPO/DRP/AO sought to exclude two comparables viz. Innovana Thinklabs Limited and K7 Computing Pvt. Ltd. and sought inclusion of 9 comparables viz. Funny Software Ltd., Dynacons Technologies Ltd., Empower India Ltd., PS IT Infrastructure & Services Ltd., JMD Ventures Ltd. (formerly JMD Telefilms), Unisys Software & Holding Industries Ltd., Compuage Infocom Ltd., Sonata Information Technology Ltd. and Advance Technologies Ltd. qua subscription segment.

25. Similarly, the assessee sought exclusion of MT Education Services Pvt. Ltd. as comparables and sought inclusion of 3 comparables viz. Compucom Software Ltd. (segment), Chitale's Personalised Learning Pvt. Ltd. and Anthena Eduspark Ltd. qua the service segment.

26. Let us examine the suitability of these comparables sought to be excluded and included by the assessee for the purpose of benchmarking one by one as under:

**Subscription segment**

**Comparable sought to be excluded**

**Innovana Thinklabs Ltd.**

27. The assessee challenged inclusion of Innovana Thinklabs Limited (for short Innovana) as a comparable on the grounds inter

alia that it fails TPO's own turnover filters which has less than 10% of the assessee's turnover. This argument was also advanced before the Ld. DRP as per written submissions available at page A289 of the paper book wherein complete data on the basis of financials of Innovana is given as assessee's segmental revenue for subscription segment is Rs.1,44,43,45,751/- as against Innovana's turnover of Rs.6,60,95,449/-. We are of the considered view that when the Ld. TPO has himself applied this filter of turnover he cannot go against it and as such Innovana is not suitable comparable vis-à-vis assessee, hence ordered to be excluded.

**K7 Computing Pvt. Ltd. (K7)**

28. The assessee challenged the inclusion of this comparable on the grounds inter alia that it is into selling its own proprietary IT security product "K7 Total Security" and "K7 Enterprises Security; that K7 owns and employs plant & equipments comprising 61% of its total tangible assets; that K7 owns significant intellectual property rights comprising 91.5% of the total fixed assets; and that K7 incurred Rs.15.75 crore on promotion i.e. 27.55% of sales during the year under consideration.

29. We have examined profile of the assessee company from its financials extracted at page A333 of the paper book wherein K7's

flagship products are K7 total security and K7 Enterprise Security. From annual report of K7 available at page A332 of the paper book it is apparent that the K7 owns and employs plant and equipment comprising 61% of its total tangible assets. Similarly, from its annual report i.e. note to the financial assets (fixed assets) available at page A332 it is proved on record that K7 owns significant intellectual property right of 91.5% of its total fixed assets. It is also apparent in the financials of K7 available at page A332 of the paper book that K7 incurred Rs.15.75 crore on promotions which comes to 27.55% of the sale.

30. When we compare all these facts vis-à-vis assessee, we are of the considered view that assessee is a limited risk reseller having no plant and equipments, owning no intangible assets, having no expenses on promotions and is not selling its product. So K7 is not a valid comparable vis-à-vis K7, hence ordered to be excluded.

**Comparable sought to be included by the assessee**

31. The Ld. A.R. for the assessee challenging the rejection of its comparables viz. Funny Software Ltd., Dynacons Technologies Ltd., Empower India Ltd., PS IT Infrastructure & Services Ltd., JMD Ventures Ltd. (formerly JMD Telefilms), Unisys Software & Holding Industries Ltd., Compuage Infocom Ltd., Sonata

Information Technology Ltd. and Advance Technologies Ltd. contended that the Ld. TPO has rejected these comparables on the sole ground that the word 'royalty' being introduced in the search process for comparables by the assessee gave absurd results and as such the assessee has not determined the price charged or paid in the international transactions in accordance with sub section 1 & 2 of the Act.

32. However, the Ld. A.R. taken us to the detail search strategies extracted at page A1056 of the paper book wherein the word 'royalty' doesn't find a place in the search process for subscription segment. We are of the considered view that when the assessee's business model has already been accepted by the Tribunal in assessee's own case in earlier years by holding that the actual payment of royalty and service fee both under subscription and service segment are in accordance with agreement entered into between assessee and its AE the rejection of the comparable chosen by the assessee and its benchmarking rejected by the Ld. TPO/DRP is not sustainable. So we direct the Ld. TPO to reconsider the aforesaid 9 comparables chosen by the assessee for benchmarking its transactions qua subscription segment.

**Service Segment****Comparable sought to be excluded by the assessee****MT Education Services Pvt. Ltd. (MT)**

33. The Ld. A.R. sought exclusion of MT on the ground that it fails TPO's own turnover filters as MT's turnover is less than 10% of assessee's turnover i.e. assessee's segmental revenue from service segment is Rs.35,07,70,817/- as against MT's turnover of Rs.232.10 lakhs. When this comparable does not qualify Ld. TPO's own turnover filters it is not a valid comparable vis-à-vis assessee, hence, ordered to be excluded.

**Company sought to be included by the assessee**

34. The assessee challenging the impugned rejection made by the Ld. TPO viz. Compucom Software Ltd. (segment), Chitale's Personalised Learning Pvt. Ltd. and Anthena Eduspark Ltd. on the ground that the Ld. TPO has rejected these comparables without examining the same on the sole ground that the word 'royalty' being introduced in the search process for comparables by the assessee gives absurd results. The Ld. A.R. taken us to his detail search strategy available at page A1146 of the paper book where the word 'royalty' is not part of the search process. Moreover, when the assessee's business morale has already been accepted by the Tribunal in assessee's own case in earlier years rejecting comparable of the assessee without examining the same is not

sustainable. So the Ld. TPO is directed to reexamine the comparables for benchmarking the international transactions qua service segment by providing opportunity of being heard to the assessee.

### **Software Support Segment**

35. During the year under assessment assessee provided software development services (SDS) to its AE, Red Hat USA pursuant to the acquisition of Gluster India into Red Hat India and remunerated for these services on a cost + 15% markup basis. The assessee claimed to have received Rs.55,82,40,145/- from its AE Red Hat USA for rendering these services.

36. The assessee in order to benchmarking its international transactions used TNMM as the most appropriate method with OP/OC as PLIs chosen 16 comparables with margin of 12.19% as against own margin of 15% and found its transactions at arm's length.

37. However, the Ld. TPO retained only 5 comparables of the assessee by rejecting remaining 11 and introduced 7 new comparables. The list of final comparable with weighted average OP/OC is as under:

<b>S.No.</b>	<b>Name of the Companies</b>	<b>Weighted Average OP/OC (%)</b>
1	C G-V A K Software & Exports Ltd.	18.05
2	Puresoftware Pvt. Ltd.	19.08
3	R S Software (India) Ltd.	21.37
4	R Systems international Ltd.	22.55
5	Nihilent Ltd.	25.64
6	Kellton Tech Solutions Ltd.	32.57
7	Infobeans Technologies Ltd.	32.71
8	Aspire Systems (India) Pvt. Ltd.	33.55
9	Nihilent Analytics Ltd.	34.20
10	Cybercom Datamatics Information Solutions Ltd.	61.72
11	Dun & Bradstreet Technologies & Data Services Pvt. Ltd.	69.56
12	Interglobe Technology Quotient Pvt. Ltd.	81.75
	<b>35<sup>th</sup> percentile</b>	<b>25.64</b>
	<b>Median</b>	<b>32.64</b>
	<b>65<sup>th</sup> Percentile</b>	<b>33.55</b>

38. The Ld. TPO determined the arm's length price of SDS segment on the basis of margin of the comparables at 32.64% vis-à-vis 15% of the assessee at Rs.8,56,29,184/-.

39. The Ld. A.R. for the assessee challenging the impugned adjustment on account of arm's length price qua SDS segment compressed the controversy by seeking exclusion of 7 comparables viz. Aspire Systems (India) Pvt. Ltd., Interglobe Technology Quotient Pvt. Ltd., Kelton Tech Solutions Ltd., Nihilent Analytics Ltd., Nihilent Limited, Dun & Bradstreet Technologies & Data Services Pvt. Ltd. and Infobeans Technologies Ltd.

AND sought inclusion of two comparables viz. Maveric Systems Ltd. & SagarSoft India Limited. For benchmarking its international transactions qua SDS segment, let us examine the suitability of the aforesaid comparable challenged by the assessee one by one as under:

**Comparable Sought to be excluded by the assessee  
Aspire System India Pvt. Ltd. (Aspire)**

40. The assessee sought exclusion of Aspire from the final set of comparables for benchmarking SDS segment on the ground that it fails Related Party Transaction (RPT) filters as its RPT/ sales ratio is more than 25%. The assessee computed the significant related party transactions at 37.58% whereas the Ld. TPO computed it at 23.55%. The TPO is directed to recalculate the RPT/sales ratio by providing opportunity of being heard to the assessee. So this comparable is remitted back to the Ld. TPO to decide afresh.

**Interglobe Technology Quotient Pvt. Ltd. (Interglobe)**

41. The assessee sought exclusion of Interglobe from the final set of comparable on the grounds that it fails TPO's employee cost filter with employee cost to revenue ratio of 6.68% and employee cost to total cost ratio of 11.91%. When the assessee has challenged filter applied by the Ld. TPO it has to be considered in the light of the financials of Interglobe by providing an opportunity

of being heard to the assessee. This comparable is also remitted back to the Ld. TPO to decide afresh.

**Kelton Tech Solutions Ltd. (Kelton)**

42. The assessee sought to exclude Kelton as a comparable on the ground that it fails the Ld. TPO's exports filter with export sales to total sales ratio of 46.43%. This plea was also taken before the Ld. DRP who have upheld the order passed by the Ld. TPO.

43. The Ld. TPO as well as the Ld. DRP have rejected this comparable on the ground that this is assessee's own comparable but we are of the considered view that since there is a no estoppel against the statute the assessee can challenge its own comparable if wrongly chosen inadvertently. Since this comparable fails TPO's own filter of export sales to total sales ratio it needs to be reconsidered by the Ld. TPO after providing opportunity of being heard to the assessee. So this comparable is also remitted back to the Ld. TPO to decide afresh after providing opportunity of being heard to the assessee.

**Nihilent Analytics Ltd. (Nihilent)**

44. The assessee sought exclusion of Nihilent on ground of its functional dissimilarity vis-à-vis assessee. We have examined the website information of Nihilent, made available by the assessee at

page No.405 of the paper book, wherein it is mentioned that it is engaged in providing advanced analytics, artificial intelligence, blockchain, business intelligence, data science, cloud services etc.

45. Perusal of the disclosure of enterprise's reportable segment explanatory available at page No.A406 of the paper book shows that Nihilent is engaged in software development and consultancy, engineering services, web development and hosting and subsequently diversified itself into the domain of business analytics and business process outsourcing and financials of Nihilent available at page No.A304, A405-A406 of the paper book shows that Nihilent has only one business segment and in the absence of segmental financials, as it is into diversified business, this company cannot be a valid comparable vis-à-vis assessee, who is a low risk entity working on cost + markup model. Hence, Nihilent is ordered to be excluded as a comparable.

**Nihilent Ltd.**

46. The assessee sought exclusion of Nihilent Ltd. as a comparable on the ground that it is functionally dissimilar vis-à-vis assessee. This objection was also raised before the Ld. DRP but rejected. The assessee relied upon website of the company which is made available at page A412 of the paper book wherein Nihilent

Ltd. is shown to be engaged in providing advanced analytics, artificial intelligence, blockchain, business intelligence, data signs, cloud services etc. The annual financials of this company available at page A412 & A413 of the paper book shows that it is rendering Enterprise transformation and change management, Digital transformation services and Enterprise IT services but segmental financials are not available as is apparent from its financials available at page A305, A412 & A413 of the paper book. When this company is into various segments but segmental financials are not available it cannot be a valid comparable vis-à-vis assessee which is a routine software development service provider working on cost + markup model, hence ordered to be excluded.

**Dun and Bradstreet Technologies & Data Services Pvt. Ltd.**  
**(Done & Bradstreet)**

47. The assessee sought to exclude Dun & Bradstreet as a comparable on the ground that it is functionally dissimilar being into providing predictive analysis, software development and related technology services and solution and on the ground that this company earns abnormally high margin of 58.19% during the relevant year. This objection was raised by the assessee both before the Ld. TPO as well as Ld. DRP but they have rejected the contention of the assessee by simply recording that “the company is

engaged in technology based solution and analytic sales, hence it is functionally similar and as such assessee's contention is rejected.”

48. We have perused a transfer pricing study of the assessee available at page A305, A412 & A413 of the paper book supported with relevant financials. Dun & Bradstreet is into providing wide area of sources such as D&B analytic services, risk management solutions, sales and marketing solution services, supply management solution etc. It has also come on record that the assessee has earned abnormally high margin of 58.19% as is evident from the annual report of Dun & Bradstreet and as such is not a valid comparable vis-à-vis assessee who is a routine software development service provider to its AE working on cost + markup model, hence order to be excluded.

**Infobeans Technologies Ltd. (Infobeans)**

49. The assessee sought exclusion of Infobeans on the ground that it is also functionally dissimilar being into providing business IT services (CAD) (application development and maintenance, Big Data, UX and UI, Automation engineering services, including product engineering and lifestyle solutions and business process management) in verticals of storage and virtualization, media and publishing, HR and Payroll and e-commerce. It is also providing

software engineering services primarily in Custom Application Development (CAM), enterprise mobility and Big Data Analytics (BDA).

50. Perusal of financials available at page A303, A418 to A421, Infobeans shows that it is into diversified services but its segmental financials are not available without which it is difficult to compute the correct profit margin of the relevant segment. So Infobeans is also ordered to be excluded as a comparable being not a comparable to the assessee.

**Company Sought to be included by the assessee**

**Maveric Systems Ltd. (Maveric)**

51. The Ld. TPO rejected this comparable being functionally dissimilar to the assessee and it fails turnover filters which has been upheld by the Ld. DRP. The Ld. A.R. for the assessee contended that the company is similar to the assessee being into the business of software testing within India and outside India and it passes turnover filter in the relevant latest years. The Ld. TPO is directed to reconsider Maveric as a comparable in view of its segmental reporting and by bifurcating the turnover between product or service categories by providing opportunity of being heard to the assessee.

**SagarSoft India Ltd. (SagarSoft)**

52. The Ld. TPO rejected this comparable on the ground that this company was non comparable for F.Y. 2012-13 and it means this company is a new venture as far as software development functions are concerned. This is reported as a loss making company in its first year of comparable and as such its PLI cannot be compared with the assessee which is well established old company of more than 10 years.

53. However, Ld. A.R. sought to include this company as a comparable on the ground that functional comparable prevails over profit results, since principal business activities of the company is software development consultancy services comprising 100% of the total turnover and it earns weighted average margin of 1.41% and as such cannot be considered as a loss making company.

54. We have perused the computation given by the assessee at page A381 and A427 of the paper book. Since it is a factual aspect, which needs to be examined at initial level, Ld. TPO may verify the same to reconsider SagarSoft as a comparable after providing opportunity of being heard to the assessee.

**IT Enabled Support Services (ITES) Segment**

55. The assessee challenged the adjustment made by the Ld. TPO/DRP/AO in ITES segment only by challenging the comparables chosen by the Ld. TPO for benchmarking the international transactions viz. Manipal Digital Systems Pvt. Ltd. and MPS Ltd. We would examine the suitability of both the comparables one by one.

**Manipal Digital Systems Pvt. Ltd. (Manipal)**

56. The assessee sought to exclude this company as a comparable on the ground that from the website of the company which is extracted at page A457 it has come on record that it is into providing wide range of services i.e. graphic solutions, packaging brand management services, learning solutions, digital publishing solutions and technology solutions, web development and other services but its segmental financials are not available. Since the assessee has relied upon information drawn from the website of the assessee and has not brought on record complete annual reports we direct the Ld. TPO to re-examine this comparable in the light of the objections raised by the assessee by providing opportunity of being heard to the assessee.

**MPS Ltd. (MPS)**

57. The assessee sought exclusion of MPS on the ground that MPS is functionally dissimilar to the assessee being into diversified business of providing publishing solutions i.e. type setting and data digitalization services for overseas publishers and supports international publishers through every stage of the author to reader publishing process. This company also provides digital first strategy for publishers across content production, enhancement and transformation, delivery and customer support and it is also engaged in research and development activities.

58. We have perused the annual report of MPS available at page A458-A460 of the paper book which shows the diversified functions being performed by MPS as contended by the assessee in the preceding para which are not comparable to the assessee who is a routine ITES service provider working on cost + model.

59. Moreover, the co-ordinate Bench of the Tribunal in the case of Credence Resource Management Pvt. Ltd. vs. ACIT, Pune (ITA No.133/PUN/2021 held that the activities of MPS are akin to a IT service provider and not an ITES service provider. So we direct to exclude MPS from the final set of comparables.

**Claim for working capital adjustment in all the four segments**

60. The assessee sought working capital adjustment in all the four segments viz. viz. Subscription Segment, Services Segment, Software Support Service Segment & IT Enabled Support Services, denied by the Ld. TPO/DRP/AO. The Ld. TPO/DRP denied the working capital adjustment primarily on the ground that the assessee has failed to demonstrate it as to how the difference in working capital, if any, has impacted profits because no analysis has been made as to how the comparable companies have financed their own working capital and as to whether any working capital cost had impacted on the margin of the comparable.

61. However, the Ld. A.R. for the assessee taken us to the computation made in its transfer pricing study and detail working capital adjustment margin computation with submissions made in a tabulated form as under:

Segment	Ground No.	Computation furnished in TP study (Paper-book)	Detailed Working Capital adjusted margin computation furnished	Submission to be relied on (Paper-book)
Subscription Segment	Ground no.1.4	A1016-A1017	A314 – A330	A62-A70
Service Segment	Ground no.2.4	A1020	A346-A359	
Software	Ground	A1026-	A375-A400	

Support Service Segment	No.3.5	A1027		
IT Enabled Support Services	Ground No.4.5	A1032-A1033	A	

62. We have perused the aforesaid computation and working capital adjusted margin computation furnished before the Ld. TPO which is a complete detail to arrive at differences between comparables vis-à-vis assessee qua working capital cost as provided under rule 10B(1)(e)(iii) of the Income Tax Rules which certainly effects profit margin of every company. Because every company is working in a different business environment on the basis of funds available with them and many other companies ought to borrow money to fund its business activities. Many companies are benefiting from a long period to pay its supplier which would reduce its borrowing components.

63. So all these facts show that though there are no science to arrive at exact working capital requirement of every company but it needs to be made on the basis of estimation in order to provide a level playing field both for comparables as well as for the tested party/assessee in this case.

64. This issue has already been examined and decided in favour of the assessee by the co-ordinate Bench of the Tribunal in the case of E Value Serve.Com vs. ITO (ITA No.393/Del/2010, New River Software Services Pvt. Ltd. vs. ACIT (ITA No.451/Del/2013) & Huawei Technologies India Pvt. Ltd. vs. JCIT (ITA(TP)No.1939/Bang/2017). So we are of the considered view that the assessee is entitled for working capital adjustment. The Ld. TPO is directed to verify the computation furnished in transfer pricing study and detailed working capital adjusted margin computation furnished by the assessee and accordingly provide the working capital adjustment to the assessee in view of the settled principle laid down by the Tribunal, in order to provide level playing field for assessee as well as comparable company.

#### **Claim for Proportionate Adjustment**

65. The assessee also sought grant of claim for proportionate adjustment for the value of international transactions thereby extending the quantum of transfer pricing adjustment to transactions with non AE also for two segments namely; “Subscription segment” and “Service segment” by relying upon the decision rendered by the Hon’ble Bombay High Court in the case of Hindustan Unilever Ltd. vs. CIT, Mumbai (Income Tax Appeal No.1873 of 2013) against which special leave petition has also been

dismissed by the Hon'ble Supreme Court and decision rendered by the Hon'ble Bombay High Court in the case of Tara Jewels Exports Pvt. Ltd. vs. CIT, Mumbai (Income Tax Appeal No.1814 of 2013).

66. We have perused the judgments rendered by the Hon'ble Bombay High Court in the case of Hindustan Unilever Ltd. (supra) and Tara Jewels Exports Pvt. Ltd. (supra) relied upon by the Ld. A.R. for the assessee which are on the identical issue. This settled legal position has not been controverted by the Ld. D.R. for the Revenue having been decided against the Revenue in number of cases by the Hon'ble Bombay High Court. The ratio of the judgment (supra) is "margin arrived at by the Ld. TPO to be applied to determine the arm's length price also applied to the transactions entered by the assessee with non AE also, leading to the enhancement of sale consideration qua the transactions with non AE also which is not a level playing field". So in order to arrive at the correct result proportionate adjustment needs to be extended to the AEs. So the Ld. TPO is directed to grant the proportionate adjustment in view of the judgment rendered by the Hon'ble Bombay High Court in the case of Hindustan Unilever Ltd. (supra) and Tara Jewels Exports Pvt. Ltd. (supra).

67. The next ground raised by the Ld. A.R. for the assessee is that the Ld. TPO has computed incorrect adjustment while giving effect to the direction dated 26.03.2021 given by the Ld. DRP and given the correct working of adjustment for subscription and service segment as under:

<b>Subscription Segment</b>		
<b>Particulars</b>	<b>Computation as per order dated 31 October 2019 (INR)</b>	<b>Computation as per order dated 18 December 2019-Corrected (INR)</b>
Operating Revenue of the Assessee	144,43,45,751	144,43,45,751
Operating Profit/Operating Revenue (OP/OR) of the Appellant	1.40%	1.40%
Operating Profit/Operating Revenue (OP/OR) of comparables	11.86%	11.86%
Operating cost of the Assessee	142,41,24,910	142,41,24,910
Arm's length Operating Revenue	161,57,53,245	1,27,30,46,345
<b>Shortfall in the Revenue</b>	<b>17,14,07,494</b>	<b>15,10,78,566</b>
<b>Service Segment</b>		
<b>Particulars</b>	<b>Computation as per order dated 31 October 2019 (INR)</b>	<b>Computation as per order dated 18 December 2019-Corrected (INR)</b>
Operating Revenue of the Assessee	34,18,58,758	34,18,58,758
Operating Profit/Operating Revenue (OP/OR) of the Appellant	13.50%	13.50%
Operating Profit/Operating Revenue (OP/OR) of comparables	21.04%	21.04%
Operating cost of the Assessee	29,57,07,826	29,57,07,826
Arm's length Operating Revenue	26,82,56,567	26,99,31,675
<b>Shortfall in the</b>	<b>2,74,51,259</b>	<b>2,57,76,150</b>

<b>Revenue</b>		
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68. Before proceedings with his argument the Ld. A.R. for the assessee brought to the notice of the Bench that he has already moved an application under section 154 of the Act with Ld. TPO which is pending adjudication to record the correct adjustment. In these circumstances, we are of the considered view that the Ld. TPO shall dispose of the application moved by the assessee under section 154 of the Act after verifying the working brought on record by the assessee to arrive at the correct adjustment made in this case within a period of three months.

69. Next issue raised by the Ld. A.R. for the assessee that the Ld. TPO has not complied with the directions issued by the Ld. DRP while giving effects to its directions that “the TPO to verify the working of the assessee and take the correct margin of calculation of valid comparables as discussed in the order. The Ld. A.R. for the assessee taken us to the Ld. DRP’s orders available on the appeal set wherein these directions are given but the Ld. TPO has not complied with by the same. So the Ld. TPO is directed to comply with the directions accordingly.

70. In view of the discussion made in the preceding paras, Ground No.1 & Grounds No.1.1, 1.2, 1.3, 1.4, 1.5 1.6 & 1.7;

Ground No.2 & Grounds No.2.1, 2.2, 2.3, 2.4, 2.5, 2.6 & 2.7; Ground No.3 & Grounds No.3.1, 3.2, 3.3, 3.4, 3.5 & 3.6; Ground No.4 & Grounds No.4.1, 4.2, 4.3, 4.4, 4.5 & 4.6 are partly decided in favour of the assessee for statistical purposes.

**Corporate Grounds**

**Grounds No.5.1, 5.2, 5.3 & 5.4**

71. The Ld. AO/DRP have made addition of Rs.28,01,90,592/- on account of unearned revenue from subscription services. The Ld. A.R. for the assessee contended that the AO/DRP have erred in making these additions by not following the order dated 10.04.2019 passed by the Tribunal in assessee's own case for A.Y. 2012-13 and 2013-14, this factual position has not been controverted by the Ld. D.R. for the Revenue.

72. We have perused the order passed by the co-ordinate Bench of the Tribunal in assessee's own case wherein the issue in question has been decided in favour of the assessee.

73. Undisputedly, the assessee has entered into Red Hat Enterprise Agreement (subscription agreement) with third party Indian customers which enable such customers to avail support services (subscription services) such as ongoing maintenance support services, updates, promotion and sale of 'Red Hat subscriptions' to customers in Indian sub-continent to avail support

services that are for the open source software system during the subscription period which generally spreads from 1 to 7 years.

74. The Ld. A.R. for the assessee contended that the assessee has recognized revenue from subscription service in its books of account as per the Percentage Completion Method (PCM) prescribed under Accounting Standard-9 (AS-9). Revenue recognition and subscriptions are provided over a period of 1 to 7 years, the amount received from customer in relation to subscription services are offered to tax on straight line basis under “Long term basis” and “other current liabilities” and is offered as income in the profit & loss account in subsequent years and accordingly offered to tax.

75. For this subscription services the assessee also claimed to have entered into agreement with Red Hat US under which it is required to pay royalty and services fee to Red Hat US, computed as specific percentage of revenue recorded in profit & loss account of the assessee for the respective years, available at page B239, B252 of the paper book of volume-2. At the same time due taxes have been deducted and paid with Income Tax Authority while making such payment to Red Hat US.

76. However, the AO treated such advances received (unearned revenue) as income of the year under assessment by rejecting the revenue recognition policy followed by the assessee.

77. We have perused the order passed by the co-ordinate Bench of the Tribunal in assessee's own case available at page B22 to B57 wherein this issue has been decided in favour of the assessee by returning the following findings:

***“61. Upon careful consideration we find that assessee has been following consistent system of revenue recognition. The assessee is inter alia engaged in the business of marketing, promotion and sale of 'Red Hat subscriptions' to customers in Indian sub-continent to avail support services that are for the open source software system during the subscription period ranging from one to seven year, which is established by the special services agreement or contract. As per the consistent policy of revenue recognition, the assessee accounts for the revenue for service which would be performed in future year in its books as unearned revenue. Assessee's claim is that this practice by the assessee in respect of accounting for the sale of subscription is in accordance with Accounting Standard-9 issued by ICAI. In support of this it is submitted that for rendering of service AS-9 provides that revenue should either be recognized on straight line basis over a period in which services are proposed to be rendered. The Assessing Officer has tinkered with this regularly adopted system on the plea that no further services is required to be performed by the assessee, that there is no significant uncertainty existing regarding amount of consideration that will be derived. The Assessing Officer has also find fault with completed contract method claimed to have been followed by the assessee.***

***62. Assessee's contention in this regard is that the assessee never claimed that it is recognizing revenue from subscription under completed service contract method***

*rather it is following the percentage completion method for recognition of revenue. Assessee has further reiterated that the assessee has been regularly recognizing revenue over a period to which such subscription relates. It has been claimed that the said practice of recognizing revenue is in accordance with paragraph-? of percentage complete method of AS-9. The assessee has further placed reliance upon the Income Computation and Disclosure Standard (ICDS) issued by the CBDT pursuant to section 145(2) vide Notification No. 21/2016 dated 29.9.2016 for the proposition that when services are provided by indeterminate number of acts over a period of specified time, Revenue may be recognized on straight line basis over specified period. The assessee has further relied upon the analogy from recently introduced section 43CB. In the light of the above assessee's contention is that subscription package agreed may involve various support services which cannot be predeterminate. Recipient of service can raise queries numerous times during the tenure of agreement. Similarly, any correction bug fixes etc. can be required by the customers any time during the duration of the agreement. In the light of the above submissions in our considered opinion the Assessing Officer has clearly erred in changing consistently followed method of revenue recognition adopted by the assessee. In the facts and circumstances elaborately dealt with above, we find due merits of the revenue recognition adopted by the assessee which is duly supported by mandate of AS-9 and other parameters referred above.*

*63. We also note that it is also a settled law that unless there is change in the facts and circumstances or that it can be said that earlier adopted system was wrong, revenue recognition method cannot be disturbed. We note that no such case exists here. In these circumstances, we set aside the order of the Assessing Officer and delete the addition in this regard.”*

78. Moreover, revenue recognition policy has been consistently being followed by the assessee over the years. This identical issue has also been dealt with by the Hon'ble Delhi High Court in the

case of CIT vs. Dinesh Kumar Goel (197 Taxman 375) by relying upon the decision rendered by the Hon'ble Supreme Court in the case of E.D. Sassoon & Co. Ltd. vs. CIT (1954) 26 ITR 27, wherein the issue "whether the customer had paid entire fee in advance on which services remained due to be rendered in succeeding years, such receipts could not be considered as income accrued in the year of receipts", has been decided by the Hon'ble High Court by returning the following findings:

***"Reading of the accounting standard makes it clear that the revenue is recognized only when the services are actually rendered. If the services are rendered partially, revenue is to be shown proportionate to the degree of completion of the services. This really clinches the issue in favour of the assessee."***

***"...What is the relevant yardstick is the time of accrual or arisal for the purpose of its taxation, viz., in order to be chargeable, the income should accrue or arise to the assessee during the previous year. If income has accrued or arisen, even if actual receipt of the amount is not there, it would be chargeable to tax in the said year. Though the amount may be received later in the succeeding year, the income would be said to accrue or arise if there is a debt owed to the assessee by somebody at that moment. From this, it follows that there must be the "right to receive the income on a particular date, so as to bring about a creditor and debtor relationship on the relevant date". The Court further explained that a right to receive a particular sum under the agreement would not be sufficient unless the right accrued by rendering of services and not by promising for services and where the right to receive is interior to rendering of service, the income, therefore, would accrue on rendering of services..."***

79. So in view of the matter and by following the order passed by co-ordinate Bench of the Tribunal in assessee's own case for A.Y. 2012-13 & 2013-14 (supra), we are of the considered view that when due taxes have been deducted and paid to the Income Tax Authorities while making such payment to Red Hat US in terms of the agreement entered into between the assessee and the Red Hat US in accordance with the consistent revenue recognition policy adopted by the assessee, upheld by the Tribunal in assessee's own case for earlier years, addition made by the Ld. AO/DRP on account of unearned revenue qua subscription services is not sustainable in the eyes of law. So grounds No.5.1, 5.2, 5.3 & 5.4 are determined in favour of the assessee for statistical purposes.

**Grounds No.6.1, 6.2, 6.3 & 6.4**

80. The Ld. AO/DRP has made addition of Rs.25,97,21,357/- on account of employee stock option plan (ESOP) expenses. During the year under assessment Red Hat US granted ESOPs/restricted stock units (RSU) to certain employees of the assessee for which Red Hat Inc. charged the ESOP cost of Rs.25,97,21,357/- from the assessee on cost to cost basis as per duly executed RSU gross charge agreement entered into between the assessee and the Red Hat Inc. available at page B77 to B82 of paper book-2.

81. The AO proposed the disallowance on the grounds inter alia that assessee has failed to submit copies of email exchange, resolution of board of directors and minutes of meetings wherein the decision to cross charge was taken; that RSU agreement is not acceptable on the ground of non submission of copy of the incentive scheme of Red Hat Inc. and independent valuation; that underlying internal memorandum to the cross charge agreement has been issued by the assessee and not by the Red Hat Inc.; that letter was dated 10.10.2014 and the effective date of cross charge recharge agreement is April 15<sup>th</sup>, 2015; that the payment is contingent in nature and there is a lack of clarity whether ESOP actually granted to the assessee; that the ESOP expenditure is not fully incurred for the purpose of business of the assessee and that without prejudice to the above the expenditure is of capital in nature. The Ld. DRP upheld the aforesaid disallowance.

82. The Ld. A.R. for the assessee challenging the impugned findings returned by the Ld. AO/DRP contended that the AO has ignored the documents viz. “recharge agreement” between the assessee and the Red Hat Inc. and internal memorandum prior to execution of the recharge agreement and that the AO has never sought the valuation report or the incentive plan during the course of assessment proceedings.

83. It is also contended by the Ld. A.R. for the assessee that before the Ld. DRP the assessee had brought on record documents as additional evidence, also available before the Tribunal as under:

***“Red Hat Inc. 2004 long term incentive plan pursuant to which RSU agreement was entered; Valuation report issued by Merchant bankers for the purpose of valuation of employee perquisites in the form of ESOPs; List of employees who have been granted such ESOPs; and Sample Form 16s wherein it is evident that due taxes have been deducted on such perquisites”.***

However, on the other hand, the Ld. D.R. relied upon order passed by the Ld. AO/DRP.

84. Since it is the case of the assessee that the Ld. DRP has failed to appreciate the additional evidence brought on record by the assessee and the AO has failed to examine the “recharge agreement” and “internal memorandum prior to the execution of recharge agreement” and has never sought “valuation report” or the “incentive plan”, we are of the considered view that this issue is required to be remitted back to the AO to decide afresh after providing opportunity of being heard to the assessee, in the light of the case law relied upon by the assessee viz. the Mumbai Tribunal in case of DCIT v. Accenture Services Pvt. Ltd. (ITA Nos. 4540, 4541, 5029, 5008 & 5009/M/2008 and Cross objections 214/M/2008, 47, 20, 44 & 45/M/2009, the Bangalore Tribunal in the case of Novo Nordisk India Private Limited vs. DCIT, Circle

12(2) (ITA No.1275/Bang/2011), DCIT vs L&T Infrastructure Finance Co. Ltd. (ITA No.3636/MUM/2017), Kotak Mahindra Asset Management Co. vs DCIT (ITA No.1416/Mum/2008), Aricent Technologies Holdings Ltd. vs. Addl. CIT (ITA No.5708/Del/2019) and Hon'ble Supreme Court's (SC) judgment in Sassoon J David & Co. Ltd. vs. CIT (118 ITR 261). Consequently the grounds No.6.1, 6.2, 6.3 & 6.4 are decided for statistical purposes in favour of the assessee.

**Ground No.7.1**

85. Ground No.7.1 is dismissed having not been pressed by the Ld. A.R. during the course of arguments.

**Ground No.8.1**

86. The assessee challenged the action of the AO in not granting deduction under section 80G of the Act with regard to the contribution made to Prime Minister's national relief fund by the assessee to the tune of Rs.1,18,85,969/-. It is the case of the assessee that he has brought on record the necessary evidence/receipts which is now available at page B169 to B 172. Since it was mistake apparent on record, the assessee was required to move an application under section 154 of the Act which has not moved. But in the interest of justice, the AO is directed to decide

this issue on the basis of evidence brought on record by the assessee by providing opportunity of being heard to the assessee. Consequently, the ground No.8.1 is decided for statistical purposes in favour of the assessee.

**Ground No.9.1**

87. The assessee has challenged the levying of interest under section 234B of the Act. Since this ground is consequential in nature, the AO is directed to deal with the issue in accordance with the law.

**Ground No.9.2**

88. This ground is premature and consequential in nature, hence need no finding.

89. In view of our findings on the grounds raised by the assessee, present appeal filed by the Assessee is partly allowed for statistical purposes.

**Order pronounced in the open court on 25.02.2022.**

**Sd/-  
(PRAMOD KUMAR)  
VICE PRESIDENT**

**Sd/-  
(KULDIP SINGH)  
JUDICIAL MEMBER**

Mumbai, Dated: 25.02.2022.

Copy to: The Appellant  
The Respondent  
The CIT, Concerned, Mumbai  
The CIT (A) Concerned, Mumbai  
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.