

IN THE INCOME TAX APPELLATE TRIBUNAL
"J" BENCH, MUMBAI

BEFORE SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER AND
SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA No. 3618/Mum./2017
(Assessment Year : 2010-11)

ITA No. 1838/Mum./2016
(Assessment Year : 2011-12)

Dy. Commissioner of Income Tax
Circle-3(3)(2), Mumbai

..... Appellant

v/s

Softdel Systems Pvt. Ltd.
86, Jolly Maker Chamber-II
225, Nariman Point, Mumbai 400 021
PAN - AAEC50576Q

..... Respondent

Cross Objection no.290/Mum./2017
(Arising out of ITA No. 1838/Mum./2016)
(Assessment Year : 2011-12)

Softdel Systems Pvt. Ltd.
86, Jolly Maker Chamber-II
225, Nariman Point, Mumbai 400 021
PAN - AAEC50576Q

..... Cross Objector
(Original Respondent)

v/s

Dy. Commissioner of Income Tax
Circle-3(3)(2), Mumbai

..... Respondent
(Original Appellant)

Assessee by : Shri Nitesh Joshi
Revenue by : Shri Tejinder Pal Singh

Date of Hearing - 09.02.2022

Date of Order - 16/03/2022

ORDER

PER SANDEEP SINGH KARHAIL, J.M.

The appeal by the Revenue for the assessment year 2010-11 is against the order dated 15.02.2017 passed under section 250 of the Income Tax Act, 1961 ("*the Act*") by the Commissioner of Income Tax (Appeals) ("*the CIT(A)*"). While the appeal by the Revenue and cross objection by the assessee for the assessment year 2011-12 are against the final assessment order dated 29.01.2016, passed under section 143(3) read with section 144C(13) of Act by the Assessing Officer ("*the AO*").

2. Since the appeals and the cross objection pertain to the same assessee and issues involved are, *inter-alia*, common therefore, these appeals and cross-objection were heard together as a matter of convenience and are being adjudicated by way of this consolidated order. Further, as the basic facts are same, we are elaborately mentioning only the facts for the first assessment year (i.e. 2010-11) before us for the sake of brevity.

3. The Revenue vide separate letters dated 29.11.2021 filed revised grounds of appeal for assessment years 2010-11 and 2011-12, which are considered for adjudication.

ITA no.3618/Mum./2017
Revenue's Appeal – 2010–11

4. The first issue to be decided in Revenue's appeal is with regard to restricting the transfer pricing adjustment to the markup allowed to the Associated Enterprise ("A.E.").

4.1 The brief facts of the case pertaining to this issue as emanating from the records are: For the relevant assessment year, the assessee filed return of income and revised return of income declaring total income at 'NIL'. The assessee is a domestic company having three A.Es. – SoftDel US and SoftDel Europe are wholly owned subsidiaries while SoftDel Japan is a branch office. The group provides software development solutions in the area of industrial automation, building automation, test & measurement and medical electronics. The software is developed at the development centre of the group in India. The group entities located in the respective countries enter into contracts on behalf of assessee for supply of software solutions. The onsite work is carried out by the A.Es. The assessee had entered into a Master Service Agreement with US based A.E. on 02.04.2001 under which A.E. was to procure clients for the assessee. A.E. also deployed personnel and infrastructure to provide Marketing and Support to the assessee in USA, for which A.E. was entitled to reimbursement of cost alongwith a mark-up of 5% on such costs.

4.2 In the transfer pricing study report, the assessee considered the US based A.E. as a tested party as it was performing simple functions and not owning any intangibles. The assessee adopted operating margin ratio (OP/TC) as profit level indicator and selected three comparables with arithmetic mean of their margin on cost at 10.35% and claimed that the international transaction was at arm's length price.

4.3 The AO made reference to Transfer Pricing Officer ("*the TPO*") for the determination of ALP of the international transactions entered into by the assessee. The TPO vide order dated 12.12.2013 passed under section 92CA(3) of the Act rejected the transfer pricing analysis conducted by the assessee on the basis that the complete audit report of the tested party and comparables were not filed by the assessee and therefore data considered by the assessee was not reliable. The TPO conducted an independent search for comparables and arrived at a set of 17 comparable companies having arithmetic mean of margins at 24.05%. Accordingly, the TPO made an adjustment of Rs. 3,17,55,936 on a transaction value of Rs. 4,81,49,214. The AO passed the assessment order dated 27.03.2014 under section 143(3) r/w section 144C(1) of the Act, *inter-alia*, on the basis of adjustment proposed by the TPO.

4.4 In appeal, the CIT(A), *inter-alia*, directed the TPO/AO to restrict the adjustment to the markup allowed to the A.E. by the assessee if the

computed adjustment exceeds this amount. Being aggrieved, the Revenue is in appeal before us.

4.5 During the course of hearing, Shri Tejinder Pal Singh, learned Departmental Representative, vehemently relied upon the order passed by the TPO/AO.

4.6 On the other hand, Shri Nitesh Joshi, learned Authorised Representative ("*learned A.R.*") appearing for the assessee supported the order passed by the CIT(A) by placing reliance on various judicial precedents. Further, learned A.R. submitted that the AO has also given effect to the order passed by the CIT(A) and restricted the transfer pricing adjustment to the markup allowed to the A.E. i.e. to Rs. 13,63,000, vide order dated 27.06.2017.

4.7 We have considered the rival submissions and perused the material available on record. In the present case, it is not disputed that the A.E. was a captive service provider and was remunerated on cost plus markup basis by the assessee. During the year, the assessee paid marketing support service charges of Rs. 4,81,49,214 to the A.E. In USD terms, the revenue from clients in USA was USD 14,82,280 of which USD 5,75,477 and USD 28,774 was retained by the A.E. towards its cost and mark of 5%, respectively, while the remaining amount was remitted to the assessee.

The details of profitability of assessee and its A.E., in the relevant assessment year, are as under:

<i>Particulars</i>	<i>Assessee company</i>	<i>SoftDel US ('A.E.')</i>
<i>Total revenue</i>	<i>6,96,54,470</i>	<i>7,02,45,249</i>
<i>Total Costs</i>	<i>10,24,60,046</i>	<i>6,88,81,649</i>
<i>Profit / (Loss) before Tax</i>	<i>(3,28,05,576)</i>	<i>13,63,600</i>

4.8 In the present case, adjustment proposed is on the basis of arithmetic mean margin of comparables selected by the TPO (i.e. at 24.05%) for benchmarking the international transaction, the same is higher than the mark up i.e. 5% allowed by the assessee to A.E. Thus, if the mark up allowed by the assessee i.e. 5% is replaced with the ALP margin proposed by the TPO i.e. 24.05%, in the facts of the present case, then it will result in higher amount (i.e. Cost component plus the ALP margin) being retained by the A.E. from the revenue received from the customers and the corresponding total revenue both of the assessee and AE will be much higher than the actual amount billed to the customer. Thus, in the facts of the present case, the ALP margin adopted by the TPO over and above the markup allowed to the A.E., for proposing the upward adjustment, was neither received by the assessee nor by the A.E. from its customers.

4.9 We find that on identical issue, the Co-ordinate Bench of the Tribunal in ITO v/s M/s. Ominiglobe Information Technologies India Pvt. Ltd., ITA

no.1380/Del./2016, vide order dated 15.04.2019, restricted the transfer pricing adjustment to the amount of margin retained by the A.E., by observing as under:-

"18. Ld. DRP reached the conclusion that TP adjustment cannot exceed the amount of margin retained by the AE. Ld. AR for the taxpayer contended that this issue is covered in favour of the taxpayer by the decision rendered by the coordinate Bench of the Tribunal in the case of HCL Technologies BPO Ltd. vs. ACIT – ITA No.3547/Del/2010 which is confirmed by Hon'ble Delhi High Court and Hon'ble Supreme Court. Operative part of which is as under :-

"11. Without prejudice to the assessee company's contention that the adjustment made by the TPO is not sustainable, it was submitted that the adjustment at best could be made only to the extent of Rs. 11,960,457, being the amount which has been retained by the associated enterprise.

12. The Ld. CIT(A) in his order restricted the Transfer Pricing adjustment to Rs. 1.19 crores holding as under:

"The Transfer Pricing Officer has computed an adjustment of Rs.17.04 crores while the value of international transactions is Rs.13,00,89,632. The total revenue received by the associated enterprises in respect of BPO services rendered by the appellant amounting to Rs.13,00,89,632 is Rs.14,20,50,089. In other words, the associated enterprise has retained Rs. 1,19,60,457 out of the total proceeds received from the customers. The adjustment computed by the TPO in the order passed under section 92CA(3) of the Act at best cannot exceed the net amount retained by the associated enterprises in respect 'of international transactions, i.e., gross revenue' received from the end customers less amount paid' to the appellant and, other operating expenses. It is observed that the gross revenue received from the end customers in respect of various contracts, the associated enterprise have retained only Rs. 1,19,60,457 at their end and the balance has been passed on to the appellant."

12.3 The issue has been considered in the recent decision of Delhi Bench of the Tribunal in the case of DCIT vs. Global Vantage P. Ltd., wherein, the Tribunal held that adjustment on account of arm's length price of international transactions cannot exceed the maximum arm's length price, i.e., the amount received by the associated enterprise from the customer and the actual value of international transactions, i.e., the amount received by the assessee in respect of international transactions.

12.4 In view of the same I am of the considered view that the adjustment to the income of the appellant has to be restricted to

Rs.1,19,60,457- being the amount retained by the associated enterprises."

13. Aggrieved with this order, the Revenue had come up in the present appeal. Ld. D.R. placed reliance on the order of Ld. CIT(A) and had prayed for quashing of CIT(A)'s order on this issue. On the other hand, Ld. Sr. Counsel submitted that the appellant could not have expected to receive from the customers of the AEs of the appellant, anything more than the amount paid by some customer to the AE, if the appellant were to be obtain the contracts for services from the customers directly, i.e., without the involvement of the AEs of the appellant. Thus, at the most the consideration received by the appellant from the AEs may be replaced by the consideration received by the AEs from its customers, for the services provided by the appellant; the price charged by AEs to the customers being the CUP. Reliance is placed in this regard on the decision of the Hon'ble Delhi High Court in the case of Sony India P. Ltd. vs. CBDT (Delhi) ; 288 ITR 52 has at pages 61-62, observed as under:

"The concept of transfer pricing leading to tax avoidance has been acknowledged in the Act only recently. It is a concomitant of the operations of multinational corporations (MNCs) that set up base by incorporating a local subsidiary in a country where they seek to operate. It is often seen that the MNC transfers goods and services to its local subsidiary at a price not reflective of the market price (or arm's length price as if is referred to in the present context) and in turn the subsidiary is able to avoid, partly or wholly, payment of the local tax, Although the expression "transfer price" has not been defined in the Act,' it is 'understood to mean "that price which is arrived at when two associated or related' enterprises deal with each other".

14. Reference was made to the Finance Minister's Budget Speech for the year 2001 that the presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern. The purpose of inserting these provisions is therefore to determine the arm's length price (ALP) of an international transaction involving an MNC and its local associate."

15. Reliance is placed on the decision of Delhi Bench of the Tribunal in the case of DCIT vs Global Vantage P. Lid., (ITA No. 1432 & 2321/Del/2009 and 116/Del/2011), wherein, the Hon'ble Tribunal held that adjustment on account of arm's length price of international transactions cannot exceed the amount received by the associated enterprise from the customer and the actual value of international transactions, i.e., the amount received by the assessee in respect of international transactions. The Hon'ble Jurisdictional High Court vide order dated 14-03-2013 (in ITA Nos. 1828/2010, 1829/2010 & 1254/2011) had dismissed the Revenue's appeal against the said order of the Tribunal. The Special Leave Petition (SLP) of the Revenue against the said order has also been dismissed by the Supreme Court vide order dated 02-01-2014 (CC No. 22166 of 2013).

16. Further reliance in this regard is placed on the following observation of the Hon'ble Delhi bench of the Tribunal in the case of *Li & Fung (India) Pvt. Ltd. vs. DC IT* (ITA No 5156/DeI/2010):

17. The Hon'ble Delhi High Court recently vide order dated 16-12-2013 (in ITA No.306/2012), while adjudicating on the said decision of the Tribunal, held in paragraph 40 of the order that "the approach of the TPO and the tax authorities in essence imputes notional adjustment / income in the assessee's hands on the basis of a fixed percentage of the free on board value of export made by unrelated party vendors. "

18. Reliance in this regard is also placed on the recent decision of Delhi Bench of the Tribunal in the case of *Hyper Quality India Pvt. Ltd. vs. ACIT* (ITA No. 5630/0ell2011), wherein, it has been held as under:

"7. Ld. TPO erred in evaluating FAR (Functions performed, Assets. employed and Risk assumed) analysis which has been summarily confirmed by DRP. To support its case, assessee furnished split financials of the appellant and its AE. Whereas the appellant has been able to earn profit in India its counterpart the AE has continuously sustained losses. There being no element of profit in the hands of the AE, there is no case of shifting of profits, practicable or probable. Invoking a higher ALP on the appellant is only anticipatory and complete ignorance of fact. The facts and figures produced before the Ld. TPO establish that there is no commercial profit available in the hands of the AE. In absence of profit availability, the any enhancement of the ALP results in artificial profit anticipated by the Ld. TPO and not earned by the Appellant. The order of the LD, TPO in enhancing the ALP offered by the appellant is in ignorance of valid FAR and factual considerations and is bad in law and facts."

19. Reliance in this regard is placed on the recent decision of Delhi High Court in case of *Sony Ericsson Mobile Communications India Pvt. Ltd. vs. CIT III* (ITA No. 16/2014) where in it has been held that the arm's length seeks to correct distortion and shifting of profits of tax the actual income earned by a resident. The Hon'ble Delhi High Court held as under:

'77. As a concept and principle Chapter X does not artificially broaden, expand or deviate from the concept of "real income". "Real income", as held by the Supreme Court in *Poona Electricity Supply Company Limited versus CIT*, [1965] 57 ITR 521 (SC), means profits arrived at on commercial principles, subject to the provisions of the Act. Profits and gains should be true and correct profits and gains, neither under nor over stated. Arm's length price seeks to correct distortion and shifting of profits to tax the actual income earned by a resident/domestic AE. The profit which would have accrued had arm's length conditions prevailed is brought to tax. Misreporting, if any, on account of non-arm's length conditions resulting in lower profits, is corrected.

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(xii) When segmentation or segregation of a bundled transaction is required, the question of set off and apportionment must be examined realistically and with a pragmatic approach. Transfer pricing is an income allocating exercise to prevent artificial shifting of net incomes of controlled taxpayers and to place them on parity with uncontrolled, unrelated taxpayers. The exercise undertaken should not result in over or double taxation. Thus, the Assessing Officer/TPO can segregate AMP expenses as an independent international transaction, but only after elucidating grounds and reasons for not accepting the bunching adopted by the assessed, and examining and giving benefit of set off. Section 92(3) does not bar or prohibit set off."

20. In view of the aforesaid, it is respectfully submitted that the adjustment shall be restricted to Rs. 1.19 crores.

21. We have head rival submissions and perused the material on record. Ld. CIT(A) had followed the ratio laid down in the case of Global Ventedge P. Ltd. (supra) (in I.T.A. No. 1432 & 2321 / Del/2009 and 116/Del/2011). This decision was affirmed by both Hon'ble High Court and Hon'ble Supreme Court and his ratio was followed in subsequent decisions as submitted earlier and, therefore, the order of Ld. CIT(A) on this issue is reasonable and we do not find any reason to interfere with this finding of Ld. CIT(A) and hence, the grounds of appeal filed by revenue are dismissed. Accordingly, appeal filed by revenue is dismissed."

19. So, following the decision rendered by the coordinate Bench of the Tribunal in HCL Technologies BPO Ltd. vs. ACIT (supra, affirmed by Hon'ble Delhi High Court and Hon'ble Supreme Court, we are of the considered view that Id. DRP has rightly held that transfer pricing adjustment should not exceed the amount of margin retained by the AE. Consequently, findings returned by the Id. DRP are hereby confirmed. So, ground no.2 is determined against the Revenue."

4.10 Similar view was also expressed by another Co-ordinate Bench of the Tribunal in Fortune Infotech Ltd. v/s ACIT, ITA no.274/Ahd./2013, vide order dated 03.02.2016. As in the facts of the present case, A.E. being remunerated on cost plus markup basis, it's margin is nothing but the markup allowed by the assessee. Respectfully following the aforesaid judicial precedence of the Co-ordinate Benches of the Tribunal, we find no infirmity in the findings of the CIT(A) on this issue. Accordingly, grounds no. 1 and 2 in Revenue's appeal are dismissed.

5. The next issue to be decided in Revenue's appeal is regarding the application of filters for selection of comparables. The CIT(A) vide impugned order directed the TPO to apply employee cost filter of 25%, filter of domestic sales exceeding 25% of total sales and also directed rejection of a comparable having related party transaction of more than 25%.

5.1 As we have upheld the order passed by the CIT(A) to the extent the TPO/AO was directed to restrict the adjustment to the markup allowed to the A.E., other ground raised by the Revenue pertaining to applicability of various filters, in the present case, becomes academic in nature. It is evident from the application dated 28.04.2017 filed by the assessee requesting for order giving effect to the order passed by the CIT(A) that even after application of the filter, as directed by the CIT(A), the mean margin of comparables was arrived at 44.53%, which was higher than the margin allowed to the A.E. by the assessee. As a result, ground no. 3 in Revenue's appeal is dismissed.

6. As regards ground no. 4 raised in Revenue's appeal, same is general in nature and is also dismissed in view of our aforesaid findings in Revenue's appeal.

7. In the result, appeal by the Revenue being ITA no. 3618/Mum/2017 is dismissed in terms of our aforesaid findings.

ITA no.1838/Mum./2016
Revenue's Appeal – 2011-12

8. The issue arising in grounds no. 1 and 2 in Revenue's appeal pertaining to restricting the transfer pricing adjustment to the markup allowed to the A.E. is similar to Revenue's appeal for assessment year 2010-11. Only difference in this assessment year is that the Revenue is aggrieved with similar directions issued by the DRP under section 144C(5) of the Act, whereby the AO/TPO was directed to restrict the transfer pricing adjustment to the amount which could have been received by the A.E. Thus, our findings/conclusion in Revenue's appeal being ITA No. 3618/Mum./2017 for assessment year 2010-11 shall apply *mutatis mutandis*. Accordingly, ground nos. 1 and 2 raised in Revenue's appeal are dismissed.

9. As we have upheld the order passed by the DRP following our findings/conclusion in Revenue's appeal for assessment year 2010-11, other grounds raised by the Revenue pertaining to applicability of various filters, in the present case, becomes academic in nature. Accordingly, grounds no. 3 and 4 raised in Revenue's appeal are dismissed.

10. As regards ground no. 5 raised in Revenue's appeal, same is general in nature and is also dismissed in view of our aforesaid findings in Revenue's appeal.

11. In the result, appeal by the Revenue being ITA no. 1838/Mum/2016 is dismissed in terms of our aforesaid findings.

Cross-objection No. 290/Mum/2017

12. As we have dismissed the appeal filed by the Revenue for assessment year 2011-12, the cross-objection filed by the assessee becomes infructuous and is accordingly dismissed.

13. In the result, the cross-objection by the assessee is dismissed as infructuous.

Order pronounced in the open court on 16/03/2022

**Sd/-
PRASHANT MAHARISHI
ACCOUNTANT MEMBER**

**Sd/-
SANDEEP SINGH KARHAIL
JUDICIAL MEMBER**

MUMBAI, DATED: 16/03/2022

Copy of the order forwarded to:

- (1) The Assessee;
- (2) The Revenue;
- (3) The CIT(A);
- (4) The CIT, Mumbai City concerned;
- (5) The DR, ITAT, Mumbai;
- (6) Guard file.

*Pradeep J. Chowdhury
Sr. Private Secretary*

True Copy
By Order

Assistant Registrar
ITAT, Mumbai