

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE**

**BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

IT(TP)A No. 280/Bang/2016
Assessment Year : 2011-12

The Income Tax Officer, Ward – 4 (1)(3), Bangalore.	Vs.	M/s. Micro Focus Software India Pvt. Ltd. (earlier known as Novell Software Development (India) Pvt. Ltd.), Bagmane Tech Park 'D' Block, 'LAUREL' 65/2, C V Raman Nagar, Byrasandra, Bangalore – 560 093. PAN: AAACN6992K
APPELLANT		RESPONDENT

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**IT(TP)A No. 319/Bang/2016
Assessment Year : 2011-12
(By Assessee)**

Assessee by	:	Smt. Tanmayee Rajkumar, Advocate
Revenue by	:	Dr. Manjunath Karkihalli, CIT (DR)

Date of Hearing	:	03-03-2022
Date of Pronouncement	:	29-04-2022

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present cross appeals has been filed by revenue as well as assessee against order dated 29.12.2015 passed by Ld. ITO Ward 5(1)(1),

Bangalore under section 143(3) read with section 144C(13) of the Act, for assessment year 2011-12 on following grounds of appeal:

Revenue's appeal

"1. The directions of the Dispute Resolution Panel are opposed to the law and not on the facts and circumstance of the case.

2. The ld.DRP erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable and accordingly erred in excluding the companies as comparables.

3. Whether the DRP is correct in excluding on the basis of Turnover filter, while the comparable is qualifying all the qualitative and quantitative filters applied by the TPO.

4. In the facts and circumstances of the case the Id.DRP erred in holding that foreign exchange loss or gain is a part of operating expense or operating income and exclusion of depreciation from cost as the case may be, when the TPO has excluded this data from that of the comparables.

5. Whether the DRP is correct in foreign exchange fluctuation as operating in nature and exclusion of depreciation from cost while treating foreign exchange fluctuation and deprecation non-operating in nature as applied by the TPO.

6. Whether the Ld.DRP was right in seeking exact comparability while searching for comparable companies of the assessee under TNMM method whereas requirement of law and international jurisprudence requires seeking similar comparable companies.

7. For these and other grounds that may be urged upon, direction of the Dispute Resolution Panel may be reversed and that assessment order be restored.

8. The appellant craves leave to add, alter, amend or delete any other grounds on or before hearing of the appeal."

Assessee's Appeal

"The Appellant submits as under:

1. Assessment and reference to Transfer Pricing Officer are bad in law

a) That the final assessment order passed by the Respondent (hereinafter referred to as 'the AO') is bad in law and on facts, and has been passed in violation of the principles of natural justice.

b) That, without prejudice to the above, the final assessment order passed by the AO is bad in law to the

extent the AO did not issue to the Appellant a show cause notice as per proviso to Section 92C(3) of the Income-tax Act, 1961 [‘the Act’].

c) That, on the facts and circumstances of the case and in law, the Respondent erred in not providing the Appellant an opportunity of being heard prior to making a reference to the Additional Commissioner of Income-Tax (Transfer Pricing) — 2(1), Bangalore [‘the TPO’ for short], which is violative of the principles of natural justice.

d) That the Respondent erred in law in making a reference to the TPO without recording an opinion that any of the conditions in Section 92C(3) of the Act were satisfied in the instant case.

e) That the final assessment order passed by the AO is without jurisdiction insofar as it purports to give effect to an invalid order of the TPO and to invalid directions of the Dispute Resolution Panel [‘DRP’].

f) That, on the facts and circumstances of the case and in law, the TPO erred in and the DRP further erred in confirming the action of the TPO in not demonstrating that the motive of the Appellant was to shift profits outside of India by manipulating the prices charged in its international transactions which is a pre — requisite condition which must be fulfilled prior to making any adjustment under the provision of Chapter X of the Act.

2. Determination of arm's length price / Erroneous data used by the TPO

a) That the TPO erred in rejecting the values of international transactions relating to software development services (IT Services'), Telecom Support Services ('ITeS') and Software Duplication and Re-Distribution Services as recorded in the books of accounts as the arm's length prices of the said services. The DRP erred in upholding the actions of the AO/ TPO.

b) That the TPO erred in law and on facts in not accepting the Appellant's economic analysis of its international transactions which was undertaken in accordance with the provisions of the Act read with the Income-tax Rules, 1962 (‘the Rules’ for short).

c) That the AO/ TPO erred in facts and in law in conducting fresh benchmarking analyses by substituting the Appellant's analyses with fresh benchmarking analyses on his own conjectures and surmises and, in doing so, determining new arm's length prices. Thus the Appellant prays that the fresh benchmarking analyses conducted by the AO/ TPO are

liable to be set aside. The DRP erred in upholding the actions of the AO/ TPO

d) That the AO/TPO has erred in law and the DRP further erred in confirming the action of the TPO in using data which was not available in the public domain at the time of conducting the transfer pricing study by the Appellant.

e) That the AO/ TPO erred in law and the DM' further erred in confirming the non-application of multiple-year data while computing the margins of alleged comparable companies.

f) That the AO/TPO grossly erred on facts in benchmarking the international transactions of the Appellant with services provided by companies operating as full-fledged entrepreneurs without considering the differences in the functions performed, assets employed and risks undertaken by the Appellant vis-à-vis the other companies.

g) That the AO/TPO erred in law in applying arbitrary filters to arrive at a fresh set of companies allegedly as comparables to the Appellant without establishing their functional comparability. The DRP further erred in confirming the same.

h) That the AO/TPO grossly erred in law in deviating from the uncontrolled party transaction definition as per the Rules and arbitrarily applying a 25% related party criteria in accepting / rejecting comparables. The DRP erred in confirming the same.

i) That the AO/TPO erred on facts and in law in arbitrarily rejecting companies having a different financial year ending (i.e. other than 31' March 2011) and inconsistently applying such filter. The DRP erred in confirming the same.

j) That the AO/TPO also erred in arbitrarily rejecting companies without considering their functional comparability. The DRP erred in confirming the same

3. Comparability analysis adopted h the TPO for determination of arm's length price relating to Software Development Services

a) That the AO/TPO erred in rejecting Helios & Matheson Information Technology Limited on the grounds of non-availability of data and for having a different financial year ending (i.e. other than 31' March 2011), despite the said company being functionally comparable to the Appellant and annual report being available. The DRP further erred in confirming the same.

b) That the AO/TPO erred in rejecting LGS Global limited and Power Soft Global Solutions Limited for non-availability of data in the public domain without properly considering their annual reports for the relevant financial year which were furnished by the Appellant. The DRP erred in confirming the same.

c) That the AO/ TPO erred on facts and in law in arbitrarily rejecting companies having export sales less than 75% of their total sales, and the DRP further erred in confirming the same.

d) That, without prejudice to the contention that the filter requiring export revenues being 75% of total sales is unwarranted, the AO/ TPO erred on facts and in law in arbitrarily rejecting Goldstone Technologies Ltd. and Vama Industries Ltd. on the ground that their export revenues constituted less than 75% of their total sales despite the said companies having export turnovers in excess of 75% of their total turnovers. The DRP further erred in confirming the same.

e) That the AO/ TPO erred on facts and in law in arbitrarily rejecting companies having employee costs less than 25% of their total revenues, and the DRP further erred in confirming the same.

f) That, without prejudice to the Appellant's contention that the AO/TPO ought not to have arbitrarily rejected those companies having employee costs less than 25% of their total revenues, the AO/TPO erred in rejecting CG Vak Software & Export Ltd. and LGS Global Limited on that ground despite the said companies having employee costs in excess of 25% of their total revenues. The DRP further erred in confirming the same.

g) That the AO/TPO also erred on facts and in law in arbitrarily rejecting R Systems International Ltd. for having a different financial year ending (i.e. other than 31' March 2011), despite the said company being functionally comparable to the Appellant. The DRP further erred in confirming the same.

h) That the AO/ TPO erred in rejecting Akshay Software Technologies Ltd., CG Vak Software & Export Ltd., LGS Global Ltd., Goldstone Technologies Ltd., Powersoft Global Solutions Ltd., R Systems International Ltd., Helios & Matheson Information Technology Ltd.. and Varna Industries Ltd., despite these companies being functionally comparable to the Appellant. The DRP also erred in confirming the same.

i) That the AO/ TPO erred in including Acropetal Technologies Ltd., e-zest Solutions Ltd., E-infochips

Ltd., ICRA Techno Analytics Ltd., and Persistent Systems & Solutions Ltd., despite these companies being functionally dissimilar to the Appellant. The DRP also erred in confirming the same.

j) The DRP has rejected Infosys Ltd., Larsen & Toubro Infotech Ltd., Persistent Systems Ltd., Mindtree Ltd., and Tata Elxsi Ltd., on application of upper turnover filter of INR 200 crores. However, the DRP has erred in not rejecting the said companies as being functionally dissimilar to the Appellant.

k) That the AO/TPO erred in wrongly computing the margins of companies identified as comparable i.e, Larsen & Toubro Infotech Ltd., Persistent Systems and Solutions Ltd. and Tata Elxsi Limited. The DRP erred in upholding the actions of the AO/TPO.

4. Determination of arm's length price relating to Telecom Support Services

a) That the AO/TPO erred rejecting Spanco Limited and In House Production Limited for non-availability of data in the public domain without considering their annual reports for the relevant financial year which were furnished by the Appellant. The DRP erred in confirming the same.

b) That the AO/TPO erred in rejecting Aditya Birla Minacs Worldwide Limited on the ground that its related party transactions exceeded 25% of its revenues despite the said company's related party transactions for the financial year 2010-11 constituting only approximately 5% of its revenues for the said year. The DRP further erred in confirming the same.

c) That the AO/ TPO erred on facts and in law in arbitrarily rejecting companies having export sales less than 25% of their total sales, and the DRP further erred in confirming the same.

d) That the AO/TPO also erred on facts and in law in arbitrarily rejecting Caliber Point Business Solutions Ltd. for having a different financial year ending (i.e. other than 31' March 2011), despite the said company being functionally comparable to the Appellant. The DRP further erred in confirming the same.

e) That the AO/TPO erred in arbitrarily rejecting companies having ITeS revenue less than 75% of total operating revenue and inconsistently applying such a filter, without considering the specific segmental results. The DRP erred in confirming the same.

f) That the AO/TPO grossly erred in rejecting Informed Technologies India Limited by applying the aforesaid filter despite the said company having ITeS revenue in excess of

75% of its total operating revenues. The DRP erred in confirming the same.

g) That the AO/ TPO erred in including Accentia Technologies Ltd., Acropetal Technologies, ICRA Online Ltd., and Jeevan Scientific Technology Ltd. in the final list of comparables despite these companies being functionally dissimilar to the Appellant. The DRP also erred in confirming the same.

h) The DRP has rejected Infosys BPO Ltd., Mindtree Ltd. and iGate Global Solutions Ltd. on application of upper turnover filter of INR 200 crores. However, the DRP has erred in *ie* 'not rejecting the said companies as being functionally dissimilar to the Appellant.

5. Determination of arm's length price relating to Software Duplication and Re-Distribution Services

a) That the AO/TPO erred in law and on facts in rejecting the Appellant's application of the Resale Price Method ('RPM') as the Most Appropriate Method ('MAM') in its TP Study for determination of the arm's length price of the above international transaction, and consequently erred in applying the Transactional Net Margin Method ('TNMM') as the MAM for the said transaction. The DRP erred in confirming the same.

b) That the AO / TPO erred in law and on facts in rejecting the Appellant's application of Gross Profit Margin as the Profit Level Indicator ('PU') for the above international transaction. The DRP erred in confirming the same.

c) That, without prejudice, the AO/TPO grossly erred in conducting a fresh transfer pricing analysis for determining the arm's length price of the above international transaction without sharing the methodology of his search process with the Appellant and without affording the Appellant an opportunity of objecting to the same or granting an opportunity of hearing prior to making an adjustment to the price for the said international transaction. which is in gross violation of the principles of natural justice and thus the adjustment made is *ex facie* illegal, bad in law and liable to be set aside. The DRP erred in confirming the same.

d) That, in any event, the AO/TPO erred in rejecting the comparable companies selected by the Appellant in its Transfer Pricing study without considering the functional and risk analysis of the Appellant. The DRP erred in confirming the same.

e) That, in any event, the AO/TPO grossly erred in arriving at a fresh set of companies allegedly as

comparables to the Appellant without establishing their functional comparability and without properly considering the functions performed, assets employed and risks undertaken by the Appellant vis-à-vis the other alleged comparable companies. The DRP further erred in confirming the same.

f) That, without prejudice to the above and in any event, the AO / TPO erred in making an adjustment to the price of the above international transaction by not restricting the adjustment to the actual value of the international transaction, i.e., the purchase price paid by the Appellant to its Associated Enterprises. The DRP erred in confirming the same.

6. Non-allowance of appropriate adjustments to the comparable companies, by the TPO

a) That the AO/TPO erred in law and on facts in not allowing appropriate adjustments under Rule 10B to account for, inter alia, the differences in (a) accounting practices; (b) marketing expenditures; (c) research and development expenditures; and (d) risk profiles to account for the differences between the Appellant and the comparable companies.

b) That the AO/TPO grossly erred in law and on facts in arbitrarily applying upper caps to the working capital adjustments allowable to the Appellant while determining the arm's length prices of its international transactions without there being any legal basis or rationale for limiting the working capital adjustments to the said percentages, and thus erred in not granting the entire adjustments allowable under Rule 10B of the Rules to account for the differences in the working capital positions of the Appellant and of the comparable companies.

c) That, despite the binding directions of the DRP, the AO / TPO grossly erred in law and on facts in not excluding the Appellant's cost of depreciation from its operating cost bases while determining the arm's length prices of its international transactions of provision of software development services and telecom support services, and thus erred in not complying with the binding directions of the DRP in this regard.

7. Variation of 5% from the arithmetic mean

That the AO/TPO erred in law in not granting the benefit of the proviso to Section 92C(2) to the Appellant.

8. Non set-off of the entire brought forward losses

a) That, after having made the transfer pricing adjustments and without prejudice to our contention that no adjustment should be made to the returned income, the AO erred in not setting-off the remaining brought forward

losses available to the Appellant while computing its taxable income for AY 2011-12.

b) That the AO erred in not complying with the directions issued by the DRP to verify the facts and allow the Appellant's claim in this regard.

9. Short grant of TDS credit

a) That the AO erred in granting credit for TDS of only Rs. 110,883/- as against an amount of Rs. 6,259,186/- claimed by the Appellant in the return of income for AY 2011-12.

b) That the AO erred in not complying with the directions issued by the DRP to verify the facts and allow the Appellant's claim in this regard.

10. Directions issued by the DRP:

That the directions issued by the DRP, to the extent they confirm the draft assessment order of the AO, are erroneous and liable to be set aside.

11. Initiation of penalty proceedings

That the AO erred in initiating penalty proceedings under Section 271(1)(c) of the Act.

12. Relief

a) The Appellant prays that directions be given to grant all such reliefs arising from the above grounds and also all reliefs consequential thereto.

b) The Appellant craves leave to add to or alter, by deletion, substitution or otherwise, the above grounds of appeal, at any time before or during the hearing of the appeal.

The Appellant submits that the above grounds are independent of and without prejudice to one another."

2. Brief facts of the case are as under:

2.1 The Assessee is a wholly owned subsidiary of Novell Inv., USA engaged in providing software development and support services to Novell US. The Assessee also provides telephonic support services to its AE. It also purchases software products from Novell USA, for direct sale to its customers in India, as well as, duplicates and markets software products purchased from Novell USA, for year under consideration, the assessee filed its return of income on 30/11/2011 declaring total income of Rs.22,10,754/-. Return was processed under section 143(1) of the Act and case was selected for scrutiny. Ld.AO observed that, assessee entered into international

transaction with associated enterprises for more than Rs.15 crores, and therefore reference was made to Ld.TPO for determining arms length price of the international transaction.

2.2 Upon receipt of reference, the Ld.TPO called for economic details of international transaction in Form 3CEB. The Ld.TPO observed that, the assessee entered into following international transaction with its associated enterprises:

Particulars	Amount in Rs.
Provision of software development services	115,84,60,432/-
Provision of IT enabled services	7,52,73,455/-
Software Duplication and Re-distribution	4,03,96,085 /-
Reimbursement of expenses	8,61,778/-
Recovery of services	2,71,58,603/-

2.3 Ld.TPO accepted arms length price, computed by assessee in respect of Software Duplication and Re-distribution (comprising purchase of software and royalty on sale of duplicated software). The only segment disputed by the Ld.TPO was in respect of Software Development Services and Provision of IT enabled serviced. It is observed that, for software development service segment, the assessee used TNMM as most appropriate method and computed its margin by using OP/TC as PLI and computed its margin at 10%. The assessee selected following 10 comparables with an average margin of 13%:

Sl. No.	Name of the company	Average NPI
1	Akshay Software	3.32%
2	CG-Vak Software & Exports Ltd.	0.35%
3	Evoke Technologies Private Ltd.	19.92%
4	Goldstone Technologies Ltd.	4.42%
5	Helios & Matheson Information Technology Ltd.	17.60%

Sl. No.	Name of the company	Average NPI
6	LGS Global Ltd.	14.67%
7	Mindtree Ltd.	12.16%
8	Persistent Systems Ltd.	23.99%
9	Powersoft Global Solutions Ltd.	14.56%
10	RS Software (India) Ltd.	12.12%
11	R Systems International Ltd.	11.85%
12	Sasken Communication Technologies Ltd.	22.04%
13	Tata Elxsi Ltd.	15.17%
14	Varna Industries Ltd.	9.85%
Arithmetical Mean		13%

2.4 In respect of IT service segment, the assessee used TNM as the most appropriate method, and OP/TC is the PLI, thereby computed its margin at 10.01%. The assessee used following 8 comparables having average margin of 15.1%:

Sl. No.	Name of the company	Average NPI
1.	Aditya Birla Minacs Worldwide Ltd.	0.22%
2.	Caliber Point Business Solutions Ltd.	21.65%
3.	Cosmic Global Ltd.	25.82%
4.	e4e Healthcare Business Services Pvt. Ltd.	20.67%
5.	Informed Technologies India Ltd.	19.29%
6.	Inhouse Production Limited	10.97%
7.	Jindal intellicom Ltd.	9.75%
8.	Spanco Limited	12.46%
Arithmetical Mean		15.10%

2.5 The assessee, thus held the transaction to be at arms length.

2.6 Ld.TPO dissatisfied with comparables selected by the assessee, applied various filters and excluded certain comparables from assessee's list. The Ld.TPO thus selected following comparables for software development service segment and IT enabled service segment.

Software development service segment:

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)	Mark-up on Total Costs (WC - adj) (in %)
1	Acropetal Technologies Ltd. (seg)	31.98	27.53

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)	Mark-up on Total Costs (WC - adj) (in %)
2	e-Zest Solutions Ltd.	21.03	17.82
3	E-Infochips Ltd.	56.44	54.94
4	Evoke Technologies Pvt. Ltd.	8.11	6.84
5	ICRA Techno Analytics Ltd.	24.83	21.66
6	Infosys Ltd.	43.39	42.28
7	Larsen & Toubro Infotech Ltd.	19.83	18.68
8	Mindtree Ltd. (seg)	10.66	8.09
9	Persistent Systems & Solutions Ltd.	22.12	20.01
10	Persistent Systems Ltd.	22.84	20.46
11	R S Software (India) Ltd.	16.37	15.06
12	Sasken Communication Technologies Ltd.	24.13	23.33
13	Tata Elxsi Ltd. (seg)	20.91	17.78
AVERAGE MARGIN		24.82	22.25

IT enabled service segment

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)	Mark-up on Total Costs (WC - adj) (in %)
1.	Accentia Technologies Ltd.	28.99	25.50
2.	Acropetal Technologies	26.86	22.15
3.	Cosmic Global Ltd.	9.81	9.75
4.	e4e Healthcare Business Services Pvt. Ltd.	12.38	13.22
5.	ICRA Online Ltd. (seg)	34.21	32.32
6.	Jeevan scientific technology Ltd.	70.66	70.60
7.	Infosys BPO Ltd.	17.89	15.30
8.	Jindal intellicom Ltd.	11.13	10.95
9.	Mindtree Ltd. (seg)	10.76	8.18
10.	iGate Global solutions Ltd.	25.07	23.82
AVERAGE MARGIN		24.77	23.18

2.7 The Ld.TPO, proposed adjustment in respect of the 2 segment is under:

Particulars	Proposed adjustment
Software development service segment	Rs.13,89,09,426/-
IT enabled services meant	Rs.90,93,681/-

2.8 Software Duplication and Re distribution(SDR) segment:

The Ld.TPO though held that the transaction in SDR segment to be at arm's length, he subsequently passed an order under Section 154 of the Act dated 04.02.2015, determining adjustment in respect of the SDR segment.

The Ld.TPO under 154 proceedings observed that, for SDR segment, the assessee used RPM as the most appropriate method and PLI was computed at 41.79% by using GP/sales. The assessee used following 8 comparables having average margin of 19.83%:

Sl. No.	Name of the company	Average PLI
1	AGC Networks Ltd.	31.58
2	Accel Frontline Ltd.	33.67
3	Dynacons Systems & Solutions Ltd.	12.40
4	Dynacons Technologies Ltd.	9.01
5	Empower India Ltd.	2.81
6	Omitech Infosolutions Ltd.	44.15
7	Softcell Technologies Ltd.	15.38
8	Sonata Information Technology Ltd.	9.63
Arithmetical Mean		19.83

The assessee, held its transaction to be at arms length.

The Ld.TPO, dissatisfied with the method applied and the PLI used for computing the margin. He thus adopted TNMM as the most appropriate method, and OP/sales as PLI, and computed assessee's margin at 2.26%.

The Ld.TPO proposed an adjustment of ₹6,63,78,224/- for SDR segment.

3. On receipt of the Transfer pricing order under 92CA, the Ld.AO passed the draft assessment order on 20/02/2015 incorporating the transfer pricing adjustment aggregating ₹.21,43,81,331/-. The

Ld.AO, further disallowed set off, of brought forward losses claimed by the assessee, and also did not grant full credit of TDS.

4. Aggrieved by the draft assessment order, the assessee raised objections before the DRP.

The DRP directed as under:

For SWD segment

- i. **Turnover filter:** The DRP directed exclusion of companies having turnover in excess of Rs. 200 crores.
- ii. **Foreign exchange fluctuation:** The DRP directed that the foreign exchange fluctuation ought to be treated as operating in nature while computing operating margins of the assessee and the companies chosen as comparables.
- iii. **Working capital adjustment:** Despite the assessee's objections, the DRP upheld the working capital ('WC' for short) adjustment determined by the TPO in the TP order, wherein the working capital adjustment was restricted to 1.63% as against the actual adjustment of 1.98%.
- iv. **Depreciation adjustment:** The DRP, following its directions in the assessee's case for AY 2010-11 and CIT(A)'s order for AY 2009-10, directed that the margins of the assessee, as well as, the comparables be computed after excluding depreciation from the cost base.

5. On giving effect to the DRP directions, the final list of comparable to the SWD service segment are as follows:

SI. No.	Name of the Company	Adjusted Margin
1.	Acropetal Technologies Ltd. (seg)	71.68
2.	e-Zest Solutions Ltd.	29.11
3.	E-Infochips Ltd.	70.50
4.	Evoke Technologies Pvt. Ltd.	11.07

5.	ICRA Techno Analytics Ltd.	31.76
6.	Persistent Systems and Solutions Ltd. Ltd.	25.67
7.	R S Software (India) Ltd.	19.75
ARITHMETICAL MEAN		37.08

For IT enabled service segment:

- v. **Turnover filter:** The DRP directed exclusion of companies having turnover in excess of Rs. 200 crores.
- vi. **Foreign exchange fluctuation:** The DRP directed that the foreign exchange fluctuation ought to be treated as operating in nature while computing operating margins of the Assessee and the companies chosen as comparables.
- vii. **Working capital adjustment:** Despite the assessee's objections, the DRP upheld the WC adjustment determined by the TPO in the TP order, wherein the adjustment was restricted to 1.47% as against the actual adjustment of 1.59%.
- viii. **Depreciation adjustment:** The DRP, following its directions in the assessee's case for AY 2010-11 and CIT(A) order for AY 2009-10, directed that the margins of the assessee as well as the comparables be computed excluding depreciation from the cost.

6. On giving effect to the DRP directions, the final list of comparable to the ITES service segment are as follows:

Sl. No.	Name of the Company	Adjusted margin (as reflected in the Final assessment order)
1.	Accentia Technologies Ltd.	40.41
2.	Acropetal Technologies	38.27
3.	Cosmic Global Ltd.	11.38
4.	e4e Healthcare Business Services Pvt. Ltd.	20.72
5.	ICRA Online Ltd. (seg)	30.52
6.	Jeevan scientific technology Ltd.	70.87

7.	Jindal intellicom Ltd.	19.84
ARITHMETICAL MEAN		33.14

In respect of the SDR segment, the DRP up held the adjustment proposed by the Ld.TPO.

7. On receipt of the DRP direction, the Ld.AO passed the impugned order, making addition in the hands of the assessee at Rs.2,01,33,808/-

We note that the issue alleged by revenue as well as the assessee is in respect of comparables excluded and retained respectively.

8. Before we undertake the comparability analysis, it is *sine qua non* to understand the FAR analysis of the assessee under both the segments.

It is been observed by Ld.TPO, that the assessee is wholly owned subsidiary of Novell Inc.USA, and is engaged in providing software development support services to Novell Inc.USA.

Functions:

In TP study, assessee is submitted to be providing development services to AE which includes developing certain components of Novell products, like e-directory, developer tools for NetWare 6 and NetWare 5 ex-IP etc. In TP study, assessee has been classified into various product groups:

- the application group;
- networking and advanced services group;
- network management services group;
- operating Systems group;
- quality management group and technology group;

It has been submitted in TP study that workflow of software development services provided by assessee can be summarised as follows:

- Novell US prepares a product requirement document (PRD) which is developed by the product management team of Novell based on the inputs from the customer, the marketing team of the product group and the core team management of Novell US, and the product engineering group of Novell India.
- The product is initiated once the PRD is received. The product engineering team of Novell India makes an engineering requirement specification. The project engineering team at Novell India develops the project based on the inputs received from Novell US to ensure that the deliveries are tied into the product release.
- Based on the project plan developed, the product engineering team of Novell India performs specific functions which comprise of defining and designing the functional specifications for the project, identification of interfaces, functions, components, coding and bug fixing, code drop, unit test, integration and final system set.
- The component developed is tested for quality and functionality with significant focus on real-life customer scenarios.
- The final tests to determine the quality of a product developed before it is released into the market is performed by the product engineering team of Novell India in coordination with Novell US.
- Novell US is responsible for the launch of the product developed.
- Novell India also renders third level customer support wherein the product engineering team of Novell India renders technical support to the technical service team of Novell US. Novell US

acts as the customer interface, though the support service could be provided by Novell India.

- Novell India is responsible for providing both technical and user documents for all components, providing communication support, project documentation and web publishing.

Assets employed:

It has been submitted in TP study that, assessee do not own any non-routine valuable intangible assets.

Risks Assumed:

It has been submitted that assessee does not assume any significant risks as entire contract is entered into by AE with end customers. Except for foreign exchange fluctuation risk assessee does not bare any other risk with respect to the ultimate success or failure of the activities.

Characterisation:

Thus from the above, assessee has been characterised as back-office service provider in the process of software development carried out by the AE.

We shall first take up revenue's appeal

9. **Ground No. 2-3** of Revenue's appeal is in respect of excluding following comparables by holding that size and turnover of these companies were deciding factors and therefore, was not comparable with that of assessee.

9.1 Ld.CIT.DR submitted that, for SWD Segment, the DRP excluded Tata Elxsi Ltd., Sasken Communication Technologies Ltd., Persistent Systems Ltd., L&T Infotech Ltd., and Infosys Ltd., by applying turnover filter; and

For ITeS Segment, Infosys BPO Ltd., iGate Global Ltd., and Mindtree Ltd., by applying turnover filter.

The Ld.CIT.DR submitted that, such filter is not prescribed under IT Rules, as one, which is to be applied while determining arms length price of international transaction. The Ld.CIT.DR placed reliance on orders passed by Ld.AO/TPO. He relied on following decisions of coordinate bench of this *Tribunal* in support of his contention:

- *NTT Data Global Delivery Services Ltd. vs ACIT reported in (2016) 59 Taxmann.com 7;*
- *LSI Technologies India Pvt.Ltd vs ITO reported in (2016) 70 Taxmann.com 189;*
- *Societe Generale Global Solutions Centre Pvt.Ltd vs DCIT reported in (2016) 69 Taxmann.com 336*
- *Capgemini India Pvt.Ltd vs ACIT reported in (2015) 58 Taxmann.com 175;*
- *Wills Processing Services India Pvt.Ltd vs DCIT reported in (2013) 30 Taxmann.com 350.*

9.2 Ld.AR submitted that, application of turnover filter is upheld by coordinate Bench of this *Tribunal* in several decisions, including *Genesis Integrating Systems India Pvt. Ltd. vs DCIT reported in (2012) 20 taxmann.com 715*, wherein, comparables were excluded on high turnover filter, and that, it is held that appropriate turnover range should be applied in selecting comparables of uncontrolled companies. He submitted that, this *Tribunal* in case of *Genesis Integrating Systems India Pvt.Ltd.*, (*supra*) observed as under:

"For the purpose of classification of companies on the basis of net sales or turnover, a reasonable classification has to be made. Dun & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, it is held that the turnover filter is very important and the companies having a turnover of Rs.1.00 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study"

9.3 We have perused submissions advanced by both sides, in light of records placed before us.

9.4 It is observed that, the companies engaged in software development services selected by the Ld.TPO are engaged in software development services, but has not considered verticals/functional or service lines, in which the company is engaged. Thus it is observed that comparables selected are into different verticals and functional lines, though assessee is catering to software development and maintenance needs of the group in the global trade and logistics domain and has been characterized as pure captive software development service provider and ITeS service provider. The Ld.TPO applied the lower limit of the turnover filter without capping it with the maximum limit, thereby included those companies that are into various other functions and services.

This *Tribunal* in case of *Genesis Integrating Systems India Pvt. Ltd., vs DCIT (supra)*, while considering various filters applied by Ld.TPO observed as under:

6. Functionally different filter;

The assessee is engaged in providing the software development services and the software development process is a structure imposed on development of software products. Often, the first step in attempting to design a new piece of software is to decide whether it would be in addition to existing software or is it new application, a new subsystem or a whole new system. This is what is generally referred to as 'Domain Analysis'. Assuming that the developers are not sufficiently knowledgeable in the subject area of the new software, the first task is to investigate the so called 'domain' of the software, because more knowledgeable they are about the domain already, the less the work that is required. Another objective of this work is to make the analysts who will later try to elicit and gather the requirements from the area experts or professionals, speak with them in the domain's own terminology and to better understand what is being said by these people because otherwise they will not be taken seriously. The next most important task in creating a software product is extracting the requirement of the customers and then precisely describing the software to be written possibly in a rigorous way.

In practice, most successful specifications are written to understand and fine tune applications that were already well developed, although safety critical software systems are often carefully specified prior to application and development. The architecture of a software system refers to an abstract specification of the software system and is concerned with making sure that the software system will meet the requirements of the product as well as ensuring that future requirements can be addressed. The architecture step also addresses interfaces between the software system and other software products, as well as the underlying hardware or the host operating system. Thereafter, a design is reduced to code and where the code is to be written by two different engineers, they must work together and the testing of software falls on to the shoulders of software engineers. The next important task is documenting the internal design of software for the purpose of future maintenance and enhancement. A large percentage of software projects fail because the developers fail to realize that it does not matter how much time and planning a development team puts into creating a software if nobody in the organization ends up using it. Therefore, it is very important to have training classes for the most enthusiastic software users, shifting the training towards the neutral users intermixed with the avid supporters and finally incorporate the rest of the organization into adopting the new software. The next important step is the maintaining and enhancing software to cope with newly discovered problems or new requirements. This can take far more time than the initial development of the software and about 2/3rd software engineering work is maintenance and a small part of it i.e. fixing bugs. The best known and oldest process of software development is the waterfall model which follows all the above processes and after each step is finished, the process proceeds to the next step just as builders do not revise the foundation of a house after framing has been erected.

3. From the above analysis, it can be seen that a company which develops a software product by following all the above steps involved in creating a software is a software development company and in this case, intellectual property generated belongs to the company and the products are generally sold on license basis wherein the right to use the software is transferred without giving the source code. Unlike these software development companies, pure software development service provider does a portion of the described software development life cycle. It does not generate any intellectual property of its own. The intellectual property generated belongs to the customer and not to the service provider. A software customization company buys software products in the form of licenses from third party or uses its own software products for customization to suit the requirements of the customer and in this case, only the right to use the software is passed on to the customer

and therefore, the same is also considered as software development service providers. A software trading company purchases software products in the form of licenses or on royalty basis as a right to use and sells these products as a reseller.

3.1 The assessee being a software development service provider, it cannot be compared to a software development company or a software trading company. Therefore, the companies that are functionally different from that of the tax payer are to be excluded.

.....

9. Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1.00 core to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study."

9.5 In facts of present case, assessee is doing part of software development cycle and therefore has been categorised as a captive software development service provider as well as ITeS segment, catering to needs of the group. The assessee in TP study held to be comprise of Software Engineers, who develop project based on inputs received from AE. Engineers employed by assessee designs functional specifications for the project identification of interfaces components coding and bug fixing.

Ultimate approval and owner of project developed is the AE. In our view, by involving itself in process of Software development for AE, assessee cannot be held to be fullfledged Software Development Company. One has to look into transaction in regards to services rendered and FAR, which catagorises it to be a captive service provider, working on business model of cost plus margin.

9.6 It is observed that comparables sought to be excluded are 100 % Software Development Companies, having high turnover and therefore respectfully following aforestated view in case of *Genesis Integrating Systems India Pvt. Ltd., vs DCIT (supra)* these comparables are to be excluded on both the counts of functionally not being similar with that of assessee and also because they have a high turnover of more than 200 crore.

9.7 Reliance is also placed on decision of this *Tribunal* in case of *Autodesk India Pvt.Ltd. vs DCIT* reported in (2018) 96 *Taxmann.com* 263, followed similar view to exclude identical comparables by applying turnover filter, wherein all the decisions relied upon by Ld.CIT.DR has been considered and dealt with.

9.8 In support, reliance was placed on decisions of this *Tribunal* in case of *Triology E Business Software India Pvt.Ltd., vs DCIT* reported in (2013) 29 *Taxmann.com* 310 and decision of *Hon'ble Bombay High Court* in case of *CIT vs Pentair Water India Pvt. Ltd* in *ITA No. 18/2015 vide order dated 16/09/15. Hon'ble High Court* in case of *Paintair water India Pvt.Ltd (supra)* held that, turnover is a relevant criteria for choosing companies as comparables for determining ALP of international transaction. Even otherwise, all above referred comparables are functionally

not similar with that of assessee, which is only a captive software development service provider, which does not design/develop/sell software products and does not own any IP.

9.9 Therefore, respectfully following above decisions, we uphold exclusion of Tata Elxsi Ltd., Sasken Communication Technologies Ltd, Persistent Systems Ltd., L&T Infotech Ltd., and Infosys Ltd., by applying turnover filter under SWD Segment and for ITeS Segment, Infosys BPO Ltd., iGate Global Ltd., and Mindtree Ltd., by applying turnover filter, from final list.

We therefore uphold exclusion of this comparable by Ld.AO.

Accordingly Ground No.2-3 raised by revenue stands dismissed.

10. **Ground No 4-5** raised by the revenue is against holding the foreign exchange loss or gain as part of operating expenditure and excluding depreciation cost.

10.1 The revenue is contending that the DRP erred in directing the Ld.AO/TPO to consider the foreign exchange fluctuation to be operating in nature.

10.2. On the other hand, the Ld.AR submitted that it is one of the settled position that gains/loss arising from fluctuation of foreign exchange having nexus with the international transaction ought to be treated as being operating income and ought to be taken into consideration while computing the operating margin of the company. She relied on the decision of coordinate bench of this *Tribunal* in case of

(i) *e4e Business Solutions India (P.) Ltd. v. DCIT* reported in (2016) 67 *taxmann.com* 68.

(ii) *Finastra Software Solutions (India)(P.)Ltd.* reported in (2018) 93 *taxmann.com* 460.

10.3. We have perused the submissions advanced by both sides in light of records placed before us.

Coordinate Bench of this Tribunal in case of *Finastra Software Solutions (India)(P.)Ltd.(supra)*, on identical facts observed and held as under:

“38. As far the issue treating foreign exchange gain as operating revenue is concerned, it has been held in several decisions of various Benches of ITAT that foreign exchange gain, to the extent it relates to or connected with the business for which ALP is determined, is to be regarded as operating revenue or loss as the case may be. In the case of SAP Labs India (Pvt.) Ltd. [6 ITR (Trib) 81] and Trilogy E Business Software India (Pvt.) Ltd. vs. DCIT [(2011) 12 taxmann.com 464], which decisions have subsequently been consistently followed by this Tribunal, lays down the proposition that foreign exchange gain or loss has to be regarded as operating revenue or loss. The learned DR however brought to our notice a decision of the ITAT Bangalore Bench in the case of Commonslope Networks (India) Pvt.Ltd. Vs. The ITO IT(TP) A.No.166 & 181/Bang/2016 order dated 22.2.2017 wherein it was the foreign exchange gain or loss that arises should relate to the concerned AY because what is compared is the profit margin of a particular AY. According to him therefore the TPO/AO should examine the nature of foreign exchange gain or loss in the case of the Assessee and the comparable companies and to the extent it relates to turnover of the relevant AY and the segment for which ALP is being determined, the same should alone be considered as part of the operating revenue or loss. The learned counsel for the Assessee pointed out that it is impossible to carry out such an exercise. The Assessee might be willing to carry out such an exercise but the same cannot be expected from the comparable companies who have to furnish the relevant data. He also pointed out that under rule 10B (3) of the criteria for comparability is the effect of profit on account of differences. Rule 10B(3) reads thus:

“(3) An uncontrolled transaction shall be comparable to an international 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."

The learned counsel for the Assessee therefore submitted that profit arising from comparable transaction will not be materially affected by adopting the foreign exchange gain as reflected in the accounts of the comparable companies because the terms of credit are almost identical in the line of business of SWD Services and ITES.

39. We have considered the rival submissions and are of the view that in the light of Rule 10B(3) of the Rules and the business cycle in the relevant business, the comparability will not be materially affected if the foreign exchange gain is considered as reflected in the accounts of the comparable companies as available in public domain. To this extent the decision rendered by the Bangalore Bench of ITAT in the case of Commonslope Networks (India) Pvt.Ltd. (supra) is distinguishable. Therefore respectfully following the decision of the ITAT Bangalore in the case of SAP Labs (supra), we hold that the DRP was justified in directing the AO to consider the foreign exchange gain or loss as operating in nature. Therefore, in light of the above, this ground of the Revenue is liable to be dismissed."

Respectfully following the above view, we uphold the treatment of foreign exchange loss/gain to be operating in nature.

10.4. Depreciation cost treated as being non-operating in nature:

10.5. In this regard, it is submitted by the Ld.AR that, the assessee has a policy of charging higher rate of depreciation as compared to the companies selected as comparables. Therefore, in order to eliminate the impact on the margins arising on account of the above, an adjustment is required to be made. The Ld.AR placed reliance on following decisions:

- (i) Assessee's own case A.Y: 2009-10 in IT(TP)A No. 1491/Bang/2014 & C.O. No.69/Bang/2015 by order dated 04.09.2019;*
- (ii) Decision of by coordinate bench of this in case of DCIT v. Novell Software Development (India) (P.) Ltd. by Order dated 04.09.2019 passed in IT(TP)A No. 1491/Bang/2014 and C.O. No. 69/Bang/2015 for the assessment year 2009-10*

- (iii) *Decision of by coordinate bench of this in case of Honeywell Technology Solutions Lab (P.) Ltd.v. DCIT reported in (2013) 35 taxmann.com 144;*
- (iv) *Decision of Hon'ble Pune Tribunal of this in case of E-gain Communication (P.) Ltd. v. ITO reported in (2009) 118 ITD 243; and*
- (v) *Decision of by coordinate bench of this in case of 24/7 Customer.com (P.) Ltd. v. DCIT reported in (2012) 28 taxmann.com 258).*

10.6. On the contrary, the Ld.CIT.DR relied on orders passed by authorities below.

10.7. We have perused the submission advanced by both sides in light of records placed before us.

As far as issue of excluding depreciation cost alleged by the revenue is concerned, *Coordinate Bench* of this *Tribunal* in assessee's own case for A.Y: 2009-10 in *IT(TP)A No. 1491/Bang/2014 & C.O. No.69/Bang/2015* by order dated 04.09.2019 observed and held as under:

"11. Ground No.3 is in respect of disallowing depreciation as an adjustment in comparables.

Ld.AR submitted that assessee has a policy of charging higher rate of depreciation as compared to companies selected by Ld.TPO. Assessee placed reliance on the accounting notes wherein policy of depreciation at page 15 of paper book, Vol-1 has been encapsulated. She thus submitted that adjustment is to be made to eliminate difference between assessee and comparables. Placing reliance upon decision of this Tribunal as well as Pune Tribunal in Honeywell Technology solutions Lab Pvt.Ltd in ITA No. 1344/Bang/2011 and E-Gain Communications Pvt.Ltd vs ITO reported in (2008) 23 SOT 385, she submitted that Ld.CIT (A) rightly directed Ld.TPO to exclude depreciation from operating costs of assessee as well as comparables.

Ld.CIT DR placed reliance upon orders passed by Ld.AO/TPO.

12. We have perused submissions advanced by both sides in the light of the records placed before us.

It has been submitted by the Ld.AR that for assessment year 2005- 06 in assessee's own case when this issue was remanded by this Tribunal is Ld.TPO/AO had inter alia granted the adjustment on depreciation after taking into consideration the detailed working submitted by

assessee. Placing reliance upon page 892-898 of paper book, it has been submitted that for year under consideration detailed working is already available before authorities below. Ld.CIT (A) observed as under:

"14.5.(v) Depreciation Adjustment 14.5.1. An extract of my predecessor's order is reproduced as under; During the appellate proceedings, it is submitted that the appellant company as a policy of charging a higher rate of depreciation as compared to the Companies selected by the TPO, therefore, there is need for making an adjustment to eliminate the difference in the accounting policies for the tested parties and the comparable companies.

Having heard the contention of the appellant, as per Rule 10B(3), the margin of the comparables and the tested party have to be computed on the same base considering the accounting policies followed. Accordingly, instead of allowing any adjustment on this account, the AO is directed to compute the margin in respect of the comparables after excluding the depreciation from the cost and also in the case of the appellant the depreciation to be excluded from the cost for computing the arm's length difference. The appeal on the above issue is disposed accordingly".

14.5.2 Similar claim has been made in this year and I see no reason to differ with my predecessor and hence, the TPO is directed to follow this direction in the current year. It is ordered accordingly.

Considering above discussion and observations by Ld.CIT (A), we do not find any infirmity in adopting a consistent view and the same is upheld."

10.8. Ld.AR submitted that for year under consideration also the assessee charged higher rate of depreciation as compared to companies selected by Ld.TPO. Facts being the same with assessment year 2009-10, we do not find any infirmity in adopting the consistent view to in computing the margin in respect of the comparables after excluding the depreciation from the cost.

In the result the appeal filed by revenue stands dismissed.

11. As far as the appeal filed by assessee is concerned, the grounds that are pressed and argued by the Ld.AR are adjudicated as follows.

12. **Ground No.3(i):** That the lower authorities erred in including Acropetal Technologies Ltd., e-Zest Solutions Ltd., E-Infochips Ltd., ICRA Techno Analytics Ltd. and Persistent Systems & Solutions Ltd. despite these companies being functionally dissimilar to the SWD services segment of Assessee.

A. Acropetal Technologies Ltd

A.1 The Ld.AR submitted that assessee seeks exclusion of this comparable as it fails the software development services revenue filter at 75%, which is applied by the Ld.TPO. She submitted that the revenue from IT services as considered by the TPO is less than 75% of the total revenue of the company 57.47%. The Ld.AR submitted that this comparable is functionally not comparable to the assessee as on a perusal of the services offered under its information technology services segment, which was what was considered by the Ld.TPO, it is evident that services such as IT infrastructure management services and information life cycle management form a part thereof. In this regard, it is submitted that such services are akin to IT enabled services and thus given that there is no bifurcation of the revenue within the IT segment into IT and IT enabled services, the company ought to remain excluded from the list of comparables.

A.2 In support she placed reliance on coordinate bench of this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT* reported in TS-815-ITAT-2016(Bang)-TP at paras 16.1 to 16.4 at pages 31-32, *Finastra Software Solutions (India) (P.) Ltd. v ACIT* reported in (2018) 93 taxmann.com 460 at para 15 and *Aspect Technology Center (I.) Pvt. Ltd. v. ITO* by order dated 30/07/2020, passed by this Tribunal in IT(TP)A No.187/Bang/2016 at para 20, in the

case of similarly placed assesseees, the exclusion of the said company from the list of comparables was upheld.

A.3 On the contrary, the Ld.DR relied on orders passed by the authorities below.

A.4 We have perused the submission advanced by both sides in light of records placed before us.

A.5 We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Aspect Technology Center (I.) Pvt. Ltd. v. ITO(supra)* observed and held as under:

*20. However, as far as Acropetal Technologies Ltd. (Ground No. 4 in Revenue's appeal) is concerned, Acropetal was directed to be excluded by the DRP not only on the ground that it was held to be predominantly engaged in onsite development of software in view of its expenses in foreign currency, but also on the following grounds - (i) that, in the absence of segmental information containing the break-up of its export sales, it was not possible to ascertain if it passed the export earnings filter; and (ii) that, in the absence of segmental information containing the break-up of its employee costs, it was not possible to ascertain if it passed the employee costs filter (Pages 18-20 of the DRP's directions). Revenue vide ground Nos. 2 to 4 is seeking the inclusion of the company in the final list of comparables. After hearing the rival submission on exclusion of Acropetal from the list of comparable companies, we find that exclusion of this company from the list of comparable companies should be upheld because this company fails the employee cost filter of employee cost being equal to at least 25% of the total operating revenue. From the annual report of the company it can be seen that the employee costs incurred by the company is 11.51% of the total operating revenue. Apart from the above, the Company also fails the TPO's filter of service revenue is excess of 75% as the income from software development activity is Rs. 81.40 Crores out of total operating revenue of Rs. 141 Crores. As it is clear that the company fails TPO's own filters of employee cost in excess of 25% and service revenue is excess of 75%, the company ought to remain excluded from the final list of comparables. We also find that this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT [IT(TP)A Nos. 17 & 39/Bang/2016]* at paras 16.1 to 16.4 at pages 1606-1607; *Finastra Software Solutions (India) (P.) Ltd. v. ACIT [2018] 93 taxmann.com 460 (Bangalore - Trib.)* at para 15 at page 1744; *Electronic Imaging India P. Ltd v. DCIT [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 8 at pages 1725-1726]* and *IT(TP)A Nos.187 & 175/Bang/2016 Commscope Networks (I) Pvt. Ltd. v. ITO [TS-161-ITAT-2017(Bang)-TP at para 9 on pages 1639-1640]* held that this company should be excluded from the list of comparable*

companies in the case of companies engaged in rendering SWD services such as the Assessee.”

A.6 Respectfully following the above view, we direct the Ld.AO/TPO to exclude this Comparable from the final list.

B. e-Zest Solutions Ltd.

B.1 The Ld.AR submitted that the company is engaged in end to end product development, including product design and development and is incomparable to the Assessee. Further, she also submitted that, it has significant inventory (nearly 15% of the income from its operations) which substantiates the Assessee's contention that it is a product development company, and thus incomparable to the Assessee which is engaged in rendering routine IT services.

B.2 In addition, the Ld.AR submitted that, services rendered by E-Zest Solutions Ltd. are diverse such as product development, software services, web development, and support services. The company is also engaged in rendering business intelligence and analytical services, and are thus akin to IT enabled services / Knowledge Process Outsourcing ('KPO') services. Since there are no segmental details available in its annual report, the company is liable to be excluded from the final list of comparables. Submissions in this regard are placed at pages 1325-1329 and 2000-2004 of the paperbook.

B.3 Reliance is placed on *Coordinate Bench* of this *Tribunal* in case of *Applied Materials India Pvt. Ltd. v. ACIT* (supra) at paras 9.1.1 to 9.1.3 pages 16-18 and in *Finastra Software Solutions (India) (P.) Ltd. v ACIT* (supra) at para 16.

B.4 On the contrary, the Ld.DR relied on orders passed by the authorities below.

B.5 We have perused the submission advanced by both sides in light of records placed before us.

B.6 We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Aspect Technology Center (I.) Pvt. Ltd. v. ITO(supra)* observed and held as under:

33. As far as e-Zest Solutions Ltd., and Persistent Systems & Solutions Ltd., is concerned, these were Comparable companies chosen by the TPO. The Assessee did not object to inclusion of these two companies before the TPO nor were objections filed against inclusion of these two companies before the DRP. The Assessee now wants to content that these two companies are functionally different and based on judicial decisions in which these two companies were excluded as functionally not comparable with a company rendering SWD services such as the Assessee. The Assessee seeks to rely on the decision of the Special Bench ITAT Chandigarh in the case of DCIT Vs. Quarks Systems Pvt. Ltd., 42 DTR 414 (Chandigarh-SB) wherein it was held that there cannot be estoppel against law and that non-comparable companies even if selected by the assessee in TP study can be sought to be excluded by the assessee based on functional comparability or other valid reasons. We therefore admit the relevant ground of appeal seeking exclusion of these two companies. Since the TPO/AO did not have opportunity to decide the issue, we are of the view that it would be just and appropriate to remand the issue to the TPO for deciding the correctness of choosing this company as a comparable company. The TPO/AO shall afford opportunity of being heard to the Assessee.”

B.7 Respectfully following the above view, we remand the issue to the TPO for deciding the correctness of choosing this company as a comparable company. Needless to say that proper opportunity of being heard will be granted to the assessee.

C. E-Infochips Ltd.

C.1 The Ld.AR submitted that this company is engaged in diverse activities such as software development, product development and the provision of IT enabled services for which no separate segmental information is available in its annual report. On the contrary, the diverse activities of software development and the IT enabled services are considered and reported together in one

segment. Thus, in the absence of such segmental details, the company ought to be held as functionally not comparable to the assessee, which is a captive software development service provider. Further, the company also has significant inventory and intangibles in its books of account, unlike in the case of the assessee. Submissions in this regard are placed at pages 1330-1337 and 2005-2012 of the paperbook.

C.2 The Ld.AR placed reliance on the decisions of coordinate bench of this *Tribunal* in *Finastra Software Solutions (India) (P.) Ltd. v ACIT* (supra) at para 17 and *Aspect Technology Center (India) Pvt. Ltd. v. ITO* (supra) at para 21, where the exclusion of the said company from the list of comparables was upheld.

C.3 On the contrary, the Ld.DR relied on orders passed by the authorities below.

C.4 We have perused the submission advanced by both sides in light of records placed before us.

C.5 We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Aspect Technology Center (I.) Pvt. Ltd. v. ITO*(supra) observed and held as under:

“21. As far as Gr.No.6 raised by the Revenue is concerned, the revenue in this ground has challenged exclusion of E-Infochips Ltd. on the ground that it failed the software service income filter at 75%. At the outset, the Assessee submits that E-Infochips Ltd. was excluded by the DRP on the ground that: (i) no segmental information regarding its diverse functions is available; (ii) there is presence of significant inventory and (iii) it failed the software service income filter at 75% (Pages 17-18 of the DRP's directions). The Revenue, in its appeal, has challenged its exclusion only the first and the third grounds. In other words, the Revenue has not challenged its exclusion on the ground of presence of significant inventory and thus its exclusion on this ground has attained finality and cannot be disturbed by this Hon'ble Tribunal. Apart from the above, we find that the company's software development service revenue for FY 2010-11 was less than 75% of its total operating revenue for that year. Thus, the above action of the DRP in rejecting the above company is correct. The DRP has also rightly

*appreciated that the above company is engaged in diverse activities such as product development and the provision of IT enabled services for which no separate segmental information is available in its Annual Report. On the contrary, the diverse activities of software development and the IT enabled services are considered and reported together in one segment. Thus, in the absence of such segmental details, the company was rightly held to be functionally not comparable to the Assessee which is a captive software development service provider (relevant submissions at internal IT(TP)A Nos.187 & 175/Bang/2016 page 73 of the objections filed before the DRP and pages 237-239 of the paperbook). Further, as was noted by the DRP, the company also has presence of inventory and is, therefore, incomparable to the Assessee. We also find that this Tribunal in *Electronic Imaging India P. Ltd v. DCIT [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 9 at pages 1726-1727]*; *Saxo India Pvt. Ltd. v. ACIT [2016] 67 taxmann.com 155 (Delhi - Trib.) (paras 10.1 and 10.2 at pages 1656-1657)* (which came to be upheld by the Hon'ble Delhi High Court); *Finastra Software Solutions (India) (P.) Ltd. v. ACIT [[2018] 93 taxmann.com 460 (Bangalore - Trib.) at para 17 at page 1744]*; *Cypress Semi-conductor Technology India Pvt. Ltd. v. DCIT [IT(TP)A No.356/Bang/2016 at paras 19-20 at pages 1773-1775]*; and *Commscope Networks (I) Pvt. Ltd. v. ITO [TS-161-ITAT-2017(Bang)-TP at para 9 on pages 1639-1640]* held that this company ought to be excluded from list of comparable companies in the case of companies rendering SWD services similar to that of the Assessee. Consequently, for the above reasons, the action of the DRP in directing the exclusion of E- Infochips Ltd. is upheld and the ground is dismissed.”*

C.6 Respectfully following the above view, we direct the Ld.AO/TPO to exclude this Comparable from the final list.

D. ICRA Techno Analytics Ltd.

D.1 The Ld.AR submitted that this company is functionally not comparable as it is engaged in high end KPO services and also fails the RPT filter applied by the Ld.TPO. The annual report and website extracts of the company make it clear that, the company is engaged in software development, engineering services, web development & hosting, business analytics and business process outsourcing, with details of all the segments reported under one segment. It also has revenues from licensing fees and annual maintenance charges which are not in the nature of software development. The services rendered by the company as per its

website also include services akin to IT enabled services/KPO services. Submissions in this regard are placed at pages 1343-1349 and 2013-2021 of the paperbook.

D.2 The Ld.AR placed reliance on the decisions of coordinate bench of this *Tribunal* in *Applied Materials India Pvt. Ltd. v. ACIT* (supra) at paras 17.1 to 17.2 pages 32-34, *Finastra Software Solutions (India) (P.) Ltd. v ACIT* (supra) at para 17 and *Aspect Technology Center (India) Pvt. Ltd. v. ITO* (supra) at para 22, where in the case of assessees similar to the assessee herein, the exclusion of the said company from the final list of comparables was upheld.

D.3 On the contrary, the Ld.DR relied on orders passed by the authorities below.

D.4 We have perused the submission advanced by both sides in light of records placed before us.

D.5 We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Aspect Technology Center (I.) Pvt. Ltd. vs. ITO*(supra) observed and held as under:

*As far as Gr.No.7 raised by the revenue is concerned, the revenue in this ground has challenged the action of the DRP in excluding ICRA Techno Analytics Ltd. This company was rejected by the DRP for the reason that the entire revenue of the company has been reported under one segment, and in the absence of segmental information regarding the same, the company could not be held as a comparable to the Assessee. At the outset it is submitted that the action of DRP in rejecting this company is right in law and does not require any interference by this Hon'ble Tribunal. We find that this company is engaged in diversified activities of software development and consultancy, licensing and sub-licensing, annual maintenance for software support, web development & hosting and revenue from all the activities are reported under one segment, without any segmental information regarding the same made available. Therefore, in the absence of segmental information, it cannot be ascertained whether the company passes all the filters applied by the TPO and therefore ought to stand excluded from the final list of comparables. We also find that this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT* [IT(TP)A Nos. 17 &*

39/Bang/2016] at paras 17.1 to 17.2 at pages 1607-1609]; *Finastra Software Solutions (India) (P.) Ltd. v. ACIT* [(2018] 93 taxmann.com 460 (Bangalore - Trib.) at para 17 at page 1744]; and *Electronics Imaging India P. Ltd v. DCIT* [(2017) 85 taxmann.com 124 (Bangalore-Trib) para 10 at pages 1727] excluded this company from the list of comparables in the case of companies that were engaged in rendering SWD services similar to that of the Assessee. We therefore find no merit in Gr.No.7 raised by the revenue.

D.6 Respectfully following the above view, we direct the Ld.AO/TPO to exclude this Comparable from the final list.

E. Persistent Systems & Solutions Ltd.

E.1 The Ld.AR submitted that the assessee seeks exclusion of this company from the final list of comparables on the basis that it is, *inter alia*, functionally not comparable to it.

E.2 The Assessee submits that the above company is engaged in diversified activities i.e. rendering of software services and licensing and royalty of software products without there being separate segmental details for the aforesaid diverse activities.

E.3 Further, if its turnovers for FY 2010-11 and the preceding two years are examined, it can be seen that there has been an abnormal increase in its turnovers year-on-year (184%) and that the said increase far exceeds the industry average for that period (19%). The reason for this excessively high increase in its operations is the increased funding received by it from its holding company viz. Persistent Systems Limited. The Assessee submits that in view of its peculiar economic circumstance the company ought to be rejected as a comparable. Submissions in this regard are placed at pages 1366-1369 and 2039-2041 of the paperbook.

E.4 The Ld.AR placed reliance on the decisions of coordinate bench of this Tribunal in *Applied Materials India Pvt. Ltd. v. ACIT* (supra) at paras 9.2.1 to 9.2.4 pages 18-22, where in the case of

assesseees similar to the assessee herein, the exclusion of the said company from the final list of comparables was upheld.

E.5 On the contrary, the Ld.DR relied on orders passed by the authorities below.

E.6 We have perused the submission advanced by both sides in light of records placed before us.

E.7 We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Applied Materials India Pvt. Ltd.*

v. ACIT (supra) observed and held as under:

“9.2.4 We have considered the rival submissions as well as the relevant material on record. At the outset we note that the functional comparability of these two companies have examined by the co-ordinate bench of this Tribunal in the case of DCIT Vs. Electronics for Imaging India Pvt. Ltd. (supra) in para 60 and 61 & paras 24 to 26 as under :

" Persistent Systems & Solutions Ltd.

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

Having considered the rival submissions as well as relevant material on record, at the outset, we note that the DRP has examined the functional comparability of this company by considering the relevant details as given in the annual report of this company. The DRP has given the finding that the entire revenue has been earned by this company from the sale of software services and products and in the absence of segmental details, it cannot be considered as comparable with software services segment. We find that this company has shown the income from sale of software services and products to the tune of Rs.6.67 crores. We further note that as per Schedule 11, the entire revenue has been shown under one segment i.e., sale of software services and products. Therefore, no separate segment has been given in respect of software services. Accordingly, the composite data of revenue as well as margins of this company pertaining to the sale of software services and products cannot be considered as comparable with the software development services

segment of the assessee. In view of the above facts and circumstances, we do not find any error or illegality in the directions of the DRPJ excluding this company from the list of comparables. This ground of CO is dismissed.

.....

We further find from the Annual Report that there is no change in the activity and functions of these companies during the year under consideration in comparison to the Assessment Year 2010-11. Accordingly, following the decisions of the co-ordinate benches of this Tribunal (supra), we direct the A.O./TPO to exclude these two companies from the set of comparables.”

E.8 Respectfully following the above view, we direct the Ld.AO/TPO to exclude this Comparable from the final list.

Accordingly, this ground raised by assessee stands allowed.

13. **Ground No.3(h):** That the lower authorities erred in rejecting LGS Global Ltd. while performing the comparability analysis for the SWD services segment of the Assessee. .

13.1. LGS Global Ltd.

The Ld.AR submitted that the assessee seeks inclusion of LGS Global Ltd., which was proposed by the assessee during the proceedings before the Ld.TPO as the company is functionally comparable to the assessee. The Ld.TPO rejected the company on the ground that, the financial data of the company is not available in the public domain, whereas, the assessee had furnished the annual report before the Ld.TPO. It is submitted that the Ld.TPO failed to take the same into consideration. In this regard, it is submitted that the company is functionally comparable and passes all the filters applied by the TPO. Submissions in this regard are placed at pages 1497-1500 and 1977-1981 of the paperbook.

13.2 As regard employee cost, the assessee submits that under Schedule VI to the Companies Act, 1956, all categories of expenditure incurred on account of salary and wages are not required to be disclosed under the head 'personnel expenditure'. Further, it is submitted that, the employee costs incurred by many companies are not separately clubbed as 'Employee expenses' in their financial statements. For instance, some companies club the employee costs under the head 'Cost of Services'. Some others, like LGS Global Ltd., club the expenses under the head 'Personnel and Purchase Cost'.

13.3 Since, for a service provider, the major component of the 'Purchases & Personnel Cost' would be employee-related expenses, it is apparent that LGS would pass the employee costs filter at 25% of total sales.

13.4 It is submitted that LGS Global Ltd. is consistently figuring in the final list of comparables in the case of the assessee and in the case of several other similarly placed assessees for many assessment years. In that view of the matter, it is submitted that LGS Global Ltd. ought to be included in the final list of comparables.

13.5 Reliance is placed on coordinate bench of this *Tribunal* in case of *Applied Materials India Pvt. Ltd. v. ACIT* (supra) where, in the case of a similarly placed assessee, this *Tribunal* remanded the examination of the comparability of the company to the AO/TPO.

13.6 On the contrary, the Ld.DR relied on orders passed by the authorities below.

13.7 We have perused the submission advanced by both sides in light of records placed before us.

13.8 We note that the Ld.TPO/AO did not verify the annual report filed by assessee of this comparable. We deem it proper to remand this comparable to the Ld.AO/TPO to consider this comparable in the light of the annual report and the observations of this *Tribunal* in case of *Applied Materials India Pvt. Ltd. v. ACIT* (supra).

Accordingly we remit this comparable to consider it afresh.

14.Ground No.4 (g): That the lower authorities erred in including Accentia Technologies Ltd, Acropetal Technologies, ICRA Online Ltd. (seg) and Jeevan Scientific Technology Ltd. despite these companies being functionally dissimilar to the ITE services segment of Assessee .

A. Accentia Technologies Ltd. – It is submitted that this company is engaged in providing high end services in the nature of Knowledge Process Outsourcing ('KPO') which is evident from its annual report, whereas, the assessee is engaged in rendering information technology enabled back-office services which are merely supportive. Further, the said company not only does medical transcriptions, but has also ventured into healthcare receivables cycle management and high end consultancy to start-ups requiring field experts. Referring to the the annual report, the Ld.AR submitted that coding income is contributing 15% of the total income which activities are akin to software development activity while the assessee is a mere provider of IT enabled services. She submitted that this company has invested huge sums in the development of EMR software and Saas, and that

segmental details of its various activities are unavailable. The company further owns significant intangibles. Submissions in this regard are placed at pages 1448-1455 and 2104-2111 of the paperbook.

B. Acropetal Technologies Ltd. - The assessee seeks rejection of Acropetal Technologies Ltd. because the EDS segment of Acropetal fails the 75% service revenue filter applied by the Ld.TPO. Acropetal is engaged in software development, web development and engineering design services. The engineering design service has been considered as comparable to the Assessee by the Ld.TPO. However, the Assessee wishes to highlight that the functions under taken by Acropetal under the engineering design segment are different from the ITES provided by Assessee. Therefore, the assessee seeks exclusion of the above company as it fails the service revenue filter besides also being functionally not comparable to the assessee company. Submissions in this regard are placed at pages 1441-1448 and 2097-2103 of the paperbook.

C. ICRA Online Ltd. - The assessee company seeks exclusion of ICRA Online Ltd. as it is functionally not comparable to its ITE service segment. It is engaged in high end KPO services whereas the assessee is engaged in low end back office services. The above company also fails the RPT filter applied by the Ld.TPO as its RPT 19.89%. Thus, the above company ought to stand excluded. Submissions in this regard are placed at pages 1436-1441 and 2092-2096 of the paperbook.

D. Jeevan Scientific Technology Ltd. – It is submitted that this company ought to be rejected from the list of comparables on for following reasons:

The company fails TPO's own filter of Sales > 1 Crore:

24.1 Jeevan's service income from the BPO segment for the AY in question was Rs. 79 Lakh and the company therefore fails the Ld.TPO's own filter of sales greater than Rs. 1 crore, which was not appreciated by the DRP.

The company fails TPO's own filter of service income > 75% of total operating revenue:

D.1. The segmental income from the BPO segment of the company is 32% of its total operating revenue, therefore failing the filter of service income being greater than 75% of the total operating income.

D.2. Functionally dissimilar:

The company has classified its segment into 4 categories, one of them being BPO segment. However, the segmental details are unavailable and therefore it cannot be ascertained whether the services provided by the company in the BPO segment is same as that of the assessee. The mere fact that the segment has been classified as BPO does not mean that it would be comparable to the assessee and the company's website does not throw light on the same either. Moreover, the BPO segment of the company has ceased to exist from FY 2011-12 onwards. Therefore, in the absence of information on this segment, the company ought to be deleted from the list of comparables. Further, she submitted that the Ld.TPO considered the ERP segment to be comparable to ITeS carried out by the assessee although the two services are not

similar. The nature of services rendered by Jeevan is also different from the assessee as is evident from the website extracts produced before the DRP. Submissions in this regard are placed at pages 1424-1431 and 2079-2086 of the paperbook. The company, therefore, cannot be considered as a comparable to the assessee's ITE service segment.

D.3. Reliance is placed on the decisions of *Coordinate Bench* of this *Tribunal* in case of *Swiss Re Shared services (India) Pvt. Ltd. v. ACIT* (order dated 08.07.2016 in IT(TP)A No. 380/Bang/2016), *Finastra Software Solutions (India) (P.) Ltd. v ACIT* (supra) at para 25 and *Aspect Technology Center (India) Pvt. Ltd. v. ITO* (supra) at para 41, where, in the case of assessee similar to the assessee herein, for the same Assessment Year, the company was directed to be excluded from the list of comparables/exclusion was upheld. The company is, therefore, not comparable to the assessee and it ought to be rejected from the list of comparables.

D.4. On the contrary, the Ld.DR relied on orders passed by the authorities below.

D.5. We have perused the submission advanced by both sides in light of records placed before us.

We note that in similar circumstance of a captive service provider, this *Tribunal* in case of *Aspect Technology Center (I.) Pvt. Ltd. v. ITO(supra)* observed and held as under:

41. We have heard the rival submissions of the parties. As far as Gr.No.14 of the revenue's appeal is concerned, the Revenue is seeking the inclusion of Acropetal Technologies Ltd., Jeevan Scientific Technology Ltd., Accentia Technologies Ltd., iGate Global Solutions Ltd. and ICRA Online Ltd. We find that the above companies were rightly rejected by the DRP and the same requires no interference from this Hon'ble Tribunal. We find that Acropetal Technologies Ltd., is engaged in the business of software development and services, contract centre

service and IT enabled services and the same are reported together as one segment. In the absence of segmental details made available, the company could not be treated as a comparable. The TPO, while choosing the company as a comparable, has selected its Engineering Design Segment ('EDS' for short) which is in the nature of high end IT enabled services which are in the nature of Knowledge Process outsourcing ("KPO"). The high end services provided by the company cannot be compared with the routine services provided by the Assessee. This is a settled position and reliance can be placed on the decision of this Hon'ble Tribunal's in the case of Symphony Marketing Solutions India Pvt. Ltd.(ITA No. 1316/Bang/2012) where it was held that Acropetal cannot be considered as a comparable to assessee performing routine low end IT enabled services function. As far as exclusion of company Jeevan Scientific Technology Ltd., we find that this company was rejected by the DRP for the reason that it was engaged in diverse functions and the same were reported under one segment without segmental details regarding the same being made available. The DRP is right in excluding the company as without segmental details, the comparability of the company cannot be determined. In any event, the ERP segment of the company is not comparable to the assessee, the BPO segment of the company fails the filter of service income being greater than 75% of total revenue, and the company suffers from huge fluctuations which indicate that certain peculiar circumstances influencing the profit margin of the company exist, for which appropriate adjustments cannot be made to balance the effect. It is submitted that the ERP implementation services are not in the nature of IT enabled services which were notified by CBDT vide Notification No. SO 890(E) dated 26.09.2000. If the BPO segment is considered, the company fails to satisfy the TPO's own filter of service revenue from the relevant segment having to be in excess of Rs. 1 crore as the revenue from the BPO segment of the said company is Rs. 79 lakhs only. The company is therefore not comparable to the Assessee. This Tribunal in the case of Swiss Re Shared services (India) Pvt. Ltd. v. ACIT (order dated 08.07.2016 in IT(TP)A No. 380/Bang/2016) directed the TPO to verify as to whether the TPO's filter of Sales > 1 Crore is satisfied by this company. In the present case, as can be seen from the annual report of the company the sale of the company in respect of the BPO segment amounts to only 79 lakhs, and therefore it fails the TPO's filter. As far as exclusion of Accentia Technologies Ltd., is concerned, we find that this company was excluded by the DRP for the reason that the details regarding its diverse functions were reported under one segment, without segmental details regarding the same being made available. In the absence of segmental details being made available, the comparability of the company with that of the assessee cannot be determined. In any event, Accentia is engaged in providing high end services in the nature of Knowledge Process Outsourcing ('KPO') which is evident from its annual report, whereas, the assessee is engaged in rendering routine low end information technology enabled services.

Further, the said company not only does medical transcriptions, but has also ventured into healthcare receivables cycle IT(TP)A Nos.187 & 175/Bang/2016 management and high end consultancy to start-ups requiring field experts. As can be seen from the annual report, coding income is contributing 15% of the total income which activities are akin to software development activity while the assessee is a mere provider of IT enabled services. The company has invested huge sums in the development of EMR software. Segmental details of its various activities are unavailable. The company further owns significant intangibles. This Tribunal in the case of Swiss Re Shared India Pvt. Ltd. v. ACIT [TS-598-ITAT-2016(Bang)-TP at paras 9-20 on pages 7-21] where, in similar circumstances and for the same assessment year, this Hon'ble Tribunal directed the exclusion of this company from the list of comparables. Accentia Technologies Ltd. is, therefore, not comparable to the Assessee and was rightly rejected as a comparable. As far as iGate Global Solutions Ltd., is concerned, DRP rejected this company as comparable company for the reason that the details regarding its diverse functions are reported under one segment without segmental details regarding the same being made available. Therefore, the comparability of the company cannot be determined. It is seen that iGate is engaged in provision of varied services and no segmental breakup of the same is available in its Annual Report. Further, the company's software services segment is clubbed with its ITES segment and there is no breakup between the revenues generated from the two segments. During the year under consideration, the company has acquired majority equity interest in Patni Computer Systems Ltd. rendering it incomparable due to it failing the TPO's own filter of having peculiar economic circumstances. In addition, the company owns significant intangibles in its name, which is evident from the balance sheet of the company for the Financial Year 2010-11. For the reasons above, the company is not comparable to the Assessee and the DRP's findings on exclusion of iGate is right in law. As far as the company ICRA Online IT(TP)A Nos.187 & 175/Bang/2016 Ltd., is concerned, the DRP excluded this company for the reason that the details regarding its diverse functions are reported under one segment without segmental details regarding the same being made available. Therefore, the comparability of the company cannot be determined. In any event, this company is functionally dissimilar for the reason that the outsourced services segment of the company is engaged in the provision of high end consultancy services which cannot be compared to the assessee who is into provision of low end IT enabled services which are routine in nature. Further, the company fails the TPO's own filter of export turnover in excess of 75% of total sales as the export turnover of the company amount to only 61.88% of its sales. Therefore, the company cannot be held as a comparable to the assessee.”

D.6. Respectfully following the above view, we direct the Ld.AO/TPO to exclude Accentia Technologies Ltd, Acropetal

Technologies, ICRA Online Ltd. (seg) and Jeevan Scientific Technology Ltd., from the final list.

Accordingly this ground raised by assessee stands allowed.

15. Ground No.5 (a): That the lower authorities erred in rejecting the Assessee's application of the Resale Price Method ('RPM' for short) as most appropriate method in its TP study for determination of ALP in the SDR services segment and consequently erred in applying the Transactional Net Margin Method ('TNMM' for short) as the most appropriate method for the said transaction.

15.1.Ground No.5(b): That the lower authorities erred in rejecting the Assessee's application of Gross Profit Margin as Profit Level Indicator ('PLI' for short) for the SDR services segment.

15.2.Ground No.5(c): That the lower authorities erred in conducting a fresh TP analysis in respect of the SDR services segment without sharing the methodology of the TPO's search process and the list of comparables and without granting sufficient opportunity of hearing to the Assessee

It is submitted that the assessee purchases software products from its AE, duplicates and markets it in India. The Assessee has no right to modify or create any derivative works of the duplicated product, and thus there is no value addition made by the Assessee to the product. In the TP study maintained by the Assessee, for the purposes of benchmarking the above transaction, it applied, Resale Price Method ('RPM' for short) as the most appropriate method with Gross Profit Margin ('GPL' for short) as the PLI.

15.3. The Ld.TPO, in the order passed under Section 92CA of the Act, categorically held since on an independent search made by the Ld.TPO, the margin of the comparables selected by him was 7.42% on cost and 2.26% on sales, no adverse inference is drawn with regard to the transaction under this segment. However, subsequently, the TPO passed an order under Section 154 of the Act determining a TP adjustment of Rs. 6,63,78,224/-. The Ld.TPO, while holding that the Assessee does not hold any intangibles, and is a routine trader with no value addition to the products purchased from the AE, arbitrarily rejected the Assessee's TP study and proceeded to determine the TP adjustment on application of the TNM method.

15.4. At the outset, it is submitted that the Ld.TPO's action in determining the TP adjustment under the order passed under Section 154 of the Act is unsustainable in as much as the jurisdiction under the said section could be exercised only to rectify mistakes apparent on record. In the present case, the TPO on application of mind, has passed the original order accepting the above international transaction as being at arm's length. Thus, no further adjustment could be determined, much less vide an order under Section 154 of the Act. Reliance in this regard is placed on the decision of the *Hon'ble Kerala High Court* in the case of *K. Parameswaran Pillai v. AITO reported in (1955) 28 ITR 885* and the decision of the *Hon'ble Supreme Court* in the case of *ITO v. Volkart Brothers reported in (1971) 82 ITR 50* .

Therefore, the TP adjustment determined vide order passed under Section 154 of the Act is unsustainable.

15.5. Secondly, the action of the Ld.TPO in determining the adjustment as is done, is erroneous. The TPO failed to furnish the search process adopted, the filters applied and the final list of comparables arrived at. In effect, the order passed under Section 154 of the Act is a non-speaking order and is therefore erroneous and unsustainable.

15.6. Lastly, it is submitted that the Appellant is a routine distributor and does not perform any value added services to the product, which is also accepted by the Ld.TPO. Since the assessee is merely a routine trader of services, without any value addition, RPM is the MAM. Reliance in this regard is placed on the following decisions:

- (i) *Textronix India (P.) Ltd. v. DCIT* ([2013] 29 taxmann.com 288 (Bangalore-Trib.) at para 5);
- (ii) *ACIT v. Akzo Nobel Car Refinishes India (P.) Ltd.* ([2017] 84 taxmann.com 199 (Delhi-Trib.) at paras 6 and 7);
- (iii) *ITO v. L'oreal India P. Ltd.* (Order dated 25.04.2012 passed in ITA No. 5423/Mum/2009 at paras 18 and 19) which was upheld by the Hon'ble High Court of Bombay (reported in [2015] 53 taxmann.com 432 (Bombay));
- (iv) *DCIT v. A. O. Smith India Water Heating (P.) Ltd.* ([2018] 97 taxmann.com 218 (Bangalore - Trib.) at paras 16-20; and
- (v) *PCIT v. Matrix Cellular International Services (P.) Ltd.* ([2018] 90 taxmann.com 54 (Delhi) at para 12)

15.7. It is submitted that in assessee's own case for the assessment years 2012-13 to 2014-15, the transaction in the SDR segment, was benchmarked by the assessee by applying RPM was accepted by the Ld.TPO to be at arm's length. It is submitted that the facts and circumstances involved in the above assessment years are similar to that of the present assessment year, and therefore no adjustment is warranted in the said segment. Reliance in this regard was placed on the decision of the Hon'ble Delhi Tribunal in the case of *Topcon Sokkia India Pvt.*

Ltd. v. DCIT by order dated 29.02.2020 passed in ITA No. 8110/Del/2018. It is also submitted that, the revenue ought to adopt a consistent approach across assessment years, as laid down by the *Hon'ble Supreme Court* in the case of *Radhasaomi Satsang v. CIT* reported in 193 ITR 321.

15.8. Further the Ld.AR relied on placed on the decision of *Hon'ble Mumbai Tribunal* in the case of *Bristol Myers Squibb India Private Limited v. DCIT* by order dated 28.08.2019 passed in ITA No.1969/Mum/2014, wherein it was held that,

“Thus, if the ALP of a transaction can be determined by applying any of the direct methods like CUP, RPM, CPM then they should be given a preference, and it is only where the said traditional methods have been rendered inapplicable that under such circumstances TNMM should be resorted to”.

Therefore, the TP adjustment determined by the Ld.TPO ought to be rejected and the price paid for purchase of software ought to be held as being at arm's length.

15.9. Without prejudice, she submitted that, in the event that method applied by the Ld.TPO is upheld, the assessee submits that, it ought to be furnished with the search process and the final list of comparables selected by the Ld.TPO, to enable it to examine the functions, assets and risks of the companies selected by the Ld.TPO and seek exclusion or inclusions of such companies as may be warranted. The Ld.AR prayed for appropriate directions in this regard be issued to the Ld.TPO.

15.10. Both sides submitted that the issue may be remanded to the Ld.TPO for *de novo* consideration. Based on the above discussions and submissions, we direct the Ld.TPO to consider the claim of the

assessee as submitted in the TP study. Admittedly, in the assessee's own case for the assessment years 2012-13 to 2014-15, the transaction in the SDR segment, benchmarked by the assessee by applying RPM was accepted by the revenue. In the event the comparables captured under the search process is akin to RPM as MAM, then the same must be resorted to, for computing the margin. Only under the circumstances as considered by *Hon'ble Mumbai Tribunal* in the case of *Bristol Myers Squibb India Pvt.Ltd. vs. DCIT (supra)*, TNMM should be considered.

15.11. The assessee is directed to provide all relevant information and evidences to substantiate its claim. Needless to say that proper opportunity of being heard must be granted to the assessee in accordance with law.

Accordingly, Ground No.5 raised by assessee stands allowed for statistical purposes.

16. Ground No.6(b): In this ground, it is alleged by the assessee that the lower authorities erred in applying upper caps to the working capital adjustment.

16.1. The Ld.AR submitted that, the working capital adjustment must be granted in full without there being any arbitrary and adhoc upper cap or restriction to the same, as has been done by the TPO. The Ld.TPO applied upper cap of 1.63% and 1.47% to the working capital adjustments to the SWD and ITE service segments respectively, without providing any legal basis or rationale.

16.2. The Ld.AR submitted that, working capital adjustment is one such adjustment which is to be applied in order to adjust for the differences between the working capital positions of the tested party and of the comparable. In this regard, she placed reliance on the decision of coordinate bench of this *Tribunal* in:

(i) *ARM Embedded Technologies Pvt.Ltd vs. ITO in IT(TP)A No.1369/Bang/2014, in paragraph 24-25 at pages 16-18.*

(ii) *Brocade Communications Systems (P) Ltd. Vs. DCIT in IT(TP)A No.79/Bang/2019 dt.19.06.2020 in Para 40 to 46.*

16.3. The Ld.AR submitted that, the working capital adjustment computed by the Ld.TPO is also erroneous, inasmuch as, the average receivables and payables are wrongly considered which also needs to be rectified. Placing reliance on Pages 2120-2121 of the paper book, the Ld.AR submitted that correct computation of average working capital of the assessee therein.

16.4. The Ld.CIT.DR on the contrary relied on the view taken by the authorities below.

16.5. We have perused the submissions advanced by both sides in light of records placed before us.

The contention of the Ld.AR that the Working Capital Adjustment has to be applied in the order to adjust the difference of working capital of the tested parties. Coordinate Bench of this *Tribunal*, in case of *Brocade Communications Systems (P) Ltd. Vs. DCIT(supra)*, held as under:

35. It was submitted by the learned counsel for the Assessee that the TPO, while granting working capital adjustment in respect of the Assessee's SWD and ITES segment, has arbitrarily and unreasonable restricted the same at 1.63% and 1.47% respectively, without providing any legal basis or rationale for limiting the working capital adjustment to the said percentage (page No. 22 of the TPO's order). The DRP also, vide its directions upheld this act of the TPO (page No. 10 of the DRP's directions). It was submitted that this direction of the DRP is erroneous and merits the interference of this Hon'ble Tribunal.

It is submitted that working capital adjustment must be granted in full without there being any arbitrary and ad hoc upper cap or restriction to the same, as has been done by the TPO. The working capital adjustment has been arrived at by the TPO on the basis of a scientific calculation and by adopting the methodology prescribed by the OECD Guidelines. Thus, once a working capital adjustment is arrived at in the manner prescribed by law, the consequences of such an adjustment on a comparable's profit margin cannot be the reason for applying a cap on

such adjustment. Rule 10B(3) of the Income-tax Rules, 1962 (the IT Rules' for short), provides that an adjustment ought to be provided for any differences in the economic factors between the tested party and the comparables. A working capital adjustment is one such adjustment which is to be applied in order to adjust for the differences between the working capital positions of the tested party and of the comparable. The IT Rules do not provide for the requirement of application of any cap or upper limit to such adjustments. This position under the Act and the IT Rules is also evident from the OECD Guidelines. In this regard, our attention was drawn to a decision of Hon'ble Tribunal in ARM Embedded Technologies (P.) Ltd. v. ITO [2015] 64 taxmann.com 445 (Bang.-Trib) (paragraph 24-25) which supports the contention of the learned counsel for the Assessee. Hence it was submitted that the above action of the TPO and subsequent confirmation of the same by DRP is wholly erroneous and liable to set aside by this Hon'ble Tribunal. The learned DR relied on the order of the TPO/DRP. In the light of the decision cited by the learned counsel for the Assessee, we are of the view that the working capital adjustment has to be allowed on actual and there cannot be any cap that can be imposed in allowing adjustment to the margins of comparables or that of the tested party towards working capital adjustment.

36. *The learned counsel for the Assessee also submitted that the working capital adjustment as computed by the TPO was also erroneous inasmuch as the average receivables and payables of the comparable companies are wrongly considered which ought to be rectified. The details regarding the average receivables and payables of the comparables are provided at page Nos. 512-514 of the paperbook. Therefore, the working capital adjustment ought to be allowed on actuals upon taking into consideration the correct value of receivables and payables. We are of the view that it would be appropriate to direct the TPO/AO to examine the grievance of the Assessee in this regard and rework the working capital adjustment in accordance with law.*

16.6. Respectfully following the We are of the view that it would be appropriate to direct the Ld.TPO/AO to examine the grievance of the Assessee in this regard and rework the working capital adjustment in accordance with law.

Accordingly, this ground raised by assessee stands allowed for statistical purposes.

17. Ground No.9:Short-Grant of TDS Credit

The Ld.AR submitted that, the assessee is entitled to TDS credit of Rs.62,59,186/, as claimed in the revised return of income filed for the year under consideration. In the draft assessment order, the

Ld.AO, erroneously restricted the claim to Rs.1,10,883/-. The assessee raised objections before the DRP, the DRP directed the Ld.AO to verify the claim and allow it, accordingly. However, in the final assessment order, the Ld.AO granted TDS credit of only Rs.1,10,883/-, as against the amount of Rs.1,93,12,904/- that was claimed by the assessee.

17.1. We direct the Ld.AO to verify the claim based on the evidence filed by the assessee in accordance with law.

Accordingly, this ground raised by assessee stands allowed for statistical purposes.

In the result, appeal filed by assessee stands allowed and appeal filed by the revenue stands dismissed.

Order pronounced in open court on 29th April, 2022.

Sd/-
(CHANDRA POOJARI)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 29th April, 2022.
/MS /

Copy to:

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

By order

Assistant Registrar,
ITAT, Bangalore