

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

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

IT(TP)A No.2412/Bang/2019
Assessment Year: 2015-16

M/s. LG Soft India Pvt. Ltd. Embassy Tech Square Marathahalli-Sarjapur Outer Ring Road Bangalore 560 103 PAN NO : AAACL3009P	Vs.	Deputy Commissioner of Income-tax Circle 4(1)(1) Bangalore
APPELLANT		RESPONDENT

Appellant by	:	Sri K.R. Vasudevan, A.R.
Respondent by	:	Sri Pradeep Kumar, DR

Date of Hearing	:	18.04.2022
Date of Pronouncement	:	31.05.2022

O R D E R

PER CHANDRA POOJARI, ACCOUNTANT MEMBER:

This appeal by assessee is directed against the final assessment order passed by Deputy Commissioner of Income-tax Circle 4(1)(1), Bangalore dated 27.9.2012. The assessee has raised following grounds of appeal:-

I. “Transfer Pricing

The grounds mentioned hereinafter are without prejudice to one another.

- 1. The learned Assessing ,Officer (learned AO'), learned Transfer Pricing Officer (learned TPO') and the Honourable*

Dispute Resolution Panel ('Hon'ble DRP') grossly erred in determining an adjustment of INR 19,64,72,927/- with respect to the international transaction rendered by the tax payer u/s 92CA of the Income-tax Act, 1961.

2. *The learned AO/ learned TPO/ Hon'ble DRP erred in rejecting the TP documentation maintained by the Appellant by invoking provisions of sub-section (3) of 92C of the Act.*
3. *The learned AO/ learned TPO/ Hon'ble DRP erred in rejecting comparability analysis carried in the TP documentation and in conducting a fresh comparability analysis by introducing various filters while determining the Arm's Length Price ('ALP').*
4. *The learned AO/ learned TPO/ Hon'ble DRP erred in not considering the financial data of the preceding two years in case of the comparable companies wherein the data for the current year is unavailable, while determining the ALP.*
5. *The learned AO/ learned TPO/ Hon'ble DRP erred in applying different financial year ending filter while selecting the comparable companies.*
6. *The learned AO/learned TPO/Hon'ble DRP erred in applying the service income filter of 75% to sales, leading to a narrower comparable set.*
7. *The learned AO/learned TPO/Hon'ble DRP erred in applying export earning filter of 75% of the total sales, leading to a narrower comparable set. •*
8. *The learned AO/learned TPO/Hon'ble DRP erred in rejecting companies having ratio of employee cost to sales of less than 25%.*
9. *The learned AO/ learned TPO/ Hon'ble DRP erred in not applying the upper limit on turnover while selecting the comparable companies.*
10. *The learned AO/ learned TPO/ Hon'ble DRP erred in the method of computing the percentage of related party transaction of 25% to total sales.*
11. *The learned AO/ learned TPO/ Hon'ble DRP erred in accepting companies that ought to have been rejected as comparable:*
 - *Tata Elxsi Ltd.*

- *Mincltree Ltd.*
 - *Persistent Systems Ltd.*
 - *InfoBeans Technologies Ltd.*
 - *Nihilent Technologies Ltd.*
 - *Aspire Systems (India) Pvt. Ltd.*
 - *Infosys Ltd.*
 - *Thirdware Solutions Ltd.k---*
 - *Cybage Solutions Ltd.*
 - *Larsen & Toubro Infotech Ltd.*
 - *Rheal Software Pvt. Ltd.*
 - *Inteq Software Pvt. Ltd.*
12. *The learned AO/ learned TPO/ Hon'ble DRP erred in rejecting companies that ought to have been accepted as comparable:*
- *Akshay Software Technologies Ltd.*
 - *TVS Infotech Ltd.*
 - *Evoke Technologies Ltd.*
 - *Helios & Matheson Infpration Technology Ltd.*
 - *I2T2 India Ltd.*
 - *Bells Softech Ltd.*
 - *Minvesta Infotech Ltd.*
 - *New-Age Bizsoft Solutions Pvt. Ltd.*
 - *Melstar Information Technologies Ltd.*
13. *The learned AO/ learned TPO erred in computing the operating mark-up for Sasken Communication Technologies Ltd. and Daffodils Software Ltd.*
14. *The learned AO/ learned TPO/ Hon'ble DRP erred in not considering provision of bad and doubtful debts and operating in nature.*
15. *The learned AO/ learned TPO/ Hon'ble DRP has erred in mat allowing appropriate adjustments towards working capital.*
16. *The learned AO/ learned TPO/ Hon'ble DRP erred in not allowing appropriate adjustment towards the risk difference between the Appellant vis-à-vis the comparable companies.*

II. Corporate Tax

Levy of interest under section 234A of the Act – INR 5,32,362

17. *The learned AO has erred in levying interest under section 234A of the Act amounting to INR 5,32,362.*

18. *The due date of filing the return of income in case of an Assessee who is required to furnish a report referred under section 92E of the Act. is 30 November of the Assessment year.*
19. *The learned AO ought to have appreciated that the appellant has filed the return of income on 27 November 2015 i.e. within the due date of filing the return of income for Assessment year 2015-16 i.e. 30 November 2015 and accordingly, any levy of interest under section 234A of the Act is unwarranted.”*

2. The assessee raised additional grounds with regard to non-granting of deduction towards payment of educational cess on income tax and secondary & higher education cess on income tax for the year under consideration. At the time of hearing, assessee has not pressed these additional grounds. Accordingly, these additional grounds are dismissed as not pressed.

3. Ground No.1 to 10 in main grounds are not pressed before us. Accordingly, these grounds are dismissed as not pressed.

Ground No.11:-

4. Ld. A.R. pressed for exclusion of only following comparable companies:-

- i. Mind Tree Ltd.
- ii. Persistent Systems Ltd.
- iii. Infosys Ltd.
- iv. Thirdware Solutions Ltd.
- v. L&T Infotech Ltd.

I. Mind Tree Limited:

5. The Ld. A.R. submitted that this company is not functionally comparable as it is engaged in providing service in diverse areas such as analytics, information management, application development business process management, business technology consulting,

infrastructure management services, product engineering & SAP services. It was also contended that this company is engaged in sale of product and also engaged in outsourcing IT services in banking and financial services and insurance sector and also as R&D operations and patents and hence not functionally comparable. However, Ld. Dispute Resolution Panel (“DRP”) observed that this company is only engaged in software development and related services as seen from its financials. Therefore, the plea of the assessee that company performs different and diverse activities and hence functionally different was rejected by Ld. DRP. Further, it was observed by Ld. DRP that provision of data analytic services is not functionally different from software development activity. Data analytic services also used only in certain software and tools, writes codes task. Like in other software application, these tools also facilitate and enable business of enterprises for enough management and decisions. Therefore, the Ld. DRP observed that there cannot be any distinction between high end software activity and low-end activity so long as it falls within the purview of software development services. It was observed that under TNMM, such differences are tolerable and there is no requirement that services for activities performed are identical. It is informed that the services are similar and fall within the same domain of software development. Accordingly, Mind Tree Ltd. was included in the list of comparables while determining the ALP of international transactions with A.Es. Against this assessee is in appeal before us.

5.1. We have heard the rival submissions and perused the materials available on record. This company Mind Tree Ltd. was considered as not comparable in the case of Yahoo Software Development India Pvt. Ltd. in IT(TP)A No.2657/Bang/2018 &

2365/Bang/2019 dated 28.2.2020 by Bangalore Bench of Tribunal, wherein it was held as under:-

“41. The next company sought to be excluded is Mindtree Ltd. The submissions made before us were as follows:-

“Functionally dissimilar, diversified operation, significant R&D spend, ownership of intangibles.

- Also engaged in business of rendering IP-Led revenue, infrastructure management, package implementation, consultancy services, etc. constituting 45% of overall revenue during FY 2014-15.

- Diversified operation i.e. engaged in infrastructure management services, business process management, technology consulting, product engineering and SAP services. Also lacks segmental data

- Significant research & development activity. By incurring R&D expenses, it was able to deliver IP based video surveillance management, recording and analytic products and solutions. It has filed 4 patents in India and US so far in the area of Video analysis.

- Ownership of intangibles in the form of intangible property. Significant onsite activity:

- 46% of revenue earned under Onsite model.

- Incurred overseas branch office expenses amounting to INR 1582 crores - Receives incentives from State of Florida in relation to the development center located overseas. Lack of segmental data

- Does not maintain segmental information in respect of profitability reported from business activities in the nature of infrastructure management services, technology consulting and SAP services. -

Acquisition of subsidiary – Discoverture Solutions LLC

42. The DRP while dealing with the aforesaid objections has merely taken the view that the presence of IPR revenue was insignificant and so also expenses of brand value, R&D & intangibles. More importantly, the DRP did not dispute the presence of 46% of revenue

from onsite model, but went on to hold that the presence of revenue is not sufficient to exclude a company, when it is otherwise functionally comparable. On this aspect, we have already referred to the decision of the ITAT Bangalore Bench in the case of Trilogy e-business Software India P. Ltd. (supra) and in the light of this decision and the admitted factual position regarding presence of onsite revenue over and above the threshold limit of 25% of total revenue, we are of the view that this company should be excluded from the list of comparable companies. We hold and direct accordingly.”

5.2. In view of the above order of the Tribunal, we are inclined to direct the AO/TPO to exclude this company from the list of comparables. Directed accordingly.

II. Persistent systems Limited:-

6. The Ld. A.R. submitted that this company is a product-based company and has revenue from software licenses; that it is also engaged in R&D activities with significant intangibles. The company has diversified activities and it has no segmental information and hence cannot be considered as comparable. It was also submitted that it has significant onsite expenses and RPT transactions. It was also argued that it has made certain acquisition and therefore, on account of such peculiar economic circumstances Ld. A.R. requested that it has to be excluded as a comparable.

6.1 Ld. DRP observed that the company's core activity was rendering product development services i.e. providing services to business enterprise to develop software products. As per the information at page 211 of the annual report, it has reported income from software services of Rs.12,353.53/- million and software licenses of Rs.71.45/- million aggregating to

Rs.12,424.98/- million. Thus, the income from software licences constitute a meagre 0.58% of its operating revenue. It is also noted by Ld. DRP that this company in response to the notice u/s 133(6) of the Act had given details of such licence income as under:-

<i>Software product</i>	<i>Category</i>	<i>Revenue as per books of accounts (INR)</i>
<i>eMee</i>	<i>Internally developed</i>	<i>20,525,798</i>
<i>Radia</i>	<i>Acquired for Distribution activity</i>	<i>3,421,402</i>
<i>GEMS</i>	<i>Reselling activity</i>	<i>14,374,000</i>
<i>SAP</i>	<i>Reselling activity</i>	<i>28,877,317</i>
<i>WCM Connector (ECSC)</i>	<i>Internally developed</i>	<i>1,046,640</i>
<i>eDocs DM connector (ECSC)</i>	<i>Internally developed</i>	<i>876,282</i>
<i>AWS</i>	<i>Reselling activity</i>	<i>790,500</i>
<i>Cloudsquad</i>	<i>Acquired for Distribution activity</i>	<i>1,533,750</i>
<i>Grand Total</i>		<i>71,445,689</i>

6.2 From the information in the above table Ld. DRP observed that only an amount of Rs.2.25 crore (i.e. 22.5 million) represent income on account of internally developed which constitute 0.18% of operating revenue, and all others license revenue was from distribution or reselling activity. Besides, the company has also categorically clarified in its reply u/s 133(6) that it is engaged in software product development services only. The relevant extract of the reply is as under:-

"Persistent System Limited is predominantly engaged in the business of providing outsourced software product development services to customers across the globe from following industry verticals: Infrastructure and systems, Telecom and Wireless, Life science and Healthcare and Financial services.

The company reports segment information based on the above industry verticals. The nature of services provided that each of these segments differs only in terms of the industry and specific requirements of customers in each of these industries. The essential activity across all business segments can be considered to be software product development services".

6.3 Further, Ld. DRP observed that the assessee based on certain information discussed in the consolidated annual report (which included discussion of financial results of Persistent Systems Ltd and its six subsidiaries associates) argued that this company is into product development and IP led revenue. It would be totally incorrect to consider the information pertaining to the entire group as such, when the comparability is to be seen with reference to the stand alone financials of Persistent Systems Ltd, which was considered for comparable analysis by the TPO.

6.4 In this regard, Ld. DRP in his report stated that it is pertinent to note as per the consolidated annual report the revenue from software licence was Rs.535.59 million for the entire group whereas, such revenue in the case of M/s Persistent Systems Ltd was only Rs.71.45 million (Ref page 168 and page 211 of the annual report). It is also seen that in the P&L account of the consolidated financial statement expenses were debited towards Royalty expenses of Rs.176.73 million (refer page 169) and such a debit is not to be noted in the P&L account of M/s. Persistent Systems Limited.

6.5 Further, as per information at page 88 of the annual report for FY 2012-13 it was stated in the notes to the consolidated results that the increase of intangible block of assets during the year (2012-

13), of Rs.262.84 million, was mainly on account of acquisition of various IPs during the year and the same is shown in the intangible Asset Schedule of the consolidated financial statement at page 115 as under:-

<i>Intangible Assets of Group 2012-13</i>		<i>(in Rs.Millions)</i>	
	<i>Software</i>	<i>Acquired contractual rights</i>	<i>Total</i>
<i>Gross block (At cost)</i>			
<i>As at April 1, 2012</i>	<i>1,287.49</i>	<i>281.63</i>	<i>1569.12</i>
<i>Additions</i>	<i>94.03</i>	<i>261.23</i>	<i>355.26</i>
<i>Disposals</i>	<i>116.10</i>	<i>--</i>	<i>116.10</i>
<i>Other adjustments</i>			
<i>Exchange differences</i>	<i>23.86</i>	<i>(0.18)</i>	<i>23.68</i>
<i>As at March 31, 2013</i>	<i>1,289.28</i>	<i>542.68</i>	<i>1,831.96</i>

6.6 All these clearly show that the IP related and product revenue pertain to other group entities and does not pertain to M/s Persistent Systems Ltd, which is being compared. It is also relevant to note that this company has clarified in its reply given u/s 133(6) of the Act, that M/s Persistent Systems Ltd is predominantly engaged in the business of rendering software development services; the revenue reported is primarily on account of rendering of software development services only. The relevant extract is as under:-

"In respect of the information you have requested under 3(a) and 3(c) in respect of software products and innovations, overseas subsidiary companies of Persistent Group have acquire certain Intellectual Property (IP) products and generating some revenue from licencing and support of these products. In case of PSL India, which is predominantly engaged in the business of rendering software development services, the revenue reported is primarily on account of rendering of software development services only"

6.7 The above clarification also makes it clear that this company is not into diversified activities.

6.8 Further, Ld. DRP observed that the expenditure incurred towards R&D as per page 225 of the annual report was Rs.62.24 million, which constitute meagre 0.50% of operating revenue. Further, the capital expenditure towards R&D was only Rs.0.28 million, which clearly show that the R&D activities are routine. The value of intangible assets was only Rs.162.85 million constituting 1.31% of operating revenue. There is no reference to any intangible assets or patent owned or developed by the company, in the stand alone annual report. There is also no acquisition of intangibles during the year. Further as per note of the annual report, software product developments costs are expensed as incurred unless the technical and commercial feasibility of the project enable to use or sell the software, they are not capitalized. Such a development is not reflected in the Asset schedule. Thus, it can be inferred that the R&D and intangible assets do not have impact on the revenue and profitability of the company. The assessee has failed to establish that such differences, if any, on account of R&D, brand and IRPs have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B, which provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences, if any, between enterprises entering into business transactions or-likely to materially affect the profit arising from such transactions in the open market. The said company also clarified u/s 133(6) that its intangible assets are in the nature of software licenses acquired for use in the operation of the company and are not in the nature of inbuilt software product generating revenue for the company. Further, the assessee also performs R&D functions. Hence, these pleas were rejected by Ld. DRP.

6.9. Further, as per Ld. DRP's report, this company was held to be engaged in software development and not a product company

and hence functionally comparable to a software service provider company, by the coordinate bench of ITAT Bangalore in the case of M/s. Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14). In view of the above, Ld. DRP upheld the selection of this comparable.

6.10 Ld. DRP observed that the approach of the TPO in treatment of related party transaction into two sets, are for revenue transactions and other for expense transaction is logical and correct. Further, the RPT filter was adopted by the TPO was with the above conditions and has adopted consistently. Hence, Ld. DRP did not find any infirmity in the approach. Hence, Ld. DRP rejected the assessee's plea.

6.11 In view of the above discussion, Ld. DRP upheld the selection of this company as comparable.

6.12. Against this assessee is in appeal before us.

6.13. We have heard the rival submissions and perused the materials available on record. As rightly pointed out by Ld. A.R., this comparable is considered as not a comparable in the case of Yahoo Software Development India Pvt. Ltd. cited (supra), wherein it was held as under:

“32. At the time of hearing, the ld. counsel for the assessee has prayed for exclusion of 4 comparable companies that remain after the order of the DRP viz., Persistent Systems Ltd., Infosys Ltd., Mindtree Ltd. and L&T Infotech Ltd. He brought to our notice that as far as Persistent Systems Ltd. is concerned, the reasoning given for excluding this company for AY 2014-15 will equally hold good for the present year as well. In this regard, our attention was drawn to page 601 of the assessee's PB wherein in the annual report of this company, Notes forming part of financial statement in Note (i) which gives the description of income from

software services, there is a reference to revenue from licensing & software, which sufficiently indicates that the assessee is not a pure SWD services provider. It was also brought to our notice that the profit & loss account which is at page 596 read with Notes forming part of the financial statement at page 604 wherein the segmental reporting is not based on different segments and the statement presents a consolidated financial statement without any segmental reporting. This company has also significant RPT transaction of 25% on sales. He pointed out that the TPO & DRP on the application of RPT filter has not expressed any opinion. The Id. DR relied on the order of DRP wherein the DRP has made extensive reference to each of the objections regarding absence of segmental revenue in the accounts and has also noticed that the software products segment had an insignificant revenue and that the ownership of intangibles by the assessee has had no effect whatsoever.

33. We have considered the rival submissions. We find that on the question of application of RPT filter, the assessee had made the following submission before the DRP:-

4. Fails the Related Party Transaction to Sales filter applied by the learned TPO

In the show-cause notice issued, the learned TPO has excluded companies for which the ratio of RPT to sales exceeds 25% during the current year i.e., during FY 2014-15. The relevant extract from the show-cause notice is reproduced below for ease of reference:

e) Companies who have more than 25% related party transactions of the sales were excluded.

Companies having related party transactions of more than 25% are proposed to be excluded. A threshold of 25% is being applied following the provisions of Section 92A(2)(a) which provides a limit of 26% of the equity capital carrying voting rights for treating an enterprise as Associated Enterprise. if the limit is reduced further it would only result in eliminating more and more companies, on the other hand if the limit is relaxed then companies with predominantly related party transactions would get included which would not

represent uncontrolled transactions. Therefore, on a balancing note, 25% is a proper threshold limit for related party transactions. The companies having more than 25% related party transactions should therefore be rejected as comparables.

The Hon'ble ITAT has upheld the application of this filter by the TPO in its order in the case of M/s. Supporisoft India Pvt. Ltd for AY 2005-G6 in IT (TP)A 1372/B/11 & 20/2012 dated 28.03.2013 following its own decision in the case of M/s. Actis Advertisers Pvt. Ltd vide ITA No.5277/De1/2011 dated 12.10.2012.

On perusal of the Annual Report of Persistent, we observe that the company has RPT in excess of 25% of the sales. The calculation of the same has been provided below for your ease of reference:

RPT to Sales ratio for FY 2014-15	Amount
Particulars	(INR Million)
Sale of services	2,410.02
Commission received	10.26
Purchase of software	1.49
Cost of technical professional	1,339.1
Commission paid on sales	111.79
Traveling and conveyance	19.27
Total related party transactions (A)	3,891.93
Total Sales (B)	12,424.98
RPT % of Sales (A/B)	31.32%

From the above computation, it is clear that the controlled transactions of Persistent constitutes 31.32% of sales. Based on the above, it can be seen that Persistent fails the 'RPT to sales ratio' filter applied by the learned TPO and should therefore not be considered as a comparable."

34. This argument has been addressed by the DRP in its order as follows:-

"4.4.9 We note that the approach of the TPO in treatment of related party transaction into two sets, are for revenue transactions and other for expense transaction is logical and correct. We also note that the RPT filter was adopted by the TPO was with the above conditions

and has adopted consistently. Hence, we do not find any infirmity the approach. Hence, we reject the assessee's plea. We hold that onsite expenses do not adversely affect comparability and hence, such plea is rejected.”

35. Further, the assessee had also raised plea with regard to onsite revenue filter by pointing out that onsite revenue is substantial and therefore this company should not be regarded as a comparable company with a company which does not have any onsite revenue. In this regard, the ld. counsel for the assessee placed reliance on the decision of the ITAT Bangalore Bench in the case of Trilogy e-business Software India P. Ltd. v. DCIT, ITA No.1054/Bang/2011 for AY 2007-08 dated 23.11.2012 wherein this Tribunal took the following view:-

“64. The next objection of the Assessee is that when the most appropriate method selected for determining ALP is the TNMM there is no reason as to why one should look at price difference in offshore software development and onsite software development. It is no doubt true that in TNMM it is only the margins in an uncontrolled transaction that is tested with reference to the controlled transaction but it is not possible to ignore the fact that pricing will have an effect on the margins obtained in a transaction. The argument that if pricing structure were to be considered as criteria, then it will have to be seen as to what is the pricing structure of all the comparable for various projects cannot be accepted because the TPO has not chosen any other onsite software service provider with a revenue composition of more than 75% from onsite software services as comparable. As rightly observed by the TPO, the pricing is different in onsite when compared to offshore operations. The further observations of the TPO that the reasons for the same lie in the fact that while in the case of OFFSHORE projects most of the costs are incurred in India; an ONSITE project has to be carried out abroad significantly increasing the employee cost and other costs.

65. *The next objection of the Assessee is with regard to Assets employed. The companies, which predominantly generate revenues from onsite activity, do not have significant assets as most of the work is carried on the site of customer outside India. The argument that the TPO has himself observed that software service providers do not require much assets cannot be basis to accept the Assessee's plea. Those observations are made by the TPO in the context of application of turnover filter and have been quoted out of context by the Assessee.*

66. *The next argument of the Assessee is that TPO has held that margins are lower in onsite software services and that margin is not a criteria to select or reject a comparable under Rule 10B(2) of the I.T. Rules. We are of the view that this argument again ignores the fact that the approach of the TPO has been to highlight the fact that there can be no functional comparability, if the assets employed and risks assumed are taken into consideration. It is in that context the TPO has referred to the margins.*

67. *The companies who generate more than 75% of the export revenues from onsite operations outside India are effectively companies working outside India having their own geographical markets, cost of labour etc., and also return commensurate with the economic conditions in those countries. Thus assets and risk profile, pricing as well as prevailing market conditions are different in predominantly onsite companies from predominantly offshore companies like the taxpayer. Since, the entire operations of the tax payer are taking place offshore i.e. in India; it is but natural that it should be compared with companies with major operations offshore, due to the reason that the economics and profitability of onsite operations are different from that of offshore business model. As already stated the Assessee has limited its analysis only to functions but not to the assets, risks as well as prevailing market conditions in which both the buyer and seller of services located. Hence, the*

companies in which more than 75% of their export revenues come from onsite operations are to be excluded from the comparability study as they are not functioning in similar economic circumstances to that of the tax payer. Hence, it is held that this filter is appropriately applied by the TPO.

68. Admittedly the onsite revenue in the case of the following comparable companies identified by the Assessee was more than 75% of its export revenues viz., a) Visu International Ltd. b) Maars Software International Ltd. c) Akshay Software Technologies Ltd. d) VJIL Consulting Ltd. e) Synfosys Business Solutions Ltd. The above companies were therefore rightly not considered as comparable by the TPO. We hold accordingly.”

36. It is seen that the TPO in coming to the conclusion that the onsite revenue filter is not applicable has placed reliance on the decision of the ITAT Mumbai Bench in the case of Capegemini as quoted in para 16 in para 14 of the TPO’s order, but that decision does not deal with a case of onsite revenue filter and the decision was rendered on the facts of its own case.

37. On the issue of RPT filter, we notice that the TPO in para 16 has accepted that the RPT filter should be @ 25%. In the case of Persistent Systems Ltd., the RPT is at 31.32% as extracted in the earlier part of this order and therefore this company should be excluded by application of RPT filter. In view of the above, we do not wish to go into other grounds on which this company is sought to be excluded viz., that it is a product company and there is no segmental data between product and services segment, presence of onsite activity and the impact of extra-ordinary event of acquisition during the relevant previous year. Therefore, this company is directed to be excluded from the list of comparable company.”

6.14 In view of the above order of the Tribunal, we are inclined to direct the AO/TPO to exclude this company Persistent Systems Ltd. from the list of comparables.

III. Infosys Ltd.:-

7. The Ld. A.R. submitted that this company has to be excluded from the list of comparables on the following reasons:-

- Infosys is functionally dissimilar and ought to be rejected.
- No segmental details are available in the annual report and hence the company should be rejected.
- The company also derives income from licensing of software products.
- Infosys is engaged in R&D activities.
- Infosys has presence of brand.
- Infosys has invested in IP.
- Infosys fails upper turnover filter.

7.1 Ld. DRP in his report observed that after having considered the submissions, and on perusal of the annual report of the company, this company is engaged in providing IT technology services comprising Application developing and maintenance Independent validation, testing services, Business service management, consulting and systems integration services. All these activities fall within the gamut of 'software services', though performed in five different business verticals. As per the P&L account, the company has revenue from 'software services' of Rs.45,658/- crores and from software products of Rs.1642/- crores (refer page 61 of the annual report), and that the product revenue constitute meagre 3.6% of total operating revenue. Therefore, taking into consideration the various information available in the annual report, and the fact that the company is predominantly having revenue from software services, Ld. DRP was of the considered view that this company can be considered as functionally comparable to the assessee. Accordingly, the plea that

the company is engaged in diversified activities was rejected by Ld. DRP.

7.2 A plea was raised before Ld. DRP by the assessee that this company also provides data analytic services which is high end and hence, cannot be compared to the assessee. Ld. DRP did not find merit in the plea, as undoubtedly, provision of data analytic services is not functionally different from software development activity. The data analytic services also use only certain software and tools, write codes to perform certain tasks. Like any other software application, these tools also facilitate and enables business enterprises for informed management and decision. Therefore, Ld. DRP did not find merit in the plea. Further, there cannot be any distinction between high end software activity and low end activity, so long as it falls within the purview of software development services. Besides, under the TNMM, such differences are tolerable and there is no requirement that the services / activities performed are identical. It is enough that that the services are similar and fall within the same domain of software development. Accordingly, the pleas raised were rejected by the Ld. DRP.

7.3 It was pleaded by assessee that this company has a huge brand which has contributed to its growth in revenue and hence not comparable. A perusal of the annual report show that the growth in revenue was on account of various business initiatives taken to accelerate growth such as — internal re-organization, implementing cost effectiveness through reducing cost of operation, improving utilization percentage of employee, restricting the organization for agility by creating smaller and nimbler sales regions, redesigning supply chain functions, reducing attrition rate, increasing the offshore mix, improving delivery expertise etc., As per information in page 14 of annual report, 97.8%' of revenues was from repeat

business. At page 67 of the annual report, it is discussed, "Clients often cite our industry expertise, comprehensive end-to-end solutions, ability to scale, superior quality and process execution, global delivery model, experienced management team, talented professionals, track record and competitive pricing as reasons for awarding contracts'. Thus, the growth in revenue is not on account of its brand or any exceptional event, and hence cannot be a reason for rejecting this company, which is otherwise found to be functionally comparable.

7.4 The perusal of the details in the annual report by Ld. DRP showed that the company has incurred R & D expenditure to the tune of Rs.605 crores, which constitute meagre 1.3% of its total operating revenue, and which is much less than the generally acceptable tolerable limit of 3% of the total revenue. It was also noted that out of this, only Rs.15 crore was capital in nature and the remaining Rs.590 crore represented revenue expenditure, which go to show that the R&D initiative are substantially routine for immediate business purposes for developing expertise and improved process execution. It was also pleaded that the company has significant intangibles. However, on perusal of the information at page 86 of the annual report, Ld. DRP noted that the value of intangible assets as on 31.03.2015 was Nil and as on 31.0.2014 was Rs.13 crore, which is insignificant considering its turnover of Rs.47,300 crore and Asset portfolio of Rs.7347 crore. Ld. DRP noted that, the assessee has failed to establish that such differences, if any, on account of brand and intangibles have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B, which provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences, if any, between enterprises entering into business transactions or likely to materially affect the profit arising from such

transactions in the open market. Further, as discussed in para 2.6.2.3 above, the assessee also performs R&D functions. Hence, these pleas were rejected by Ld. DRP.

7.5 On the plea as to difference in the scale & size of operations and consequent abnormal profits, Ld. DRP noted that turnover does not influence the margins in the service sector: Ld. DRP already held that turnover cannot be a criteria for selection of comparables. In this regard it is relevant to note that the coordinate bench of Bangalore in the case Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14) rejected the plea of the assessee to exclude a company comparable on the ground of size and level of operations. Hence, these pleas were rejected by the Ld. DRP.

7.6 In view of the above, Ld. DRP upheld this company as comparable to the assessee.

7.7 Against this assessee is in appeal before us.

7.8 We have heard the rival submissions, perused the materials available on record and gone through the orders of the authorities below. This comparable is considered as no comparable in the case of Yahoo Software Development India Pvt. Ltd. cited (supra) wherein it was held as under:

“39. The next company which the assessee seeks to exclude is Infosys Ltd. As far as this company is concerned, it is seen that the following are the functional dissimilarities brought to our notice:-

“Functionally dissimilar - owns intellectual properties, incurs significant R&D costs & onsite activity.

- Engaged in diversified business activities.

- Involved in development of software products in addition to software services. - Owns intellectual property rights.
- Incurs significant research and development costs.
- Carries out significant activities based on onsite business.
- Owns products such as Finacle, Edge Verve and other product based solutions.

Extra-ordinary event of merger with Infosys Consulting India Ltd.

Segmental profit & loss account not available.

Commands substantial brand value

40. The DRP, however, has not thought it fit to exclude this company by observing that this company has substantial pre-dominant revenue from software services and the growth was not attributable to any brand value. Presence of onsite activity and the expenses on R&D have all been brushed aside. In our view, the difference pointed out by the ld. counsel for the assessee before us show that this company cannot be compared with that of the assessee basically because of its business model, presence of onsite revenue generation and other reasons cited before us. Besides, the reason that turnover of this company is huge and more than 10 times that of the assessee.”

7.9 In view of the above order of the Tribunal cited (supra) we direct the AO/TPO to exclude this company from the list of comparables.

IV. Thirdware Solutions Pvt. Ltd.:-

8. The Ld. A.R. submitted that this company has to be excluded from the list of comparables on the following reasons:-

- Thirdware is functionally dissimilar and ought to be rejected.
- No segmental details are available in the annual report and hence the company should be rejected.
- Thirdware has incurred brand promotion expense.

8.1 The Ld. A.R. for the assessee argued that this company is engaged in sale of products and diversified activities. It was also argued that there is no segmental information for the product and services business and hence cannot be taken as comparable. It was also contended that the company has intangibles and deriving revenue from licensing of software.

8.2 Ld. DRP observed that on perusal of the annual report, Ld. DRP noted that this company is engaged in the business of software development services and software services. (page 116 of annual report), and that the company's operation comprises of software, development, implementation and support services (page 127 of annual report). At page 120 of the annual report, the company's Revenue Recognition disclosure refers to revenue from services from software development and implementation and not to product sales. At page 143 of the annual report, the company has mentioned revenue from sale of products at NIL. However, in the foot note given at page 147 of annual report, it is clearly mentioned that the revenue on account of export of software services was Rs.22,473.24 lakhs, from software services from domestic market Rs.475.67/- lakhs, from subscription and training Rs.44.32/-lakhs, from sale of licenses 14.75 lakhs. The revenue from software license constitute meagre 0.06% of total operating revenue. Thus, the information in the annual report clearly show that this company is predominantly (99.93%) into sale of software services and hence, it is, functionally comparable to the assessee. Further, as per information provided in response to notice u/s 133(6), the company has categorically stated that it is engaged in providing IT software services; and that the revenue of Rs.14.75 lakh represent trading in software license. In

view of these, Ld. DRP upheld the selection of this company as comparable.

8.3 Against this assessee is in appeal before us. We have heard the rival submissions and perused the materials available on record. As rightly pointed out by the Ld. A.R., this comparable is considered as not a comparable in the case of LG Soft India Pvt. Ltd. Vs. Deputy Commissioner of Income-tax in IT(TP)A No.3122/Bang/2018 dated 28.5.2019 for the AY 2014-15, wherein it was held as under:

“8. We also notice that in AY 2008-09, the co-ordinate bench has excluded M/s Thirdware Solutions Ltd also by following the decision rendered in the case of 3DPLM Software Solutions Ltd (IT(TP)A No.1303/Bang/2012 dated 28.11.2013, where in it was held that M/s Thirdware solutions Ltd is engaged in product development and earns revenue from sale of licenses and subscription. Further, the segmental details were not available.

8.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee’s own case in AY 2008-09 in IT(TP)A No.1673/Bang/2012 , we direct exclusion of M/s Thirdware Solutions Ltd.”

8.4 In view of the above order of the Tribunal cited (supra) we direct the AO to exclude this company from the list of comparables.

V. L&T Infotech Ltd.:-

9. The Ld. A.R. submitted that this company has to be excluded from the list of comparables on the following reasons:-

- L&T Infotech is functionally dissimilar and ought to be rejected.
- No segmental details are available in the annual report and hence the company should be rejected.
- L&T Infotech has presence of intangibles.
- L&T Infotech has presence of brand.
- L&T Infotech has incurred brand promotion expense.
- L&T Infotech fails upper turnover filter.

9.1 It was contended by the Ld. A.R. that this company provides wide range of services and also engaged in sale of products and in the absence of segmental information, this company is not comparable. It was contended that L&T Infotech is a brand across globe which has impacted the margins of the company. It was further argued that the company is engaged in trading of goods which is evident from page 1364 of the annual report for FY 2014-15. It was also argued by the Ld. A.R. that because of investment in technology absorption and R&D, it should not be considered as comparable.

9.2 Ld. DRP observed that, at the outset, the assessee had selected this company as functionally comparable in its TP study giving the following reasons, "Larsen & Toubro Infotech Limited is an IT service company. The company is engaged in providing Application Maintenance and Development, Enterprise Resource Planning and specialized services like Data Warehousing and Business Intelligence, Testing Services and Infrastructure Management Services. The services offerings are focussed mainly

towards four verticals namely manufacturing, utilities, financial services and telecom. For the period ended March 31, 2015, March 31, 2014 and March 31, 2013. 100% of the operating revenues respectively were derived from software development services". However, without giving reasons, it has raised a plea that it is functionally different, when the TPO has selected this company as comparable. Further, Ld. DRP also noted that this company has two business segments —services cluster and industrials cluster operating in software development services. The information in the annual report clearly shows that the entire revenue is from provision of software services. As per Note 2, regarding Accounting principle on Revenue Recognition, it is stated that revenue is recognized when services are rendered and related costs incurred; and there is no reference to sale of products. The financial statements do not mention about any product sale or inventory. As there is no revenue stream on account of product sales, Ld. DRP did not find any merit in the argument that the company is engaged in product sales. Accordingly, Ld. DRP held it as functionally comparable being a software service provider.

9.3 On the pleas as to presence of brand, Ld. DRP noted that, there is no specific information in the financial statements to indicate that the brand has contributed to revenue growth of the company. On the other hand, the reference in the annual report mentions that the company's efforts to be cost-effective and agile in contributing value to clients have strengthened its brand. In other words, its operational efficiency has contributed to its revenue growth and brand name and not the other way. There is no information to indicate that the brand has impacted the revenue or profit of the company. The intangibles referred in the Asset Schedule represent the computer software, and business rights and as such does not refer to any IPR or license owned by the said

company. Certain developments are under way which has not crystallized into an intangible to be a source of revenue. Thus, the assessee has failed to establish that such differences have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B, which provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences, if any, between enterprises entering into business transactions or likely to materially affect the profit arising from such transactions in the open market. Hence, these pleas of assessee were rejected by the Ld. DRP.

9.4 On the plea as to difference in the scale & size of operations and consequent abnormal profits, Ld. DRP observed that turnover does not influence the margins in the service sector and held that turnover cannot be a criteria for selection of comparables. Hence, these pleas of assessee were rejected by Ld. DRP.

9.5 Further, Ld. DRP observed that this company was upheld to be functionally comparable to as software service provider company, by the coordinate bench of Bangalore in the case of M/s. Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14). In view of the above, Ld. DRP upheld the selection of this comparable.

9.6 Against this assessee is in appeal before us.

9.7 We have heard the rival submissions and perused the materials available on record. This company is considered as not a comparable in the case of LG Soft Pvt. Ltd. cited (supra) wherein it was held as under:-

“38. As far as L&T Infotech Ltd. is concerned, the ld. counsel for the assessee brought to our notice the decision of ITAT Delhi Bench in the case of Saxo India Pvt. Ltd. v. ACIT, ITA No.6148/Del/2015 for AY 2011- 12, order dated 5.2.2016, wherein the Tribunal took note of the fact that this company was also trading in software and owned insignificant intangible assets. The company was excluded from the list of comparable companies with reference to SWD services provider such as the assessee. The ld. Counsel pointed out that though this decision was rendered with reference to AY 2011-12, the same reasoning would apply to AY 2015-16 also and in this regard, he drew our attention to page 696 of assessee’s PB, which gives the details of the revenue generated by this company without any segmental break-up. Our attention was also drawn to page 682 of PB which shows that there is substantial onsite revenue activity as well as cost incurred on onsite software development. We notice from page 676 of assessee’s PB that this company as part of its operating profit in Schedule O of profit & loss account contains expenditure for ‘cost of bought out items for resale’ and this is a significant part of the operating expenditure. When we see the revenue in Schedule M of the profit & loss account, there is no break-up of the revenue with regard to software services and software product. In our opinion, this distinction is enough to exclude this company from the list of comparable companies as held by the Hon’ble Delhi ITAT in the case of Saxo India Pvt. Ltd. (supra) which decision was also confirmed by the Hon’ble Delhi High Court.”

9.8 Similar view was taken in the case of Yahoo Software Development India Pvt. Ltd. cited (supra), wherein, L&T Infotech Ltd. has been excluded from the list of comparables. Respectfully

following the above order, we direct the AO/TPO to exclude L&T Infotech Ltd. from the list of comparables.

10. Next ground for our consideration is that assessee sought the inclusion of following comparables only.

- i. I2T2 India Limited
- ii. Melstar Information Technologies Ltd.

Other comparables in ground No.12 is not pressed. Accordingly, dismissed as not pressed.

I. I2T2 India Ltd.:-

11. The Ld. A.R. submitted that this company has to be included in the list of comparables on the following reasons:-

- The TPO has erred in rejecting I2T2 India on the ground that Related Party Transactions (“RPT”) data for FY 2014-15 is not available in the annual reports.
- I2T2 India is functionally comparable and ought to be accepted.
- I2T2 India qualifies all the filters applied by the TPO.

11.1 We have heard the rival submissions and perused the materials available on record. As rightly pointed out by the Ld. A.R., this company is considered as comparable in the case of LG Soft India Pvt. Ltd. cited (supra), wherein it was held as under:-

“12. We find force in the contentions of Ld A.R. If the Annual report of this company does not mention about Related Party transactions, then the assessee cannot be held responsible to prove a fact relating to a third party, which may or may not exist. We notice from the Auditors Report of M/s T2T2 India Ltd that the auditor in para 5(b) of Annexure to the Auditors’ report has mentioned as under:-

“There are no transactions that are made at prices exceeding Rs.5 lakhs in respect of any party who is covered under section 301 of the Act during the financial year.”

Hence, in the absence of any specific information, there is merit in the contentions of the assessee that the above said company might not have had related party transactions during the year under consideration. Accordingly, we do not agree with the reasoning given by Ld DRP for excluding this company as a comparable. Accordingly, we direct the AO/TPO to include this company.”

11.2 In view of the above, we direct the AO/TPO to verify this company’s annual report for AY 2015-16 and decide accordingly in the light of above observations of the Tribunal.

II. Melstar Information Technologies Ltd.:-

12. The Ld. A.R. submitted that this company has to be included in the list of comparables on the following reasons:-

- The TPO has erred in stating that Melstar has incurred persistent losses
- Melstar is functionally comparable and ought to be accepted.
- Melstar qualifies all the filters applied by the TPO.

12.1 Ld. DRP in his report observed that the TPO has applied filter to remove companies who have incurred losses during 2 years out of 3 years (including the year under consideration) to arrive at final set of comparables. The rationale for adopting consistent loss-making filter in the line of business followed by the tax payer is merely that this sector is a rapidly growing sector in India and against this sectoral trend, persistent loss making by a company is clearly an aberration. This filter is based on the existence of exceptional circumstances which alone would explain the extreme divergence of financial results from the normal industry trend.

Accordingly, a company which fails this filter cannot be considered as a normal comparable. Admittedly, this company has incurred losses in FY 2012-13 and 2013-14 and hence, rejection is upheld by the Ld. DRP.

12.2 Against this assessee is in appeal before us.

12.3 We have heard the rival submissions and perused the materials available on record. The Ld. A.R. submitted that this company Melstar Information Technologies Ltd. is a loss making company in the last 3 continuous successive assessment years and if there is a profit in any one of the past 3 financial years, then that company cannot be excluded on the basis of persistent loss making filter. For this purpose, he relied on the order of the Tribunal in the case of KBACE Technologies Pvt. Ltd. Vs. Deputy Commissioner of Income-tax in IT(TP)A No.3189/Bang/2018 and he drew our attention to the following findings of the Tribunal:-

8. "As far as inclusion of 3 companies which was argued before us by the Id. counsel for the assessee, the first company which the assessee seeks for inclusion is Sagarsoft (I) Ltd. This company was rejected by the TPO by applying the RPT filter which was not accepted by the DRP. The DRP directed the TPO to consider the comparability of this company afresh. The TPO while giving effect to the order of DRP, chose to reject this company as a comparable by pointing out that this company fails the persistent loss filter. It was the submission of the Id. counsel for the assessee that that in the light of decision of ITAT Pune Bench in the case of Yezaki (I) Pvt. Ltd., ITA No.621/PUN/2014 AY 2009-10, order dated 11.17.2019, the persistent loss filter can be applied only if there is a loss

in 3 successive assessment years and that if there is a profit in any one of the 3 past financial years, then that company cannot be excluded on the basis of persistent loss making filter. It was submitted that all other filters have been accepted by the TPO in the order giving effect and therefore this company deserves to be included as a comparable company.”

12.4 In view of the above, in our opinion, it is appropriate to remit the issue to the file of AO/TPO to decide the same in the light of above findings of the Tribunal. Accordingly, the issue is remitted to AO/TPO for fresh consideration.

13. In ground No.13, the Ld. A.R. submitted that the TPO arrived in computing the operating markup for Sasken Communications Technologies Ltd. and Daffodil Software Ltd. After hearing both the parties, we direct the AO/TPO to take a correct operating markup of these two companies. Directed accordingly.

14. Ground No.14 is not pressed and dismissed accordingly.

15. Ground No.15 is with regard to granting of appropriate adjustments towards working capital. After hearing the parties, we direct the AO/TPO to grant appropriate adjustments towards working capital as directed by Ld. DRP. In other words, actual working capital adjustment to be given. Directed accordingly.

16. With regard to ground No.16, no argument was put forth on this ground. Accordingly, this ground is not considered.

17. Ground No.17 is with regard to the levy of interest u/s 234A of the Act. The contention of the Ld. A.R. is that the assessee filed the return of income before due date and therefore levy of interest u/s 234A of the Act is unwarranted and is to be deleted. Further, it was submitted that draft assessment order did not contain this interest computation. Hence, no ground is raised before the Ld. DRP. This ground is remitted to AO/TPO to consider chargeability of interest u/s 234A of the Act and decide accordingly.

18. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 31st May, 2022

Sd/-
(Beena Pillai)
Judicial Member

Sd/-
(Chandra Poojari)
Accountant Member

Bangalore,
Dated 31st May, 2022.
VG/SPS
Copy to:

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

By order

Asst. Registrar,
ITAT, Bangalore.