

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

**BEFORE SMT. BEENA PILLAI, JUDICIAL MEMBER AND
MS. PADMAVATHY S, ACCOUNTANT MEMBER**

IT(TP)A No.260/Bang/2021
Assessment Year : 2016-17

M/s. Enstage Software Private Limited, 16/1, WINGS, 2 nd Floor, Cambridge Road, Halsuru, Bengaluru – 560 008. PAN : AAACE 9963 B	Vs.	DCIT (Exemptions), Circle – 2(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Smt. Tanmayee Rajkumar, Advocate
Revenue by	:	Smt. Susan Dolores George, CIT(OSD)(DR)(ITAT), Bengaluru.

Date of hearing	:	07.06.2022
Date of Pronouncement	:	13.06.2022

ORDER

Per Padmavathy S, Accountant Member

This appeal is against the order of National e-Assessment Centre – Delhi passed under section 143(3) r.w.s 144C(13)) of the Income Tax Act (the Act) dated 21.04.2021 for the assessment year 2016-17.

2. The assessee raised 8 grounds and several sub-grounds. The following are the main issues that arise for consideration from the appeal

- (a) Transfer Pricing (TP) adjustment of Rs. 1,86,14,568/- made by the Transfer Pricing Officer (TPO) towards the international transaction of provision of software

development services (SWD services) to the Assessee's Associated Enterprises (AE) – Ground No. 4

- (b) Disallowance of Rs. 19,22,610/- as being provision for bad and doubtful debts. Ground No.7

Rest of the grounds are general, academic or not pressed by the Id AR during the course of hearing. Therefore these grounds do not warrant adjudication and hence dismissed.

2. The assessee is a subsidiary of Wibmo Inc., USA. The Wibmo group is a leader in mobile payments. The assessee is engaged in rendering software development and related support services to its AE. In terms of Sec.92B(1) of the Act, the transaction of providing SWD Services were “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, any income arising from an international transaction shall be computed having regard to the arm's length price.

3. The assessee filed the return of income for the assessment year 2016-17 on 30.11.2016 declaring a total income of Rs.2,17,59,360. The case was selected for scrutiny. Since the assessee had international transactions the Assessing Officer (AO) made reference to the TPO as per the provisions of section 92CA of the Act. In respect of the SWD services rendered by the assessee to its AE which the TPO determined a TP adjustment of Rs. 1,86,14,568/-. Initially, a draft assessment order dated 16.12.2019 came to be passed by the AO in which the aforesaid TP adjustment was incorporated, and beside the AO proposed a disallowance of Rs. 19,22,610/- which was reflected in the financial statements as provision for bad and doubtful debts. Aggrieved, the Assessee filed its objections before the DRP which, vide its directions dated 25.02.2021 affirmed the draft assessment order in its entirety. The assessee is in appeal before the Tribunal against the final order of the AO passed pursuant to the directions of the DRP.

TRANSFER PRICING ADJUSTMENT

4. The FAR analysis of the assessee as per the TPO's order reads as under

2.1. Enstage Software Private Limited is a private limited company registered under the Companies act 1956 is a wholly owned subsidiary of Wibmo Inc., (formerly Enstage Inc) USA. The company is engaged in providing payment security software and related support services to be Wibmo Inc. Enstage India has been providing software development services to the parent company and successfully developed the software which

is operational and they continue to maintain and support including forage improvement for their parent company and they also provide software and related ITeS support services for card payment authentication and processing solutions and focused on the prepaid online and mobile payments to their customers in India who are mostly public sector banks.

“2.2 The summary of functions performed by Enstage Software Pvt. Ltd. vis-a-vis its AE are provided below:

Functions	Assessee	AE
Software Development Activities		
Understand the nature of work required by the client	Yes	No
Providing instruction/specifications work	No	Yes
Develops cost standards	No	Yes
Develops and performs quality control standards	No	Yes
Supervising the operations	Yes	No
Execution of work orders	Yes	No
Other general functions		
General administrative activities	Yes	Yes
Human Resource management	Yes	NO
Infrastructure management	Yes	NO

2.3 In the performance of the above-mentioned functions, the taxpayer uses the routine tangible assets for its business operations. The taxpayer does not own any non-routine intangibles such as trade secrets, patents, trademarks, etc. On the other hand, the AE, being the entrepreneurial entity, performs the necessary R&D function and owns intangible of products developed.

2.4 A summary of the risks assumed by the taxpayer and its AE under software development services is as under:

<i>Risks</i>	<i>Taxpayer</i>	<i>AE</i>
<i>Market risk</i>	<i>NO</i>	<i>YES</i>
<i>Financial Risk</i>	<i>NO</i>	<i>YES</i>
<i>Credit & Collection risk</i>	<i>NO</i>	<i>YES</i>
<i>Technology obsolescence risk</i>	<i>NO</i>	<i>YES</i>
<i>Foreign exchange fluctuation risk</i>	<i>YES</i>	<i>No</i>
<i>Working Capital Risk</i>	<i>NO.</i>	<i>YES</i>

The FAR analysis serves as a foundation to characterize entities for the purpose of intercompany transfer pricing. Based on the analysis of the functions performed, assets employed and risks assumed, it is appropriate to characterize the taxpayer as a captive service provider which assumes minimal risks associated with the business of providing software development services.”

5. The assessee has entered into the following international transaction with its AE during the year under consideration

Particulars	Amount in Rs.
Provision of software development services	Rs. 20,18,51,846/-
Trade advances received	Rs. 5,50,19,732/-

6. The assessee has adopted transactional net margin method (TNMM) as the most appropriate (MAM) for computing arms length

price (ALP). Operating profit/operating cost is taken as the profit level indicator (PLI). The assessee applied certain filters and chose the following 30 comparables

Sl. No.	Company Name	Margin (OP/OC)
1.	Sundaram Business Services Ltd.	1.60%
2.	Digicall Teleservices Pvt. Ltd.	3.47%
3.	Ajel Ltd.	4.03%
4.	Kals Information Systems Ltd.	4.36%
5.	Melstar Information Technologies Ltd.	5.60%
6.	Marketplace Tech Infra Services Pvt. Ltd.	5.76%
7.	Sankhya Infotech Ltd.	7.47%
8.	Net Access India Ltd.	8.12%
9.	Onward Eservices Ltd.	9.27%
10.	Ace Software Exports Ltd.	9.52%
11.	Allsec Technologies Ltd.	9.62%
12.	8K Miles Software Services Ltd.	11.25%
13.	C G-V A K Software & Exports Ltd.	14.61%
14.	Quexa Systems Pvt. Ltd	14.97%
15.	P C S Technology Ltd.	17.59%
16.	Nucleus I T Enabled Services Ltd.	19.03%
17.	Axiscades Engineering Technologies Ltd.	21.02%
18.	Care Kalypto Risk Technologies & Advisory Services Pvt. Ltd.	21.30%
19.	Geometric Ltd.	24.08%
20.	Cosyn Ltd.	24.43%
21.	Cigniti Technologies Ltd	27.12%
22.	Magnasoft Consulting India Pvt. Ltd.	28.71%
23.	O F S Technologies Ltd.	29.00%
24.	Objectone Information Systems Ltd.	30.32%
25.	Infinite Computer Solutions (India) Ltd.	34.38%
26.	3D P L M Software Solutions Ltd.	37.65%
27.	Pagetraffic Web-Tech Pvt. Ltd	43.50%
28.	Threesixty Logica Testing Services Pvt. Ltd.	47.99%
29.	Eclerx Services Ltd.	53.25%
30.	Cybermate Infotek Ltd.	58.82%
35th Percentile		10.5
65th Percentile		19.5

Net mark-up on cost earned by the assessee is computed as below

Operating Income	Rs. 20,18,51,846/-
Operating Cost	Rs. 17,55,23,344/-
Operating Profit (Op. Income – Op. Cost)	Rs. 2,63,28,502/-
Operating/Net mark-up (OP/TC)	15%

The operating margin being within the range as per the comparables chosen by the assessee, the assessee is within the arm's length price for the SWD services rendered to its AE.

7. Out of the 30 comparables selected by the Assessee, the TPO accepted the 2 highlighted above, viz. Kals Information Systems Ltd., and CG-Vak Software & Exports Ltd. and rejected the other 28. The TPO applied fresh filters and chose the following companies

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)
1.	Kals Information Systems Ltd.	8.05
2.	E-Zest Solutions Ltd.	10.87
3.	Rheal Software Pvt. Ltd.	14.50
4.	Harbinger Systems Pvt. Ltd.	15.06
5.	CG-VAK Software & Exports Ltd.	18.50
6.	Pure Software Pvt. Ltd.	19.25
7.	R S Software (India) Ltd.	20.87
8.	Larsen & Toubro Infotech Ltd.	24.83
9.	Nihilent Technologies Ltd.	26.36
10.	Inteq Software Pvt. Ltd.	28.20
11.	Persistent Systems Ltd.	30.89
12.	Infobeans Technologies Ltd.	32.42
13.	Thirdware Solution Ltd.	36.90
14.	Infosys Ltd.	38.61

15.	Aspire Systems (India) Pvt. Ltd.	39.28
16.	Cybage Software Pvt. Ltd.	66.45
35th Percentile		19.25
Median		25.60
65th Percentile		30.89

8. The TPO accordingly arrived at the TP adjustment as per the below given workings

Taxpayers operating revenue	Rs. 20,18,51,846/-
Taxpayer operating cost	Rs. 17,55,30,585/-
Taxpayers operating profit	Rs. 2,63,21,261/-
Taxpayers PLI	15%
35 th Percentile Margin of comparables set	19.23%
Adjustment required (if PLI<35 th Percentile)	Yes
Median margin of comparable set	25.60%
Arm's length price	Rs. 22,04,66,414/-
Price received	Rs.20,18,51,846/-
Shortfall being adjustment u/s. 92CA	1,86,14,568/-

9. The DRP rejected the objections of the assessee and affirmed the adjustment made by the TPO. The AO passed the final assessment order in line with the directions of the DRP, in which the TP adjustment of Rs. 1,86,14,568/- was incorporated.

10. The assessee has raised several sub-grounds in Ground No.4. Out the same only the following sub-grounds are pressed

- a. The TPO while applying the turnover filter at the lower limit erred in not applying the said filter at the upper end so as to reject high turnover companies. (Ground No. 4.3)
- b. The TPO erred in erroneously computing the margins of certain companies. (Ground No. 4.9)
- c. The TPO erred in including RS Software (India) Ltd., Larsen and Toubro Infotech Ltd., Persistent Systems Ltd., Thirdware Solution Ltd., and Infosys Ltd. as a comparable

despite the companies not being comparable to the Assessee (Ground No. 4.12.1, 4.12.2, 4.12.4, 4.12.5, 4.12.6)

11. The Id AR submitted that the TPO had not applied a cap on upper limit on the turnover/service revenue while selecting the companies comparable to the assessee and that application of turnover filter is a relevant criteria in choosing comparable companies. The Id AR also It is submitted that the difference in the scale of operations have a direct impact on the profitability and an increase in the size and scale of the operations leads to a decrease in the long run average cost of each unit or each service project delivered, and therefore, the per unit fixed cost of a small scale company would be much higher than that of a medium/large size organisation. The Id AR further submitted that medium/large size organisation operating in a particular industry also enjoys benefits of certain other market drivers and cost arbitrages. The Id AR drew our attention to the fact that the turnover of the assessee from rendering SWD services is Rs.20,18,51,846/- and therefore the TPO ought to have applied the upper turnover filter while selecting companies comparable to the assessee. The Id AR mainly relied on the decision of coordinate Bench of the Tribunal in the case of Autodesk India (P) Ltd. V. DCIT (2018) 96 taxmann.com 263 (Bang Trib)) in addition to several other decisions of the Hon'ble Tribunal.

12. The Id DR relied on the orders of the lower authorities.

13. We heard the rival submissions and perused the materials on record. In so far as comparability of companies as per the list considered by the TPO is concerned, the admitted factual position is that the turnover of these companies (except R S software (India) Ltd) is more than Rs.200 Crores and the Assessee's turnover is only Rs.20,18,51,846/-. The TPO excluded from the list of comparable companies chosen by the Assessee in its TP study companies whose turnover was less than Rs.1 Crore. The Assessee raised objections before the DRP that while the TPO excluded companies with low turnover, whereas he failed to apply the same yardstick to exclude companies with high turnover compared to the Assessee. The TPO excluded the companies with less than Rs.1 crore turnover is that such companies do not reflect the industry trend as their low cost to sales ratio made their results less reliable. The contention of the Assessee was that there would be effect on profitability wherever there is high or low turnover and therefore companies with high turnover should also be excluded from the list of comparable companies. The DRP rejected the contention of the assessee by analyzing the turnover vs the profitability of one of comparables Infosys Ltd for prior years, to conclude that there is no direct impact on margin on account of turnover. The DRP also relied on several Tribunal decision and also the decision of the Delhi High Court in the case Chryscapital Investment Advisors India Pvt.Ltd Vs. DCIT 82 Taxmann.com 167(Del), wherein it was held that high turnover ipso facto does not

lead to the conclusion that a company which is otherwise comparable on FAR analysis can be excluded and that the effect of such high turnover on the margin should be seen. The DRP therefore held that a company which is otherwise functionally comparable cannot be excluded only on the basis of high turnover.

14. We notice that the coordinate bench of the Tribunal in the case of Barracuda Networks India Private Limited v. DCIT (IT(TP)A No. 229/Bang/2021 dated 25.10.2021) has dealt in detail the application of the turnover filter and has held as under –

“12. On the issue of application of turnover filter, we have heard the rival submissions. The parties relied on several decisions rendered on the above issue by the various decisions of the ITAT Bangalore Benches in favour of the Assessee and in favour of the Revenue, respectively. The ITAT Bangalore Bench in the case of Dell International Services India (P) Ltd. Vs. DCIT (2018) 89 Taxmann.com 44 (Bang-Trib) order dated 13.10.2017, took note of the decision of the ITAT Bangalore Bench in the case of Sysarris Software Pvt.Ltd. Vs. DCIT (2016) 67 Taxmann.com 243 (Bangalore-Trib) wherein the Tribunal after noticing the decision of the Hon’ble Delhi High Court in the case of Chryscapital (supra) and the decision to the contrary in the case of CIT Vs. Pentair Water India Pvt.Ltd., Tax Appeal No.18 of 2015 dated 16.9.2015 wherein it was held that high turnover is a ground to exclude a company from the list of comparable companies in determining ALP, held that there were contrary views on the issue and hence the view favourable to the Assessee laid down in the case of Pentair Water (supra) should be adopted. The following were the conclusions of the Tribunal in the case of Dell International (supra):

“41. We have given a very careful consideration to the rival submissions. ITAT Bangalore Bench in the case of Genesis

Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010, relying on Dun and Bradstreet's analysis, held grouping of companies having turnover of Rs. 1 crore to Rs.200 crores as comparable with each other was held to be proper. The following relevant observations were brought to our notice:-

“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 .ire (sic) 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 & 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 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.”

42. *The Assessee’s turnover was around Rs.110 Crores. Therefore the action of the CIT(A) in directing TPO to exclude companies having turnover of more than Rs.200 crores as not comparable with the Assessee was justified. As rightly pointed out by the learned counsel for the Assessee, there are two views expressed by two Hon’ble High Courts of Bombay and Delhi and both are non-jurisdictional High Courts. The view expressed by the Bombay High Court is in favour of the Assessee and therefore following the said view, the action of the CIT(A) excluding companies with turnover of above Rs.200 crores from the list of comparable companies is held to correct and such action does not call for any interference.”*

13. *The Tribunal in the case of Autodesk India Pvt.Ltd. Vs. DCIT (2018) 96 Taxmann.com 263 (Bangalore-Tribunal), took note of all the conflicting decision on the issue and rendered its decision and in paragraph 17.7. of the decision held as that high turnover is a ground for excluding companies as not comparable with a company that has low turnover. The following were the relevant observations:*

17.7. *We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt.Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of CIT Vs. Pentair Water India Pvt.Ltd. Tax Appeal No.18 of 2015 judgment dated 16.9.2015 has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer*

pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5 companies from the list of comparable companies chosen by the TPO on the basis that the 5 companies turnover was much higher compared to that the Assessee.

17.8. In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys Integrating (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capegemini India Pvt.Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of M/S.NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time. Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR

before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra).

14. In view of the aforesaid decision, we hold that companies listed in Sl.No.(a) to (g) of Grd.No.4 raised by the Assessee whose turnover in the current year is more than Rs.200 Crores should be excluded from the list of comparable companies.”

15. Respectfully following the decision of the coordinate bench of the Tribunal in the case of Barracuda Networks India Private Limited (supra) we hold that the companies whose turnover in the current year is more than Rs.200 crores needs to be excluded for the purpose of comparable companies.

16. The assessee is seeking exclusion of R S software (India) Ltd vide Ground No.4.12.1. In this regard the ld AR submitted that the company, during the financial years 2013-14 and 2014-15 had realised turnover of Rs. 351.88 crores and 345.51 crores, and profit margin of 24.14% and 32.75%, respectively. However, during the financial year 2015-16, the company realised a turnover of Rs. 171.41 crores, leading to loss of - 2.09%. Therefore it was submitted that there is an apparent wide fluctuation in the margin of the company. The relevant details as computed by the TPO is extracted hereunder:

*figures in crores	FY 2015-16	FY 2014-15	FY 2013-14

Operating revenue	171.41	345.50	351.89
Operating cost	175.07	260.26	283.47
Operating profit	-3.66	85.24	68.42
OP/OC	-2.09%	32.75%	24.14%

The Id AR argued that the wide fluctuations in profit suggest the existence of a peculiar economic circumstance, for which no appropriate adjustment could be made to mitigate the impact on the margin of the company and therefore the company cannot be selected as a comparable.

17. Without prejudice to the above submission the Id AR submitted that if the company were to be retained in the final list of comparables, the company's turnover for the financial years 2013-14 and 2014-15 is in excess of Rs. 200 crores, and therefore the margins for the said years ought to be excluded, and the margin of the company at -2.09% ought to be considered. In this regard reliance was placed on the decision of this Hon'ble Tribunal in the case of *BORQS Software Solutions Pvt. Ltd. v. ACIT* (IT(TP)A No. 310/Bang/2021 dated 25.10.2021 at paras 15-20).

18. We heard the DR who supported the decision of TPO/DRP. This issue of inclusion of R S software (India) Ltd has also been decided by the Hon'ble Tribunal in the case of Barracuda Networks India Private

Limited (supra) and the relevant extract of the decision of the Tribunal is reproduced below:

15. As far as company listed at Sl.No.(h) of Grd.No.4 and Grd.No.5 i.e., R.S.Software (India) Ltd., is concerned, the turnover of this company in the current year is less than Rs.200 Crores but in the earlier two years its turnover was more than Rs.200 crores and was liable to be excluded in those earlier two years. The question raised in the aforesaid grounds is as to:

whether this company should also be excluded on the application of turnover filter by reason of its turnover in the earlier two years being more than Rs.200 crores in the light of Rule 10CA of the rules which were applicable from AY 2014-15 onwards

or

whether in computing the weighted average profit margin of this company, the earlier two years profit margins have to be ignored because they fail the test of comparability in those two earlier years by reason of the application of the Rs.200 Crore turnover filter.

*16. To answer the above question, we need to look at the amendment to the rules that allow for introduction of a “range concept” for determination of ALP and “use of multiple year data” for undertaking comparability analysis in **transfer pricing** cases. The provisions of the Income-tax Act were amended through the Finance (No.2) Act, 2014 to facilitate alignment of Indian transfer regime with international best practices. The manner of computation of ALP is laid down under the Income-tax Rules. The Government has notified the amended Rules for determining ALP vide S.O. No. 2860 (E) dated 19/10/2015. The amended regime will be applicable for computation of ALP of international transactions and specified domestic transactions undertaken on or after 1/04/2014 i.e. on and after PY 2014-15. The amended rules allow for introduction of a “range concept” for determination of ALP and “use of multiple year data” for undertaking comparability analysis in **transfer pricing** cases. The use of range concept being a statistical tool enhances the reliability of analysis undertaken for computation of ALP. The range concept will be applicable in certain cases for determining the price and will begin with the 35th percentile and end with the 65th percentile of the comparable prices. Transaction price shown by the taxpayers falling within the range will be accepted and no adjustment will be made. The*

use of multiple year data allows for yearly variations to be averaged out and would therefore add value to transfer pricing analysis. The Amended Income tax Rules, 1962 ('Rules') via Notification 83 of 2015 which is the 16th amendment to the originally drafted Indian Tax Rules, 1962, are applicable for transactions undertaken on or after 1 April 2014 (i.e. from FY 2014-15 and onwards). These amended provisions are applicable only when the determination of 'ALP' is done under the MAM being resale price method ('RPM'), cost plus method ('CPM') or transactional net margin method ('TNMM'). The relevant provisions of Rule 10CA of the Rules, in so far as it relates to choice of comparable companies, read as follows:

“Computation of arm's length price in certain cases.

10CA. *(1) Where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in sub-section (1) of section 92C results in determination of more than one price, then the arm's length price in respect of such international transaction or specified domestic transaction shall be computed in accordance with the provisions of this rule.*

(2) A dataset shall be constructed by placing the prices referred to in sub-rule (1) in an ascending order and the arm's length price shall be determined on the basis of the dataset so constructed:

Provided *that in a case referred to in clause (i) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,—*

- (i) *the most appropriate method used to determine the price of the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and*
- (ii) *the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1):*

Provided further *that in a case referred to in clause (ii) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then,—*

- (i) *the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the*

- (ii) *financial year immediately preceding the current year; and the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1) :*

Provided also that where the use of data relating to the current year in terms of the proviso to sub-rule (5) of rule 10B establishes that,—

- (i) *the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or*
- (ii) *the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,*

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

(3) Where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:—

- (i) where the prices have been determined using the method referred to in clause (b) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales which has been considered for arriving at the respective prices;*
- (ii) where the prices have been determined using the method referred to in clause (c) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs which has been considered for arriving at the respective prices;*
- (iii) where the prices have been determined using the method referred to in clause (e) of sub- rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices*

.....

17. Let us apply the above rules to the comparable company R.S.Software (India) Ltd. As per Rule 10CA(2), the dataset of comparable companies chosen has to be arranged in ascending

order. As per the 1st proviso to Rule 10CA(2), R.S.Software (India) Ltd., was chosen as a comparable company based on the data relating to the current year and in the earlier two financial years immediately preceding the current financial year. In all the financial years the said company has undertaken similar comparable uncontrolled transaction. Clause (i) to 1st proviso to Sec.10CA(2) mandates that the same MAM has to be used to arrive at the price of the comparable uncontrolled transaction undertaken by R.S.Software (India) Ltd., in the financial years 2013-14 and 2014-15. As per clause (ii) of 1st proviso to Sec.10CA(2), weighted average of the prices of the 3 financial years have to be taken in accordance with Rule 10CA(3) and the weighted average so taken shall be included data set instead of the price arrived at by using current year data alone. In the present case, if one sees the chart of comparables of TPO given in paragraph-4 of this order, the profit margins of the Company R.S.Software (India) Ltd., for the three financial years were 2013-14 to 2015-16 were 24.14%, 32.75% and -2.09% respectively and the weighted average margin of 24.83% has been considered by the TPO.

18. The second proviso to Sec.10CA(2) of the Rules provides for a situation where R.S.Software (India) Ltd., has undertaken comparable uncontrolled transaction only in Financial year 2014-15 & 2015-16, then the weighted average of the two financial year 2014-15 and 2015-16 has to be computed in the manner laid down in Rule 10CA(3) of the Rules and the margin so arrived at has to be included in the dataset.

19. The third proviso to Sec.10CA(2) of the rules provides that if in the current year i.e., financial year 2015-16 if R.S.Software (India) Ltd., has not undertaken any uncontrolled comparable transaction then that company can never be considered for inclusion in the dataset.

20. The submission of the learned Counsel for the Assessee was that as per the proviso to Rule 10CA(2) of the Rules, R.S.Software (India) Ltd., cannot be regarded as comparable company for

Financial Year 2013-14 and 2014-15 because in those years, the turnover of this company was more than Rs.200 crores. Therefore as per the first and second proviso to Rule 10CA(2) of the Rules, the profit margin of this company for Financial year 2013-14 & 2014-15 has to be ignored and the profit margin of the financial year 2015-16 alone should be taken. If one looks at Rule 10CA(2) in isolation, we have to reject this argument because the 1st and 2nd proviso to Rule 10CA(2) of the Rules refers to only R.S.Software (India) Ltd., (i.e., “*where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction*”) undertaking uncontrolled transaction during the relevant previous year and if this condition is satisfied then the profit margin of R.S.Software for the 2 financial years immediately prior to the current financial year has to be taken. A plain reading of the 1st proviso would show that the question of comparability is not to be seen while applying the 1st and 2nd proviso to Rule 10CA(2) of the Rules. The provisions of Rule 10CA(2) have to be read harmoniously with the other provisions of Rule 10B

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

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

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

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

(i) the net profit margin realised by the enterprise from an international transaction [*or a specified domestic transaction*] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or

having regard to any other relevant base;

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

.....

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

- (a) the specific characteristics of the property transferred or services provided in either transaction;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the

- responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

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

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

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction [*or a specified domestic transaction*] shall be the data relating to the financial year [*(hereafter in this rule and in rule 10CA referred to as the 'current year')*] in which the international transaction [*or the specified domestic transaction*] has been entered into :

Provided that data relating to a period not being more than two years prior to [*the current year*] may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared:

A reading of Rule 10B(3) shows that comparison of an uncontrolled transaction to an international transaction can be done only if differences, if any, between the transactions that are 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 reasonably accurate adjustments can be made to eliminate the material effects of such differences. A reading of Proviso to Rule 10B(4) would show that use of data relating to a period of two years prior to the current year may also be considered but with a rider that “if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared”. If by application of any filter an enterprise undertaking uncontrolled transaction similar to an international transaction is regarded as not being comparable in the earlier two years immediately preceding the current year and thereby attracting the provisions of Rule 10B(2) or 10B(3) then the data for those years will not have any influence on the determination of transfer prices in relation to the transactions being compared for the current year and hence have to be ignored. On a harmonious reading of the provisions of Rule 10CA, 10B(3) (4) of the Rules, we agree with the stand taken by the learned counsel for the Assessee. Therefore, if at all R.S.Software Ltd., is to be regarded as a comparable company, then the margins for AY 2014-15 and 2015-16 of the company have to be ignored because in those years they are to be regarded as not comparable. We hold accordingly.

19. Respectfully following the decision of the coordinate bench of the Tribunal we hold that R.S.Software Ltd., should be excluded from the list of comparables.

20. Ground No. 4.12.1, 4.12.2, 4.12.4, 4.12.5, 4.12.6 raised contending the inclusion of RS Software (India) Ltd., Larsen and Toubro Infotech Ltd., Persistent Systems Ltd., Thirdware Solution Ltd., and Infosys Ltd.

as a comparable have become academic in the light of the decision give in the aforesaid paras and hence dismissed as not pressed.

21. Vide **Ground No. 4.9**, the assessee is seeking the rectification of margin of Harbinger Systems Pvt. Ltd. We notice that the computation of the margin of the company as per the annexure to the TPO order is set out as under:

	FY 2015-16	FY 2014-15	FY 2013-14	Sum
Operating revenue	Rs. 71,68,44,154/-	Rs. 62,41,11,264/-	Data not available in public domain	Rs. 134,09,55,418/-
Operating cost	Rs. 63,61,23,427/-	Rs. 53,26,16,903/-		Rs. 116,87,40,430/-
Operating profit	Rs. 8,07,20,627/-	Rs. 9,14,94,361/-		Rs. 17,22,14,988/-
OP/OC	12.69%	17.18%		14.74%

The weighted average margin of the company was rightly computed by the TPO 14.74%, however in the final list of comparables in page 50 of the TPO order, the TPO adopted the margin at 15.06%, which is an apparent mistake. We therefore direct the TPO to consider this afresh while re-computing the ALP in the SWD services segment in the light of the directions given in this order.

22. We will now take up the corporate tax issue raised by the assessee with respect to disallowance of provision for Bad Debts. The assessee during the financial year 2015-16, the Assessee debited an

amount of Rs. 19,22,610/- under the head 'provision for bad debts' in the profit and loss account. Before the AO the assessee submitted that of the sum of Rs. 19,22,610/-, an amount of Rs. 16,25,897/- represent actual bad debts which were written off, and only an amount of Rs. 2,96,713/- represents the provision. The Assessing Officer proposed a disallowance of the entire sum of Rs. 19,22,610/- as being a mere provision. The DRP upheld the disallowance stating that (i) the Assessee has not written off the amount and the same is still outstanding; and (ii) the Assessee has not established that the amounts were disclosed as income in the previous years as required under Section 36(2) of the Act.

23. The Id AR reiterated the submissions made before the lower authorities. The Id AR also submitted that the amount of Rs. 16,25,897/- which is the actual write off done during the year under consideration was created as a provision in books of accounts for the assessment year 2014-15 and the same was also disallowed in the computation of income for the said assessment year. The Id AR drew our attention to the partywise list of actual bad debts as submitted before the DRP and the computation of income of the assessment year 2014-15. As regards the balance amount of Rs. 2,96,713/-, the Id AR submitted that the amount was inadvertently not added back while computing the taxable income.

24. The Id DR relied on the order of the DRP where the DRP has upheld the disallowance on the basis that it is an unascertained liability.

25. We heard the rival submissions and perused the material on record. We notice that the party wise details of the bed debts written off for Rs. 16,25,897/- was furnished before the DRP (page 577 of the paperbook). Further the sum of Rs. 16,25,897/- was created as a provision in the financial year relevant to assessment year 2014-15 was offered to tax in the said year which fact is substantiated by the relevant extracts of the financial statements and the statement of computation of income for the assessment year 2014-15 that can be seen from pages 578-586 of the paperbook. Based on these facts we are of the considered view that that the disallowance to the extent of Rs. 16,25,897/- which was already disallowed in the computation of income of the assessee should be deleted since otherwise the same would result in double disallowance. It is ordered accordingly. This ground is allowed partly allowed in favour of the assessee.

26. In result the appeal of the assessee is partly allowed.

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

Sd/-
(BEENA PILLAI)
Judicial Member

Sd/-
(PADMAVATHY S)
Accountant Member

Bangalore,
Dated: 13.06.2022.
/NS/*

Copy to:

- | | |
|---------------|---------------|
| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.