

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

BEFORE SHRI PRASHANT MAHARISHI, AM
AND
SHRI PAVAN KUMAR GADALE, JM

ITA No. 2067/Mum/2017
(Assessment Year 2012-13)

ITA No. 7398/Mum/2018
(Assessment Year 2014-15)

Polycom Technology (R&D)
Center Private Limited
4th Floor, Block 1,
DLF Cyber City,
Plot No. 129-132, APHB colony,
Gachibowli, Hyderabad -500 081

Vs.

The DCIT
Circle 7(3)(2)
Mumbai

(Appellant)

(Respondent)

PAN No. AAACP 3319 G

Assessee by : Shri M. P. Lohia & Shri Mihir
Chitalia, ARs'
Revenue by : Ms. Vatsalaa Jha, CIT DR

Date of hearing: 08.06.2022

Date of pronouncement 26.07.2022

:

ORDER

PER PRASHANT MAHARISHI, AM:

01. These two appeals are filed by the assessee against the orders [Assessment Orders] passed by Dy. Commissioner of

Income Tax, Central Circle 7(3) (2), Mumbai, (the learned Assessing Officer) for A.Ys. 2012-13 & 2014-15 dated 20th January, 2017 and nil respectively, under Section 143(3) read with section 144C (13) of Income-tax Act, 1961 (the Act).

01. The assessee in ITA No. 2067/Mum/2017 for A.Y. 2012-13 has raised following grounds of appeal:-

"On the facts and circumstances of the case and in law, the learned Assessing Officer (AO) has erred in passing the assessment order under section 143(3) read with section 144C (13) of the Income-tax Act, 1961 (the Act) after considering the adjustments proposed by the learned Transfer Pricing Officer (TPO) in his order passed under section 92CA (3) of the Act and subsequently confirmed by the Hon'ble Dispute Resolution Panel (DRP).

Each of the ground is referred to separately, which may kindly be considered independent of each other.

On the facts and circumstances of the case and in law, the learned AO/TPO/ Hon'ble DRP have:

General ground:

1. erred in determining the total taxable income of the appellant at INR 6,49,49,092 as against INR 1,09,25,800 as reported in the return of income filed by the appellant.

Transfer Pricing Grounds:

2. erred in making an addition of INR 5.40,23,292 to the total income of the appellant in respect of international transaction pertaining to provision of



contract software development services by the appellant to its associated enterprise (AE) (hereinafter referred to as 'impugned transaction');

Invalid reference made to TPO:

3. erred in making a reference to the TPO under section 92CA of the Act for determining the arm's length price ('ALP') of the international transactions in a mechanical manner, without demonstrating the necessity or expediency of doing so as mandated under sub-section (1) of the Act;

Rejection of the appellant's economic analysis:

4. erred in not accepting the economic analysis undertaken by the appellant in accordance with the provisions of the Act read with the Rules, and modifying the same for determination of ALP of the appellant's international transactions holding that the impugned international transaction is not at arm's length and Rejection of use of multiple-year data by the appellant:

5. erred determining the arm's length margins / prices using data pertaining only to financial Year (FY) 2011-12 (not available to the appellant at the time of complying with the Indian TP documentation requirements) and rejecting the use of multiple year data by the appellant not Erroneous re-characterization of the appellant's functional profile:

6. erred in characterizing the appellant as contract R&D service provider instead of contract software development service provider, wherein erred in

ignoring substance of the impugned transactions and merely relied on determining the substance of the impugned transaction on the basis of mere nomenclature mentioned in the inter-company agreement and financial statements,

7. erred in determining the appellant as the economic owner of the Intangible Property (IP) as a result of research and development services provided by the appellant to its AE;

8. erred in erroneously rejecting the comparable companies selected by the appellant in its transfer pricing documentation, maintained under Rule 10D(4) of the Income tax Rules, 1962 ("Rules") for the international transactions undertaken with the AE's;

9. erred in proposing his own comparable set by cherry picking of the below mentioned 2 comparables for the impugned transaction on an ad-hoc basis.

- Acropetal Technologies Limited (Segmental)*
- Eclerx Services Limited*

resulting in arm's length margin of 45.50 percent for the impugned transaction, as against the Appellant's margin of 15.00 percent:

Earlier year's ITAT orders:

erred in undertaking comparability analysis without appreciating the actual functional profile of the appellant for the impugned transaction, and thus not following the orders of Hon'ble ITAT in the appellant's

own case for earlier years (e. AY 2009-10, AY 2010-11 and AY 2011-12), wherein the Hon'ble ITAT had remanded back the cases to the file of TPO/AO to determine ALP by examining the functional profile of the appellant.

Alternate benchmarking adopted by TPO:

11. erred in carrying out an alternate benchmarking analysis in respect of the impugned transaction, by selecting the following 4 engineering design service provider companies, which is contradictory to primary analysis so undertaken, in violation of provisions of law and lacks any cogent reasoning

- Acropetal Technologies Limited (EDS Segment)*
- Holtec Consulting Private Limited*
- Mitcon Consultancy Services Limited*
- Cether Consulting Engineering Limited*

resulting in an arm's length margin of 38.33 percent for the impugned transaction, as against the Appellant's margin of 15.00 percent

Working capital adjustment:

12. erred in not making suitable adjustments to account for differences in working capital deployed by the appellant vis-à-vis the comparable companies.

Risk adjustment:

13. *erred in not making suitable adjustments to account for differences in the risk profile of the appellant vis-à-vis the comparable companies,*

Interest under Section 234B:

14. *erred in levying interest under Section 234B of the Act,*

Interest under Section 234C:

15. *erred in levying interest under Section 234C of the Act:*

Erroneous initiation of penalty proceedings

16. *erred in initiating penalty proceedings under section 271(1)(c), 271B, 271BA and 271F of the Act;*

The appellant craves leave to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal.

The appellant prays for appropriate relief based on the said grounds of appeal and the facts and circumstances of the case.

02. Assessee in ITA No. 7398/Mum/2018 for A.Y. 2014-15 has raised following grounds of appeal:-

"On the facts and circumstances of the case and in law, the learned Assessing Officer (AO) has erred in passing the assessment order under section 143(3) read with section ("rows") 144C of the Income-tax Act, 1961 (the Act) after considering the adjustments proposed by the learned Transfer Pricing Officer

(TPO) in his order passed under section 92CA(3) of the Act and subsequently confirmed by the Hon'ble Dispute Resolution Panel ('DRP').

Each of the ground is referred to separately, which may kindly be considered independent of each other. On the facts and circumstances of the case and in law, the learned AO/TPO/ Hon'ble DRP have:

General ground:

1. erred in determining the total taxable income of the appellant for AY 2014-15 at INR 16,61,59,297 as against INR 4,43,99,441 as reported in the return of income filed by the appellant on 28 November 2014;

Transfer pricing ground:

2. erred in making an addition of INR 12,17,59,856 to the total income of the appellant in respect of international transaction pertaining to provision of contract software development services by the appellant to its associated enterprise ('AE') (hereinafter referred to as 'subject transaction');

Erroneous re-characterization of the appellant's functional profile:

3. erred in ignoring the substance of the subject transaction and re-characterized the appellant's functional profile to be of R&D service provider on the basis of mere nomenclature in the inter-company agreement and ignoring the functional profile of the appellant as documented in TP study report i.e.

rendering contract software development services in the nature of documentation, coding and testing of software;

4. erred in not appreciating the detailed documentary evidence submitted by the appellant in the form of STPI forms, bug fixing activities in support of nature of activities being in the nature of software development carried out by it during relevant AY and making incorrect inferences merely on the basis of inter-company Erroneous characterization of the appellant as owner of intangible property:

5. erred in determining the appellant as the economic owner of the Intangible Property (IP) as a result of research and development services provided by the appellant to its Associated Enterprises

Rejection of comparables selected by appellant in TP documentation:

6. erred in erroneously rejecting the comparable companies selected by the appellant in its TP documentation, maintained under Rule 10D(4) of the Income-tax Rules, 1962 (Rules) for the international transactions undertaken with the AEs;

Cherry picking of comparables for benchmarking:

7. without prejudice to the above, also erred in not carrying out any search process based on any scientific approach as stipulated by the Act and the Rules and instead have resorted to cherry picking of companies by merely relying on the assessment order of earlier years;

8. erred in considering following comparables for the subject transaction on an ad-hoc basis, and without following any scientific or rationale methodology, ie, without appreciating that the said companies are not comparable to the appellant due to various differences in FAR;

- Eclerx Services Limited;
- I-Design Engineering Solution Limited;
and
- Acropetal Technologies Limited
(Segmental)

Rejection of Alternate benchmarking proposed by the appellant:

9 without prejudice to the above, erred in not considering the fresh search undertaken by the appellant on a scientific basis for identifying companies engaged in providing research and development services;

Risk adjustment:

10. erred in not making suitable adjustments to account for differences in the risk profile of the appellant vis-à-vis the comparable companies.
Interest under Section 234A of the Act:

11. erred in erroneously levying interest of INR 6,27,750 under section 234A of the Act while completely disregarding the provisions of the Act,

Interest under Section 234B of the Act:

12. erred in levying interest of INR 1,72,63,125 under Section 234B of the Act while completely disregarding the provisions of the Act;

and Erroneous initiation of penalty proceedings:

13. erred in initiating penalty proceedings under section 27101Xc) read with section 274 of the Act.

The appellant craves leave to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal.

The appellant prays for appropriate relief based on the said grounds of appeal and the facts and circumstances of the case.

03. Brief fact of the case shows that the assessee is engaged in ITES services. It filed its return of income on 30th March, 2013 for A.Y. 2012-13 at ₹7,88,63,940/-. Assessee has entered into international transactions and therefore, reference was made to the learned DCIT 3(3)(1), Mumbai, (the learned Transfer Pricing Officer) for determination of Arm's Length Price of the international transaction.
04. The assessee has entered into seven different type of International transactions, however, the dispute before us is only with respect to International Transaction of provision of contract research and development (R&D) services amounting to ₹40,24,59,724/- originally. Subsequently, there is a demerger of one of the segment and the value of the transaction was then stated to be only Rs. 20,36,94,379/-.



05. Assessee adopted the Transactional Net Margin Method as the most appropriate method and stated that its international transactions are at arm's length selecting 24 comparables, taking Profit level indicator of OP/OC of 9.80%, whereas the margin of the assessee is 15.03%.
06. However so far as the functions of the assessee are concerned, Assessee submitted that assessee is engaged in provision of contract software development services, whereas the Ld Transfer Pricing Officer noted that assessee is engaged in R&D services. In T P Study Report transactions is treated as software development services, which is quite different from research and development services. But Ld TPO characterized function of assessee as Contract research and Development service provider, and noted that assessee is falling in the domain of knowledge Processing Outsourcing Services (KPO). He therefore, rejected the TP study report of the assessee, selected fresh comparables, whose arithmetic mean of PLI of OP/TC was 45.50%, and assessee's margin was 15%. He also considered the alternative plea of the assessee and treated it as EDS services provider i.e. Engineering Design Service provider and also selected four comparables alternatively whose margin was 38.33% and stated that alternative benchmarking will be used in case of first and primary benchmarking done by the Transfer Pricing Officer treating the assessee as research and development service provider fails. Accordingly, Ld TPO characterized function of assessee as research and development service provider and adjustment of ₹5,40,23,292/-. Draft assessment order was passed on 29th March 2016, wherein above adjustment was made.
07. Assessee filed objection before the learned Dispute Resolution Panel. Assessee submitted that it does not take any function of



research and development as well as of Engineering Design Services but of software development services. It was further stated that the learned Assessing Officer has merely looked at nomenclature of the transactions based on title of agreement and not on evidences. Assessee submitted that it is engaged only in bug fixing activities but learned Transfer Pricing Officer has noted that the service agreement with the Associated Enterprises is for provision of research and development services, therefore, he proceeded to benchmark the international transactions accordingly. Ld Dispute Resolution Panel noted that as per title of agreement, assessee is engaged as a contractor to perform research and development services. It that even bugs fixing activity cannot be termed as routine software development services. Accordingly, the order of the learned Transfer Pricing Officer was upheld. Thus, assessee was characterized by Revenue authorities to be a research and development service provider. Based on this, final assessment order u/s 13 (3) rws 144C (13) of The Act was passed on 20th January 2017 where the addition of ₹ 5,40,23,292/- was made on account of Arm's Length Price of the international transaction. Assessee aggrieved and has preferred this appeal.

08. The learned Authorized Representative submitted that ground no. 1, 2, and ground no. 4 of the appeals are general in nature and further, ground no. 3 and 5 are not pressed. Accordingly, all these grounds of appeal are dismissed.
09. The learned Authorized Representative submitted that only ground no. 6 and 7 are pressed and all other grounds are merely consequential. He submitted that the ground no. 6 challenges that functions of assessee are characterized as contract research and development service provider, but



Assessee is merely a contract software development service provider. The lower authorities have merely gone on the basis of nomenclature of the agreement and not on the functional profile of the assessee. He referred to page no. 66 of the Paper Book, which is the annexure no. 2 of the form no. 3CEB where assessee has given a description of the transaction of contract software development services. However, the learned Transfer Pricing Officer has classified the assessee as research and development service provider. He further referred to page no. 311 of the Paper Book, which is a 'research and development service agreement'. He submitted that though the agreement is titled as 'research and development service agreement' but in fact, assessee is providing software development services. He also referred to the decision of the co-ordinate bench in assessee's own case for A.Y. 2009-10, wherein there is a dispute about the characterization of the nature of services provided by the assessee. He referred to paragraph no. 10 where the whole issue is set aside to the file of the learned Assessing Officer for determination of the nature of services provided by the assessee. He further referred to page no. 10 of the order of the learned Transfer Pricing Officer and stated that assessee has been characterized as research and development service provider merely, for the reason that the agreement is titled as 'research and development services Agreement'. He further referred to a supplementary paper book filed by him where the details of employees, log book of bug fixing activities, SEZ tax forms, organization structure and the certificate of activities conducted by the assessee was provided. He further referred to the advance pricing agreement entered into by the assessee for financial year 2015-16 to 2019-20, wherein also the assessee is classified as provider of software development services. He further referred to the inter group



services and inter group agreement to show that services provided by the assessee is not of contract research and development services but of software development services. He therefore, was grossly aggrieved by re- characterization of the services of the assessee.

010. The learned Departmental Representative vehemently supported the order of the learned Transfer Pricing Officer and learned Dispute Resolution Panel. He referred to the agreement, which is titled as "research, and development service agreement". He also referred to the order of the learned Dispute Resolution Panel wherein bug-fixing activities were also held to be part of research and development activities.

011. We have carefully considered the rival contentions and perused the orders of the lower authorities. The only issue involved in this appeal is that whether the assessee is providing contract research and development activities or merely providing contract software development services of bug fixing. No doubt, the agreement produced before the lower authorities showed that the title of agreement is research and development activity. However, the evidences produced before us in the form of log of bug fixing activities, details of employees, the various forms filed, the organization structure, form no. 3CEB as well as the earlier year orders of co-ordinate Bench indicate that assessee is engaged in contract software development services. Thus, the real functions of the assessee, the use of assets well as the risk assumed by the assessee are clearly in dispute. As the learned Transfer Pricing Officer and the learned Dispute Resolution Panel without verifying, the actual functions performed by the assessee were guided only by the title of the agreement, characterizes assessee as



research and development service provider. Lower authorities also without looking into the functional profile claimed by the assessee in form no. 3CEB have changed the characterization of assessee. As the functions performed by assessee is not verified and merely based on agreement, lower authorities have upheld the benchmarking of International Transactions. Decision of coordinate benches in assessee's own case for earlier years on this issue has also set aside benchmarking back to the Id AO/ TPO. In view of this, we set aside the whole of issue back to the file of the learned Transfer Pricing Officer with a direction to the assessee to substantiate that it is not a research and development service provider but a contract software development service provider. The assessee is at liberty to produce such documents as well as cost incurred in provision of the services, work force employed, certificate of work, and various other material such as contract papers, engagement letters etc to substantiate the same. Assessee is also directed to show benchmarking analysis of these transactions. The learned Assessing Officer/ TPO are directed to examine nature of services provided by the assessee and then, determine its arm's length price in accordance with the law. Accordingly, ground no. 6 & 7 of the appeal is allowed with above directions.

012. In the result, appeal of the assessee for A.Y. 2012-13 is partly allowed.
013. Coming to the appeal of the assessee for A.Y. 2014-15 also involving the ground no. 3 and 4 of the appeal with respect to the characterization of the functional profile of the assessee involving the similar facts challenged as per ground no. 3 & 4, appeal of the assessee for A.Y. 2014-15 is also set aside to the file of the learned Assessing Officer/ Transfer Pricing Officer



with similar directions. Accordingly, appeal for A.Y. 2014-15 is also partly allowed.

014. Accordingly, both the appeals of the assessee are allowed for statistical purposes.

Order pronounced in the open court on 26. 07.2022.

Sd/-
(PAVAN KUMAR GADALE)
(JUDICIAL MEMBER)

Sd/-
(PRASHANT MAHARISHI)
(ACCOUNTANT MEMBER)

Mumbai, Dated: 26. 07.2022

Sudip Sarkar, Sr.PS

Copy of the Order forwarded to :

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

BY ORDER,

True Copy//

Sr. Private Secretary/ Asst. Registrar
Income Tax Appellate Tribunal, Mumbai