

**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.266/Bang/2021
Assessment Year: 2016-17

LG soft India Private Limited 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	:	Smt. Rashmi R., A.R.
Respondent by	:	Shri Praveen Karanth, D.R.

Date of Hearing	:	28.07.2022
Date of Pronouncement	:	28.07.2022

O R D E R

PER CHANDRA POOJARI, ACCOUNTANT MEMBER:

This appeal by assessee is directed against order of the Deputy Commissioner of Income-tax, Circle 4(1)(1), Koramangala, Bangalore passed u/s 143(3) r.w.s. 144C(13) r.w.s. 144B of the Income-tax Act,1961 [‘the Act’ for short] dated 30.4.2021.

2. The assessee has raised various grounds of appeal. However, Ld. A.R. has pressed only ground Nos.11 & 17, which reads as follows:-

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“11. The Learned AO/Learned TPO/Hon’ble DRP erred in accepting companies that ought to have been rejected as comparable:

- Rheal Software Pvt. Ltd.
- Larsen & Toubro Infotech Ltd.
- Nihilent Technologies Ltd.
- Inteq Software Pvt. Ltd.
- Persistent Systems Ltd.
- InfoBeans Technologies Ltd.
- Thirdware Solutions Ltd.
- Infosys Ltd.
- Aspire Systems (India) Pvt. Ltd.
- Cybage Software Private Ltd.

17. The Learned AO/Learned TPO/Hon’ble DRP has erred in not allowing appropriate adjustment towards working capital between the appellant vis-à-vis the comparable companies.”

3. Facts of the case are that the assessee is a wholly owned subsidiary of LG Electronics and provides software development services in the areas such as mobile application development, digital video broadcast and biometrics software etc.

3.1 During AY. 2016-17, the international transactions with its AE are as follows:-

International transaction	Value (INR)
Provision of software development services	3,185,967,639/-

The **OP/OC** as per TPO is **15.59%**.

TPO's Comparables

3.2 The TPO rejected the TP study done by the appellant, conducted his own TP analysis and selected the following set of comparables

SI. No.	Company Name	Average of 3 years
1	Kals Information Systems	8.60%
2	Rheal Software Pvt.	14.50%
3	Sybrant Technologies Pvt.	14.74%
4	CG-Vak Software & Exports Ltd.	18.50%
5	R S software India Ltd.	20.87%
6	Larsen & Toubro Infotech Ltd.	24.83%
7	Nihilent Ltd.	26.36%
8	Inteq Software Pvt. Ltd.	28.20%
9	Persistent Systems Ltd.	30.89%
10	Infobeans Technologies Ltd.	32.42°/0
11	Thirdware Solutions Ltd.	36.90°/0
12	Infosys Ltd.	38.61%
13	Aspire Systems India Pvt. Ltd.	39.28%
14	Cybage Software Pvt. Ltd.	66.45%
	35th Percentile	20.87%
	Median	27.28%
	65th Percentile	32.42%

3.3 The TPO did not allow any **working capital or risk adjustments**.

3.4 The **TP Adjustment** in the **SWD segment** is **INR 32,43,02,300/-**.

Proceedings before the Ld. Dispute Resolution Panel ('DRP')

3.5 In relation to assessee's contention on inclusion of companies to be considered as comparable, the DRP directed inclusion of two (2) companies i.e., Eluminous Technologies Ltd. & Sasken Communication Technologies Ltd.

3.7 The TP adjustment post the DRP Directions was re-worked, and a Final Assessment Order was passed wherein the total TP adjustment stood at **INR 32,43,02,300/-**. Aggrieved, the assessee approached this Tribunal.

4. In ground No.11, assessee seeks exclusion of following comparables only. Other comparables are not pressed and the assessee also made an endorsement that assessee is not pressing other comparables in this ground.

- 1) L&T Infotech Ltd.
- 2) Persistent Systems Ltd.
- 3) Infosys Technologies Ltd.
- 4) Thirdware Solutions Ltd.

L&T Infotech Ltd.

5. The Ld. A.R. submitted that similar comparable was considered for exclusion in earlier assessment year 2015-16 in assessee's own case in IT(TP)A No.2412/Bang/2019 vide Tribunal order dated 31.5.2022.

5.1. We have heard the rival submissions and perused the materials available on record. This comparable has been considered in assessee's own case in AY 2015-16, wherein held as under:-

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

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- *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

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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. "*

5.2 The facts in this assessment year are also similar. Being so, following the above order of the Tribunal in assessee's own case, we direct the AO/TPO to exclude this company from the list of comparables.

Persistent Systems Ltd.

6. The Ld. A.R. submitted that similar comparable was considered for exclusion in earlier assessment year 2015-16 in assessee's own case cited (supra).

6.1. We have heard the rival submissions and perused the materials available on record. This comparable has been considered in assessee's own case in AY 2015-16, wherein held as under:-

"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:-

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

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:-

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"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 ld. 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

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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

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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.”*

6.2. The facts in this assessment year are also similar. Being so, following the above order of the Tribunal in assessee's own case, we direct the AO/TPO to exclude this company from the list of comparables.

Infosys Technologies Ltd.

7. The Ld. A.R. submitted that similar comparable was considered in earlier assessment year 2015-16 in assessee's own case cited (supra).

7.1 We have heard the rival submissions and perused the materials available on record. This comparable has been considered in assessee's own case in AY 2015-16, wherein held as under:-

“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

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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.

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*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.”

7.2 After hearing both the parties, we are of the opinion that the facts in this assessment year are also similar. Being so, following the above order of the Tribunal in assessee’s own case, we direct the AO/TPO to exclude this company from the list of comparables.

Thirdware Solutions Ltd.

8. The Ld. A.R. submitted that similar comparable was considered in earlier assessment year 2015-16 in assessee’s own case cited (supra).

8.1 We have heard the rival submissions and perused the materials available on record. As rightly pointed out by the Ld. A.R., this comparable has been considered by the Tribunal on the earlier occasion and directed the AO/TPO to exclude this comparable from the list of comparables by observing as under:-

“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.*

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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.”*

8.2 In view of the above order, we direct the AO/TPO to exclude this company from the list of comparables.

Ground No.17:-

9. Facts of the case are that the TPO did not allow any working capital adjustment and the Ld. DRP also confirmed the order of the TPO.

9.1 We have heard the rival submissions and perused the materials available on record. The similar issue came for consideration before this Tribunal in the case of Huawei Technologies Ltd. reported in 101 Taxmann.com 313 (Bang Trib) (IT (TP)A No.1939/Bang/2017 dated 31.10.2018), wherein held as under:-

10. *The next grievance projected by the Assessee in its appeal is with regard to the action of the CIT (A) in not allowing any adjustment towards working capital differences. On this issue we have heard the rival submissions. The relevant provisions of the Act in so far as comparability of international transaction with a transaction of similar nature entered into between unrelated parties, provides as follows:*

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 (b)**

(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];*

(f)** ** **

(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.*

11. A reading of Rule 10B(1)(e)(iii) of the Rules read with Sec.92CA of the Act, would clearly shows that the net profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.

12. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the "TPG") contain extensive guidance on comparability analyses for transfer pricing purposes. Guidance on comparability adjustments is found in paragraphs 3.47-3.54 and in the Annex to Chapter III of the TPG. A revised version of this guidance was approved by the Council of t OECD on 22 July 2010. In paragraph 2 of these guidelines it has been explained as to what is comparability adjustment. The guideline explains that when applying the arm's length principle, the conditions of a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are generally compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that:

None of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), Or

Reasonably accurate adjustments can be made to eliminate the effect of any such differences. These are called "comparability adjustments."

13. In Paragraphs 13 to 16 of the aforesaid OECD guidelines, need for working capital adjustment has been explained as follows:

"13. In a competitive environment, money has a time value. If a company provided, say, 60 days trade terms for payment of accounts, the price of the goods should equate to the price for immediate payment plus 60 days of interest on the immediate payment price. By carrying high accounts receivable a company is allowing its customers a relatively long period to pay their accounts. It would need to borrow money to fund the credit terms and/or suffer a reduction in the amount of cash surplus which it would otherwise have available to invest. In a competitive environment, the price should therefore include an element to reflect these payment terms and compensate for the timing effect.

14. The opposite applies to higher levels of accounts payable. By carrying high accounts payable, a company is benefitting from a relatively long period to pay its suppliers. It would need to borrow less money to fund its purchases and/or benefit from an increase in the amount of cash surplus available to invest. In a competitive environment, the cost of goods sold should include an element to reflect these payment terms and compensate for the timing effect.

15. A company with high levels of inventory would similarly need to either borrow to fund the purchase, or reduce the amount of cash surplus which it is able to invest. Note that the interest rate July 2010 Page 6 might be affected by

the funding structure (e.g. where the purchase of inventory is partly funded by equity) or by the risk associated with holding specific types of inventory)

16. Making a working capital adjustment is an attempt to adjust for the differences in time value of money between the tested party and potential comparables, with an assumption that the difference should be reflected in profits. The underlying reasoning is that:

A company will need funding to cover the time gap between the time it invests money (i.e. pays money to supplier) and the time it collects the investment (i.e. collects money from customers)

This time gap is calculated as: the period needed to sell inventories to customers + (plus) the period needed to collect money from customers (less) the period granted to pay debts to suppliers."

14. Examples of how to work out adjustment on account of working capital adjustment is also given in the said guidelines. The guideline also expresses the difficulty in making working capital adjustment by concluding that the following factors have to be kept in mind (i) The point in time at which the Receivables, Inventory and Payables should be compared between the tested party and the comparables, whether it should be the figures of receivables, inventory and payable at the year end or beginning of the year or average of these figures, (ii) the selection of the appropriate interest rate (or rates) to use. The rate (or rates) should generally be determined by reference to the rate(s) of interest applicable to a commercial enterprise operating in the same market as the tested party. The guidelines conclude by observing that the purpose of working capital adjustments is to improve the reliability of the comparables.

15. In the present case the TPO allowed working capital adjustment accepting the calculation given by the Assessee. The CIT (A) in exercise of his powers of enhancement held that no adjustment should be made to the profit margins on account of working capital differences between the tested party and the comparable companies for the following reasons:

(I) The daily working capital levels of the tested party and the comparables was the only reliable basis of determining adjustment to be made on account of working capital because that would be on the basis of working capital deployed throughout the year.

Segmental working capital is not disclosed in the annual reports of companies engaged in different segments and therefore proper comparison cannot be made.

(iii) Disclose in the balance sheet does not contain break up of trade and non-trade debtors and creditors and therefore working capital adjustment done without such break up would result in computation being skewed.

(iv) Cost .of capital would be different for different companies and therefore working capital adjustment made disregarding this

different based on broad approximations, estimations and assumptions may not lead to reliable results.

16. The CIT (A) also placed reliance on a decision of Chennai ITAT in the case of Mobis India Ltd. v. Dy. CIT 120131 38 taxmann.com 231/120141 61 SOT 40. That decision was based on the factual aspect that the Assessee was not able to demonstrate how working capital adjustment was arrived at by the Assessee. Therefore nothing turns on the decision relied upon by the CIT (A) in the impugned order. In the matter of determination of Arm's Length Price, it cannot be said that the burden is on the Assessee or the Department to show what is the Arm's Length Price. The data available with the Assessee and the Department would be the starting point and depending on the facts and circumstances of a case further details can be called for. As far as the Assessee is concerned, the facts and figures with regard to his business has to be furnished. Regarding comparable companies, one has to fall back upon only on the information available in the public domain. If that information is insufficient, it is beyond the power of the Assessee to produce the correct information about the comparable companies. The Revenue has on the other hand powers to compel production of the required details from the comparable companies. If that power is not exercised to find out the truth then it is no defence to say that the Assessee has not furnished the required details and on that score deny adjustment on account of working capital differences. Regarding applying the daily balances of inventory, receivables and payables for computing working capital adjustment, the Delhi Bench of ITAT in the case of ITO v. E Value Serve.com 120161 75 taxmann.com 195 (Delhi - Trib.), has held that insisting on daily balances of working capital requirements to compute working capital adjustment is not proper as it will be impossible to carry out such exercise and that working capital adjustment has to be based on the opening and closing working capital deployed. The Bench has also observed that that in Transfer Pricing Analysis there is always an element of estimation because it is not an exact science. One has to see that reasonable adjustment is being made so as to bring both comparable and test party on same footing. Therefore there is little merit in CIT (A)'s objection on working adjustment based on unavailable daily working capital requirements data. There is also no merit in the objection of the CIT (A) regarding absence of segmental details available of working capital requirements of comparable companies chosen and absence of details of trade and non-trade debtors of comparable companies as these details are beyond the power of the Assessee to obtain, unless these details are available in public domain. Regarding -absence of cost of working capital funds, the OECD guidelines clearly advocates adopting rate(s) of interest applicable to a commercial enterprise operating in the same market as the tested party. Therefore this objection of the CIT (A) is also not sustainable.

17. In the light of the above discussion we are of the view that the CIT (A) was not justified in denying adjustment on account of working capital adjustment. Since, the CIT (A) has not found any error in the TPO's working of working capital adjustment, the working capital adjustment as worked out by the TPO has to be allowed. Wttmay also add that the complete working capital adjustment working has been given by the Assessee and a copy of the same is at pages 173 & 192 of the Assessee's paper book. No defect whatsoever has been pointed out in these

working by the CIT (A). We may also further add that in terms of Rule 10B(1)(e) (iii) of the Rules, the net profit margin arising in comparable uncontrolled transactions should be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions which could materially affect the amount of net profit margin in the open market. It is not the case of the CIT (A) that differences in working capital requirements of the international transaction and the uncontrolled comparable transactions is not a difference which will materially affect the amount of net profit margin in the open market. If for reasons given by CIT (A) working capital adjustment cannot be allowed to the profit margins, then the comparable uncontrolled transactions chosen for the purpose of comparison will have to be treated as not comparable in terms of Rule 10B(3) of the Rules, which provides as follows:

"(3) An uncontrolled transaction shall be comparable to an international transaction if—

- (I) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged to 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."*

18. In such a scenario there would remain no comparable uncontrolled transactions for the purpose of comparison. The transfer pricing exercise would therefore fail. Therefore in keeping with the OECD guidelines, endeavor should be made to bring in comparable companies for the purpose of broad comparison. Therefore the working capital adjustment as claimed by the Assessee should be allowed."

9.2 In view of the above order of the Tribunal, we direct the AO/TPO to grant working capital adjustment on actual basis.

10. No other grounds were pressed before us. Accordingly, all other grounds are dismissed as not pressed.

11. In the result, the appeal filed by the assessee is partly allowed.
Order pronounced in the open court on 28th Jul, 2022

Sd/-
(Beena Pillai)
Judicial Member

Sd/-
(Chandra Poojari)
Accountant Member

Bangalore,
Dated 28th Jul, 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.