

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I', NEW DELHI**

Before Sh. Kul Bharat, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

ITA No. 6468/Del/2018: Asstt. Year: 2014-15

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| TPG Software Pvt. Ltd, Candor Techspace, B-2, Tower-3, Sector-62, Noida (APPELLANT) | Vs. | DCIT, Circle-25(2), New Delhi (RESPONDENT) |
| PAN No. AADCT8715F | | |

Assessee by : Sh. Vishal Kalra, Adv.

Revenue by : Sh. Rajesh Kumar, CIT DR

Date of Hearing: 20.06.2023

Date of Pronouncement: 11.09.2023

ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal has been filed by the assessee against the order dated 29.08.2018 passed by the AO u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961.

2. The assessee has raised the following grounds of appeal:

"1. That on the facts and circumstances of the case and in law, the AO erred in assessing the total Income of the Appellant under section 143(3) read with section 144C(13) of the Act at INR 6,51,03,510 as against returned Income of INR 4,24,39,400.

2. That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in rejecting the transfer pricing study prepared by the Appellant invoking section 92C(3)(c) of the Act.

3. That on the facts and circumstances of the case and in law, the AO / DRP/TPO erred in making adjustment of INR 2,25,96,348 in respect of international transaction pertaining to provision of software development services ("SDS");

3.1 That on the facts and circumstances of the case and in law, the AO/ DRP / TPO erred in not accepting the quantitative filters selected by the Appellant in its transfer pricing documentation and instead applied his own quantitative filters which lacked valid and sufficient reasoning.

3.2 That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in arbitrarily rejecting the set of functionally comparable companies adopted by the Appellant to benchmark the transaction of provision of software development services.

3.3 That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in accepting companies, viz., Cybercom Datamatics Information Solutions Ltd, Mindtree Ltd, Persistent Systems Ltd, Tata Elxsi Ltd, and Comviva technologies Ltd. which were functionally not comparable to the Appellant in terms of functions, assets and risk profile.

3.4 That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in not providing the benefit of economic adjustment on account of difference in risk profile in arriving at the arm's length mean margin.

3.5 That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in considering the current year data (i.e. FY 2013-14) for comparability despite the fact that the same was not necessarily available to the Appellant at the time of preparing its transfer pricing documentation.

3.6 That on the facts and circumstances of the case and in law, the AO / DRP / TPO erred in adopting inconsistencies in calculation of the operating margin of the comparable companies and the Appellant.

4. That on the facts and circumstances of the case and in law, the AQ erred in levying interest under section 234B, 234C and 234D of the Act.

5. That on the facts and circumstances of the case and in law, the AO erred in proposing to initiate penalty proceedings under section 271(1)(c) of the Act mechanically without recording any adequate reasons for such initiation."

3. TPG Software Private Limited ("TPG India") is a private limited company incorporated on June 9th, 2011 under the provision of the companies Act, 1956. The Company's registered office is situated at New Delhi and unit office is situated at Noida, Uttar Pradesh. The company is a subsidiary of 3pillar

Holdings LLC, USA. The Company is involved in providing software development services to its customers in India and abroad. During the year under analysis, TPG India was engaged in provisioning of software development services to TPGI. The AE, TPGI was founded in 2006 and is based in Fairfax, Virginia, 3Pillar Global, Inc. Operates as a products lifecycle management and software product development company. The company offers services in the areas of strategy and consulting, customer experience design, platform development, and software engineering aspects; and delivery, support, and testing solutions for agile system administration ("DevOps"). It serves media/entertainment, financial service, information service, and health and wellness industries worldwide. TPGI is complete software development and engineering company which provides services in the diverse sectors ranging from media/entertainment, financial services to health and other industries. TPG India is responsible for provisioning of software development and related services under the projects sub-contracted to it by the AE as per the specifications and requirements provided by the AE TPG India employs the resources required for development of software. While TPG India undertakes necessary software development activities, the AE monitors such activities of TPG India on an on-going basis.

4. In the TPSR, the assessee selected 8 comparables out of which 5 have been rejected by the TPO and 6 have been introduced by the Revenue. The turnover of the company was Rs.43.53 Cr.

5. The TPSR considered TNMM as the MAM.

6. The OP/OC as per the assessee was 14.48% and as per the TPO was 12.82%. The ALP determined as the TPO post DRP was 18.79% resulting in adjustment of Rs.2.25 Cr.

7. The following comparables were contested by the assessee:

1. Cybercom Datamatics Information Solutions Ltd.
2. Mindtree Ltd.
3. Persistent Systems Ltd.
4. Tata Elxsi Ltd.
5. Comviva Technologies Ltd.

8. Heard the arguments of both the parties and perused the material available on record.

Cybercom Datamatics Information Solutions Ltd.

9. The TPO/DRP held that this company is primarily involved in software development services and all other activities are incidental to providing software services. The company is engaged in providing information Technology (IT), business process outsourcing (BPO) and consulting services.

10. The Id. AR submitted that the primary objective of Cybercom Datamatics is to act as consultants and advisors on information/internet system and surveyors of information services. It also carried on the business of development, testing, implementation, migration of home grown and other applications, marketing and manufacturing of information technology products and services, software and hardware systems to enterprise and embedded technologies in telecom

and other industries. The assessee has submitted that the company needs to be excluded on the following grounds:

- (i) Functionally not comparable
- (ii) Segmental information not available
- (iii) Huge investment in fixed assets
- (iv) Super normal profits

11. The Id. DR argued that the functional profile of Cybercom Datamatics as mentioned in page 10 of the Annual Report. It reveals that the principle object of the company is to act as consultants and advisors on information/ internet and surveyors of information services, and to carry on the business of development, testing, implementation, migration of home grown and other applications, marketing and manufacturing of information technology products and services, software and hardware systems to enterprises and embedded technologies in the telecom and other industries. It was argued that the functional profile is similar to the functional profile of the assessee company i.e. both the assessee company as well as Cybercom Datametic deal in complete cycle of development of software. Further reference is also made to para c i.e. revenue recognition at page 10 of PB, wherein it is clearly provided that the revenue from technical and software services is recognized on a time and material basis. This is also similar to the software services and engineering services provided by the assessee company to its AE. Even though the word software products have been mentioned, but it is not out of place to mention that on page 17 at note 20/page 8, it is clearly mentioned that revenue from operations is only from sale of services and not of

products. Thus this company is functionally similar to the assessee company.

12. With regard to the segmental information, the Id. DR argued that segmental information is not available however it is seen that M/s Cybercom Datamatic is involved in one segment. only which is mentioned at note 23/page 18 which reads "*the Principle business of the Company is of providing of technical and software services. All other activities of the Company revolve around its main business Hence no additional disclosure under Accounting standard -17, "Segment Reporting" are required in these financial statements.*" Hence, it was submitted that lack of segmental information cannot be a criteria for rejection of the comparables.

13. With regard to the Investment in fixed assets, the assessee has submitted that M/s Cybercom Datamaties has made huge investment in fixed assets as compared to assessee company. The Id. DR argued that from the perusal of the fixed asset schedule it is seen that out of net block Rs.4.97 crores, the asset of lease hold premises comprise of Rs. 4.04 crores, thus the assessee contention are clearly not tenable in the sense that there is no correlation between the leasehold premises and the net sales and assessee's contentions are superfluous and misplaced. The Id. DR argued that in fact, the biggest asset in software service company is the employees and it is seen that the ratio of employee benefit expenses to the total revenue is Rs.13.69/Rs.43.53 crores which is 70.5% in the case of assessee whereas in the case of Cybercom Datamatics this ratio is Rs.5.15 crores/14.69 is 35.05% which clearly

proves that assessee has major investment in employees then M/s Cybercom Datamatics.

14. With regard to the extraordinary/abnormal profits, the Id. AR sought exclusion based on the fact that M/s Cybercom Datamatics earned super normal profit of around 87%. The Id. DR argued that a company can't be excluded based on high profits/ fluctuating profits and this issue has already been decided by the Hon'ble Jurisdictional Delhi High Court in the case of ChrysCapital Investment advisers (India) Pvt. Ltd. v/s DCIT in 56 taxmann.com 417, 2015 (Delhi) (para 44) wherein Hon'ble High Court clearly held that only on the reason of high/extremely high, high/low, profit/loss, an entity can't be excluded as comparable.

15. Rebutting the case laws relied upon by the Id. AR, the Departmental Representative argued that M/s Cybercom Datamatics as a right comparable to M/s Steria India Ltd. for software development services and the facts of the instant case are identical to the facts of the Steria India Ltd.

16. Hence, based on the FAR, we hold that since the primary conditions are met with, we hold that Cybercom Datamatics Information Solutions Ltd. can be considered as a right comparable.

Mindtree Ltd.

17. The assessee has selected this comparable in the TPSR for the A.Y. 2012-13 and the company is generating revenue from software development and software services.

18. The assessee has sought its exclusion based on the following facts:

- (i) Functional dissimilar
- (ii) Different business model
- (iii) Research and development activity
- (iv) Segment data not available
- (v) High turnover

19. The Id. AR submitted that the comparable incurred subcontract expenses of Rs.140 Cr. and the Id. DR rebutted, arguing that this Rs.140 Cr. constitute 0.3% of the total turnover and hence negligible.

20. With regard to the functional profile, the annual report (page 107/PB) reads *"Mindtree Limited (Mindtree' or the 'company') is an international information Techno consulting and implementation Company that delivers business solutions through global software development. The Company is structured into five verticals- manufacturing, BFSI Hitech, travel and transportation and others. The Company offers services in the areas of agile, analytics and information management, application development and maintenance, business process management, business technology consulting, cloud, digital business independent testing infrastructure management services, mobility, product engineering and SAP Services."*

21. The above functional profile, clearly shows that M/s Mindtree Ltd. is a software servicing various sectors and for the sake of specialization/convenience the company had divided/structured its software development services functions in 5 sectors. This is nothing new, as all the companies for the

sake of convenience /specialization /better productivity divides/ structures its functions. Also in the financial statement at page 63 of PB, it is clearly mentioned that the entire income is from software development services only. This fact is further mentioned at page 123 of PB under the quantitative detail column. At page 123 in para 3.9 under the heading "quantitative details" it is clearly mentioned that the assessee is involved in software development services only and accordingly no other segment is applicable in the case of the assessee. Thus the assessee contention about no segmental information is not tenable. Further, with regard to the intangible of Rs.6.7 crore comes to 0.2% of turnover of Rs.3031.6 crore. However, the assessee also owns intangible of Rs.6.03 crore including goodwill, which is 13.85% of turnover of Rs. 43.53 crore. Thus this contention of assessee is without any basis and thus based on the above analysis, the assessee company is functionally similar comparable to M/s Mindtree Ltd.

Persistent Systems Ltd.

22. The Revenue held that this is functionally comparable as the companies found to be providing software services.

23. The Id. AR submitted that the company is mainly involved in software product development and development of end to end solutions. The assessee, on the other hand, is engaged in providing software development services and does not develop software products or end to end solutions. The Id. AR submitted that this company is engaged in sale of software products and not software services. The Id. AR further argued that,

1. Segmental financials are not available,
 2. The comparable is involved in R&D activities and has intangibles,
 3. The comparable had an extraordinary event namely acquisition of Cloud Squads Inc.
 4. High turnover 27 times as that of the assessee
24. The Id. DR submitted his arguments in writing which are as under:

2. Persistence systems Ltd. (PSL)

(i) Functional profile: The assessee has requested for exclusion based on the fact that it is functionally different. The assessee has stated that this company is engaged in sale of software products and not software services. The assessee allegation has been duly answered by the TPO and DRP in page 40 and page 11 of respective orders.

Also whether this company is a software product development company or services company is a fact which has already been answered in judgments of the Hon'ble Delhi ITAT only which are mentioned below:

The Hon'ble ITAT in its order in the case of Steria India Ltd. vs. Addl. CIT in [2020] 122 taxmann.com 267 (Delhi - Trib.) has treated M/s Persistent systems ltd as comparable in software development services segment only. However more relevant are the comments about profile of Persistent systems Ltd, which has been mentioned in para 115 to 118, and for ready reference is reproduced below.....

15. In case of Persistent Systems, limited Id AR submitted that Persistent Systems Ltd. is engaged in the business of development and sale of software products and therefore, cannot be regarded as comparable to the assessee, a routine software service provider. At page 27 (Pg 192 of Annual Report paper book) it is stated that the company specializes in building software products and the business of the company is inter-alia focused on products. Also, at page 105 (Pg 270 of annual report paper book) of the annual report it is stated that the company derives significant portion of its revenue from export of software services and products (IP based software products). It is further submitted that at Page 164 & 183 of the Annual report it is stated that the company specializes in software products, services and technology innovations. It is further submitted that segmental profitability of this company from provision of software services is not available in the annual report and accordingly, Persistent Systems Ltd cannot be regarded as an appropriate comparable for the purpose of benchmarking analysis.

116. The learned departmental representative vehemently supported the order of the learned dispute resolution panel and the learned transfer-pricing officer and submitted that they have discussed the functionality of this company in detail and therefore this company is functionally comparable.

117. We have carefully considered the rival contentions and perused the standalone financial statement of the above

company placed in the paper book at page number 110-153 (annual report page number 156 198). In its revenue stream as per page no 166 of Standalone Financial statements its revenue recognition shows that:-

"Income from software services

Revenue from time and material engagements is recognized on time proportion basis as and when the services are rendered in accordance with the terms of the contracts with customers. In case of fixed price contracts, revenue is recognized based on the milestones achieved as specified in the contracts, on proportionate completion basis. Revenue from royalty is recognized in accordance with the terms of the relevant agreements. Revenue from maintenance contracts is recognized on a pro-rata basis over the period of the contract. Unbilled revenue represents revenue recognized in relation to work done on time and material projects and fixed price projects until the balance sheet date for which billing has not taken place. Unearned revenue represents the billing in respect of contracts for which the revenue is not recognized. The Company collects service tax and value added taxes (VAT) on behalf of the government and, therefore, these are not economic benefits flowing to the Company. Hence, they are excluded from revenue.

118. At note no 21 Page No 181 of Standalone Financial statements it has only one stream of Revenue i.e. Sale of Software services as under:

21. Revenue from operations (net) [In Million) For the year ended March 31, 2014 March 31, 2013 Sale of software services

11,841.16

9,967.51

Therefore, we do not agree with the arguments of the assessee, and hold that Persistent System Ltd. does not sale products, but it is engaged only in sale of software services. No other reasons were given to us for its exclusion; hence, we are of the view that Persistent system has rightly been included as Comparable company by Id DRP and TPO.

Thus this company is clearly held to be involved in sale of software services only and not in sale of software products. Also in the case of Motherson Sumi infotech and Design Ltd. vs/ ACIT 112 Taxmann.com 300 (2019) again this company was held to be involved in software services only. The para 32 of the Hon'ble ITAT order is very pertinent and reproduced below for ready reference...

32. The Annual Report of this company is placed at pages 762 to 895 of the paper book. In its Profit and Loss account, sale of software services and products is at Rs.31,231/- and in Schedule 11, bifurcation is given for sale of software services and products - export and domestic. Though segmental information is provided in the Annual Report, from which sale of software services can be separately known from the sale of products, but the information received by the TPO u/s 133(6) of the Act, the

company has informed that its software products sales constituted 0.73% of the Revenue which means that more than 99% of the Revenue is from software services.

33. The Id counsel for the assessee vehemently stated that this company is functionally dissimilar as it is engaged in outsourced software product development services as investment in Intellectual property led sales. The Id. counsel for the assessee further stated that this company has undertaken significant restructuring and has very high turnover, but failed in convincing us the impact of these things on the overall margin of the company. Therefore, we are of the considered view that this company passes all the filters and has been rightly taken in the final set of comparables. No interference is called for.

Thus in view of the above, it is absolutely clear that this company is involved in sale of software services only for the same assessment year i.e. A.Y. 2014-15 only, like the assessee company and these are the findings/decisions of Hon'ble Jurisdictional ITAT only, which have a binding precedence. Also, the P&L account shows M/s PSL. has only one stream of income (page 449) i.e. from sale of software services only.

The assessee has quoted certain case laws including the decision of the Hon'ble Delhi High Court in the case of Microsoft India Ltd. however the facts of that case were different i.e. M/s Microsoft was found engaged in rendering software development services and ITES. Further the assessment year involved in that case was A.Y. 2011-12

and A.Y. 2012-13 which are different from the present appeal. Also, the other decisions cited are distinguishable and they were rendered before the decision of Hon'ble ITAT in the case of case of Steria India Ltd. vs. Addl.CIT in [2020] 122 taxmann.com 267 (Delhi - Trib.).

The assessee has further raised following grounds which are mentioned below:-

(ii) Segmental information not available:- the segmental information is available in para 27/page 407 of PB, wherein it is clearly mentioned that company provides Software services only in 3 sectors namely Telecom + Wireless, Life sciences + Healthcare and infrastructure + Systems. As the software services are treated as a common and single segment only by the assessee company, accordingly the assessee has treated it as single segment only. Thus the assessee contentions about no segmental information are wrong and deserves to be rejected.

(iii) Occurrence of extraordinary event/The assessee has also alleged opening of new offices by M/s PSL.

a. Acquisition of Cloud Squads. The PSL has acquired clouds Squads only in February 2014 (i.e. only in the end) and it is small company and the assessee has failed to mention the impact on financials /P&L on such acquisitions. Also the allegation that assessee has opened new branch offices in Germany and South Africa will at best have negative impact on P&L. because it is a established fact that whenever new offices are opened initially it has negative impact on profits

because it takes time to stabilize the business activities from new offices.

(iv) High turnover. The assessee has alleged that the PSL has turnover of 1184 crores i.e. high as compared to the assessee company and M/s PSL enjoys economic of scale. This fact has been answered by the TPO in detail in page 33 to 36 of his order and for the sake of brevity, arguments are not repeated. The TPO has clearly demonstrated by comparing revenue/turnover with operating margins of all the 14 comparables and clearly demonstrated that there is no correlation between the high turnover and the profit margins. Further it is established fact, that the turnover may have role in manufacturing industries but in service industries the criteria or the principle of economics of scales does not work. The assessee has also placed reliance on the decision of Hon'ble Delhi High Court in the case of Pr. CIT Delhi-1 vs. M/s Agnity India Technologies Pvt. Ltd. In ITA No. 447/2018 to claim that companies with high turnover cannot be compared with low turnover companies. The decision of the Hon'ble High Court has been perused and it is seen that in that case M/s Vipro Technology was excluded as a comparable on several grounds and the contentions of the assessee are not clearly borne out of the decision of the Hon'ble Delhi High Court, a fact, which has been duly observed by the Hon'ble Bench also. Further, the assessee reliance on DRPS findings for A.Y. 2012-13 with regard to highturn over companies is also not mentioned in the order of the Hon'ble Delhi High court.

(v) Intangibles: Further the assessee has alleged that M/s PSL owns intangibles of Rs.16 crores however if we compare it with sales of Rs.1184 crores then it is only 1.35% of the turnover which is negligible. It is also not only of place to mention that assessee company has intangible including goodwill of Rs. 6.03 crore against sales of Rs. 43.53 crore, which comes out to 13.85% of turnover.

(vi) R & D activity: The assessee has also taken the ground that M/s PSL is involved in Research & Development activity. The details of Research and development expenses by M/s PSL is given on note 35 of notes forming part of financial statements (page 195 Annual report/page 463 of PB). **The total research and development expenses are Rs. 3.61 crore for F.Y. 2013-14 which comes to 0.30% of total turnover, which is negligible.**

Thus based on the above analysis, this company i.e. M/s PSL is functionally similar and also comparable on all parameters/aspects to the assessee company.

25. The Id. AR rebutted the submissions of the Id. DR. The salient features of the arguments of the Id. AR are as under:

- While rejecting exclusion of Persistent Systems, the Hon'ble Tribunal in Steria's case has held that the said company is only into software development, however, did not consider the fact the company in its audited financials at page 164 (refer pg 432 of the annual report compilation). under Note 1: Nature of operations, itself classified as global company specializing in software products, services and technology

innovation. The Company offers complete product life cycle services.

26. The Id. AR argued that the following arguments was never presented before the Bench while dealing the case of Steria (supra).

- Revenue from time and material engagements is recognized on time proportion basis as and when the services are rendered in accordance with the terms of the contracts with customers.
- In case of fixed price contracts, revenue is recognized based on the milestones achieved as specified in the contracts, on proportionate completion basis,
- Revenue from royalty is recognized in accordance with the terms of the relevant agreements.
- Revenue from maintenance contracts is recognized on a pro-rata basis over the period of the contract.
- Unbilled revenue represents revenue recognized in relation to work done on time and material projects and fixed price projects until the balance sheet date for which billing has not taken place.
- Un-earned revenue represents the billing in respect of contracts for which the revenue is not recognized. The Company collects service tax and value added taxes (VAT) on behalf of the government and, therefore, these are not economic benefits flowing to the Company. Hence, they are excluded from revenue.

27. The Id. AR argued that Persistent Systems has been held to be not comparable to the Software Development service provider in the absence of segmental and relied on the following case laws:

- EMC Software and Services India Pvt. Ltd. [IT(TP)A No. 3375/Bang/2018
- CGI Information Systems and management consultants Private Limited vs. ACIT: IT(TP)A No. 586/Bang/2015
- Saxo India Pvt. Ltd. vs. ACIT: ITA No. 6148/Del/2015

28. The Id. AR argued that the companies having significantly higher turnover than the assessee is not a good comparable:

- PCIT vs. Agnity India Technologies Pvt. Ltd.: ITA 447/2018 (Delhi High Court)
- Aggressive Digital Systems (P) Ltd. vs. ITO: [2022] 97 ITR (T) 687 (Delhi Trib.)
- Nuance Transcription Services India Private Limited vs. ACIT: [IT(TP)A No. 3230/Bang/2018)
- Deliverhealth Solutions India Pvt. Ltd. vs The AO: [IT(TP)A No. 721/Bang/2021]

29. Having gone through the submissions, we find that the turnover is within the acceptable range, the FAR matching, the segmental information is not required as there is single common segment of revenue and in the absence of financial implication on the occurrence of extraordinary events and having found intangibles being 1.35% as negligible and same with the R&D activities which is 0.3% of the turnover and hence, we hold that

Persistent Systems Ltd. can be considered as a right comparable.

Tata Elxsi Ltd.

30. The TPO/DRP considered this company based on the broad functional similarities. The company is involved in software development & services segment of Tata Elxsi consists of embedded product design and engineering services, digital content creation, industrial design and visual computing labs whereas, the assessee is a captive software development services provider.

31. The assessee submitted that the company is not comparable owing to,

1. Software development and services
2. Systems integration and support
3. Embedded product design
4. Industrial design
5. Visual computing labs

32. The case was selected by the assessee itself in the A.Y. 2012-13. The turnover of the company's 20 times that of the company which is within the acceptable range and the FAR has been similar, hence, we hold that it can be considered as a right comparable.

Comviva Technologies Ltd.

33. The assessee has also sought the exclusion of Comviva Technologies Ltd. By claiming that the company is not

functionally comparable to the assessee company and also it has high turnover. At the outset, it is seen from the records and the assessee written contentions that this company was in the list of assessee's own comparables and both at the stage of TPO as well as DRP. Since, this comparable has not been examined by the authorities below, in the fitness of things, the matter is referred to the file of the TPO/DRP to examine the issue afresh.

34. In the result, the appeal of the assessee is dismissed.
Order Pronounced in the Open Court on 11/09/2023.

Sd/-

(Kul Bharat)
Judicial Member

Dated: 11/09/2023

Subodh Kumar, Sr. PS

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR