

आयकर अपीलीय अधिकरण "सी" न्यायपीठ पुणेमें।
IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCHES "C" :: PUNE

BEFORE SHRI S.S.GODARA, JUDICIAL MEMBER
AND
DR. DIPAK P. RIPOTE, ACCOUNTANT MEMBER

आयकरअपीलसं. / ITA No.692/PUN/2022
निर्धारणवर्ष / Assessment Year : 2018-19

M/s.Persistent Systems Limited, "Bhageerath" 402, Senapati Bapat Road, Pune – 411016. PAN: AABCP 1209 Q	V s	Assessment Unit, Income Tax Department.
Appellant/ Assessee		Respondent /Revenue

Assessee by	Shri Dhanesh Bafna& ShriAditya Vaidya– AR's
Revenue by	Shri Suhas Kulkarni - IRS Addl Commissioner of Income Tax
Date of hearing	26/09/2023
Date of pronouncement	02/11/2023

आदेश/ ORDER

PER DR. DIPAK P. RIPOTE, AM:

This appeal filed by the Assessee is directed against the Assessment Order, dated 20.07.2022 under section 143(3) r.w.s. 144C(13) read with section 144B of the Income Tax Act, 1961 for A.Y.2018-19. The assessee has raised the following grounds of appeal:

"Ground 1: Order is invalid / non est

- *On the facts and in the circumstances of the case, and in law, the Assessment Unit ('AU') has erred in passing the draft assessment*

order without following the procedures as laid down in Section 144B of the Income Tax Act, 1961 ('the Act') with regard to granting an opportunity for personal hearing via video conference and without providing an opportunity to the Appellant to file a written submission in response to the Show-cause notice. Dispute Resolution Panel ('Ld. DRP') erred in upholding the same by contending that there was no denial of opportunity to the appellant.

- *Further, the Ld. DRP erred in not providing an opportunity to the appellant to provide its contentions on the second remand report issued by the Ld. TPO on 14 June 2022, thereby not complying with the provisions of Section 144(11) of the Act.*
- *The Ld. DRP has failed to comply with the provisions of Section 144C(6)(C). The Ld. DRP has erred not considering the rejoinder to the remand report dated 15 March 2022 filed by the appellant on 25 March 2022 wherein the appellant has provided its detailed contentions on the comparability of certain companies rejected by the Ld. TPO in the first remand report dated 15 March 2022.*

Prayer

- *The Appellant prays that the order passed by the AU be considered non est in accordance with the provisions of Section 144(7) of the Act.*
- *The appellant is aggrieved that the opportunity of being heard was not provided by the Ld. DRP with the reference to the remand report and the same is not in accordance with the provisions of Section 144(11) and Section 144C(6)(C) of the Act.*

The grounds of appeal mentioned below are without prejudice to the above ground.

Transfer Pricing related grounds

Ground No. 2: General Ground

On the facts and in the circumstances of the case, and in law, the AU pursuant to the directions of the Ld. DRP, erred in making a TP

adjustment of INR 27,05,17,208 to the income of the Appellant, by holding that the Appellant's international transaction pertaining to Provision of Software Development Services is not at arm's length.

Prayer

The Appellant prays that the economic analysis documented in the TP study report should be accepted and consequently, the TP adjustment of INR 27,05,17,208 ought to be deleted.

Ground No. 3; Entity Level PIT

Without prejudice to the other grounds of appeal, on the facts and in the circumstances of the case and in law, the AU based on the directions of Ld. DRP has erred by undertaking an inconsistent TP analysis by not considering the entity level Profit Level Indicator ('PLI') of the Appellant while computing the arm's length price ('ALP') in spite of re-working of the segmental P&L and accepting the regional comparability analysis for other set of transactions.

Prayer

The Appellant prays that, in case the Segmental P&L as per the TP study of appellant is reworked (by aggregating branches with Indian location and re-allocating G&A costs from one segment to another); then the Segmental P&L of the appellant be rejected in its entirety and entity level PLI as submitted by the Appellant be accepted.

Ground a: Separate testing of branches' profitability for ALP determination

On the facts and in the circumstances of the case and in law, the AU based on the directions of Ld. DRP has erred in not separately testing the profitability of the overseas branches (the branches) and Indian location of the Appellant without taking cognizance of the facts, scheme of the law and specific provisions of Rule 10B(2)(d) of the Income Tax Rules, 1962 ('the Rules')

Prayer

The Appellant prays that the approach adopted by the Ld. DRP/ TPO in aggregating/not separately testing the profitability of the overseas branches and the Indian location of the appellant be rejected. The benchmarking analysis conducted by the Appellant in its TP Report ought to be accepted. Accordingly, the Ld. DRP/ TPO be directed to

determine the arm's length price after separately testing the profitability of the branches operating in different regions and the Indian location of the appellant.

Ground Reworking of segmental profitability

Based on the facts and in the circumstances of the case, and in law, the Ld. DRP/ AU/ TPO has erred in reworking the segmental profit and loss account of the Appellant by ignoring the existing overhead absorption rate and adopting an incorrect/adhoc allocation key for G&A costs and depreciation.

Prayer

The Appellant prays that the segmental profitability as provided in the TP Report should be accepted. Appellant also prays that, if at all, the reworking made by TPO is upheld, the "average person month" should be accepted as an allocation key for absorption of G&A Costs in respect of software development services segment.

The Appellant further prays that, if at all, the reworking made by Ld. TPO is upheld, the Ld. TPO be directed to ignore the adhoc/arbitrary allocation of depreciation expenses and adopt consistent allocation key for depreciation expenses after ignoring Depreciation expenses originally absorbed by the appellant in its Segmental P&L as per TP Report.

Ground 6: Non-acceptance/exclusion of overseas comparable companies

On the facts and in the circumstances of the case and in law, the AU based on the directions of Ld. DRP has erred in notaccepting/excluding the overseas comparable companies operating in the regions where the branches of the appellant operated during the year, thereby leading to the blatant inconsistency in the TP analysis for provision of services and availing of services.

Prayer

The Appellant prays that the regional/overseas comparable companies selected by the Appellant should be accepted and included in the set of comparable if the overseas branches of the Appellant are aggregated with the Indian location.

The Appellant also prays that if at all the said approach of the Ld.DRP/TPO is accepted then it should be consistently followed for all transactions of the Appellant including availing of services and entity level TNMM be accepted.

Ground 7: Non-acceptance/exclusion of overseas comparable companies operating in Japan

Without prejudice to the Ground 6 above, on the facts and in the circumstances of the case and in law, the DRP/AU/ TPO has erred in restricting qualitative analysis to specific countries i.e. Canada, United Kingdom and India, thereby not accepting/excluding the overseas comparable companies operating in Japan where the Appellant operated a branch during the year and provided services therefrom.

Prayer

The Appellant also prays that if at all the comparable companies are restricted to the countries where the branches of the appellant are located, the comparable companies operating in Japan be accepted, as the appellant provides subject services from the Japan branch as well.

Ground 8: Selection of functionally non-comparable companies

On the facts and in the circumstances of the case, and in law, the AU based on the directions of Ld. DRP has erred in selecting the functionally non-comparable companies in the set of comparable companies namely E-inrochips Private Limited, Cybage Software Private Limited, Nihilent Limited, Exilant Technologies Private Limited and Ninestar Information Technologies Limited.

Prayer

The Appellant prays that the functionally non-comparable companies namely E-infochips Private Limited, Cybage Software Private Limited, Nihilent Limited, Exilant Technologies Private Limited and Ninestar Information Technologies Limited selected by the AU based on the directions of Ld. DRP ought to be rejected.

Corporate tax related grounds

Ground o: Additional disallowance u/s 14A of the Act read with Rule 8D(2)(ii) of the Rules

On the facts and in the circumstances of the case, and in law, the AU based on the directions of Ld. DRP has erred in invoking and applying the provisions of Rule 8D of the Rules and thereby proposing an additional disallowance of INR 4,50,70,798 under section 14A of the Act by directly applying formula given in Rule 8D(2)(ii) of the Rules (being 1% of the annual average of monthly value, the income from which do not form part of total income).

Prayer

The Appellant prays that the AU be directed to not invoke provisions of Rule 8D(2)(ii) of the Rules and not to consider the disallowances of INR 4,50,70,798 u/s 14A of the Act r.w rule 8D(2)(ii), and therefore additional disallowance of INR 4,50,70,798 under u/s 14A of the Act r.w rule 8D(2)(ii) be deleted.

Ground 10: Additional relief under section 90

On the facts and circumstances of the case, and in law, the AU based on the directions of Ld. DRP erred in disregarding Appellant's claim for additional relief under section of 90 of the Act of INR 48,97,620 over and above the relief under section 90 claimed by the Appellant in its Return of Income.

Prayer

The Appellant prays to allow additional relief under Section 90 of the Act to the extent of INR 48,97,620 over and above the relief under section 90 claimed by the Appellant in its Return of Income, the corresponding income has already been offered to tax in the year under consideration and for which the additional copies of corresponding withholding tax certificates as received from the deductor/overseas customers have been submitted by the Appellant.

Ground 11: Initiation of penalty proceedings

On the facts and in the circumstances of the case and in law, the AU has erred in initiating the penalty proceedings under Section 274 r.w.s 270A of the Act.”

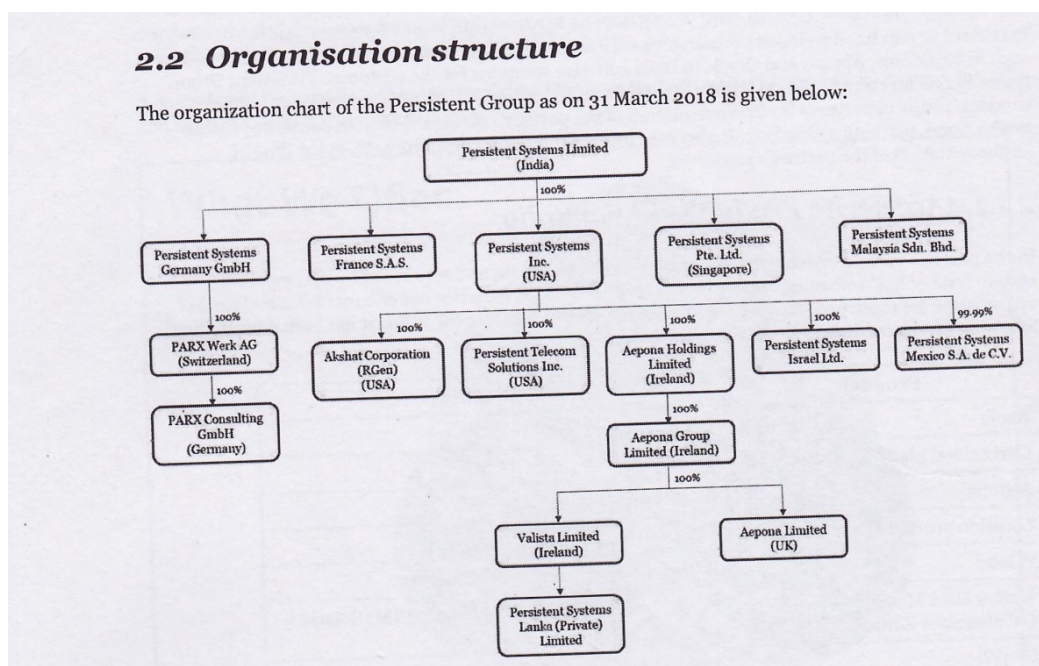
Brief facts of the case :

2. The Assessee is a Public Limited Company which is listed on Bombay Stock exchange and National Stock Exchange. It is engaged in the business of Software development, and related services. It operates from various locations in India and also have branches in UK, Netherland, Canada, Japan, Australia, South Africa. The assessee had filed its return of Income for A.Y.2018-19 on 16.11.2018 declaring total income of Rs.365,59,48,240/-. The case of the assessee was selected for scrutiny assessment. During the scrutiny proceedings the Assessing Officer made a reference to Transfer Pricing officer u/s 92CA of the Income Tax Act 1961. The Transfer Pricing Officer (TPO) Passed an order under section 92CA(3) of the Act on 30/07/2021 recommending an adjustment of Rs.27,05,17,208/- to the value of the international transaction. Aggrieved by the order of the TPO the assessee filed an appeal before Dispute Resolution Panel (DRP).The DRP confirmed it. Then the Assessing Officer passed the Final Assessment order giving effect to the directions of the DRP. Aggrieved by the Final Assessment order, the Assessee has filed this appeal.

2.1 As per the Transfer Pricing Study Report submitted by the assessee and as per the order of the TPO, the assessee has entered into following International Transactions with its Associated Enterprises (AE) :

Sr. No.	Description of the international transactions	Amount (INR)	Method used
1	Provision of software development services by Persistent Systems Ltd(PSL) or its branches	1,591,300,721	TNMM
2	Payment of licensing of distribution rights of software product	102,064,491	RPM
3	Payment for Support and Maintenance services in relation to sublicensing	56,793,750	RPM
4	Onsite software development services availed from AEs	1,719,812,996	TNMM
5	Commission received for Sales and Marketing Services	18,077,794	CUP
6	Commission paid for Sales and Marketing Services	604,009,635	TNMM
7	Offshore Software Development Revenue received by PSL from AE net of compensation for Sales & Marketing services by AE	3,033,905,444	TNMM
8	Recovery of cos of assets from AEs	2,733,134	Other method
9	Outsources software development services availed from AEs	8,867,115	Other method
10	Receipt of interest on loan granted for working capital	30,864,339	Other method
11	Reimbursement of expenses	51,748,895	Other method
12	Recovery of expenses	82,205,774	Other method
13	Receipt of insurance claim on behalf of AE	157,355,828	Other method
14	Receipt of guarantee commission	1,846,769	Other method
15	Change back of ESOP cost	2,600,510	Other method
		746,44,46,387	

2.2 The organisation chart of the Persistent System Limited and its AEs is as under:



Submission of Id.AR :

3. At the outset, the Ld.Authorised Representative(Id.AR) submitted that the Assessee will not press for ground number 1 and 4. Ld.AR also submitted that the Ground Numbers 3,6,7 are academic in nature. The Ld.AR in addition to elaborate oral submission also made an elaborate written submission.The relevant part of the written submission is reproduced here under :

“3. Appellant’s submission on allocation of G&A Common costs basis person months(headcount):

3.1 The Appellant has benchmarked the POSS segment under the Transactional Net Margin Method (TNMM) and using a PLI of Operating profit/Operating Costs (OP/OC). As per Rule 10B(i) (e) of Income-tax Rules 1962 which deals with TNMM, requires that the net margin realized by the enterprise from an international transaction entered into with an associated enterprise is compared

with the net profit margin realised in a comparable uncontrolled transaction. In order to compute such net operating profit for the POSS segment, segmental profitability was computed by considering all the costs which were directly in relation to the POSS segment on an actual basis. Further, certain G&A/common costs which are not directly allocable to any segment of the Appellant but were incurred to benefit all the segments of the Appellant, were required to be allocated to the POSS segment by considering an appropriate allocation key to arrive at the correct margin earned in the POSS segment.

3.2 The Appellant has considered per months (headcount) as the appropriate allocation key to allocate costs to the POSS segment. The Appellant wishes to respectfully make its submissions on the reasonableness and appropriateness of using the said allocation key in the ensuing paragraphs.

3.3 The Appellant submits that costs such as G&A, which are not direct in nature but are of a common nature, may be allocated on a reasonable basis, having regard to the nature of expenses and applying a reasonable allocation key accordingly.

3.4 In the present case, the common costs to be allocated to segments are in the nature of G&A staff cost (for HR/Finance/Admin departments), recurring cost of computers & laptops, communication costs, etc. By the very nature of these expenses, it is evident that such costs are common in nature and can at best, have a correlation or. may change depending upon on the number of people/resources utilised by the assessee.

3.5 For example, HR and finance teams cater to various needs of employees working for different segments of the Appellant. The HR team looks after the People function, the finance team processes payroll for the employees, the admin team plans and controls overall administration and functioning of offices. Communications expenses such as mobile or landline or internet expenses are again expenses incurred by a company for its employees and depend upon number of telephone users

3.6 Therefore, considering the nature of G&A/common costs, it is evident that the same are dependent or have a correlation to the

number of employees in the company i.e. headcount of the company. Accordingly, person months (headcount) should be considered as the morerational and appropriate allocation key for allocating the costs while computing segmental P&L.

3.7 Further, the Appellant would like to submit that the Appellant is engaged in provision of software development or support services. In the Service industry such as the Appellant's, the resources involved or deployed on the project is the most essential element as the billing for the time and material projects typically happens on the basis of the relevant person months. Therefore, allocation of common costs by factoring the person months (headcount) of the company would be a rational and appropriate method for computing the segmental P&L.

3.8 In support of the above contentions, the Appellant would like to draw Your Honors' attention to the decision rendered by the Hon'ble Delhi Tribunal in the case of Xansa India Ltd - [2016] 75 taxmann.com 123. In this case, the Hon'ble Tribunal was dealing with a similar issue of allocation of common costs while arriving at segmental profit for the IT enabled services for the purpose of transfer pricing benchmarking under section 92C of the Act. The Hon'ble Tribunal upheld 'headcount' as an appropriate allocation key for costs related to the employees, conveyance expenses, general administration expenses, IT expenses, communication, etc. The relevant extract of the decision is reproduced below for ease of reference:

"We have carefully considered the rival contentions and also perused the material available on record as well as the arguments advanced by the parties

*Provisions of section 92C prescribes 6 methods by which this exercise can be done by adopting most appropriate method having regard to the nature of transaction or class of transactions or functions performed by the parties. In the present case the revenue as well as appellant both has agreed that transactional net margin method is the most appropriate method for determination of ALP. This method compares the **net profit margin realized by the enterprise from an international transaction entered into with an***

associated enterprise and net profit margin is computed after determining the appropriate cost incurred. Therefore the determination of the cost incurred for the purpose of determining ALP is an important task. There may be direct and indirect cost involved in performing certain services. Where there are direct costs are involved they are required to be directly attributed to the particular profitability statement of that segment however when indirect costs are involved it is necessary that appropriate allocation keys which are rational and quantifiable are adopted for allocating them to the particular business segment to derive its correct profitability. This exercise can be carried out by the authorities as well as the appellant to fulfill the object of determination of the arm's length pricing of an international transaction. As the allocation keys for allocating indirect cost earlier adopted by the appellant was 'headcount' and now also the appellant for most of the indirect expenditure has retained the same allocation key and out of indirect expenses some of the direct expenses have been identified and are allocated to a particular business segment, further when neither the remand report nor before us any infirmity was pointed out with respect to the allocation keys adopted by the appellant before CIT appeal, we see no infirmity in the order of Ld. CIT (A) in arriving at ALP of the international transaction of the appellant....”

(emphasis supplied)

3.9 In addition to the above, the Appellant would also like to place reliance on the following decisions rendered by the Hon'ble High Courts/Tribunals wherein the allocation key of 'headcount' has been accepted as a rational and appropriate key for the purpose of allocation of G&A/common/unallocable costs:

- a) *EHPT India P. Ltd. - [2013] 350 ITR 41 (Delhi High Court)*
- b) *Fujitsu India Pvt Ltd. - ITA No. 604/2017 (Delhi High Court)[rendered in the context of transfer pricing adjustments in the services segment]*
- c) *Cisco Systems (India) P. Ltd. - ITA No. 140/2014 (Karnataka High Court)*
- d) *Net Guru Ltd. [2020] 116 taxmann.com 237 (Kolkata Tribunal) [rendered in the context of transfer pricing*

adjustments in the software development services - similar to the present case]

- e) *Lummus Technology Heat Transfer BV [2014] 42 taxmann.com 342 (Delhi Tribunal) [rendered in the context of transfer pricing adjustments in the services segment]*

3.10 *In view of the above, the Appellant humbly submits that the average person month (headcount) should be accepted as an allocation key for computing segmental P&L while allocating G&A/common costs. The segmental profitability working using the said allocation key was submitted to the TPO vide submission dated 22 July 2021, at Annexure 12 (please refer Page No. 627 of the paperback).*

4. 'Direct Cost'/'Direct cost + All other costs' is not an appropriate allocation key for allocation of G&A/Common costs:

4.1 *The Appellant humbly wishes to submit that the TPO has not justified the rationale behind using Direct Cost ratio as more appropriate method than the headcount basis.*

4.2 *Moreover, the TPO has in effect applied a ratio of 'Direct cost + Indirect Cost + Other costs' to allocate common costs. Such an allocation key consisting of various direct and indirect costs clubbed together in order to allocate common costs is not an accepted method of allocation.*

4.3 *The direct costs of the Appellant are mainly the salary costs of employees and indirect costs include costs such as Selling and marketing expenses. These expenses, evidently do not have any correlation to the common costs such as G&A staff cost (for HR/Finance/Admin departments), recurring cost of computers & laptops, communication costs, etc. Allocation as per Direct cost ratio would result in allocating higher costs to segments where the salary cost of employees is higher and vice versa. Here, the Appellant wishes to submit that while the number of employees is a relevant factor for incurrance of common costs, the salary of such employees have no relevance to such common costs. For example, communication costs such as telephone or internet or administrative expenses such cost of water bottles, refreshments,*

etc. would depend on number of users, irrespective of their salary or designation.

4.4 *An allocation key for allocation of common costs cannot be a combination of other costs which have no correlation with the common costs whatsoever. Such a method would not lead to determination of correct profitability. Thus, the Appellant submits that the allocation key applied by the TPO is without any basis and is arbitrary in nature.*

4.5 *Further, the Appellant would also like to point out that the **TPO himself has admitted that in software companies, allocation of unallocated cost considering per person factor is normal** and yet, the TPO proceeded to apply a ratio of Direct costs + All other costs on the basis that economic factors are different for different locations of the Appellant and hence per person factor is not appropriate. Here, the Appellant wishes to submit that the TPO has failed to understand and appreciate that while the direct costs are usually incurred at the respective branches, whereas the common costs are mainly incurred at PSL India. Accordingly, the economic factors affecting the direct costs may not really be relevant for incurrence of common costs. As explained above, the headcount factor would affect the incurrence of common costs more and the direct and other costs, having no relation with common costs would not be an appropriate factor for allocating the common costs.*

4.6 *During the course of hearing of the present case on 16 February 2023 before the Hon'ble Bench, the learned DR had put forth its contentions regarding use of headcount as an appropriate allocation key. At the outset, the Appellant wishes to point out that the Ld. DR did not object to use of headcount as an allocation key in principle while allocating common costs to different segments. The Ld. DR mainly reiterated the case of the Ld. TPO in rejecting the Appellant's allocation key of headcount that the same cannot be used since the Appellant operates in different economic locations. The Ld. DR also fairly admitted that Revenue cannot be used as an allocation key as Revenue for POSS segment is tainted in nature.*

4.7 *It may be noted that besides the aforesaid reason of different economic circumstances, no other reason has been provided by the TPO or the Ld. DR on the inappropriateness or unreasonableness*

of use of headcount as an allocation key. The TPO himself has rightly rejected Revenue as an allocation key for the POSS segment since the transaction of sales are entirely with the AEs and therefore tainted in nature. Further, the TPO has not justified how Direct cost is a better allocation key than the headcount. The Appellant has already submitted in the above paragraphs why the Direct cost ratio is not an appropriate allocation key. Accordingly, the Appellant prays that the headcount allocation key as applied by the Appellant should be accepted as a reasonable and appropriate allocation key for allocating common costs in a service industry. It is reiterated that the main driver of the service industry is its people and hence it would not be unreasonable to use headcount as a basis for allocation of all common costs.

4.8 Further, the Ld. DR also relied on an extract of the OECD Guidelines which dealt with the issue of allocation in the context of intra group services. The Appellant would like to submit here that the OECD guidelines in fact support the case of the Appellant that the allocation of expenses should be carried out by having regard to the nature of expenses and headcount/no. of employees/no. of users is an acceptable key for the said purposes. Also, the OECD guidelines nowhere recommend that Direct cost could be an acceptable allocation key for the purpose of allocating common costs. The Appellant would also like to humbly submit that to the best of our knowledge, none of the case laws on the said issue of allocation key approve or discuss allocation of common costs on the basis of Direct Cost ratio.

4.9. In light of the above, the Appellant humbly submits that headcount allocation key is a more appropriate and rational method to approximate/calculate the costs allocable to segments rather than the ratio of Direct costs + All other costs.

6. Conclusion

In order to conclude and summarise the above submissions, the Appellant would like to state as under:

- a) The issue under dispute in ground no. 5 of the captioned appeal pertains to deciding the most appropriate allocation key for the purpose of allocating G&A costs to arrive at the segmental profitability of the POSS segment*
- b) The allocation keys for the said purpose as discussed by the*

TPO/DRP/L. DR/ Appellant/ case laws are either on the basis of Revenue, Direct costs or Person months (Headcount).

- c) The allocation key of Revenue is not appropriate since the Revenue side is tainted in the case of POSS segment, as agreed by the TPO as well as the Ld. DR.*
- d) The allocation key of Direct cost applied by the TPO is also not appropriate as direct costs such as salary expenses, etc. has no correlation with the incurrence of common costs such HR, admin, communication costs, etc. An allocation key cannot be a combination of direct/other costs which have no correlation with the common costs. Further, to the best of our knowledge, none of the judicial precedents and OECD uphold the use of Direct Cost ratio as an appropriate allocation key.*
- e) The headcount is an appropriate allocation key since the common costs such as G&A staff cost (for HR/Finance/Admin departments), recurring cost of computers & laptops, communication costs, etc. evidently have a correlation or dependency on the number of people/resources utilised by the assessee.*
- f) For a service industry such as IT &ITeS, the main driver of revenue is based on the resources/employees deployed on the projects and is the most essential element for billing purposes and hence headcount is an appropriate allocation key.*
- g) The judicial precedents and the OECD guidelines also support the use of headcount as an appropriate and reasonable allocation key.”*

Submission of Id.Departmental Representative (Id.DR) :

4. The Ld.DR in addition to oral submission made an elaborate written submission. The relevant part is reproduced here under :

“(1) Allocation of Cost:

The assessee has bifurcated cost amongst various heads as

- (i) Actual Cost - The same is not disputed by TPO*

(ii) *Unallocated cost*

During Transfer pricing proceedings the dispute arose regarding allocation of Unallocated cost amongst various segments.

- a) *In TPSR, the Assessee used sales ratio*
- b) *When TPO showed disagreement with (a) above, the assessee revised its PLI computation by allocating such cost on man-hour basis*
- c) *However, in TP Order, the TPO disagreed with the method adopted by the assessee and PLI computation is made using Direct cost as the basis.*

1.1 TPO's stand on allocation of cost:

In thesegmental accounts as prepared by the assessee in TPSR, the assessee has prepared segmental based on sales. Contention of the assessee is rejected on the basis that

para 7 of TPO order

The assessee is having 3 different segments:

<i>Segment 1</i>	<i>POSS-Software Development Services</i>	<i>The Revenue (receipt) is tainted (i.e.- controlled transaction). The receipts therefore are dependent on the cost incurred and receipts would be in proportion to agreed mark up between the AEs</i>
<i>Segment 2</i>	<i>Distribution Segment</i>	<i>The Cost is tainted (i.e.- controlled transaction).</i>
<i>Segment 3</i>	<i>Non AE Segment</i>	<i>The entire business is with non-AE</i>

Therefore, when the common cost is required to be allocated while deriving PLI for POSS, the basis for revenue is not appropriate, because the same is tainted and the allocation on the basis of revenue in the POSS segment would result in allocation as per the agreed mark up on the cost.

Therefore, TPO has proceeded with the allocation of expenses on the basis of direct cost and not on the basis of sales as done by the assessee in TPSR.

As regards allocation in distribution, the revenue in distribution segment is 1.2% of total revenue and therefore will not have any significant impact on PLI. Further, the TPO has not made any adjustment in that segment.

1.2 OECD on cost allocation :

D.2.3. Allocation of low value-adding service costs

7.59. The third step in this simplified charge method for low value-adding intra-group service costs is to allocate among members of the group the costs in the cost pool that benefit multiple members of the group. The taxpayer will select one or more allocation keys to apply for this purpose based on the following principles. The appropriate allocation key or keys will depend on the nature of the services. The same allocation key or keys must be used on a consistent basis for all allocations of costs relating to the same category of services. In accordance with the guidance in paragraph 7.24, the allocation key or keys selected with respect to costs for each relevant category of services should reasonably reflect the level of benefit expected to be received by each recipient of the particular service. As a general rule, the allocation key or keys should reflect the underlying need for the particular services. By way of examples, the allocation key for services related to people might employ each company's share of total group headcount, IT services might employ the share of total users, fleet management services might employ the share of total vehicles, accounting support services might employ the share of total relevant transactions or the share of total assets. In many cases, the share of total turnover may be a relevant key.

7.60 The examples of allocation keys provided in the previous paragraph are not intended to be an exhaustive

list. Depending on the facts and circumstances moresophisticated allocation keys might be used. However, a balance should be struck between theoretical sophistication and practical administration, bearing in mind that the costs involved are not generating high value for the group. In this context, there may be no need to use multiple allocation keys if the taxpayer can explain the reasons for concluding that a single key provides a reasonable reflection of the respective benefits. For reasons of consistency, the same allocation key or keys should be applied in determining the allocation to all recipients within the group of the same type of low value-adding intra-group services.

(Source: Base Erosion and Profit Shifting (BEPS) - Comments Received onPublic Discussion Draft - BEPS Action 8 - Implementation Guidance on Hard-to-Value Intangibles; 5th July 2017)

1.3 Assessee's reliance on various Judgements:

During the hearing, before the Hon'ble bench, the DRs have distinguished the judgments as all the judgements, which are relied by the assessee are based on set of different facts/arbitrariness as pointed out by the Hon'ble ITATs

1.4.1 Further submission in this matter:

1.4.1 As already mentioned, in the TP order, the assessee's segmental turnover is as under:

<i>No</i>	<i>Nature of Transaction</i>	<i>Turnover</i>	<i>% of total TO</i>
	<i>POSS</i>	<i>1,59,13,00,720</i>	<i>9.18</i>
	<i>Distribution Segment</i>	<i>21,18,10,988</i>	<i>1.22</i>
	<i>mer sales</i>	<i>15,52,43,78,013</i>	<i>89.59</i>
		<i>17,32,74,89,721</i>	

Above table shows, only 9.18% of turnover of the assessee is from software segment, as against 90.19% turnover of the assessee in rest of the business (with non AE and distribution). As such the Manpower of the assessee has been distributed unequally in the business and almost 90% of manhour are working for Non AE Segment. Thus, allocation of cost on man hour basis would distort

the profit. It would result higher cost to nonAE business (notionally lowering its profit/PLI in this segment) and lower cost to AE business (Notionally increasing its Profit/PLI in this segment)

As the Direct cost of the assessee are true indicators of allocation of cost, irrespective of the nature of business with AE and NonAE, the allocation as made by the TPO is correct. Further, in computation of PLL, as assessee's cost is untainted, and PLL is derived on OP/OC basis, allocation of cost on direct cost basis is more appropriate.

(2) *Comparable Selected by the TPO:*

2.1 *As per TPSR, assessee selected following comparable- # Page 51 of TPSR*

	Name of the Company	Remark
	oke Technologies Pvt. Ltd.	
'1 2	ken Technologies Ltd.(Software Services)	
	-VAK Software & Exports Ltd.	
	Zest Solutions Ltd.	ld as product development company Lam Research India - IT(TP)A No. 458/Bang/2019 GXS India Technology Centre - IT(TP)A No. 1444/Bang/2012
	ystems International Ltd	
	obeans Technologies Ltd.	ld as product development company EIT Services India-IT(TP)A No. 2498/Bang/2019 SAP Labs India -IT(TP)A No.
	Bhilwaralnfotechnology Ltd. (Software & IT related)	

	<i>a Elxsi</i>	<i>Held as product development company 3DPLM Software - IT(TP)A No. 1303/Bang/2012 GXS India Technology Centre - IT(TP)A No. 1444/Bang/2012</i>
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2.2 In view of this specific observation by TPO, a query was raised in SCN to the assessee as under:

2.3 The relevant discussion in TP Order is as under

17. The issue of comparable:

From the TPSR and benchmarking analysis and comparable selected by the assessee, it is noticed that the assessee has selected most of the comparable in product development category. Assessee therefore was asked a very specific query regarding selection of such comparable. A query raised by the TPO and the reply received by the assessee vide letter dated 07/07/2021 is reproduced below:

FAR and comparable

2.1. Relevant extract from your goodself's notice:

6. Regarding the work related to software development services, you have carried out benchmarking analysis using TNMM as MAM. Some of the comparable selected by you are in product development category. This issue was under discussion in meeting dated 01/07/2021. Subsequently, in your letter dated 02/07/2021, you have clarified that these comparable companies, (though engaged in product development) are having broader functional similarity with your company's FAR analysis. Similar discrepancy is also noticed in the case of comparable selected for benchmarking of transaction of your branch office.

Please confirm that all the comparable of branch offices are also matching in FAR analysis.

2.2. Our response:

2.2.1. As detailed in the TP study report and our letter dated 02 July 2021, we confirm that PSL as well as its branches are engaged in provision of software

development and related services. The comparable companies are also engaged in the similar functional profile of provision of services.

2.2.2. *Your goodselfs referring to companies involved in provision of product development services category. Here we would like to submit that the comparable selection for branches is also aligned with Functional Profile of the said branches of PSL i.e. provision of information technology services. Your goodself will appreciate that the terms software development services or product development services or application development services etc. are typically interchangeably used in the IT industry. Here, we would like to state that the companies engaged in the provision of product development services should be compared with the assessee. Thus, we believe there is no discrepancy in the comparable selection. However, should your goodself have any specific contention against any of the comparable company then we would be happy to address the same.*

18. *Thus, assessee even though some comparable are in product category, the assessee has admitted that the product companies comparable as mentioned in TPSR matches with the FAR analysis of the assessee.*

19. *Assessee even though an opportunity was provided by TPO did not avail an opportunity to revisit the comparables.*

20. *With reference to the submission as mentioned by the assessee in reply to the SCN, the TPO has also verified the comparable selected by the assessee in past 3 years are. The same are tabulated as under:*

<i>Comparable Name</i>	<i>2016-17</i>	<i>2015-16</i>	<i>2014-15</i>
<i>G-V A K Software & Exports Ltd.</i>	<i>11.97%</i>	<i>9%</i>	<i>10.07%</i>
<i>gniti Technologies Ltd.</i>	<i>18.24%</i>	<i>—</i>	<i>—</i>
<i>Zest Solutions Ltd.</i>	<i>8.48%</i>	<i>—</i>	<i>11.84%</i>
<i>ntec Systems Ltd.</i>	<i>19.00%</i>	<i>—</i>	<i>—</i>
<i>garsoft (India) Ltd.</i>	<i>3.22%</i>	<i>—</i>	<i>—</i>

Elxsi Ltd.	25.16%	—	—
oke Technologies Pvt Ltd	3.68%	5.47%	5.69%
oBeans Technologies Ltd	27.00%	—	—
real Software Ltd	2.66%	—	—
tems International Ltd. - Information Technology Services & Products	26.56%	22.41%	20.49%
ken Technologies Ltd. - Software Services	35.96%	5.71%	5.57%
ppiest Minds Technologies Pvt Ltd - Product Engineering Services	11.82%	-	-
hanging Solutions Ltd.	—	14.21%	—
ense Technologies Ltd.	-	19.34%	17.36%
ndtree Ltd.	-	19.89%	21.10%
lios & Matheson information Technology Ltd.	—	-	19.36%
Software (India) Ltd.	—	28.85%	25.42%
shay Software Technologies Ltd.	—	--	3.29%

21. With such specific reply from the assessee (as mentioned above) with regard to selection of product companies in comparable set and looking to the record of the assessee for accepting such comparable as product company the in previous years, TPO concluded that the FAR of the assessee matches to the FAR of the product development companies.

22. Accordingly, TPO carried out search of the comparable on the basis of reply of the assessee and on the basis of search strategy as adopted by the assessee and mentioned in TPSR, TPO suggested additional comparable.

In view of the specific submission made by the assessee on the SCN issued on the functional profile of the comparable, none of the comparable as selected by the assessee has been rejected, in spite of judicial pronouncements of various judicial authorities rejecting such comparable with captive service providers.

24. Final list of the comparable as selected by the assessee is as under-

	<i>Name of the Company</i>	<i>OP/OC</i>
1(*)	<i>Evoke Technologies Pvt. Ltd.</i>	4.22
2(*)	<i>Sasken Technologies Ltd.(Software Services)</i>	6.52
3	<i>Harbinger Systems Pvt. Ltd.</i>	7.91
4(*)	<i>CG-VAK Software & Exports Ltd.</i>	8.19
5(*)	<i>E-Zest Solutions Ltd.</i>	13.73
6	<i>Exilant Technologies Pvt. Ltd.</i>	15.09
7	<i>Apttus Software Pvt. Ltd.</i>	17.03
8	<i>Ninestars Information Technologies Ltd.</i>	17.17
9	<i>Sagarsoft (India) Ltd.</i>	18.28
10	<i>Gwynniebee India Pvt. Ltd.</i>	19.81
11	<i>Nihilent Ltd.</i>	21.14
12	<i>Cygnnet Infotech Pvt. Ltd.</i>	24
13 (*)	<i>R Systems International Ltd</i>	24.17
14 (*)	<i>Infobeans Technologies Ltd.</i>	26.37
15(*)	<i>BhilwardInfotechnology Ltd. (Software & IT</i>	26.45
16(*)	<i>Tata Elxsi</i>	27.19
17	<i>E-InfochipsPvt. Ltd.</i>	56.48
18	<i>Cybage Software Pvt. Ltd.</i>	57.12
	<i>35th percentile</i>	17.03
	<i>Median</i>	19.04
	<i>65th percentile</i>	24

(*)selection of the assessee.

In view of the same, product related comparable were selected by the TPO while determining PLI.

As the assessee himself has stated in reply to query that product development comparables are in synchronization with the FAR of the assessee, the submission of the assessee to exclude the product development companies, would not be appropriate and hence require to be rejected.

(3) *Benchmarking analysis by considering the profit derived from all branches situated in India and abroad.*

(4) *Even though the assessee has taken this ground at Ground No. 4, of the appeal, during the proceedings, before Hon'ble ITAT, the assessee's counsel has not made any discussion. In view of this it is presumed that the assessee has not specifically pressed on this issue. Therefore, if the assessee makes any written submission, the department may also be provided an opportunity to rebut the argument advanced by the assessee.*

(4) *Prayer:*

In view of the same, it is humbly prayed that the

(i) The assessee's contention on allocation of cost on man-hour may please be rejected. Comparables selected by the TPO may be retained.”

Findings and Analysis :

5. We have heard both the parties and studied the records. We will discuss each ground of appeal here onwards.

Ground No.5 : Allocation of Common Cost:

6. The assessee has benchmarked provision of software development services by using Transactional Net Marginal Method(TNMM). The value of the said transaction was Rs.1,59,13,00,721/-. The profit level indicator (PLI) adopted by assessee was OP/OC. The TPO has accepted TNMM as the most appropriate method and OP/OC as the PLI. However, TPO has observed that while calculating Operating Cost(OC), the assessee has allocated common cost on the basis Sales Ratio (page 6 of the TPO para 7.5). However, in the Transfer pricing Study Report the assessee has given following comment for the allocation of common cost, *“The Management has represented that the profitability is computed based on prudent basis of allocation*(page 301 of the Paper book)” In the Transfer Pricing

Study Report there is no specific discussion regarding basis of allocation of Common Cost. Transfer Pricing Study report should have contained all these details but it does not contain the details of basis of allocation of common cost.

6.1 The turnover of the three segments of the assessee as tabulated by TPO as under :

<i>S.No.</i>	<i>Nature of Transaction</i>	<i>Turnover</i>	<i>% of total TO</i>
<i>1</i>	<i>POSS</i>	<i>1,59,13,00,720</i>	<i>9.18</i>
<i>2</i>	<i>Distribution Segment</i>	<i>21,18,10,988</i>	<i>1.22</i>
<i>3</i>	<i>Other sales</i>	<i>1552,43,78,013</i>	<i>89.59</i>
		<i>17,32,74,89,721</i>	

The segment labelled as “Other Sales” is with non-AE. The other two segments are with AE. The TPO observed that assessee’s allocation of common cost on the basis of sales is not proper, because in two segments the transactions are with AE; meaning thereby these are tainted segments. The Assessee has charged its AE at Cost Plus model. We agree with the TPO’s observation that Sales cannot be taken as the basis for allocation of Common Cost as it is tainted. The TPO has allocated common cost based on direct cost. The DRP has upheld TPO’s this view. During the Transfer Pricing Proceedings, the assessee

submitted without prejudice that common cost may be allocated based on per person working. The assessee had submitted said working before the TPO. The TPO rejected assessee's said contention. The TPO stated that Direct Cost per person shows variations in different geographies, for example in Australia it was 6,50,429/-, whereas in India it was 1,14,315/- per person. Therefore, TPO was of the opinion that Direct Cost varies per person depending on the geographical location of the Branch/AE. The TPO stated that same thing applies to the formulae of per person allocation of common cost. TPO was of the opinion that common cost cannot be allotted based on the formula per person, because it varies with geographical location of AE. Therefore, TPO rejected assessee's contention.

6.2 It is a fact that one has to allocate common cost to various segments. One also has to consider only the segmental profit level indicators for comparison with comparables. The only question is basis on which common cost shall be allocated. There is no dispute of the assessee and Department on the issue that common cost is to be allocated segmentally. During the hearings before us, the ld.Authorised Representative(ld.AR) of the assessee submitted that there are around 415 employees

working in G & A Department, such as Executives, Corporate Planning, Finance, Legal, HR, Internal Audit etc. The Id.AR invited our attention to Page No.665 of the Paper Book which provides the said details and it was filed before the TPO. The Id.AR explained that all these 415 employees are situated in India. They provide the various common services, like HR, Legal, Internal Audit, Corporate Planning, Corporate Finance etc., to various AEs situated outside India, from India. Common Cost also consist of recurring cost of computers, laptops, Communications Cost, Internet Cost, Mobile cost etc. The Ld.DR has pleaded that Direct cost percentage shall be the appropriate parameter for allocation of the Common Cost of G&A expenses. However, as seen from the letter of Mr.Praveen Joshi, Head-Corporate Planning, dated 18/10/2021, which is at page 673 of the paper book, it has been explained by the Head of Corporate Planning that even the Direct cost is worked based on the Allocated Person Months(APM).The exact words of the said letter are reproduced here as under :

“Generally, the direct costs for the projects are based on APMs which are base for identification of the direct costs. Further, in respect of inter-company projects, these APMs are taken as the basis for charging indirect costs (such as General & admin costs) to the respective Associated Enterprises (AEs). ”

Based on a specific request from the corporate tax team of PSL, I have reviewed the internal records and confirm that during FY 17-18, total number of APMs in respect of all the employees of Persistent Systems Limited ('PSL') were 93,352. I further confirm that out of the above APMs, the APMs of technical resources deployed on various projects executed for AEs under Provision of Software Services (POSS) segment from various locations are given below:

Location	India	Canada (Branch)	UK (Branch)	South Africa (Branch)	Australia (Branch)	Japan (Branch)	Total.
APMs	5282	663	477	5	12	12	6451

The aforementioned details are backed by robust records maintained by the Company based on internal systems and processes.”

6.3 Therefore, even the Direct Cost, which is relied by the TPO for Common Cost allocation is ultimately based on the Manhour spent. Thus, the direct cost itself has a nexus with APM.

7. The working submitted by the Assessee before the TPO which is at the page no.627 of the paper book is as under :

Annexure 12 – SEGMENTAL FINANCIAL ACCOUNTS OF PSL ON A WITHOUT PREJUDICE BASIS

Sr.No	Particulars	Total Rs.	Segment I-Provision of outsourced software services					Segment II- Distribution of software products	Segment III
			UK and South Africa branches	Australia and Japan branches	Canada Branch	India	Subtotal		
A	Revenue from Operations	17,327,489,722	331,557,737	17,164,372	476,033,511	767,545,100	1,591,300,720	211,810,988	16,524,378,013
B	Expenses								
B.1	Total Direct Expense	8,787,541,990	275,470,240	15,610,299	411,534,416	603,782,763	1,306,397,717	158,858,241	7,322,286,032
	Gross Profit							52,952,747	
	Gross Profit/Sales							25%	
B.2	Indirect Expenses								

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B.2.1	Total S & M Expenses	1,072,751,144						6,038,790	1,066,712,354
B 2.2	Total G & A Expenses – originally absorbed	0	0	0	0	0	0	0	0
B 2.2A	Total G & A Expenses – reworked	1,603,349,994	8,291,756	412,252	11,388,625	90,725,266	110,817,900	4,791,224	1,487,740,871
B 2.3	Cost of Technical professions- Others	1,960,871,669							1,960,871,669
B 2.4	Provision for doubtful debts	-146,424,759							-146,424,759
B 2.5	Bad debts	157,622,688							157,622,688
B 2.6	Depreciation and Amortisation – originally absorbed	0	0	0	0	0	0	0	0
B 2.6A	Depreciation and Amortisation – reworked	537,805,260	2,781,271	138,280	3,820,041	30,431,612	37,171,204	1,607,101	499,026,955
B.2	Sub total Indirect expenditure	5,185,975,966	11,073,027	550,532	15,208,666	121,156,878	147,989,103	12,437,115	5,052,549,778
B = B1 + B2	Total Expenditure	13,973,517,986	286,543,267	16,160,831	426,743,082	724,939,641	1,454,386,820	171,295,356	12,347,835,810
c	Operating	3,353,971,736	45,014,470	1,003,541	48,290,429	42,605,459	136,913,900	40,515,632	3,176,542,203
	OP/Sales	19.36%	13.58%	5.85%	10.17%	5.55%	8.60%	19.13%	20.46%
	OP/TC	24.00%	15.71%	6.21%	11.32%	5.88%	9.41%	23.65%	25.73%
Allocation keys									
1	Manmonth	93,342	483	24	663	5,282	6,451	279	86,612
	Person Month Ratio		0.52%	0.03%	0.71%	5.66%	6.91%	0.30%	92.79%

7.1 No where the assessee has provided how they have arrived at the Manmonths.

7.2 However, the Assessee while working out the allocation has considered the number of manhours spent on Direct cost as the basis for allocation. To explain it, the Total Person Month for entire Persistent System Limited is 93352 as per the letter of the Head-Corporate Planning, out of that 483 (477+5) person Month have been spend on UK and South Africa Branch by the Technical resources deployed on various projects executed for the AE under provision of software services segment called

POSS. Therefore, the assessee worked out the formula as under $483/93342 = 0.52\%$. The assessee allocated Common Cost to its AE UK and South Africa 0.52% of the total common cost of G&A expenses. Thus, actually the assessee had applied Technical ManpowerRatio for allocation of G & A expenses. G&A expenses are general in nature like Legal, Audit, HR, Corporate Planning, Finance, Communications cost, Cost of Laptop computers used, etc. Therefore, the application of Technical Manpower ratio by the assessee in its working submitted to TPO is, conceptually wrong and the formula applied by the assessee may not be able to arrive at an appropriate profit level indicator. Therefore, for all the reasons discussed, the working submitted by the assessee is rejected. These services have been provided by 415 employees of the assessee from India. However, nowhere the Assessee has submitted Actual Number of Employees working in various branches situated outside India. The Actual Number of employees working in various branches situated outside India, are important because the manhour spent by HR team, manhour Spend by Account Team to prepare the monthly payment sheet, etc depend on the actual number of employees working in these

branches. The communication expenses which is part of G & A depends on the number of employees of the Branches who availed these services. Also, the actual number of employees in the Branches are required to understand the utilisation of Communication Cost. We have already made it clear that all these details have nowhere been placed on records on behalf of the assessee. We have already mentioned that the Assessee has not categorically mentioned the basis of Common Cost Allocation in the Transfer Pricing Study Report, to that extent the Transfer Pricing report is unclear.

7.3 Therefore, in these facts and circumstances of the case, we agree with the TPO's calculation of allocation based on the direct cost as it is the best suitable basis for allocation of Common Cost of G&A. Because the direct cost is easily available and verifiable. The onus is always on the assessee to file all necessary details before the TPO to prove the allocation. In this case the assessee failed to file all the essential details even before us. Therefore, the allocation made by the TPO is sustained. Accordingly, the Ground Number 5 of the assessee is dismissed. The case laws relied by the assessee are factually distinguishable.

7.4 Accordingly, the Ground Number 5 of the Assessee is dismissed.

Ground Number 3: Entity Level PLI :

8 In Ground Number 3, the assessee has pleaded that the entity level PLI should be accepted.

8.1 It is an accepted fact that there are independent different Segments. The assessee during Transfer Pricing Proceedings had submitted Segmental PLI working. This explains that there are different segments. In this case the transactions with the Non-AE are 89.59%, it means the transactions with the Non-AE independent entities are almost 90%. It means the entity level profit is mainly influenced by the 90% transactions which are with the Non-AE. Therefore, considering the Entity Level PLI will give distorted results as it is affected by 90% transactions which are with the Non-AE. Therefore, in these facts and circumstances of the case we reject the Assessee's plea that Entity Level PLI shall be considered for bench marking transactions with the AE.

8.2 Therefore, the Ground Number 3 of the Assessee is rejected.

Ground Number 8 :

9. The assessee vide Ground Number 8 has challenged selection of following comparables by the TPO.

- Exillant Technologies Pvt.Ltd.
- E-Infochips P Ltd
- Nihilent Ltd
- Cybage Software P Ltd
- Nine Star Information Technologies Ltd.

9.1 The assessee company is in the business of Providing Software Development Services (POSS) to its AE on its own account or through its branches. Assessee had benchmarked the transaction of POSS by using Transactional Net margin Method (TNMM).

10. During the Transfer Pricing Proceedings, the TPO carried out fresh search of comparables using the same criteria as used by the assessee while bench marking the transaction. The TPO had not rejected any of the comparables selected by the assessee. However, the TPO had added certain comparables to the list of comparables on the ground that those comparables were functionally comparable to the assessee, those comparables had appeared in the search conducted by the assessee, however, the

Assessee had excluded those comparables. The TPO had issued Show cause notice to the assessee before adding those comparables. The assessee had filed its objections. However, the TPO rejected the objections of the assessee giving following reasons:

Quote, “Assessee has also relied on annexure-9 of the submission, related to the search carried out by the assessee. As it has been held in various judicial rulings, there cannot be a cherry-picking approach for selecting comparable by the TPO as well as assessee. Assessee should have subjected all the comparable selected by revenue to the same test. In the process of any analysis objectivity and consistency was to be maintained. Once the diversify business and the product development category are accepted by the assessee in reply to SCN and evident from the selection of comparable in last 3 years, the objections of the assessee on such issues are rejected.” Unquote.

10.1 Thus, while rejecting the objections of the assessee, the TPO has not discussed Functional Comparability of these Additional Comparables individually. The TPO has also not discussed the case laws relied by assessee.

11. The assessee had also made elaborate submissions before the Dispute Resolution Panel(DRP) on this issue.

12. We will discuss each comparable here onwards.

Exilant Technologies Pvt. Ltd. :

12.1 Assessee had submitted before the DRP and TPO that Exilant Technologies Pvt. Ltd., is functionally not comparable as it is also in the business of “Sale of Products”. The assessee had also submitted that during the year there was a unique event that 99.99% of the shares of Exilant Technologies Pvt. Ltd., have been acquired by Quest Global Engineering w.e.f. 14.02.2018 as is evident from page no.5623 of the paper book. The financial statements of Exilant Technologies Pvt. Ltd., have only been prepared up to 14.02.2018. The assessee has also relied on following case laws :

- PCIT vs. Aptara Technology (P.) Ltd. [2018] 92 taxmann.com 240 (Bom HC) (AY 2008-09).
- PCIT vs. J.P.Morgan India (P.) Ltd. [2019] 102 taxmann.com 335 (Bom HC) (AY 2006-07).

12.2 On perusal of the Annual Report of the Exilant Technologies Pvt. Ltd., it is observed that the Annual Report is only for the period 01.04.2017 to 14.02.2018. It is also observed that during the year 99% of its shares have been acquired by Quest Global Engineering. There are also another extraordinary events like sale of subsidiaries during the year. It is also

observed neither TPO, nor DRP has discussed these events in the orders, though they are very much obvious from the Annual Report. In these facts and circumstances of the case, since Annual Report is not available for the entire year and presence of extraordinary events, we hold that Exilant Technologies Pvt. Ltd., cannot be included in the comparables for the present year. Accordingly, the TPO is directed to exclude Exilant Technologies Pvt. Ltd., from the list of comparables.

E-Infochips Pvt. Ltd. :

13. The Id.DRP has upheld inclusion of E-Infochips Pvt. Ltd., in para 7.2(a) of the order as under :

“We find that this company is also engaged primarily engaged in sale of products which is similar to the activity of product development carried out by the assessee. As per the annual report it is engaged in Computer programming, consultancy and allied activities and it operates in a single segment and hence does not require segmental data .The assessee is also engaged in SDS and product development activities including maintenance and support, software testing , software updates and software consulting services as discussed in its TPSR (POSS segment). Also it has been stated in the TPSR that" PSL is a global company specialising in software products, services and technology innovationsAs stated in the TPSR, the assessee along with its AE's are engaged in development of products and the assessee is involved in High level Design of the products and development of product architecture and it provides technical inputs to the AE also in this regard. Hence the claim of the assessee that product -development is a high end activity that

cannot be compared to the functions of the assessee in respect of POSS is not correct .Hence , the company E-Infochips (P) Ltd. is found functionally comparable to the assessee under TNMM method and hence we reject the contentions raised by the assessee in this regard.”

13.1 We have perused the Annual Report filed by the assessee of E-Infochips Pvt. Ltd. It is observed that there is sale of products. It is also observed that it is in the business of Software Development and ITES. However, no segmental profitability is separately available in the Annual Report. We are searching comparable for the Software Development Activity of the assessee. However, in the case E-Infochips Pvt. Ltd., there is Revenue from Sale of Products. It is also having the activity of ITES as mentioned in note 42 of the Annual Report which is at page 5441 of the Paper Book filed by the assessee. However, the assessee is not into any trading activity. Therefore, assessee's segment of software development cannot be compared with E-Infochips Pvt. Ltd., as it also has trading activity and ITES, in the absence of segmental accounts. The TPO and DRP has not discussed these issues. However, on the facts and circumstances of the case, we hold that E-Infochips Pvt. Ltd., is not comparable to Software Development Segment of the assessee.

Accordingly, TPO is directed to delete the E-Infochips Pvt. Ltd., from the list of comparable.

Nihilent Ltd., :

14. The DRP has upheld the selection Nihilent Ltd., as comparable in para 7.2(c) as under:

“On perusal of the annual report of this comparable for the relevant financial year and as per the annual report this company is into Software development, IT consultancy and related activities. and this company is operating in a single segment of SDS like the assessee SDS segment. This company has gross intangibles less than 25% filter, has minimal R & D expenses and as per the annual report it is engaged in software development activity. The assessee has claimed that this company is into diverse activity has also been made. The assessee also has branches abroad and derives revenues from these branches .Also as discussed in detail in paragraphs above , under TNMM broad comparability is required and we find that this company is functionally comparable to the assessee. Accordingly we reject the objections raised by the assessee in this regard.”

14.1 We have perused the Annual Report of Nihilent Ltd., filed by assessee in the paper book.

14.2 As per the Annual Report of the Nihilent Ltd., the business of Nihilent Ltd., is as under :

“Consulting: Nihilent partners with business in transforming their organizations with solutions using a holistic design-thinking led

approach to problem solving. Our suite of consulting-led offerings include customer driven digital transformation, industry transformation, and organizational change management services. We have deep expertise and several person-years or experience in strategy alignment and execution, organizational design and process restructuring, balanced scorecards, customer loyalty evaluation among others.”

Analytics : We help enterprises answer complex business questions of the day by getting them to make sense of all the data they have. Our leading-edge analytics solutions include predictive analytics techniques like fraud analytics, churn analytics, market basked analysis among others, data visualization and dashboards, and data enrichment and insight offerings including sentiment analysis, data abstraction, deep learning & artificial intelligence.

Technology : Our technology-driven service offerings help businesses achieve greater agility in the digital era and enable systems to be future-ready, using a holistic design-thinking approach. Some of our most important technology offerings include produce development, user experience testing, technology re-engineering, cloud-based services, blockchain, Internet of Things SAP S4 HANA implementation & consulting, among others.”

14.3 Thus, it is seen from the description of the services provided in the Annual Report that these services are functionally dis-similar to the services provided by assessee, hence, it is not functionally comparable. Hence, the TPO is directed to delete it.

Cybage Software Pvt. Ltd. :

15. The DRP has upheld the selection of Cybage Software (P) Ltd., as comparable in para 7.2(b) as under:

“As regards judicial decision cited by the assessee, we have already pointed out in paragraphs above that the decisions have been rendered in the specific fact patterns of the given case and the assessee has to prove that the facts of its case are similar so as to seek application of the said decisions. We find that the assessee has made general claims. The assessee is also engaged in providing technology consulting and is engaged in diversifying activities and also has overseas branches like Cybage Software (P) Ltd. The claim of high turnover is also not correct since the judicial decisions have laid down the broad range of turnover – minimum and upper turnover filters applied by the TPO works out to 1/10th and 10 times of the turnover of the assessee, respectively. In a recent decision dated 17/05/2017 in the case of Jacobs Engineering (I) Pvt. Ltd. (ITA No.7194/Mum/2012) for A.Y. 2008-09, the Hon’ble Mumbai ITAT held that the upper turnover filter can be reasonably fixed at approximately 10 times the turnover of the tested party and the lower turnover filter can be reasonably fixed at approximately 1/10th of the turnover of the tested party.

*.....
Hence the claim of turnover of Cybage being 4.6 times does not exclude it from being a valid comparable. The assessee has made general claims that the company Cybage Software (P) Ltd has earned abnormal margins without proving the same.”*

15.1 The assessee had submitted before the DRP that the Cybage Software (P) Ltd., is functionally not comparable as it is also in the business of ITES, BPO and segmental profit is not available. The DRP has not discussed the impugned claim of the assessee that it is not functionally similar.

15.2 Before us also, the Ld.AR submitted that it is into ITES, BPO. Ld.AR filed copies of the print outs taken from the web

site of the Cybage Software (P) Ltd, to demonstrate that it is into ITES, BPO.

15.3 On perusal of the said documents it appears that Cybage Software (P) Ltd.,is also into ITES, BPO Services. It is also mentioned that Cybage Software (P) Ltd., is also involved in branding creative production, content marketing, campaign management. Therefore, we are convinced that Cybage Software (P) Ltd., is functionally dis-similar and hence cannot be accepted as comparable. Accordingly, TPO is directed to delete Cybage Software (P) Ltd., from list of comparables.

Ninestars Information Technologies Ltd. :

16. The DRP has upheld the selection of Ninestar Information Technologies Ltd., as comparable in para 7.2(e) as under:

“We find that in the notes forming part of the financial statements of the company, under the heading ‘Corporate Information’, it has been stated that, Ninestar Information Technologies Ltd. is the world’s leading digital transformation solution company and the number one offshore global media monitoring solutions provider. Thus, from the Annual Report of Ninestars, it is clear that the company is engaged in provision of software development services. Even if the company is catering to customers in publication, communication and other industries to which the assessee is not catering to, it does not affect its comparability. What is to be seen is whether the assessee and the companies selected as comparables are providing services which fall under the same category (software development services, in the present case),

and it is not material whether the companies selected are catering to the same industry/segment(s) as the assessee. Since the company is found to be engaged in provision of software development services, the contentions of the assessee regarding functional non-comparability are rejected. Also the assessee is also engaged in product development and related activities and hence we find that this comparable has been rightly selected as functionally comparable to the assessee under TNMM method, which enables broad comparability. Hence we approve the selection of this company as a valid comparable and accordingly reject this ground of objection raised by the assessee.”

16.1 The Id.AR submitted that it is functionally dis-similar. Ninestar Information Technologies Ltd., is involved in provision of content services, analytical services, Tech Services, Software Consultancy etc., therefore, the Id.AR pleaded that it is not functionally comparable.

16.2 We have studied the Annual Report of Ninestar Information Technologies Ltd. There is only one finding in the Annual Report i.e.“Revenue is primarily derived from digitisation and related services”[Page No.5948 of the Paper Book]. In the table of the Annual Report, descriptions of services is referred as ‘Software Services’[Page 5850 of Paper Book].

16.3 Thus, on perusal of the Annual Report which is at Page No.5850 to 5949 of the Paper Book filed by the assessee, we

could not specifically observe that Ninestar Information Technologies Private Ltd., is in the business of Software Development Services. Therefore, based on the cryptic information available in the Audit Report, it is not possible to understand actual functions performed by Ninestar Information Technologies Pvt. Ltd. Hence, Ninestar Information Technologies Pvt. Ltd., is held to be functionally not comparable with the assessee. Accordingly, the TPO is directed to delete the comparable.

16.4 Thus, Ground No.8 raised by the assessee is Allowed.

Ground No.9 (Disallowance u/s 14A) :

17. The Assessing Officer(AO) in the order has mentioned as under :

“The assessee submission has been perused and it has been found that during the year, the assessee has earned dividend of Rs.171252600/- which was claimed as exempt income under section 10(34) of the Act. The assessee has furnished computation of disallowance as per Rule 8D vide letter dated 23/11/2020, Annexure-13b. The assessee has submitted no disallowance u/s 14A of the Act be made directly applying Rule 8D due to there is no specific direct expenditure was incurred except some administrative expenses. However, assessee has submitted computation of disallowance as per Rule 8D of investment in Dividend Scheme and Tax Free Bond. The assessee further submitted in Note that “the investments in mutual funds under ‘Growth Scheme’ should not be considered while applying formula prescribed under Rule 8D(2)(iii) of the Rules to calculate the disallowance u/s 14A of the Act as the returns from these investments under ‘Growth Scheme’ are not received in the form of dividend income,”.

The assessee in its working of computation has disallowed of Rs.48,228,350/- as per Rule 8D. The working of disallowance for administrative cost incurred in making and maintaining these investments income from which is an exempt income as given by the Assessee Company in Annexure 13(b) of its submission has been found to be fair. Therefore, an amount of Rs.48,228,350/- less Rs.3157552/- which has already been debited towards expenditure to earn exempt income i.e Rs.4,50,70,798/- is disallowed u/s.14A of the Act and added back to the total income of the assessee.”

17.1 Thus, it can be seen that the AO has not specified the sub-rule of Rule 8D under which the disallowance has been made.

17.2 The ld.AR relied on the order of ITAT Pune in assessee’s own case in ITA No.1232/PUN/2017. The ITAT has held as under :

“The spirit of the judgment of the Hon'ble Supreme Court on the issue is that the Assessing Officer ought to record his satisfaction to the effect that assessee’s claim of expenditure of lesser amount having regard to its account is incorrect. In this case, the Assessing Officer without discussing the issue has merely stated in the assessment Order that appropriate disallowance should be made u/s.14A of the Act and accordingly, disallowed the additional amount of Rs 1,26,64,970/- u/s 14A of the Act which was deleted by the Ld. CIT(Appeals).”

17.2 We have reproduced in earlier para the observations of the Assessing Officer, thus, no satisfaction has been recorded by the Assessing Officer that the AO is not satisfied with the correctness of the claim of the assessee in respect of the expenditure in relation to exempt income. We have already

observed that the AO has also not mentioned which sub rule of rule 8D has been invoked. The Assessee had claimed that Assessee had not borrowed any money for investing into these investments hence no interest disallowance can be made. The AO has not discussed anything about the fund position of the assessee. On the contrary on perusal of the Balance Sheet as on 31/03/2018, it is observed that Assessee's Equity is Rs.20,532/- Millon and the Investment is Rs.5916 Million which is much less.

17.3 The Hon'ble Bombay High Court in the case of **PCIT Vs. Godrej & Boyce Mfg. Co. Ltd** in IT APPEAL No.1029 OF 2018 vide order dated 20/02/2023 has held as under :

Quote, "We agree with the view of the ITAT that in the present case the AO has neither examined the claim in respect of expenditure incurred in relation to exempt income of the assessee nor has recorded any satisfaction with regard to the correctness of assessee's claim with reference to the books of account. Consequently, the disallowance made by applying the Rule 8D is not only against the statutory mandate but contrary to the legal principles laid down." Unquote.

17.4 Therefore, respectfully following Hon'ble Jurisdictional High Court(supra), ITAT Pune's decision in assessee's own case(supra), since no satisfaction has been recorded by the

Assessing Officer, the disallowance under section 14A is not sustainable. Accordingly, the Assessing Officer is directed to delete the addition made under section 14A of the Act.

Ground No.10 :

18. The assessee had made additional claim of deduction under section 90 of the Act by filing a letter before the Assessing Officer which was not claimed in the Return of Income. The Assessing Officer rejected the said claim as it was not claimed in the Return of Income.

18.1 It has been submitted by assessee as under :

“At the outset, the assessee would like to submit that while furnishing the return of income for AY 2018-19, the Assessee claimed relief under section 90 of the Act for an amount of INR 3,99,87,795 based on the TDS certificates received from overseas parties till the date of filing of Return of Income.

Subsequently, the Assessee paid additional taxes of INR 48,97,620 on the income outside India (refer Annexure # 8a and 8b of the submission dated November 23, 2020) for which it received additional certificates in support of the same, however no claim was made by the Assessee in its return of income filed for the year under assessment.

As the income corresponding to this additional income taxes paid overseas has already been offered to tax by the Assessee in the year

under assessment, the Assessee prays Hon'ble Panel that an additional relief of INR 48,97,620 should be granted to the assessee under section 90 of the Act. The details of such additional relief claimed under section 90 was provided as Annexure 8a to the submission dated 23 November 2020 (Page 1883 of the Paperbook) and the corresponding withholding tax certificate as received from the deductor/overseas customers was provided as Annexure 8b to submission dated 23 November 2020.

The Assessee would also like to highlight that corresponding income in respect of which tax was deducted by the overseas deductors and claimed by the assessee was received in India. The supporting bank advices were submitted as Annexure 8c to submission dated 23 November 2020.”

18.2 We set-aside the issue to the Assessing Officer for de-novo verification. Accordingly, Ground No.10 is allowed for statistical purpose.

19. The Ground No.11 is consequential in nature, hence, not adjudicated. Therefore, Ground No.11 is dismissed as not adjudicated.

20. Ground No.1 : The ld.AR submitted that he is not pressing the Ground No.1, hence, dismissed.

21. Ground No.2 : This ground is general in nature. The ld.AR submitted that when remaining grounds are decided,

Ground No.2 will be automatically decided. Hence, Ground No.2 is dismissed as not pressed.

Ground Nos. 6 & 7 :

22. The Id.AR submitted that these Ground No. 6 and 7 are academic in nature, hence, not pressed. Accordingly, Ground No.3, 6 and 7 raised by the assessee are dismissed as not pressed.

23. The Ground No.4 is not pressed, hence, dismissed as not pressed.

24. In the result, appeal of the Assessee is Partly Allowed.

Order pronounced in the open Court on 2nd November, 2023.

Sd/-
(S.S.GODARA)
JUDICIAL MEMBER

Sd/-
(DR. DIPAK P. RIPOTE)
ACCOUNTANT MEMBER

पुणे / Pune; दिनांक / Dated : 2nd Nov, 2023/ SGR*

आदेशकीप्रतिलिपिअग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant.
2. प्रत्यर्थी / The Respondent.
3. The CIT(A), concerned.
4. The Pr. CIT, concerned.
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, "सी" बेंच,
पुणे / DR, ITAT, "C" Bench, Pune.
6. गार्डफ़ाइल / Guard File.

आदेशानुसार / BY ORDER,

// TRUE COPY //

Senior Private Secretary
आयकर अपीलीय अधिकरण, पुणे/ITAT, Pune.