

IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI S. JAYARAMAN, ACCOUNTANT MEMBER

IT(TP)A No.460/Bang/2013
Assessment year : 2008-09

The Income Tax Officer, Ward 11(2), Bangalore.	Vs.	M/s. Ketera Software India Pvt. Ltd. (Now known as Deem Software India Pvt. Ltd.), Level 8, Prestige Obelisk, No.3, Kasturba Road, Bangalore – 560 001. PAN: AACCK 3825E
APPELLANT		RESPONDENT

CO No.96/Bang/2015 [in IT(TP)A No.460/Bang/2013]
Assessment year : 2008-09

The Income Tax Officer, Ward 11(2), Bangalore.	Vs.	M/s. Ketera Software India Pvt. Ltd. (Now known as Deem Software India Pvt. Ltd.), Level 8, Prestige Obelisk, No.3, Kasturba Road, Bangalore – 560 001. PAN: AACCK 3825E
CROSS OBJECTOR		RESPONDENT

Revenue by	:	Smt. Swapna Das, JCIT(DR)(ITAT-2) Bengaluru
Assessee by	:	Shri S. Raghunathan, Advocate

Date of hearing	:	02.02.2017
Date of Pronouncement	:	22.02.2017

ORDER

Per Sunil Kumar Yadav, Judicial Member

This is an appeal by the assessee against the order of the CIT(Appeals) *inter alia* on the following grounds:-

- “1. The order of the Learned CIT (Appeals), in so far as it is prejudicial to the interest of revenue, is opposed to law and the facts and circumstances of the case.
2. The learned CIT (A) erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable and accordingly erred in excluding M/s. Celestial Biolabs Ltd, M/s. Flextronics Ltd. iGate Global Solutions Ltd, Infosys Technologies Ltd, Mindtree Ltd, Persistent Systems Ltd, Sasken Communication Technologies Ltd, Tata Elxsi Ltd and Wipro Ltd as comparables.
3. The Ld. CIT (A) erred in rejecting the diminishing revenue filter used by the TPO to exclude companies that do not reflect the normal industry trend.
4. The Ld. CIT (A) erred in not appreciating that the different year ending filter applied by the TPO is necessary to exclude companies which do not have the same or comparable financial cycle as the tested party.
5. The Ld. CIT(A) erred in rejecting the employee cost filter applied by the TPO to select companies which are predominantly into software development services.
6. The learned CIT(A), in the facts and circumstances of the case, erred in holding that M/s. Avani Cimcon Technologies, cannot be taken as a comparable.
7. The learned CIT(A), in the facts and circumstances of the case, erred in holding that M/s. KALS Information Systems, cannot be taken as a comparable.

8. The CIT(A) erred in directing the AO to recompute the deduction allowable u/s 10A of the I.T. Act after reducing the communication expenses of Rs. 20,46,519/- and expenses incurred in foreign currency of Rs. 6,15,235/- from the total turnover also.

9. The Ld. CIT(A) erred in not appreciating that there is no provision in section 10A which requires the concerned expenses, which are required to be reduced from the export turnover as per clause (iv) of the Explanation to Section 10A to be reduced from the total turnover also.

10. The Ld. CIT(A) erred in not appreciating the fact that the jurisdiction High Court decision relied upon by him has not been accepted by the department and appeals have been filed before the Hon'ble Supreme Court which is still pending.

11. For these and such other grounds that may be urged at the time of hearing. it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.

12. The appellant craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal.”

2. The assessee has also filed Cross Objection assailing the order of CIT(Appeals) on the following grounds:-

“The grounds stated here under are independent of, and without prejudice to one another:

1. Comparability Analysis adopted by the TPO for determination of arm's length price.

a) The Ld. TPO and the Ld. CIT(A) erred in fact and law in including M/s. E-Zest Solutions as a comparable company, without considering the functional differences of the said company vis-a-vis the Respondent.

- b) The Ld. TPO and the Ld. CIT(A) erred in fact and law in including M/s LGS Global Ltd. as a comparable company, without considering the functional differences of the said company vis-a-vis the Respondent.
- c) The Ld. CIT(A) erred on not drawing reference to the functional dissimilarity in respect of the following comparable companies, namely, (a) M/s. Celestial Biolabs Ltd., (b) Persistent Systems Ltd., (c) Sasken Communication Technologies Ltd., (d) Tata Elxsi Ltd. and (e) Wipro Ltd vis-a-vis the Respondent while rejecting the aforesaid companies.
- d) The Ld. CIT(A) erred in confirming the action of the Ld.AO/ Ld. TPO on facts and in law in considering a set of 'secret data', i.e. data which was not available in public domain, in arriving at a fresh set of companies using his power under section 133(6), which is grossly unjustified.

2 Non-allowance of appropriate adjustments to the comparable companies, by the AO/TPO

The Ld. CIT(A) erred in upholding the action of the Ld. AO/the Ld. TPO in not allowing appropriate adjustments under Rule 10B to account for, *inter alia*, differences in differences in (a) marketing expenditure adjustment, (b) research and development expenditure adjustment; and (c) risk profile between Respondent and the comparable companies.

3. Reduction in deduction under Section 10A of the Act

- a) The learned CIT(A) has erred in upholding the action of the AO in computing the deduction under section 10A of the Act at Rs. 25,058,002.
- b) The learned CIT(A) erred in upholding the action of the AO in reducing communication expenses of Rs. 2,046,519 from the export turnover without considering the fact that the said communication expenses of Rs. 2,046,519 has already been reduced from both the export turnover and total turnover on the position that such expenses are attributable to the delivery of software outside India.
- c) The learned CIT(A) erred in upholding the action of the AO in reducing travel expenses incurred in foreign currency amounting

to Rs. 615,235 from the export turnover, without considering the fact that the said travel expenses are not incurred for the purpose of rendering any technical services outside India.

4. Relief

- a) Respondent prays that directions be given to grant all such relief arising from the above grounds and also all relief consequential thereto.
- b) Respondent craves leave to add to or alter, by deletion, substitution or otherwise, the above grounds of appeal, at any time before or during the hearing of the appeal.”

3. The assessee has also filed the following additional grounds stating that the documents in respect of these additional grounds are already before the Tribunal and no fresh examination of facts is required:-

- “1. The learned TPO has erred in selecting certain comparables in the order u/s 92CA, without considering that the scale of operations of the companies vis-a-vis the turnover of the Appellant (viz. INR 17.07 Crores) for FY 2007-08. Accordingly, the following companies cannot be compared to the Appellant on application of turnover filter to consider is the turnover/receipts of Appellant and range of upper limit at ten times and lower limit also ten times. i.e., one tenth.

Thus, the upper and lower limit shall be INR 1.70 crores (Appellant's turnover * 1/10) and INR 170.7 crores (Appellants turnover*10) respectively:

Sl. No.	Name of the Company	Turnover (in Crs.)	Margin as per TPO
1	Flextronics Software Systems Ltd.	953.35	7.86%
2	iGate Global Solutions Ltd.	781.51	13.99%
3	Infosys Ltd.	15,648	40.37%
4	Mindree Ltd (Seg).	572.97	16.41%
5	Persistent Systems Ltd.	382.88	20.31%

6	Sasken Communication Technologies Ltd.	335.80	7.58%
7	Tata Elxsi Ltd. (Seg)	342.86	18.97%
8	Wipro Ltd. (Seg)	11,956	28.45%

2. The AO / TPO erred in law in applying an arbitrary filter to reject companies having related party transactions greater than 25% of sales. Further, the Hon'ble CIT(A) also erred in upholding the related party transaction filter of 25%, disregarding the Appellant's ground for application of the related party transaction filter at a threshold of 10% or 15% of sales.

PRAYER:

The Petitioner prays that the above grounds be allowed by the Hon'ble Bench.”

4. Since the appeal and the CO were heard together, these are being disposed of through this consolidated order.

5. During the course of hearing, the Id. counsel for the assessee has filed a chart with respect to the comparables along with complete details taken by the TPO for determining the ALP of the international transactions.

6. The facts in brief borne out from the record are that the assessee, a wholly owned subsidiary of Ketera Technologies Inc., USA, is engaged in the business of providing software development services to Ketera US, which is its Associated Enterprise (AE), for which it is remunerated on a cost plus 15% margin. It filed return of income and the case was taken up for scrutiny. During the course of assessment proceedings, the AO made a

reference u/s. 92CA to the TPO for determination of the ALP of the assessee's international transaction with its AE.

7. The assessee has rendered to its AE software development services amounting to Rs. 17,07,19,114. As required under section 92D of the Act read with Rule 10D of Income-tax Rule, 1962 (the Rules), it had maintained the relevant documentation (TP study) and completed the ALP of the software development services rendered, using the transactional net margin method (TNMM) as the *most* appropriate method with a profit level indicator (PLI) of net operating profit margin based on sales (OP/Sales). The appellant had used the Prowess database to conduct a search for comparable companies and had applied various quantitative and qualitative filters to arrive at a set of 11 comparable companies with an average profit margin of 10.24%. Since the appellant's own profit margin of 3.72% was more than the arithmetical mean of the comparables, it concluded that its international transactions were at arm's length. The TPO issued a notice on 18.08.2010 initiating the transfer pricing (TP) proceedings and in response to the notice, the appellant filed the TP study and other requisite documents on 17.09.2010. Subsequently, the TPO issued a show-cause notice on 04.10.2011, proposing to reject all comparable companies selected by the appellant, select a new set of 26 comparable companies, arrive at an arithmetical mean margin of 32.07% vis-a-vis the appellant's margin 16.43%, and make a TP adjustment of Rs. 2,29,34,941. In response to the show-cause notice, the appellant made detailed written

submissions on 14.10.2011, placing on record all legal and factual arguments.

8. The TPO passed an order under section 92CA on 31.10.2011, computing the arithmetical mean margins of the 20 comparables selected by him at 23.95%, after allowing a negative working capital adjustment of 0.30%, and proposing a TP adjustment of Rs. 1,18,65,269. On receipt of the TPO's order, the AO issued a draft assessment order on 15.12.2011 incorporating the TP adjustment proposed by TPO and reducing the deduction claimed under section 10A. After the appellant filed a letter with the AO proposing to file an appeal with the CIT(Appeals), he passed the final assessment order under section 143(3) read with section 144C on 07.02.2012, determining the appellant's taxable income at Rs.1,23,30,510.

9. In the final assessment order, the AO made the following adjustments to the appellant's returned income resulting in a demand of Rs. 23,89,664:-

- Reduction from export turnover communication expenses of Rs. 20,46,519 and travel expenditure of Rs. 6,15,235 incurred in foreign currency, without reducing the same from total turnover, thereby reducing the deduction under section 10A;
- Addition of Rs. 1,18,65,269 on account of TP adjustment; and
- Levy of interest of Rs. 7,64,042 under section 234B.

10. Aggrieved, the assessee preferred an appeal before the CIT(Appeals). Partly convinced with the arguments of the assessee, the

CIT(Appeals) has excluded 13 comparables out of following 20 comparables adopted by the TPO:-

Sl.No.	Name of the company	OP /TC %
1.	Avani Cimcon Technologies	25.62
2.	Bodhtree Consulting Ltd.	18.72
3.	Celestial Labs Ltd.,	87.94
4.	e-zest Solutions Ltd.	29.81
5.	Flextronics (Aricent)	7.86
6.	iGate Global Solutions Ltd.	13.99
7.	Infosys	40.37
8.	KALS Information Systems Ltd (Seg)	41.94
9.	LGS Global Ltd.	27.52
10.	Mindtree Ltd. (seg)	16.41
11.	Persistent Systems Ltd.	20.31
12.	Quintegra Solution Ltd.	21.74
13.	R Systems International Ltd (seg)	15.30
14.	R S Software (India) Ltd	7.41
15.	Sasken Communication Technologies Ltd (seg)	7.58
16.	Tata Elxsi (seg)	18.97
17.	Thirdware Solution Ltd.	19.35
18.	Wipro Ltd. (Seg)	28.45
19.	Softsol India Ltd.	17.89
20.	Lucid Software Ltd.	16.50
	AVERAGE	23.65

11. Aggrieved, the revenue is in appeal before the Tribunal. Through CO, the assessee has sought certain adjustments in determination of the ALP.

12. During the course of hearing, the Id. Counsel for the assessee has contended that exclusion of the comparables made by the CIT(Appeals) was squarely covered by the various orders of the Tribunal. With regard to (1) Avani Cincom Technologies (2) Celestial Biolabs Ltd. (3) e-Zest Solutions Ltd. (4) Infosys Ltd. (5) Kals Information Systems Ltd. (Seg) (6) Persistent Systems Ltd. (7) Tata Elxsi Ltd. and (8) Wipro Ltd., the Id.

Counsel for the assessee has contended that these comparables are functionally different and their profile were examined by the Tribunal in the case of *M/s. Infineon Technologies India Pvt. Ltd. V. DCIT, 71 taxmann.com 139 (Bang. Trib)* and it has been categorically held that these comparables are functionally different. The profile of the assessee and of *M/s. Infineon Technologies India Pvt. Ltd. (supra)* is almost similar and the assessment year is also for AY 2008-09. Therefore, the issue of determination of comparables on functional aspect is covered by this order of the Tribunal.

13. The Id. DR placed heavy reliance upon the order of the TPO.

14. Having carefully examined the order of the Tribunal in the case of *M/s. Infineon Technologies India Pvt. Ltd. V. DCIT (supra)*, we find that the said assessee is also engaged in software development services to its AE and the Tribunal has examined the functional profile of the aforesaid comparables. Having examined the functional profile in detail, the Tribunal has held that these comparables are to be excluded from the list of comparables while determining the ALP for international transactions. For the sake of reference, we extract the relevant observations of the Tribunal hereunder:-

“6.2 We have heard both parties and perused the material on record. We find that the following were the relevant observations and findings of the co-ordinate bench of this Tribunal in the case of *Sonus Networks India Pvt. Ltd.*, in IT(TP)A No.1567/Bang/2012 dt.14.5.2015 for Assessment Year 2008-09 at paras 10 to 19.3

thereof, while excluding the 12 of the aforesaid companies listed at S.Nos.1, 3 to 13 (supra), which is extracted hereunder :-

“10. The following were the relevant observations of the tribunal on the 12 comparable companies in the aforesaid decision:-

“Companies incorrectly adopted as comparables by the TPO as per the contention of the assessee.

7.0 Avani Cincom Technologies Ltd.

7.1 This company was selected by the TPO as a comparable. The assessee objects to the inclusion of this company as a comparable on the ground that this company is not functionally comparable to the assessee as it is into software products whereas the assessee offers software development services to its AEs. The TPO had rejected the objections of the assessee on the ground that this comparable company has categorized itself as a pure software developer, just like the assessee, and hence selected this company as a comparable. For this purpose, the TPO had relied on information submitted by this company in response to enquiries carried out under section 133(6) of the Act for collecting information about the company directly.

7.2 Before us, the learned Authorised Representative reiterated the assessee's objections for the inclusion of this company from the list of comparable companies on the ground that this company is not functionally comparable to the assessee as it is into software products. It is also submitted that the segmental details of this company are not available and the Annual Report available in the public domain is not complete. It was further contended that the information obtained by the TPO under section 133(6) of the Act, on the basis of which the TPO included this company in the final list of comparable companies, has not been shared with the assessee. In support of this contention, the learned Authorised Representative placed reliance on the following judicial decisions :

- i) Trilogy E-Business Software India Pvt. Ltd. V DCIT (ITA No.1054/Bang/2011)
- ii) Telecordia Technologies India Pvt Ltd V ACIT (ITA No.7821/Mum/2011)

It was also submitted that this company has been held to be functionally not comparable to the assessee by a co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013.

7.3 The learned Authorised Representative further submitted that the facts pertaining to this company has not changed from the earlier year (i.e. Assessment Year 2007-08) to the period under consideration (i.e. Assessment Year 2008-09). In support of this contention, it was submitted that :-

(i) The extract from the Website of the company clearly indicates that it is primarily engaged in development of software products. The extract mentions that this company offers customised solutions and services in different areas;

(ii) The Website of this company evidences that this company develops and sells customizable software solutions like “DX Change, CARMA, etc.

7.4 The learned Authorised Representative submitted that a co-ordinate bench of the Tribunal in its order in Curram Software International Pvt. Ltd., in its order in ITA No.1280/Bang/2012 dt.31.7.2013 has remanded the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh, by making the following observations at paras 9.5.2 and 9.5.3 thereof :-

“ 9.5.2 As regards the submission of the learned Authorised Representative, we are unable to agree that this company has to be deleted from the list of comparables only because it has been deleted from the set of comparables in the case of Trilogy E-Business Software India Pvt. Ltd. (supra). No doubt this company has been deleted as a comparable in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) and this can be a good guidance to decide on the comparability in the case on hand also. This alone, however, will not suffice for the following reasons :-

(i) The assessee needs to demonstrate that the FAR analysis and other relevant facts of the Trilogy case are equally applicable to the facts of the assessee's case also. Unless the facts and the FAR analysis of Trilogy case is comparable to that of the

assessee in the case on hand, comparison between the two is not tenable.

(ii) After demonstrating the similarity and the comparability between the assessee and the Trilogy case, the assessee also needs to demonstrate that the facts applicable to the Assessment Year 2007-08, the year for which the decision in case of Trilogy E-Business Software India Pvt. Ltd. (supra) was rendered are also applicable to the year under consideration i.e. Assessment Year 2008-09.

9.5.3 It is a well settled principle that the assessee is required to perform FAR analysis for each year and it is quite possible that the FAR analysis can be different for each of the years. That being so, the principle applicable to one particular year cannot be extrapolated automatically and made applicable to subsequent years. To do that, it is necessary to first establish that the facts and attendant factors have remained the same so that the factors of comparability are the same. Viewed in that context, the assessee has not discharged the onus upon it to establish that the decision rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) can be applied to the facts of the case and that too of an earlier year i.e. Assessment Year 2007-08. The assessee, in our view, has not demonstrated that the facts of Trilogy E-Business Software India Pvt. Ltd. (supra) are identical to the facts of the case on hand and that the profile of the assessee for the year under consideration is similar to that of the earlier Assessment Year 2007-08. In view of facts as discussed above, we deem it fit to remand the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh by considering the above observations. The TPO is directed to make available to the assessee information obtained under section 133(6) of the Act and to afford the assessee adequate opportunity of being heard and to make its submissions in the matter, which shall be duly considered before passing orders thereon. It is ordered accordingly.”

The learned Authorised Representative submits that this company was selected as a comparable by the TPO not by any FAR analysis or as per the search process conducted by the TPO, but only as an additional comparable for the reason that it was selected as a comparable in the earlier year i.e. Assessment Year 2007-08 on the basis of information obtained under section

133(6) of the Act. In this regard, the learned Authorised Representative took us through the relevant portions of the TP order under section 92CA of the Act and the show cause notices for both the earlier year i.e. Assessment Year 2007-08 and for this year and contended that the selection of this company as a comparable violates the principle enunciated in Curram Software International Pvt. Ltd. (supra) that a company can be selected as a comparable only on the basis of FAR analysis conducted for that year and therefore pleaded for its exclusion. The learned Authorised Representative also submitted that he has brought on record sufficient evidence to show that the functional profile of this company remains unchanged from the earlier year and hence the findings rendered by the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) and in other cases like Trilogy E-Business Software India Pvt. Ltd. (supra) are applicable to the year under consideration as well.

7.5 Per contra, the learned Departmental Representative supported the order of the TPO / DRP for inclusion of this company Avani Cincom Technologies Ltd. in the final set of comparables.

7.6.1 We have heard both parties and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the final set of comparables only on the basis of information obtained under section 133(6) of the Act. In these circumstances, it was the duty of the TPO to have necessarily furnished the information so gathered to the assessee and taken its submissions thereon into consideration before deciding to include this company in its final list of comparables. Non-furnishing the information obtained under section 133(6) of the Act to the assessee has vitiated the selection of this company as a comparable.

7.6.2 We also find substantial merit in the contention of the learned Authorised Representative that this company has been selected by the TPO as an additional comparable only on the ground that this company was selected in the earlier year. Even in the earlier year, it is seen that this company was not selected on the basis on any search process carried out by the TPO but only on the basis of information collected under section 133(6) of the Act. Apart from placing reliance on the judicial decision cited

above, including the assessee's own case for Assessment Year 2007-08, the assessee has brought on record evidence that this company is functionally dis-similar and different from the assessee and hence is not comparable. Therefore the finding excluding it from the list of comparables rendered in the immediately preceding year is applicable in this year also. Since the functional profile and other parameters by this company have not undergone any change during the year under consideration which fact has been demonstrated by the assessee, following the decisions of the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013, and in the case of Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011), we direct the A.O./TPO to omit this company from the list of comparables.

9. **Celestial Biolabs Ltd.**

9.1 This comparable was selected by the TPO for inclusion in the final list of comparables. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables for the reasons that it is functionally different from the assessee and that it fails the employee cost filter. The TPO, however, brushed aside the objections raised by the assessee by stating that the objections of functional dissimilarity has been dealt with in detail in the T.P. order for Assessment Year 2007-08. As regards the objection raised in respect of the employee cost filter issue, the TPO rejected the objections by observing that the employee cost filter is only a trigger to know the functionality of the company.

9.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable, as the company is into bio-informatics software product / services and the segmental break up is not provided. It was submitted that:-

- (i) This company is engaged in the development of products in the field of bio-technology, pharmaceuticals, etc. and therefore is not functionally comparable to the assessee;
- (ii) This company has been held to be functionally incomparable to software service providers by the decision of the co-ordinate

bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra);

(iii) The co-ordinate bench of this Tribunal in its order in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) at para 43 thereof had observed about this company that –

“ As explained earlier, it is a diversified company and therefore cannot be considered as comparable functionally with the assessee. There has been no attempt to identify, eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustments, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the assessee in this regard.”

(iv) The rejection / exclusion of this company as a comparable for Assessment Year 2007-08 for software service providers has been upheld by the co-ordinate benches of this Tribunal in the cases of LG Soft India Pvt. Ltd. in ITA No.112/Bang/2011, CSR India Pvt. Ltd. in IT(TP)A No.1119/Bang/2011 and by the ITAT, Delhi Bench in the case of Transwitch India Pvt. Ltd. in ITA No.6083/Del/2010.

(v) The facts pertaining to this company has not changed from Assessment Year 2007-08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the instant case and hence ought to be rejected. In support of this contention, the assessee has also referred to and quoted from various parts of the Annual Report of the company.

9.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparable companies. The learned Departmental Representative submitted that the decisions cited and relied on by the assessee are for Assessment Year 2007-08 and therefore there cannot be an assumption that it would continue to be applicable for the period under consideration i.e. Assessment Year 2008-09.

9.4.1 We have heard both the parties and perused and carefully considered the material on record. While it is true that the decisions cited and relied on by the assessee were with respect to the immediately previous assessment year, and there cannot be an

assumption that it would continue to be applicable for this year as well, the same parity of reasoning is applicable to the TPO as well who seems to have selected this company as a comparable based on the reasoning given in the TPO's order for the earlier year. It is evidently clear from this, that the TPO has not carried out any independent FAR analysis for this company for this year viz. Assessment Year 2008-09. To that extent, in our considered view, the selection process adopted by the TPO for inclusion of this company in the list of comparables is defective and suffers from serious infirmity.

9.4.2 Apart from relying on the afore cited judicial decisions in the matter (supra), the assessee has brought on record substantial factual evidence to establish that this company is functionally dissimilar and different from the assessee in the case on hand and is therefore not comparable and also that the findings rendered in the cited decisions for the earlier years i.e. Assessment Year 2007-08 is applicable for this year also. We agree with the submissions of the assessee that this company is functionally different from the assessee. It has also been so held by co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) as well as in the case of Trilogy E-Business Software India Pvt. Ltd. (supra). In view of the fact that the functional profile of and other parameters of this company have not changed in this year under consideration, which fact has also been demonstrated by the assessee, following the decision of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 and Trilogy E-Business Software India Pvt. Ltd. in ITA No.1054/Bang/2011, we hold that this company ought to be omitted from the list of comparables. The A.O./TPO are accordingly directed.

10. **KALS Information Systems Ltd.**

10.1 This is a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on grounds of functional differences and that the segmental details have not been provided in the Annual Report of the company with respect to software services revenue and software products revenue. The TPO, however, rejected the objections of the assessee observing that the software products and training constitutes only 4.24% of total revenues

and the revenue from software development services constitutes more than 75% of the total operating revenues for the F.Y. 2007-08 and qualifies as a comparable by the service income filter.

10.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee and ought to be rejected / excluded from the list of comparables for the following reasons :-

(i) This company is functionally different from the software activity of the assessee as it is into software products.

(ii) This company has been held to be functionally not comparable to software service providers for Assessment Year 2007-08 by the co-ordinate bench of this Tribunal in the assessee's own case. This company has been held to be different from a software development company in the decision of the Tribunal in the case of Bindview India Pvt. Ltd. V DCIT in ITA No.1386/PN/2010.

(iii) The rejection of this company as a comparable has been upheld by co-ordinate benches of the Tribunal in the case of –

(a) Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011).

(b) LG Soft India Pvt. Ltd. (IT (TP) A No.112/Bang/2011)

(c) CSR India Pvt. Ltd. (IT (TP) A No.1119/Bang/2011) and

(d) Transwitch India Pvt. Ltd. (IA No.6083/Del/2010)

(iv) The facts pertaining to this company has not changed from Assessment Year 2007-08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the case on hand and hence ought to be excluded from the list of comparables. In support of this contention, the learned Authorised Representative drew our attention to various parts of the Annual Report of this company.

(v) This company is engaged not only in the development of software products but also in the provision of training services as can be seen from the website and the Annual Report of the company for the year ended 31.3.2008.

(vi) This company has two segments; namely,

- a) Application Software Segment which includes software product revenues from two products i.e. 'Virtual Insure' and 'La-Vision' and
- b) The Training segment which does not have any product revenues.

10.3 Per contra, the learned Departmental Representative contended that the decision of the co-ordinate bench of the Tribunal in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) was rendered with respect to F.Y.2006-07 and therefore there cannot be an assumption that it would continue to be applicable to the year under consideration i.e. A.Y. 2008-09. To this, the counter argument of the learned Authorised Representative is that the functional profile of this company continues to remain the same for the year under consideration also and the same is evident from the details culled out from the Annual Report and quoted above (supra).

10.4 We have heard both parties and perused and carefully considered the material on record. We find from the record that the TPO has drawn conclusions as to the comparability of this company to the assessee based on information obtained u/s.133(6) of the Act. This information which was not in the public domain ought not to have been used by the TPO, more so when the same is contrary to the Annual Report of the company, as pointed out by the learned Authorised Representative. We also find that the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) and in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) have held that this company was developing software products and was not purely or mainly a software service provider. Apart from relying of the above cited decisions of co-ordinate benches of the Tribunal (supra), the assessee has also brought on record evidence from various portions of the company's Annual Report to establish that this company is functionally dis-similar and different form the assessee and that since the findings rendered in the decisions of the co-ordinate benches of the Tribunal for Assessment Year 2007-08 (cited supra) are applicable for this year i.e. Assessment Year 2008-09 also, this company ought to be excluded from the list of comparables. In this view of the matter, we hold that this company i.e. KALS Information Systems Ltd.,

is to be omitted from the list of comparable companies. It is ordered accordingly.

11.0 Infosys Technologies Ltd.

11.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected these objections raised by the assessee on the grounds that turnover and brand aspects were not materially relevant in the software development segment.

11.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee in the case on hand. The learned Authorised Representative drew our attention to various parts of the Annual Report of this company to submit that this company commands substantial brand value, owns intellectual property rights and is a market leader in software development activities, whereas the assessee is merely a software service provider operating its business in India and does not possess either any brand value or own any intangible or intellectual property rights (IPRs). It was also submitted by the learned Authorised Representative that :-

(i) the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010 has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any intangible and hence does not have an additional advantage in the market. It is submitted that this decision is applicable to the assessee's case, as the assessee does not own any intangibles and hence Infosys Technologies Ltd. cannot be comparable to the assessee ;

(ii) the observation of the ITAT, Delhi Bench in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856 (Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and market leader assuming all risks leading to higher profits cannot be considered as comparable to captive service providers assuming limited risk ;

- (iii) the company has generated several inventions and filed for many patents in India and USA ;
- (iv) the company has substantial revenues from software products and the break up of such revenues is not available ;
- (v) the company has incurred huge expenditure for research and development;
- (vi) the company has made arrangements towards acquisition of IPRs in 'AUTOLAY', a commercial application product used in designing high performance structural systems.

In view of the above reasons, the learned Authorised Representative pleaded that, this company i.e. Infosys Technologies Ltd., be excluded from the list of comparable companies.

11.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that comparability cannot be decided merely on the basis of scale of operations and the brand attributable profit margins of this company have not been extraordinary. In view of this, the learned Departmental Representative supported the decision of the TPO to include this company in the list of comparable companies.

11.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) for Assessment Year 2007-08 is applicable to this year also. We are inclined to concur with the argument put forth by the assessee that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly.

12. **Wipro Ltd.**

12.1 This company was selected as a comparable by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables on several grounds like functional dis-similarity, brand value, size, etc. The TPO, however, brushed aside the objections of the assessee and included this company in the set of comparables.

12.2 Before us, the learned Authorised Representative of the assessee contended that this company i.e. Wipro Ltd., is not functionally comparable to the assessee for the following reasons:-

(i) This company owns significant intangibles in the nature of customer related intangibles and technology related intangibles, owns IPRs and has been granted 40 registered patents and has 62 pending applications and its Annual Report confirms that it owns patents and intangibles.

(ii) the ITAT, Delhi observation in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856(Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and a market leader assuming all risks leading to higher profits, cannot be considered as comparable to captive service providers assuming limited risk;

(iii) the co-ordinate bench of the ITAT, Mumbai in the case of Telecordia Technologies India Pvt. Ltd. (ITA No.7821/Mum/2011) has held that Wipro Ltd. is not functionally comparable to a software service provider.

(iv) this company has acquired new companies pursuant to a scheme of amalgamation in the last two years.

(v) Wipro Ltd. is engaged in both software development and product development services. No information is available on the segmental bifurcation of revenue from sale of products and software services.

(vi) the TPO has adopted consolidated financial statements for comparability purposes and for computing the margins, which is in contradiction to the TPO's own filter of rejecting companies with consolidated financial statements.

12.3 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

12.4.1 We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison.

12.4.2 We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration.

13. **Tata Elxsi Ltd.**

13.1 This company was a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on several counts like, functional dis-similarity, significant R&D activity, brand value,

size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.

13.2 Before us it was reiterated by the learned Authorised Representative that this company is not functionally comparable to the assessee as it performs a variety of functions under software development and services segment namely – a) product design, (b) innovation design engineering and (c) visual computing labs as is reflected in the annual report of the company. The learned Authorised Representative submitted that,

(i) The co-ordinate bench of the Mumbai Tribunal in the case of Telecordia Technologies Pvt. Ltd. (supra) has held that Tata Elxsi Ltd. is not a functionally comparable for a software development service provider.

(ii) The facts pertaining to Tata Elxsi Ltd. have not changed from the earlier year i.e. Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09 and therefore this company cannot be considered as a comparable to the assessee in the case on hand.

(iii) Tata Elxsi Ltd. is predominantly engaged in product designing services and is not purely a software development service provider. In the Annual Report of this company the description of the segment ‘software development services’ relates to design services and are not to software services provided by the assessee.

(iv) Tata Elxsi Ltd. invests substantial funds in research and development activities which has resulted in the ‘Embedded Product Design Services Segment’ of the company to create a portfolio of reusable software components, ready to deploy frameworks, licensable IPs and products.

The learned Authorised Representative pleads that in view of the above reasons, Tata Elxsi Ltd. is clearly functionally different / dis-similar from the assessee and therefore ought to be omitted from the list of comparables.

13.3 Per contra, the learned Departmental Representative supported the stand of the TPO in including this company in the list of comparables.

13.4.1 We have heard both parties and carefully perused and considered the material on record. From the details on record, we find that this company is predominantly engaged in product designing services and not purely software development services. The details in the Annual Report show that the segment “software development services” relates to design services and are not similar to software development services performed by the assessee.

13.4.2 The Hon'ble Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. V ACIT (ITA No.7821/Mum/2011) has held that Tata Elxsi Ltd. is not a software development service provider and therefore it is not functionally comparable. In this context the relevant portion of this order is extracted and reproduced below :-

“ Tata Elxsi is engaged in development of niche product and development services which is entirely different from the assessee company. We agree with the contention of the learned Authorised Representative that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable portion.”

As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.

14. **E-Zest Solutions Ltd.**

14.1 This company was selected by the TPO as a comparable. Before the TPO, the assessee had objected to the inclusion of this company as a comparable on the ground that it was functionally different from the assessee. The TPO had rejected the objections raised by the assessee on the ground that as per the information

received in response to notice under section 133(6) of the Act, this company is engaged in software development services and satisfies all the filters.

14.2 Before us, the learned Authorised Representative contended that this company ought to be excluded from the list of comparables on the ground that it is functionally different to the assessee. It is submitted by the learned Authorised Representative that this company is engaged in 'e-Business Consulting Services', consisting of Web Strategy Services, I T design services and in Technology Consulting Services including product development consulting services. These services, the learned Authorised Representative contends, are high end ITES normally categorised as knowledge process Outsourcing ('KPO') services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorised Representative submits that since the Annual Report of the company does not contain detailed descriptive information on the business of the company, the assessee places reliance on the details available on the company's website which should be considered while evaluating the company's functional profile. It is also submitted by the learned Authorised Representative that KPO services are not comparable to software development services and therefore companies rendering KPO services ought not to be considered as comparable to software development companies and relied on the decision of the co-ordinate bench in the case of Capital IQ Information Systems (India) (P) Ltd. in ITA No.1961(Hyd)/2011 dt.23.11.2012 and prayed that in view of the above reasons, this company i.e. e-Zest Solutions Ltd., ought to be omitted from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparables by the TPO.

14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services

performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of Capital I-Q Information Systems (India) (P) Ltd. Supra) that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company, i.e. e-Zest Solutions Ltd. be omitted from the set of comparables for the period under consideration in the case on hand. The A.O. / TPO is accordingly directed.

17. **Persistent Systems Ltd.**

17.1.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing and analytic services, it is functionally different and further that segmental results are not available. The TPO rejected the assessee's objections on the ground that as per the Annual Report for the company for Financial Year 2007-08, it is mainly a software development company and as per the details furnished in reply to the notice under section 133(6) of the Act, software development constitutes 96% of its revenues. In this view of the matter, the Assessing Officer included this company i.e. Persistent Systems Ltd., in the list of comparables as it qualified the functionality criterion.

17.1.2 Before us, the assessee objected to the inclusion of this company as a comparable submitting that this company is functionally different and also that there are several other factors on which this company cannot be taken as a comparable. In this regard, the learned Authorised Representative submitted that :

(i) This company is engaged in software designing services and analytic services and therefore it is not purely a software development service provider as is the assessee in the case on hand.

(ii) Page 60 of the Annual Report of the company for F.Y. 2007-08 indicates that this company, is predominantly engaged in 'Outsourced Software Product Development Services' for independent software vendors and enterprises.

(iii) Website extracts indicate that this company is in the business of product design services.

(iv) The ITAT, Mumbai Bench in the case of Telecordia Technologies India Pvt. Ltd. (supra) while discussing the comparability of another company, namely Lucid Software Ltd. had rendered a finding that in the absence of segmental information, a company be taken into account for comparability analysis. This principle is squarely applicable to the company presently under consideration, which is into product development and product design services and for which the segmental data is not available.

The learned Authorised Representative prays that in view of the above, this company i.e. Persistent Systems Ltd. be omitted from the list of comparables.

17.2 Per contra, the learned Departmental Representative support the action of the TPO in including this company in the list of comparables.

17.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (supra) that in the absence of segmental details / information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems Ltd. ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly."

15. Since the Tribunal has taken a particular view with regard to these comparables, we find no justification in taking a contrary view. Accordingly, we confirm the order of the CIT(A) who has rightly excluded these comparables from the final set of comparables.

16. So far as Flextronics Software Systems Ltd., iGate Global Solutions Ltd., Sasken Communication Technologies Ltd. are concerned, it has been argued that these comparables were excluded by the CIT(Appeals) having applied the turnover filter. The turnover of these companies are more than 10 times the turnover of the assessee. This proposition of law has been laid down by the Tribunal in the case of *ACIT v. McAfee Software (India) Pvt. Ltd. in IT(TP)A No. 04/Bang/2012*, copy of which is placed on record.

17. The Id. DR, however, submitted that the turnover filter should not be applied as it cannot be criteria for exclusion of these comparables.

18. Having carefully examined the order of the Tribunal and the turnover of these comparables, we find that the turnover of these comparables is certainly 10 times more than the assessee. The Tribunal has been taking a consistent view that turnover filter will apply while selecting comparables in order to determine the ALP of the international transactions. We, however, for the sake of reference, extract the relevant observations of the Tribunal in the case of *ACIT v. McAfee Software (India) Pvt. Ltd. (supra)* hereunder:-

“8. As a general proposition, various filters are required to be adopted in selecting a company as a comparable. This is part of

FAR analysis. However, there cannot be rigid rule or percentage fixed in adopting various filters. Generally, a turnover filter is adopted to avoid selection of high end companies (big companies) with that of 'minnows' in the similar line of business. How to adopt the filter depends on each case. Say for example, in the TP analysis of a company having 20 Crores receipts, a company with 2 Crores to 200 Crores can be stated to be within the range i.e., factor of ten as upper and lower limits. In certain cases, the ITAT also accepted turnover filter of 1 Crore to 200 Crores. But the range cannot be fixed, as the facts may vary from case to case. Simply a comparable can not be excluded on upper turnover limit when infact in number of cases Assessee do not raise any objection on inclusion of companies with very small turnovers. The 200 Crores upper limit also cannot be considered in a case whose turnover is, say 300 Crores. Therefore, instead of a fixed 1cr – 200 Crore range, what one has to consider is the turnover/receipts of Assessee and range of upper limit at ten times and lower limit also ten times..i.e., one tenth. Thus, for example the range for a 300 Crores company can be from 30 Crores (1/10th) to 3000 Crores (Ten times). Even this has some limitations. For example if range is considered say 2 to 200 Crores, a comparable company cannot be rejected if the turnover is 1.99 Crores or say 201 Crores. There can be margin of variation. These are broad parameters so that no fixed formula can be adopted on uniform basis across all areas of functions. The same principles will also apply to related party transactions. In all the captive service providers, RPT is at 100%. So, some broad parameters, given the fact of the case, can only be considered. Considering these observations, Learned Counsel fairly admitted that they will not context the RPT filter and turnover filter issue and restricted the agreements to only the comparability of the cases on functionality. Accordingly, the issues on RPT, turnover filter and risk adjustment are considered not pressed.”

19. Since we have been taking a consistent view that by applying the turnover filter, comparables can be excluded, we therefore find no infirmity in the order of CIT(Appeals), who has rightly applied the turnover filter.

20. Softsol India Ltd. : The CIT(Appeals) having applied the RPT filter more than 15% has excluded this company as a comparable. In the instant case, the RPT was 18.3%. It has been repeatedly held that RPT filter is not a water tight compartment and where once it crosses 15%, the comparable has to be excluded. In a number of cases, we have confirmed the RPT percentage of 15 to 20%. In the instant case, since the RPT is 18.3%, we find no justification in exclusion of this comparable from the list of comparables. We therefore do not find ourselves in agreement with the order of CIT(Appeals), who has excluded this comparable from the list of comparables. We accordingly set aside the order of CIT(Appeals) and direct the TPO/AO to take into account this comparable while determining the ALP of the international transactions. Accordingly, the AO/TPO is directed to recompute the ALP in the terms indicated above.

21. The ground raised in the CO is with regard to deduction u/s. 10A of the Act. In this regard, it has been contended that this issue is squarely covered by the judgment of the Hon'ble jurisdictional High Court in the case of *CIT v. Tata Elxsi Ltd., 349 ITR 98 (Karn)*, in which it has been held that once a particular item is to be excluded from the export turnover, it should also be excluded from the total turnover. We accordingly following the same, set aside the order of the CIT(Appeals) and restore the matter to the file of Assessing Officer with a direction to recompute the deduction u/s. 10A following the judgment of the Hon'ble jurisdictional High Court in the case of *CIT v. Tata Elxsi Ltd. (supra)*.

22. Regarding other grounds with regard to adjustment of ALP, we find no force in the contention of the assessee, as these grounds were not effectively argued by the Id. Counsel. Accordingly we reject the same.

23. In the result, the appeal of revenue as well as CO of the assessee is partly allowed for statistical purposes.

Pronounced in the open court on this 22nd day of February, 2017.

Sd/-

(S. JAYARAMAN)
Accountant Member

Sd/-

(SUNIL KUMAR YADAV)
Judicial Member

Bangalore,
Dated, the 22nd February, 2017.

/ D S /

Copy to:

1. Revenue
2. Assessee
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.