

IN THE INCOME TAX APPELLATE TRIBUNAL

“B” BENCH : BANGALORE

BEFORE SHRI A. K. GARODIA, ACCOUNTANT MEMBER AND

SMT ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

Assessee’s Appeal

ITA No.657/Bang/2011
Assessment year : 2005-06

M/s. Infineon Technologies India Ltd., 3 rd Floor, Phase-I, Kalyani Platina, Survey No. 6 & 24, Kundalahalli Village, K. R. Puram Hobli, Bangalore – 560 066. PAN : AABCS 6967 N	Vs.	Assistant Commissioner of Income Tax, Circle – 11(4), Bangalore.
APPELLANT		RESPONDENT

Revenue’s Appeal

ITA No.608/Bang/2011
Assessment year : 2005-06

Assistant Commissioner of Income Tax, Circle – 11(4), Bangalore.	Vs.	M/s. Infineon Technologies India Ltd., Bangalore – 560 066. PAN : AABCS 6967 N
APPELLANT		RESPONDENT

Revenue by	:	Ms. Neera Malhotra, CIT (DR)
Assessee by	:	Shri. K. R. Vasudevan, Advocate

Date of hearing	:	17.10.2016
Date of Pronouncement	:	06.01.2017

O R D E R

Per Asha Vijayaraghavan, Judicial Member

These are cross appeals filed by the appellant.

2. Briefly, the facts of the case are as follows:

The assessee is a 100% export oriented unit established under the software technology park scheme. The appellant is primarily engaged in the business of software development services of electronic integrated circuits and firmware development of integrated circuits. The appellant also provides marketing support services to its parent company.

3. The grounds of appeal by the assessee are:

I. ✓ Transfer Pricing

The learned Commissioner of Income-tax (Appeals) [hereinafter referred to as “the learned CIT (A)”] erred in determining that the international transactions of Infineon Technologies India Private Limited (hereinafter referred as ‘ITIPL’ or ‘the appellant’) with its Associated Enterprises are not at Arm’s Length Price.

- ✓ 1.1 The learned CIT(A) ought to have appreciated the fact that the margin earned by the appellant is reflective of services rendered by a contract service provider.
- ✓ 1.2 The learned CIT(A) has erroneously upheld the Transfer Pricing Officer’s (hereinafter referred to as ‘TPO’) contention of rejecting Cost Plus Method as the most appropriate method.
- ✓ 1.3 The Learned CIT(A) has erred in not accepting the details of direct and indirect expenses provided by the appellant in arriving at the gross margins of the appellant and the comparable companies;
- ✓ 1.4 The learned CIT(A) has erred in accepting the TPO’s contention that the Transactional Net Margin Method (TNMM) as the most appropriate method in determining the arm’s length price of the international transactions.
- ✓ 1.5 The learned CIT(A) has erred in accepting the data provided by the learned TPO wherein the TPO has obtained the data through 133(6) route which renders an unfair advantage for the TPO to accept / reject companies by selecting comparable companies which satisfies his filters, but would not have selected if information was limited to publicly available data in relation to the company. The learned CIT(A) ought to have appreciated that the power conferred under Section 133(6) of the Income Tax Act, 1961, ought to be employed in such a manner so as to comply with the provisions of judiciousness as well as with the principles of natural justice.

1.6 The learned CIT(A) erred in concluding that the appellant ought to have employed contemporaneous data in the preparation of the Transfer Pricing report.

1.7 The learned CIT(A) has erred in accepting the following filters applied by the TPO namely:

- a) Rejection of comparable companies with different year ending filter (other than March 2005);
- b) Rejection of comparable companies having onsite income greater than 75% of the operating revenue;
- c) Rejection of comparable companies with related party transactions of greater than 25% of the operating sales. The learned CIT(A) ought have rejected all the comparable companies where the related party transactions is greater than 0% of the operating sales.

1.8 The learned CIT(A) has erred in accepting the contention of the learned TPO that the following companies are to be rejected on the criterion that the employee cost is less than 25% of the revenue:

- a. Quintegra Solutions Limited;
- b. Netvista Information Technology Limited; and
- c. Orient Information Technology Limited.

1.9 Rejection of comparable companies having extreme high profits

The learned CIT(A) has rejected certain comparable companies on the contention that the comparable companies have abnormal high profits. However, the learned CIT(A) erred in not rejecting the following comparable companies with abnormal growth / extreme high profit margin rate:

- i. Sankhya Infotech Limited;
- ii. Flextronics Software Services Private Limited (seg).

1.10 Rejection of low margin comparable companies

The learned CIT(A) has erred in concluding that the extremely low margins companies has to be excluded while determining the profit level indicator. However, the learned CIT(A) in his order has not explained the basis on which the comparable companies are to be considered as extremely low margins and has inadvertently rejected the comparable companies proposed by the TPO for which the net margin are lower than 12%.

1.11 The learned CIT(A) has erred by accepting the following comparable companies, which are not comparable to the appellant company:

SL No.	Name of the Company	Contentions of the appellant for rejecting the comparable company
1.	Foursoft Ltd	<ul style="list-style-type: none"> ▪ Engaged in sale of products; ▪ Substantial selling and marketing expenses; and ▪ Related Party Transactions greater than 0%.
2.	Geometric Software Solutions Co Ltd	<ul style="list-style-type: none"> ▪ Related Party Transactions greater than 0%; ▪ Owns Intellectual property; and ▪ Services are in the nature of design and

		engineering services.
3.	Sankhya Infotech	<ul style="list-style-type: none"> ▪ Engaged in sale of products; ▪ Substantial selling and marketing expenses; ▪ Extreme high profit company; and ▪ Owns Intellectual property & Patent.
4.	Sasken Network System	<ul style="list-style-type: none"> ▪ Substantial selling and marketing expenses.
5.	Sasken Communication Technologies Ltd	<ul style="list-style-type: none"> ▪ Engaged in sale of products; and ▪ Substantial selling and marketing expenses.
6.	Tata Elxsi Ltd	<ul style="list-style-type: none"> ▪ Services are in the nature of product engineering and design services.
7.	Flextronics Software Services Private Limited (seg)	<ul style="list-style-type: none"> ▪ Extreme high profit company; and ▪ Related Party Transactions greater than 0%.

1.12 Notwithstanding and without prejudice to the contention that the comparable companies proposed by the TPO ought to be rejected and comparable companies proposed by the appellant has to be considered, the learned CIT(A) erred in considering the working capital adjustment of the comparable companies proposed by the TPO on an adhoc percentage of 2% instead of 2.66% as proposed by the TPO.

1.13 Market Risk Adjustment

- a. The learned CIT(A) has erred in accepting the learned TPO's rejection of market risk adjustment submitted by the appellant based on the Capital Asset Pricing Model (CAPM) model.
- b. The learned CIT(A) has erred in not appreciating the difference in the functional profile that exists between the appellant who functions in the role of a captive service provider vis-a-vis the independent unrelated comparable companies, who operate in the capacity of entrepreneurial entities.

1.14 The learned CIT(A) ought to have observed that the parent company of the appellant has been incurring consistent losses, whereas the appellant is earning a margin commensurate with its functions performed, assets deployed and risks assumed.

1.15 Benefit of +/-5%

The learned CIT(A) has erred in computing the benefit of +/-5%, which is rightly provided by the learned CIT(A) in determining the arm's length price of the international transactions of the appellant.

1.16 Transfer Pricing – an anti-avoidance legislation

- a. The honourable CIT (A) ought to have appreciated that Transfer Pricing provisions are in the form of an anti-avoidance legislation and that such provisions are required to be interpreted on the rules of strict interpretation. In the absence of fraudulent manipulation of Transfer Prices or an intention on the part of the appellant to shift profits from the jurisdiction of India, the Transfer Pricing provisions ought not to be applied.
- b. The honorable CIT (A) ought to appreciate the fact that the appellant is registered as an STPI unit and has claimed tax benefit under section 10A of the Income Tax Act 1961.

4. The appellant had filed the Return of Income for the Assessment Year 2005-06 on 31st October, 2005, declaring taxable income as NIL under the regular provisions of the Income Tax Act, 1961 (“the Act”) and paid taxes on book profits under section 115JB of the Act.

5. The return was assessed by the Assistant Commissioner of Income-Tax, Circle-11(4), Bangalore (hereinafter referred to as the Assessing Officer) under section 143(3) vide order dated 31st December, 2008 and received by the appellant on 1st January, 2008.

6. In the assessment order, the Assessing Officer has made the following adjustments/additions in the said Order:

Adjustment under Transfer Pricing under section 92CA of the Act

The learned assessing officer made a reference to the Additional Director of Income Tax (Transfer Pricing) (hereinafter referred to as “TPO”) to examine the international transactions between the appellant and its Associated Enterprises(AEs).

The appellant had entered into an arrangement with its AE for provision of software development services and marketing support services.

7. The appellant has given their written submissions wherein they have quoted extensively from various tribunal judgments which are actually case specific. Also the appellant has quoted from the OECD guidelines. After examining the appellant’s written submission and having gone through the TPO’s order it is held that the TPO after doing extensive analysis has computed the ALP based on the TNMM. Even the appellant had selected

TNMM as most appropriate method for determining of ALP in earlier years as mentioned by the TPO in para 7.1 in page 32 of his order. The TPO has discussed at length the reasons for rejection of cost plus method and the CUP method in his detailed discussion in para 7 page 25 to 32 and has categorically concluded the TNMM as the most appropriate method and it is held that TPO's finding in respect of selection of the most appropriate method as TNMM is in order. As can be seen from the detailed analysis of the TPO, it is seen that the filters adopted by the TPO are in order as most similar cases as that of the appellant are chosen by applying filters like companies whose software income is less than one crore, whose related party transactions are more than 25% of the sales, whose export sales are less than 25% of the total sales, companies incurring losses year after year companies having different financial years other than YE 31.03.2005. Even the TPO has considered 02 comparables as given by the appellant. Finally, the TPO zeroed in on 594 comparables, rejected 577 out of them by applying filters and accepted 17 as comparable cases. Subsequently, after accepting 02 comparables, total comparables were determined at 17. The TPO finally arrived at 17 comparables and determined the average OP to total cost at 26.59%. From the TPO's order it is very clear that the TPO has used contemporaneous data as against appellant's adoption of earlier year's data. The TPO has extensively searched "prowess", "capital line" and NASSCOM website while zeroing on the comparables. Accordingly, it is held that the TPO had done exceptional work and only after giving opportunities to the appellant has worked out the PLI and accordingly the appellant's arguments on all these grounds cannot be accepted except in respect of the following:

- Allowance of 5% standard deduction
- Exclusion of super profit/wide variation OP to cost companies.

8. Aggrieved with the order of the CIT (A), Bangalore dated 02/03/2011 the assessee preferred an appeal before Hon'ble ITAT. The learned counsel for the assessee pointed out that at page 20, para 4.5 of the order of the CIT(A) wherein he had discussed about the comparables selected by the TPO. The CIT (A) had held as follows:

“Accordingly, it is held that the TPO had done exceptional work and only after giving opportunities to the appellant has worked out the PLI and accordingly the appellant’s arguments on all these grounds cannot be accepted except in respect of the following:

- *Allowance of 5% standard deduction*
- *Exclusion of super profit/wide variation OP to cost companies.*

9. The learned counsel for the assessee also submitted that the CIT(A) had not applied his mind and had given a general statement that the TPO had done exceptional work. We have perused the order of the CIT(A). We find that the CIT(A) has not given any reasons for the comparables to have been rejected by the TPO or elaborately dealt with the issue. The absence of reasoned order by the CIT(A) has prevailed on us to send back the issue to the file of the TPO to pass a denova order to determine the PLI after giving reasonable opportunity to the assessee to present its case.

10. The learned counsel for the assessee stated that grounds 1 to 1.10 is not pressed. The learned counsel also stated that he was pressing ground No. 1.11 and ground Nos. 1.12, 1.13, 1.14, 1.15 and 1.16 are not pressed. The learned counsel by way of additional grounds raised ground No. 1.17 which is as follows:

The depreciation cost as a percentage of the cost of the appellant during the financial year 2004-05 is significantly different from that of the comparable companies.

The difference in the depreciation cost arises due to differences in the accounting treatment across the comparable companies and the appellant.

Considering the above fact, to achieve reliable comparability, the margins of the comparable companies should be adjusted for differences in depreciation cost of comparable companies and tested party.

11. We heard both the parties. We are of the opinion that when applying the arm's length principle, the conditions of a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that: none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin). In case, there are any such differences, reasonably accurate adjustments need to be made to eliminate the effect of any such differences. There are differences in the treatment across enterprises of operating expenses and non-operating expenses particularly of depreciation affecting the net profits. Such differences should be reckoned in order to achieve reliable comparability between the taxpayer and the third party comparable companies. Hence, it is essential to perform a depreciation adjustment to bridge the disparities between appellant and the comparable companies selected by the TPO.

Therefore, it is necessary to make appropriate adjustments for depreciation while benchmarking the Appellant with comparable companies. Hence we send back this issue to the file of TPO who shall follow our directions.

12. The learned counsel also raised additional grounds 1.18 to 1.21 which are as follows:

Ground No.1.18: Exensys Software Solutions Limited should be rejected as comparable companies.

The Appellant submits that the Ld. CIT(A) has erred in not adjudicating Exensys Software Solutions Limited on the basis of functional comparability and rejecting the comparable company only on the basis of super profits.

Ground No. 1.19: Thirdware Solutions Limited should be rejected as comparable companies.

The appellant submits that the Ld. CIT(A) has erred in not adjudicating Thirdware Solutions Limited on the basis of functional comparability and rejecting the comparable company only on the basis of super profits.

Ground No. 1.20: Infosys Limited should be rejected as comparable companies.

The Appellant submits that the Ld. CIT(A) has erred in not adjudicating Infosys Limited on the basis of functional comparability and rejecting the comparable company only on the basis of super profits.

Ground No. 1.21: Bodhtree Consulting Limited should be rejected as a comparable company

The Appellant submits that the Ld. CIT (A) has erred in including Bodhtree as a comparable company to the Appellant, while doing the comparability analysis.

13. With respect to the additional grounds, following the decisions in the case of M/s. Quark Systems we adjudicate as follows:

“Per contra, learned DR strongly objecting admission of above additional grounds submitted that in case these were admitted, the comparability of the concerned companies had to be referred back to the AO/TPO for verification fresh.

After considering the averments of the counsels with regard to admission of additional grounds, we find force in contention of the learned AR that by virtue of Special Bench decision in the case of M/s. Quark Systems Pvt. Ltd., (Supra), assessee can raise additional grounds seeking exclusion of comparables selected by it or not objected by it before the lower authorities. However, the Hon’ble Punjab & Haryana High Court in (2011) 62 DTR 0182 had upheld the Special Bench decision in the case of M/s Quark Systems Pvt. Ltd., (Supra) specifically noting that the Special Bench had remitted the issue of comparability of such companies to the AO/TPO for verification afresh. Hence, we are admitting the additional grounds

and we set aside the issues to the file of AO/TPO to adjudicate on the same.

14. The learned counsel also pointed out that M/s. Bodhtree Consulting Ltd., is functionally not comparable to that of the assessee company and relied on the decision of the Arm Embedded Technologies Pvt. Ltd., in IT(TP)A No. 1659/Bang/2014.

15. Further, the appellant submitted that Bodhtree provides e-paper solutions, data cleansing software, website development and other customized software and that the e-paper solutions and data cleansing services would come under category of Information Technology enabled services making it functionally not comparable to the Appellant which is involved in the software development services. The Appellant also submitted that the Bodhtree has significant related party transaction of export sales to Perigon LIC, USA of INR 133.90 lakhs, being 34.68% of the total turnover.

16. Hence, admitting the additional ground we set aside this comparable to file of the AO/TPO in order to decide whether it is to be included in the set of comparables taken by TPO.

17. With respect to 1.11, the assessee's contention for rejection of the comparable company is given below:

Sl. No.	Name of the Company	Contentions of the appellant for rejecting the comparable company
1.	Foursoft Ltd.,	Engaged in sale of products; Substantial selling and marketing expenses; and

		Related Party Transactions greater than 0%
2.	Geometric Software Solutions Co Ltd.,	Related Party Transactions greater than 0%; Owns Intellectual property; and Services are in the nature of design and engineering services.
3.	Sankhya Infotech	Engaged in sale of products; Substantial selling and marketing expenses; Extreme high profit company; and Owns Intellectual property & Patent.
4.	Sasken Network System	Substantial selling and marketing expenses.
5.	Sasken Communication Technologies Ltd.,	Engaged in sale of products; and Substantial selling and marketing expenses.
6.	Tata Elxsi Ltd.,	Services are in the nature of product engineering and design services.
7.	Flextronics Software Services Private Limited (seg)	Extreme high profit company; and Related Party Transactions greater than 0%.

18. We find that 7 companies are to be rejected/excluded from the list of comparables for the reasons given in the chart. Hence we direct the TPO to exclude 7 companies stated in 1.11.

19. The TPO shall rework the PLI after following the directions given by us with respect to ground No. 1.11 and also the additional grounds which are being restored to his file.

Revenue's Appeal (ITA No.608/Bang/2011):**Grounds of appeal:**

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 (Appeals) was not justified in directing the AO to recompute the deduction allowable u/s. 10A of I.T.Act, 1961 after reducing the telecommunication expenses amounting to Rs. 50,91,950-00 both from the export turnover and the total turnover, without appreciating the facts and circumstances of the case.
3. The learned CIT (Appeals) has erred in not appreciating that there is no provision in section 10A, which requires the telecommunication expenses reduced from the export turnover as per clause(iv) of Explanation 2 to section 10A, to be reduced from the total turnover also.
4. The Learned CIT(Appeals) was not justified in allowing relief of 8,64,61,706/- out of the adjustment made by the Assessing Officer u/s 92CA of the I.T. Act, 1961, by directing the Assessing Officer to adopt the mean PLI of 20.027% as reduced by 5%, i.e. at 15.027%, without appreciating the facts and circumstances under which the adjustment was made by the Assessing Officer based on the TPO's order.
5. The Learned CIT (Appeals) was not justified in holding that the assessee was entitled to a standard deduction of 5% from the arithmetical mean of the profit margin of the comparables under the proviso to section 92C(2) of the I.T. Act, 1961 while computing the arm's length price (ALP).
6. The Learned CIT (Appeals) has erred in interpreting the second limb of the proviso to section 92C(2) of the I.T. Act, 1961 as it stood prior to the amendment brought about by the Finance (No.2) Act 2009 with effect from 01.10.2009 without taking into consideration the ITAT decision in the case of DCIT vs Global Vantage Pvt Ltd. (2010-TIOL-24-ITAT-DEL).
7. The Learned CIT (Appeals) has erred in relying on the CBDT Circular No.5/2010 dated 03.06.2010 where it has been clarified that the second proviso to section 92C(2) was applicable for the assessment year 2009-10 onwards, which was subsequently modified by CBDT by way of a corrigendum dt. 30.9.2010.

8. The Learned CIT (Appeals) has erred in directing the Assessing Officer to exclude 7 (seven) comparable companies as being super profit making cases and companies making profits at wide variance with the arithmetic mean of the PLI of the comparables, without appreciating the detailed reasons recorded in the TPO's order for the selection of such companies as functionally comparable companies following an elaborate search process and application of appropriate filters.
9. The Learned CIT (Appeals) has erred in following the order of the ITAT, Bangalore Bench in the case of SAP Labs Ltd. for the assessment year 2003-04 in ITA No.398 and 418/Bang/2008 dated 30.08.2010 without examining the facts and circumstances of the assessee's case in detail and without appreciating that the assessee company is not a risk mitigated company and that in the above mentioned ITAT decision, no bench marks have been laid down for categorizing a company as a super profit or low profit case.
10. The Learned CIT (Appeals) has erred in relying on the above mentioned ITAT, Bangalore Bench decision in the case of SAP Labs Ltd. without pointing out any peculiar economic conditions attributable to the so called super profit or low profits of the concerned companies.
11. The Learned CIT (Appeals) has erred in arriving at the adjusted mean PLI of 20.027% on pages 27 & 28 of the appellate order after deducting working capital adjustment of 2.0% as against 2.66% as worked out by the TPO which was based on the 17 (seventeen) comparables selected by the TPO, whereas, the working capital adjustment was required to be recomputed in consequence of the CIT (Appeals) direction to exclude 7 (seven) of the comparables selected by the TPO.
12. 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 in so far as the above mentioned issues are concerned and that of the assessing officer be restored.
13. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that may be urged at the time of hearing of the appeal.

Ground No. 1 is general in nature. Ground Nos. 2 and 3 are covered in the decision of the Hon'ble High Court in the case of Tata Elxsi Ltd., in 349 ITR 98. Ground Nos. 4, 5, 6 and 7 are covered by the decision of DCIT Vs. Global Vartage Pvt. Ltd., (2010 TIOL 24 ITAT – Del) wherein it has been held as under:

“Therefore, having regard to the rival contentions and material on record, we find that similar facts and circumstances existed for the AY 2006-07 in assessee’s own case and the coordinate Bench of this Tribunal vide its order dated 29.07.2011 in ITA. No. 1433/Bang/2010 has discussed the issue at length and at para 10 of its order has held as under:

“10. Having heard both the parties and having considered the rival contentions, we find that u/s Chapter X of the Act, the TPO while computing the ALP has to issue notice to the assessee and if the assessee raises any objections relating to the method adopted by the TPO in selection of the comparables or in relation to comparables selected, he has to consider the objections raised by the assessee and deal with them by a speaking order. However in the case before us, the TPO has failed to consider the assessee's objections and deal with them judiciously. The DRP also, in our opinion, has dealt with the issue summarily without considering assessee's objections at all. The assessee has approached ORP only against the order of the TPO and it is the duty of the DRP to consider the assessee's objections to the TPO orders in judicious way. By summarily accepting the order of the TPO, the DRP has failed to perform the duty entrusted to it. However, since the TPO has not dealt with the objections raised by the assessee against the comparables selected by the TPO, we deem it fit and proper to remit the issue to the file of the assessing authority for taking necessary action of making a reference to the TPO to deal with the assessee's objections and for passing a speaking order. The AO/TPO is directed to give fair opportunity of hearing to the assessee and

also consider the judicial precedents on the issue including the orders, of the Tribunal in assessee's own case, while determining the ALP."

5. Having gone through the record before us, as recorded above, we find that even during the relevant assessment year, the assessee had made elaborate submissions and both the TPO as well as the DRP have failed to consider the said objections objectively. In view of the same, we deem it lit and proper to remit this issue to the file of the A.O./TPO for reconsideration of the issue in accordance with law. The A.O./TPO is directed to give fair opportunity of hearing to the assessee and also consider judicial precedents on the issue including the orders of the Tribunal in assessee's own case while determining the ALP.

Ground Nos. 8, 9 and 10 have been already decided in assessee's appeal in ITA No. 657. Ground No. 11 is consequential and has to be worked out by the AO after adjudicating the grounds preferred in this appeal. Ground Nos. 12 and 13 are general.

20. In the result, the appeals of the revenue and assessee are partly allowed for statistical purposes.

Pronounced in the open court on this 6th day of January 2017.

Sd/-

(A. K. GARODIA)
Accountant Member

Sd/-

(ASHA VIJAYARAGHAVAN)
Judicial Member

Bangalore.

Dated: 6th January 2017.

/NS/

Copy to:

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|-------------------------|---------------|
| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR, ITAT, Bangalore. | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.