

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K", MUMBAI

BEFORE SHRI G.S.PANNU, ACCOUNTANT MEMBER
AND
SHRI AMARJIT SINGH, JUDICIAL MEMBER

IT(TP)A No.1324/Mum/2014
(Assessment Year 2009-10)

Dialogic Networks (India) Private Limited,
3rd Floor, Pride Purple Coronet,
S.No.287/2, Baner Road,
Opp Food Bazar, Pune
PAN:AABCV9446M

..... Appellant

Vs.

The DCIT, Cir.3(3),
Mumbai.

.... Respondent

Appellant by : S/Shri Ajit Tolani/Darpan Kirpalani
Respondent by : Shri N.K.Chand
Date of hearing : 27/01/2017
Date of pronouncement : 31/01/2017

ORDER

PER G.S.PANNU,A.M:

The captioned appeal filed by the assessee pertaining to assessment year 2009-10 is directed against an order passed by DCIT, Cir.3(3), (in short the Assessing Officer) passed under section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (in short the Act) dated 09/01/2014, which is in conformity with the direction of the Dispute Resolution Panel-1, Mumbai (in short "the DRP") dated 27/12/2013.

2. In this appeal, assessee has raised the following Grounds of appeal:-

"1. On the facts and circumstances of the case, the final assessment order passed by the learned Assessing Officer ('learned AO') / learned Transfer Pricing Officer ('learned TPO') under the directions of the Hon'ble Dispute Resolution Panel (Hon'ble DRP') is bad in law.

2. Transfer Pricing - Adjustment made on Software Development Services Segment

The learned AO/TPO has erred in law and on facts in making transfer adjustment of Rs. 10,343,472 to the international transaction of provision of Software Development Services by the Assessee to AE on the basis of various presumptions and surmises:

1. The learned AO / TPO has erred in law and on facts in rejecting following . comparables selected by the Assessee for Software Development Services Segment on the basis of various presumptions and surmises:

- a) Birla Technologies Ltd.*
- b) CG- Yak Software & Exports Ltd.*
- c) Computech International Ltd.*
- d) Goldstone Technologies Ltd .*
- e) Sagarsoft (India) Ltd.*

II. The learned AO/TPO has erred In law and on facts in selecting following additional comparables for Software Development Services Segment without carrying out a methodical and scientific search of comparables and on the basis of various presumptions and surmises:

- a) Persistent Systems & Solutions Ltd*
- b) LGS Global Ltd.*
- c) Sonata Software Ltd*
- d) Igate Global Solutions Ltd.*
- e) Bodhtree Consulting Ltd.*
- f) Genesys International Corporation Ltd.*
- g) FCS Software Solutions Ltd.*

III, Without prejudice to the Ground o. 2(II) above. the learned AO / TPO has erred in law and on facts in not considering the foreign exchange loss as Operating cost for computing the margin of Persistent Systems & Solutions Ltd.

IV, The learned AO / TPO has erred in law and on facts in adopting quantitative filter of employee cost to total cost percentage of 25% for Software Development Services Segment

V. The Hon'ble DRP has erred in law and on facts in not directing the learned AO / TPO for treating the onetime restructuring expenses of Rs. 27,73,446/- as non-operating in nature leading to double taxation.

3. Transfer Pricing - Adjustment made on Global Call Center Service Segment The learned AO / TPO has erred in law and on facts in making transfer adjustment of Rs. 2,237,025 to the international transaction of provision of Global Call Center Services by the Assessee to AE on the basis of various presumptions and surmises:

I. The learned AO / TPO has erred in law and on facts in rejecting following comparables selected by the Assessee for Global Call Center Services Segment on the basis of various presumptions and surmises:

a) Allsec Technologies Ltd.

b) R Systems International Ltd.

c) Shreejal Info Hubs Ltd.

II. The learned AO / TPO has erred in law and on facts in selecting following additional comparables for Global Call Center Services Segment without carrying out a methodical and scientific search of comparables on the basis of various presumptions and surmises:

a) Informed Technologies Ltd.

b) Rev IT Systems Ltd.

III. The learned AO / TPO has erred in law and on facts in adopting discriminatory selection of quantitative filters of export sales to total sales turnover percentage of 25% for Software Development Services Segment and export sales to total sales turnover percentage of 75% for Global call Centre Services Segment

4. Transfer Pricing – General

I. The learned AO / TPO has erred in law and on facts in not using the multiple year financial data of comparable companies for computing the arm's length price.

II. The learned AO/TPO has erred in law and on facts in not allowing the working capital adjustment for comparable companies.

III. The Assessee humbly prays for application of plus-minus 5% variation while computing arm's length price under section 92C.

5. Corporate Tax - Ad-hoc Disallowance of Expenditure.

1. The learned AO has erred in law and on facts in ad-hoc disallowance of ¼ of the expenditure of PSE unit."

3. Although the assessee has raised multiple Grounds of appeal, but the substantive dispute involve three issues, which we shall deal in seriatim. The appellant before us is a company incorporated under the provisions of the Companies Act, 1956 and is, inter-alia, engaged in the business of research and development of telecommunication software and sales, marketing and customer support services. For the assessment year 2009-10, it filed a return of income declaring a total income at Rs.44,97,156/-, which was subsequently revised to Rs.46,21,652/-. In the ensuing assessment, it was noticed that assessee had undertaken international transactions within the meaning of section 92B of the Act with its Associated Enterprise (AE) and, therefore, reference was made to the Transfer Pricing Officer under section 92CA(1) of the Act for determination of their arm's length price. The Transfer Pricing Officer has passed an order under section. 92CA(3) of the Act dated 28/01/2013 holding that so far the international transactions relating to Provision of software development services and Provision of Global call centre services are concerned, the stated value of transactions are not at an arm's length price and instead he worked out adjustments of Rs.1,03,43,472/- and Rs.22,37,025/- respectively. The Assessing Officer passed a draft assessment order on 20/03/2013, wherein, inter-alia, an adjustment of Rs.1,25,80,497/- was made to the total income, against which assessee raised objections before the DRP. The DRP vide order dated 27/12/2013 considered the objections of the assessee and passed directions and in compliance thereof the Assessing Officer has finalized an assessment under section 143(3) r.w.s. 144C(13) of the Act , whereby adjustment as worked out by the Transfer Pricing Officer at Rs.1,25,80,497/- has been added to the returned income. Against such a decision assessee is in appeal before us.

3.1 In so far as the first issue is concerned, the same relates to an adjustment of Rs.1,03,43,472/- made to the international transaction of Provision of software development services by the assessee to its Associated Enterprises. In this segment assessee had rendered software development services to its Associated Enterprise for a stated consideration of Rs.7,00,07,515/-. In this context, relevant facts are that assessee is a 100% subsidiary of Veraz Networks Ltd., USA (Now known as Dialogic Inc.). The assessee company has set-up unit for development of telecommunication software for its group entities and it also provides marketing and customer services and back-office support services (ITES) to its group entities. One of the segment is Provision of software development services to its Associated Enterprise based in Israel and USA. In consideration of the services provided, assessee receives compensation at cost + 12% and during the year under consideration it received a sum of Rs.7,00,07,515/- for rendering of such services. For the purposes of benchmarking of aforesaid international transactions, Transactional Net Margin Method (TNMM) was selected as most appropriate method and the profit level indicator(PLI) was taken as Operating Profit to Total Cost (OP/TC). The assessee had determined the margin of 7.48% and after comparing it with the average margin of the comparable concerns identified, it was asserted by the assessee that the stated value of the transactions was at an arm's length price as per Indian Transfer Pricing Regulations. The Transfer Pricing Officer has not differed with the selection of TNMM or the PLI factor or the computation of assessee's margin. However, the Transfer Pricing Officer culled out the filters enumerated in para 5.2 of his order, and differed with the assessee on the selection of the comparable

concerns. The Transfer Pricing Officer selected the following set of comparables whose average margin was determined at 23.23%:-

<i>S.No.</i>	<i>Name of the Company</i>	<i>OP/TC%</i>
1.	<i>Akshay Software Technologies Ltd.</i>	<i>12.48</i>
2.	<i>Neilsoft Ltd.</i>	<i>8.47</i>
3.	<i>Aztechsoft Software Tech</i>	<i>1.21</i>
4.	<i>Indium Software Ltd</i>	<i>-9.53</i>
5.	<i>PSI Data System Ltd</i>	<i>-3.06</i>
6.	<i>Persistent Systems & Solutions Ltd.</i>	<i>30.86</i>
7.	<i>LGS Global</i>	<i>21.35</i>
8.	<i>Sonata Software Ltd.</i>	<i>29.51</i>
9.	<i>Igate Global Solutions Ltd.</i>	<i>23.64</i>
10.	<i>Bodhtree Consulting Ltd.</i>	<i>64.89</i>
11.	<i>Genesys International Corp</i>	<i>58.47</i>
12.	<i>FCS Software Solutions</i>	<i>40.5</i>
	<i>Arithmetic Mean</i>	<i>23.23</i>

Accordingly, the Transfer Pricing Officer has worked out an adjustment of Rs.1,03,43,472/- to the stated value of the transactions, in order to determine its arm's length price.

3.2 With respect to the aforesaid, the Ld. Representative for the assessee has primarily argued for exclusion/inclusion of certain concerns, in the final set of comparables. Firstly, we may take up the plea of the assessee for exclusion of certain concerns from the list of comparables, as according to the appellant, the same are not comparable to the assessee. The first objection of the assessee is against the inclusion of Persistent Systems & Solutions Ltd. in the final set of comparables. In this context, multiple arguments have been put-forth by the Ld. Representative for the assessee seeking exclusion of the said concern from the final set of comparables. Firstly, it is pointed out that

the total sales of the said concern are to the tune of Rs.527.06 crores for the year under consideration, whereas the assessee's turnover from the software development segment is only Rs.7.00 crores and this vast difference signifies the differences in Functions performed, Assets used and the Risk assumed by the said concern vis-a-vis those undertaken by the assessee in its segment of software development services. Secondly, it is pointed out that the said concern is not a pure software development company but is also engaged in development of software products, an activity which is incomparable with assessee's segment of pure software development services. Furthermore, a reference has been made to the Annual Report of the said concern, which has been placed in the Paper Book at pages 14 to 25 to point out that the said concern is engaged in variety of activities which, inter-alia, include joint research projects with leading Universities of USA, an activity which is completely missing so far as the assessee's segment of software development services is concerned. By referring to the Annual Report, it has also been pointed out that it has a huge workforce which is quite incomparable to the assessee. Further, it has also been pointed out that the sale of software services and products has been accounted for together in the P&L Account and in the absence of any segmental accounts relating to the income from software development services, the reported margin of the said concerns is incomparable to the margin of the assessee in its software development segment. Without prejudice, the Ld. Representative for the assessee pointed that even if the said concern was to be retained in the final set of comparables, the margin of the said concern taken by the Transfer Pricing Officer at 30.86% is wrong, inasmuch as, while computing such margin the Transfer Pricing Officer has not considered the foreign exchange loss as a part of the operating

costs and that if the said correction is undertaken, the margin of the said concern will reduce to 18.31%.

3.3 On the other hand, the Ld. Departmental Representative has not disputed the factual matrix asserted by the Ld. Representative for the assessee, but vehemently pointed out that the Transfer Pricing Officer has not applied any upper turnover filter and, therefore, it would be wrong to exclude the said concern by applying turnover filter because it would mean applying the turnover filter on a selective basis.

3.4 We have carefully considered the rival submissions. The strategy and the filters applied by the Transfer Pricing Officer have been elucidated in para 5.2 of his order, which does not entail application of any upper turnover filter. Therefore, we find merit in the argument of the Ld. CIT-DR that excluding Persistent Systems & Solutions Ltd. based on a filter, which has otherwise not been applied for the residual concerns would not be in the fitness of things. So however, the other pleas of the assessee that the said concern is non-comparable due to difference in functions is quite potent. Ostensibly, the said concern is involved in not only rendering software development services, but also in sale of products, as is evident from the Annual Report placed in the Paper Book. More importantly, the Annual Report also shows very qualitative difference in the activities undertaken by the said concern. Notably, it is involved in creating research development centre in partnership with Indiana University USA, for development and research in life sciences, products lifecycle services, medical research, chemistry, bio-informatics, etc. It is also involved in developing specialized medical applications jointly with Washington University. It is also undertaking virtual observatory India project

in collaboration with foreign institutions. Putting all these features together, it is quite evident that the said concern is incomparable with the activities of the assessee before us, which are purely rendering of software development services. Therefore, we uphold the plea of the assessee that the said concern is excludible from the final set of comparables for the purposes of carrying out benchmarking assessee's segment of providing software development services to its Associated Enterprise.

4. The second plea of the assessee is for exclusion of M/s. Sonata Software Ltd. from the final set of comparables. On this aspect various submissions have been made, but a pertinent point has been raised to the effect that the said concern has related party transaction (RPTs) of more than 25% of its total revenue and therefore, the said concern is excludible. In this context, reference has been made to the Paper Book where Annual Report of the said concern has been placed at pages 32 to 37 and also to the decision of the Delhi Bench of the Tribunal in the case of M/s. Fiserv India Pvt. Ltd. in ITA NO.1822/Del/2014 dated 26/06/2015, wherein for the very same assessment year of 2009-10, RPTs of the said concern has been noted at approximately 40%.

4.1 We find that the plea of the assessee is quite justified inasmuch as the Transfer Pricing Officer has applied a filter to exclude concern where RPTs exceed 25% of total revenues. Therefore, on the basis of the aforesaid fact-situation, as also the decision of the Hon'ble Delhi Bench of the Tribunal in the case of M/s. Fiserv India Pvt. Ltd. (supra), the said concern is liable to be excluded from the final set of comparable. We hold so.

5. The next plea of the assessee is for exclusion of Igate Global Solutions Ltd. from the final set of comparables. On this aspect, the plea of the assessee is that the said concern is functionally dissimilar inasmuch as its activities are in the nature of ITE services, which is quite different from rendering of pure software development services. In support of such claim, the Ld. Representative for the assessee referred to the Annual Report of the said concern, copies of which has been placed in the Paper Book at pages 38 to 52. The stand of the Revenue, as emerging from the order of the Transfer Pricing Officer, is that the said concern is comparable because it is rendering software related services.

5.1 In our considered opinion, the assessee has to succeed on this aspect. We say so for the reason that as per the segmental reporting contained in the Annual Report of Igate Global Solutions Ltd., it is clearly brought out that it is operating “ *in one single segment with respect to product and services*”. It is also brought out that operations of the said concern relates to providing information services, contact centre services delivered to customers globally with the work being performed onsite and offshore. Considering that the segment under test before us is providing of software development services, in our view, the activities of Igate Global Solutions Ltd. are in the field of ITE services and it is not comparable with that of the assessee. Thus, on this aspect also, assessee succeeds.

6. The next plea of the assessee is for exclusion of Bodhtree Consulting Ltd. from the final set of comparables. The exclusion of the said concern is sought on the ground that the said concern has earned an abnormal high margin of

64.89% and is, therefore, excludable from the final set of comparables. In support reliance has been placed on the following decisions:-

- (i) M/s. Mindteck (India) Ltd. vs. DCIT, I.T(TP)No.70/Bang/2014
- (ii) Qlogic (India) Pvt. Ltd. vs. DCIT Pune, ITA No.227/PN/2014
- (iii) Barclays Technology Centre vs. ACIT, Pune- ITA 2279/PN/2012
- (iv) Softek India Pvt. Ltd. vs. ITO, ITA No.222/Bang/2014

7. The CIT-DR, on the other hand, pointed out that the Transfer Pricing Officer has included said concern for the reason that functionally the same is comparable to the activities undertaken by the assessee.

8. We have carefully considered the rival submission. We find that in the case of M/s. Mindteck (India) Ltd. (supra), the Bangalore Bench of the Tribunal has considered the said concern for the very same assessment year while benchmarking software development services. The plea before the Bangalore Bench of the Tribunal was that the concern has earned abnormal high margin and was therefore, excludable. The Bangalore Bench of the Tribunal found that the business model of the said concern was such that the margin did not reflect a normal business condition. In this context, the following discussion in the order of the Tribunal is relevant:-

"1. Bodhtree Consulting Ltd :

As far as this company is concerned, the submission of the learned counsel for the assessee was that this company made extra ordinary profits during the previous year. Our attention was drawn to the fact that the operating profit / operating cost of this company jumped from 17% for F Y 2007-08 to 56% in FY 2008-09. It dipped in FY 2009-10 to 40% and in FY 2010-11 it became (-) 2% and 5% in FY 2011-12 and finally touched (-) 9% in FY 2012-13. Our attention was drawn to the fact that the Special Bench of the Tribunal, Mumbai, in the case of Maersk Global Centres (India) P. Ltd., in

ITA.7466/Mum/2012, dt 07.03.2014 for AY 2008-09 had an occasion to consider the question as to whether companies having abnormal profits should be excluded as a comparable. The Special Bench took the view that it has to be shown that the high profit margin does not reflect the normal business conditions and only in such circumstances, high profit margin companies can be excluded. Our attention was drawn to the DRP's observation in its order on the issue which is as follows :

"Bodhtree :

The assessee has objected to selection of this entity on the basis of following objections:

- The entity has fluctuating margins*
- The company is more of a product company rather than software service company.*

The Panel has considered the objections of the assessee. Insofar as the contention regarding the rejection of this entity on the basis of fluctuating margin is concerned, in order to appreciate the compatibility or otherwise of this entity, it is important to first note that the Indian software industry uses two different models for revenue recognition. The first is the Time and Material (T&M) Contracts model in which Customer are billed on the basis of hours worked by the employees of supplier software companies. Hourly rates are agreed on by both parties and are applied to the total hours worked to arrive at the revenue that is to be recognized. The second is the Fixed Price Project Model (FPP). Under the Fixed Price Project Model, the total contract price is agreed upon between the parties. Billing may be done either at the end of the contract or over the period of the contract on the basis of the agreed milestone for billing. In this respect, the basis of revenue recognition by this entity can be seen from the annual report as below:

3. Revenue Recognition :

Revenue from software development is recognised based on software developed and billed to clients.

From perusal of the above, it is seen that this entity is engaged in building revenues through Fixed Price Project model. As is a natural corollary in such type of revenue recognition, some part of the expenditure may be booked in one year, for which the revenue may have been recognised in the earlier or subsequent year. Therefore, it is but natural that there is some fluctuation in the profitability margin of such entity. Merely because of such fluctuations, an entity engaged in the development of software, being functionally comparable to the assessee, cannot be rejected only on this ground."

14. *The learned counsel for the assessee drew our attention to the fact that Bodhtree Consulting admittedly follows a fixed price project model whereby revenues from software development is recognized based on software and billed to clients. In such business model expenditure for developing software would be billed in an earlier year but the revenue would be recognized in a subsequent year. It was his submission that this fact is recognized by the DRP in its order. According to him this circumstance would be sufficient to show that the margin reflected of this company does not reflect the normal business condition.*

15. *The learned DR placed reliance on the reason given by the DRP in its order.*

16. *We have considered the rival submissions. The Special Bench of the ITAT in the case of Maersk Global Centres (supra) had an occasion to deal with the question as to whether high profit margin making companies should be excluded as a comparable. The Special Bench after considering several aspects held in para 88 of its order that the potential comparable companies cannot be excluded merely on the ground that their profit is abnormally high. The Special bench held that in such cases it would require further investigation to ascertain the reasons for unusually high profit and in order to establish whether the entities with such high profits can be taken as comparable or not. In the light of the aforesaid decision of the Special Bench and in view of the admitted position that the assessee follows Fixed Price Project model where revenues from software development is recognized based on software developed and billed to clients, there is a possibility of the expenditure in relation to the revenue being booked in the earlier year. The results of Bodhtree from FY 2003 to 2008 excluding FY 2007 as given by the learned counsel for the assessee were also perused. Perusal of the same shows, that there has been a consistent change in the operating margins. The chart filed by the assessee in this regard is given as an annexure to this order. It appears to us that the revenue recognition method followed by the assessee is the reason for the drastic variation in the profit margins of this company. In the given circumstances, we are of the view that it would be safe to exclude Bodhtree Consulting from the final list of comparables chosen by the assessee. We hold and direct accordingly.”*

Following the aforesaid precedent, which has been rendered under identical circumstances for the same assessment year, we direct that Bodhtree Consulting Ltd. be excluded from the final set of comparables. Thus, on this aspect also assessee succeeds.

9. The next plea of the assessee is for exclusion of Genesys International Corporation Ltd. from the final set of comparables. In this context, the sum and substance of the plea of the assessee is that the said concern is engaged in different activities and it is not comparable to assessee's activities of providing software development services. To substantiate, reference has been made to pages 65 to 73 of the Paper Book, wherein a copy of the extract from the Annual Report of the said concern has been placed. Apart therefrom, it has also been pointed out that the nature of the services rendered by the said concern are in the field of IT Enabled Services (ITES). On this issue, reference has also been made to the decisions of the Bangalore Bench of the Tribunal in the cases of Symphony Marketing Solutions India Pvt. Ltd. in ITA No.1316/Bang/2012 and Hyderabad Bench in the case of M/s. Capital IQ Information Systems Pvt. Ltd. in ITA No.124/Hyd/2014.

9.1 On the other hand, the Ld. CIT-DR has merely referred to the order of the Transfer Pricing Officer in support of the inclusion of the said concern, but the factual matrix brought out by the Ld. Representative for the assessee has not been disputed.

9.2 We have carefully considered the rival submissions. In our considered opinion, the stand of the assessee that the said concern is functionally incomparable to the tested segment of the assessee, namely, Provision of software development services is quite justified. The extracts from the Annual Report, which has been placed in the Paper Book, shows that the said concern is a geospatial services and content provider, which specializes in land based technologies. It is also observed that the said concern is the exclusive reseller of Navteq data for the Enterprise space in India. The skill-sets available with

the said concern include urban planners, cartographers, remote sensing scientists, etc. The fact that the said concern is an IT enabled service provider is affirmed by the decision of the Hyderabad Bench of the Tribunal in the case of M/s. Capital IQ Information Systems Pvt. Ltd. (supra), which has been rendered for assessment year 2009-10, which is also the year before us. In the case of Symphony Marketing Solutions India Pvt. Ltd.(supra) also, the said concern has been evidently accepted as an ITES provider, which is quite distinct from the tested transaction of Provision of software development services in the instant case. Considering the aforesaid fact position, in our view, inclusion of Genesys International Corporation in final set of comparables for benchmarking assessee's segment of Provision of software development services is not tenable and is hereby set-aside. Thus, on this aspect also assessee succeeds.

10. The next point raised by the assessee is for the exclusion of FCS Software Solutions Ltd. from the final set of comparables. In this context, the plea of the assessee is that the said concern is functionally dissimilar to the activities being carried out by the assessee, inasmuch as, the said concern is engaged in diverse activities and that no segmental financial information is available in the Annual Report. By referring to pages 74 to 78 of the Paper Book, wherein is placed extracts of the Annual Report of the said concern, the Ld. Representative for the assessee pointed out that it is engaged in three strategic business units, namely, IT consulting – 48%; E-learning solutions - 35%; and infrastructure management services – 17%. It is pointed out that in the absence of any segmental data, the said concern's entity level margin is not comparable to the tested transaction, which is Provision of software

development services. In this context, reliance has also been placed on the decision of the Pune bench of the Tribunal in the case of Barclays Technology Centre India Pvt. Ltd. in ITA No.2279/PN/2012 dated 28/1/2015.

10.1 On the other hand, the Ld. CIT-DR pointed out that since the said concern was also rendering software development services, the same has been included in the final set of comparables by the Transfer Pricing Officer.

10.2 We have carefully considered the rival submissions. A perusal of the diverse activities undertaken by the said concern, which is evident from its Annual Report, reveals that the same are incomparable with assessee's activities of software development services. Ostensibly, one of the segments undertaken by the said concern is Infrastructure Management, wherein it is managing the hardware requirements of its clients. It is also seen that it is serving as outsourcing centre for hardware requirements of its customers. Apart therefrom, it is involved in imparting internet based E-learning and is running a Corporate University. The third notable segment is IT consulting services. Pertinently, the segmental reporting furnished by the said concern is based on Geographics, in which it operates and not as per different activities undertaken by it. Therefore, the final data of such a concern includes those activities which are in-comparables to the tested transactions of the assessee before us and, therefore, on this count itself, in our view, the said concern deserves to be excluded from the final set of comparables. We hold so.

10.3 Apart from the aforesaid, the plea of the assessee is for inclusion of certain concerns, which according to the assessee have been wrongly excluded by the income-tax authorities while benchmarking the segment of software development services. On this aspect, the first plea of the assessee is with

respect to the exclusion of Sagarsoft (I) Ltd. it is pointed out that the said concern has been excluded by the Transfer Pricing Officer on the ground that it does not comply with the export turnover filter. The Ld. Representative for the assessee pointed out with reference to the extracts from the Annual Report of the said concern that 90% of its operating revenues are by way of export earnings and, therefore, the said concern has been wrongly excluded by the Transfer Pricing Officer.

10.4 On the other hand, the Ld. CIT-DR points out that the said aspect may be verified by the Transfer Pricing Officer and a decision be taken afresh.

10.5 We have carefully considered the rival submissions and find that one of the filters applied by the Transfer Pricing Officer was to exclude concerns whose export earnings were less than 25% of the total operating revenues. In the context of Sagarsoft (India) Ltd., the plea of the assessee is that almost 90% of its operating revenue is from exports and, therefore, the said concern is includible. We deem it fit and proper to restore the matter to the file of Assessing Officer /Transfer Pricing Officer in order to verify the aforesaid position and, thereafter, consider the inclusion of the said concern in the final set of comparables. Needless to mention, the Assessing Officer /Transfer Pricing Officer shall allow the assessee a reasonable opportunity of being heard and, thereafter, decide on this aspect afresh, as per law. Thus, on this aspect assessee succeeds for statistical purposes.

11. The next plea of the assessee is for inclusion of CG- Vak Software & Exports Ltd. in the final set of comparables, which according to the assessee has been wrongly excluded by the income-tax authorities. It is noticed that the Transfer Pricing Officer has excluded the said concern on the ground that

the employee cost to the total operating revenues is less than 25%. The Ld. Representative for the assessee pointed out that in the case of CG- Vak Software & Exports Ltd., the Transfer Pricing Officer has erred in applying the aforesaid filter. The sum and substances of the plea is that the employee cost filter does not fail in the present case and, therefore, CG- Vak Software & Exports Ltd. is includible in the list of comparables. The Ld. Representative for the assessee referred to the decision of the Bangalore Bench of the Tribunal in the case of Lam Research (India) Private Limited, IT(TP)A No.1437/Bang/2014 dated 30/04/2015 (supra), which has considered a similar objection while dealing with the inclusion of CG- Vak Software & Exports Ltd. In particular, our attention has been drawn to the following discussion of the Tribunal in its order dated 30/04/2015(supra), wherein following the earlier decision in the case of Yodlee Infotech Pvt. Ltd., CG- Vak Software & Exports Ltd. has been held to be good comparable in order to benchmark the software development services for assessment year 2009-10. The relevant finding of the Tribunal is as under:-

“21. We have perused the orders and considered the rival contentions. This Tribunal in the case of Yodlee Infotech Pvt. Ltd. (supra) at para 22 of its order held as under:-

22. Vis-à-vis inclusion of M/s. CC –VAK Software & Exports Pvt. Ltd., which was not accepted by the TPO and DRP, we are of the opinion, by virtue of this Tribunal’s Co-ordinate Bench decision in the case of M/s. Cisco systems Pvt. Ltd. vs. DCIT (ITA No.271(B)/2014 dated 14/08/2014) it has to be considered as functionally comparable to the assessee. Relevant para-27.8 of this Tribunal is re-produced hereunder;

27.8 CG-VAK Software & Exports Ltd.

(D)(i) As far as this company is concerned, the TPO rejected the same by applying the 25% employee cost filter. According to the TPO, usually software development services are high-end services performed by skilled and professional employees and hence the cost of rendering such high-end services is also high as they comprise of high salaries and better welfare

facilities, compared to low-end services. Therefore, the filter of employee cost of more than 25% of turnover was considered by the TPO while choosing the comparable.

{ii} The submission of the Id. counsel for the assessee was that in the case of assessee, this test is satisfied. In this regard, our attention was drawn to page 818 to 824 of the assessee's paper book wherein annual report of this company has been provided. Attention was drawn to the fact that in the profit & loss account of the audited accounts, the cost of services has been shown as an expenditure and in Schedule 15 to the Notes to Accounts, it has been elaborated as follows:-

Cost of services:

Cost of Services – Overseas	2,77,32,337
Cost of Services - Domestic	2,58,40,435
Transcription charges	3,97,389
Web Designing Charges	1,64,602
Staff Welfare	11,43,144
Staff Training	3,63,496
Contribution to PF & ESI	15,47,906
Gratuity	13,04,894
Ex Gratia	0
HRD Expenses	<u>3,10,871</u>
	<u>5,88,05,074</u>

(iii) It was submitted by the Id. counsel for the assessee that the TPO ignored the contribution to PF & ESI, Gratuity and Ex Gratia payments and arrived at the employee cost. According to the Id. counsel for the assessee, doing so was not proper. If all the employee costs are properly considered, then, this company can pass the filter applied by the TPO for excluding it.

(iv) We have considered the submission of the Id. counsel for the assessee and are of the view that prima facie the submissions of the Id. counsel are acceptable. We however, feel that it would be just 'and appropriate to direct the TPO to consider including this company as comparable afresh in the light of the facts brought to our notice by the Id. Counsel for the assessee. We hold and direct accordingly.

We therefore, direct the TPO to include CG- V AK Software & Exports Pvt. Ltd.(supra) in the set of comparables.

Accordingly, we direct that VG-Vak Software and Exports Ltd. be considered as a proper comparable.”

Following the aforesaid precedent, which has been rendered in the context of the same assessment year, we direct the Assessing Officer/Transfer Pricing Officer to include CG- Vak Software & Exports Ltd in the final set of comparables. Thus, on this aspect assessee succeeds.

12. The next plea of the assessee is for inclusion of Computech International Ltd. in the final set of comparables. On this aspect, the rival contentions remain the same as considered by us in the context of inclusion of CG- Vak Software & Exports Ltd. in the earlier paras. It is pointed out by the Ld. Representative for the assessee that the employee cost has been wrongly taken by the Transfer Pricing Officer to exclude this company based on the employee cost filter. It is pointed out that the employee costs incurred by the said concern are not separately shown in the P&L account as Employee expenses, but it has been considered as a part of software development expenses and, therefore, it would be inappropriate to reject the concern by applying employee cost filter. On this aspect of the matter, we deem it fit and proper to restore the matter to the file of Assessing Officer/Transfer Pricing Officer for the purpose of culling out appropriate facts and to thereafter decide the matter afresh. Needless to mention, the Assessing Officer/Transfer Pricing Officer shall provide a reasonable opportunity of being heard to the assessee and, thereafter, decide on this aspect afresh, as per law. Thus, on this aspect assessee succeeds for statistical purposes.

13. The last point made by the assessee in the context of software development services is for the inclusion of Goldstone Technologies Ltd., which according to the assessee has been wrongly excluded by the Transfer Pricing Officer. The Ld. Representative for the assessee pointed out that the

said concern is indeed engaged in providing software development services and it should be included in the final set of comparables. On this aspect, we find that the Transfer Pricing Officer has not given any reasoning to exclude the said concern from the list of comparables although its inclusion was sought by the assessee. Therefore, considering the arguments set up by the assessee, we restore the matter back to the file of Assessing Officer/Transfer Pricing Officer, who shall consider the plea of the assessee that the said concern is functionally similar as it is engaged in rendering software development services, as evidenced by the extract of its Annual Report placed before us in the Paper Book at page 10. Needless to mention, the Assessing Officer/Transfer Pricing Officer shall provide a reasonable opportunity of being heard to the assessee and, thereafter, decide on this aspect afresh, as per law. Thus, on this aspect assessee succeeds for statistical purposes.

13.1 Thus, in so far as, the first issue relating to the benchmarking of international transaction of provision of software development services is concerned, no other arguments have been set-up before us and accordingly, we conclude by directing the Assessing Officer/Transfer Pricing Officer to redetermine the arm's length price of such transactions as per our aforesaid directions.

14. The next issue relates to the adjustment of Rs.22,37,025/- made to the international transaction of Global Call Centre Services rendered by the assessee to its associated enterprises. In this segment, assessee was rendering Call Centre services to its associated enterprises for a stated consideration of Rs.2,24,83,800/-. In this segment, assessee was receiving compensation at cost plus mark-up of 12%. For the purposes of benchmarking of such

international transactions, assessee had selected TNM method as most appropriate method and the PLI was taken as Operating Profit to Total Cost(OP/TC). Before the Transfer Pricing Officer, assessee had asserted that its margin of 12.12% was higher than the average margin of the comparable concerns identified and, therefore, the stated value of the transactions was at an arm's length price. In this segment, the Transfer Pricing Officer had not differed with the assessee on the selection of the TNM method or computation of PLI filter, but he has formulated the filters in para 6.1 of his order and thereafter, selected the following set of comparables, whose margin was determined at 23.63%:

<i>S.No.</i>	<i>Name of the comparable</i>	<i>Margin</i>
1.	<i>ICRA Techno Analytics</i>	<i>10.01</i>
2.	<i>Informed Technology</i>	<i>23.13</i>
3.	<i>Rev IT System</i>	<i>27.69</i>
4.	<i>Nittany Outsourcing Services Pvt. Ltd.</i>	<i>32.22</i>
	<i>Arithmetical Mean</i>	<i>23.26</i>

Since the margin of the assessee was 12%, the Transfer Pricing Officer worked out an adjustment of Rs.22,37,025/- to the stated value of the transactions in order to compute its arm's length price.

14.1 With respect to the aforesaid, the first plea of the assessee is that the Transfer Pricing Officer has erred including the Informed Technologies Ltd. in the final set of comparables. According to the appellant, the said concern is functionally dissimilar as it is not providing any Call Centre services. At the time of hearing the Ld. Representative for the assessee referred to pages 84 to 94 of the Paper Book, wherein is placed an extract from the Annual Report of the said concern to point out the dissimilarity in functions performed.

14.2 The Ld. CIT-DR, on the other hand, pointed out that such a point was not raised by the assessee before the lower authorities, though the factual matrix brought out by the assessee is not disputed on the basis of material available on record.

14.3 We find that Informed Technologies Ltd. is operating as an IT enabled, knowledge based Back Office Processing Centre which serves the needs of the financial content sector in the USA. It is also emerging from the Annual Report of the said concern that it collects and analyses data on financial fundamentals, Corporate governance, Executive compensation and capital markets and other services for research/advisory reports. In fact, the appellant has correctly asserted that its activities are not comparable to the Call Centre services being rendered by the assessee and, therefore, the said concern deserves to be excluded from the final set of comparables. We hold so.

15. The only other concern which is sought to be excluded from the final set of comparables is Rev IT Systems Ltd. The Ld. Representative for the assessee has pointed out that the said concern deserves to be excluded because it is earning almost 62.68% of its total revenues from the subsidiary companies. In support, reference has been made to pages 91 to 93 of the Paper Book, wherein is placed an extract of the Annual Report of the said concern, which shows that the RPTs are more than 25%, a filter that has been applied by the Transfer Pricing Officer. On this aspect of the matter, we find enough weight in the plea of the assessee for exclusion of Rev IT Systems Ltd. on account of RPTs being more than 25% of the total revenues, a filter which has been applied while conducting the transfer pricing assessment. Thus, the Assessing

Officer/Transfer Pricing Officer is directed to exclude the Rev IT Systems Ltd. from the final set of comparables.

15.1 The only other plea of the assessee is for inclusion of Allsec Technologies Ltd.; R Systems International; and, Shreejal Info Hubs Ltd. in the final set of comparables. In so far as, the inclusion of R Systems International and Shreejal Info Hubs Ltd. is concerned, the same was not pressed at the time of hearing and is accordingly dismissed.

15.2 With respect to Allsec Technologies Ltd., the Ld. Representative for the assessee pointed out that the said concern has been wrongly excluded from the list of comparables. It is pointed out that in assessment year 2007-08, the said concern was included as a comparable; and, that it is not a persistently loss making concern, so to be rejected for the reason that it has incurred losses in this year. The Ld. Representative for the assessee pointed out that the said concern has been considered to be a good comparable by the Hyderabad Bench of the Tribunal in the case of M/s. Capital IQ Information Systems (India) Pvt. Ltd. in ITA No.124& 170/Hyd/ 2014 dated 31/07/2014 for assessment year 2009-10 and the following discussion is relevant:-

“(a) Allsec Technologies Limited:-

23. As far as this company is concerned, its comparable nature was analysed by the coordinate Bench of the Tribunal in the case of M/s. Mercer Consulting (India) P. Ltd. (supra), in its order dated 6.6.2014. As seen from the TPO's order on comparables selected by the tax payer, this company is rejected as it fails export sales filter which was determined at 74.45% of its service revenue. On similar reason, the coordinate Bench in the above referred case has analysed and directed the TPO to include the said comparable, by stating as under-

"9.1. This case was included by the assessee in the list of comparables which was excluded by the TPO on the ground of diminishing sales for the last three years and the export revenues less than 75% of the total turnover. Here, it is

relevant to mention that the TPO adopted certain filters which have been mentioned on pages 13 and 14 of his order. One of such filters is the exclusion of companies whose export sales are less than 75% of the total sales from ITES. Another filter applied by the TPO is the exclusion of cases with diminishing revenues. The TPO recorded that this company has some peculiar problems and hence the same is not in line with the growth in software industry. However, he did not delve into the actual figures of diminishing revenues of this company. As against this, it is observed that Allsec's operating revenue has increased in the financial year 2008-09 over the previous year which is apparent from the Statement of facts given by the assessee. On a specific query, the Id. DR could not point out any material to indicate or support the TPO's assertion in his order about the diminishing revenue of Allsec Technologies Ltd for the last three years. The second reason given by the TPO for discarding this case from the list of comparables is export less than 75% of the total turnover. We observe that albeit this contention of the TPO is correct that this case does not pass the filter or test laid down by the TPO, but the fact of the matter is that the actual ratio of export revenue to total turnover of Allsec Technologies stands at 74.45% as shown on page 84 of the paper book. If we literally consider the filter applied by the TPO, this case does not pass the test. However, it is seen that the assessee included this case in the list of comparables by applying the filter of excluding the cases in which export revenue was less than 25% of the total revenue. There can be no hard and fast rule for putting a specific ceiling in a particular filter. The filters are not sacrosanct as not statutorily prescribed. These are used or modified for selection or rejection of comparables as per the convenience of the concerned party. If an assessee wants to include a certain case in the list of comparables which suits its requirements, then, it will suitably modify the filter itself or the ceiling in such filter, so as to fit the bill. Position is no different when it comes to the turn of the Revenue. If it wants to include a particular case in the list of comparables, it will also modify the filter or ceiling in such filter to suit its interest. Equally, if both the sides want to exclude a case, they will modify the filter accordingly. The nutshell is that some sort of cherry-picking is done by both the sides.

9.2. The exclusion of this case has been done by increasing the limit in filter to 75% as against 25% applied by the assessee because the percentage was 74.45%. If the actual ratio in this case had been more than 75%, and the Revenue hell bent on excluding this case, then it would have resorted to increasing the ceiling in the filter to 80% or still more so as to ensure that it remains outside the limit set by it. As the ratio of 75% is not something which is scientifically proven and the export revenue of Allsec Technologies is 74.45% as against the TPO's filter of 75%, we are of the considered opinion that the same cannot be excluded for such a minuscule difference if it is otherwise comparable. It is patent that the TPO has not disputed the

otherwise functional comparability of this case with that of the assessee. If we consider the case of Allsec Technologies on a criteria of preponderance of comparability, we find that the same merits inclusion in the list of comparables. Not only the TPO's reasoning about the declining revenue of Allsec Technologies over a period of three years is incorrect, this case is also passing the test of the ratio of export turnover to total turnover on a pragmatic rational basis. We, therefore, hold that this case should be included in the list of comparables."

For the reasons stated above, we are of the opinion that in this case also, this company should be included as a comparable. We direct the Assessing Officer/TPO accordingly."

15.3 Following the aforesaid precedent, we direct the Assessing Officer/Transfer Pricing Officer to include the said concern in the final set of comparables. Thus, on this aspect assessee succeeds.

15.4 In so far as the segment of provision of IT enabled services is concerned, no other argument has been set-up before us and accordingly, we direct the Assessing Officer/Transfer Pricing Officer to recompute the arm's length price of the international transaction of the segment of IT enabled services, keeping in mind our aforesaid directions.

16. The only other issue in this appeal is with respect to an addition of Rs.38,97,332/- made by the Assessing Officer out of expenditure in PSE(Non-domestic Division). The relevant facts in this regard are that the assessee company had four divisions, out of which three divisions enjoy the benefits of section 10A of the Act and the fourth division, namely, PSE division is not eligible for the benefits of section 10A of the Act. In the PSE division assessee had declared sales of Rs.2,28,93,269/-, against which an expenditure of Rs.2,45,87,822/- was claimed, thereby resulting in a loss of Rs.16,94,553/-. The Assessing Officer observed that assessee had booked the expenses of the 10A

units to the non-10A units so as to deflate the profits of non-10A units and increase the profits of the 10A units. Following the decision of his predecessor for the preceding assessment year, the Assessing Officer disallowed 1/4th of the expenditure of PSE division i.e. Rs.38,97,332/-. The DRP has also affirmed the approach of the Assessing Officer.

16.1 Before us, the plea of the assessee is that the disallowance is not justified as it has been made in an adhoc basis. The Ld. Representative for the assessee pointed out that the expenses are booked against the specific cost centre for which it relates to and there is no justification to say that expenses have been over-booked in the PSE division. The Ld. Representative for the assessee has referred to copy of the written submissions submitted to the DRP to point out that the detail of the expenditure booked in the PSE division was furnished and there is no incidence pointed out as to which of the expenses are relatable to non-PSE division.

16.2 On the other hand, Ld. CIT-DR has reiterated the stand of the Assessing Officer, which we have already adverted to in the earlier paras and the same is not being levied for the sake of brevity.

16.3 Having considered the rival submissions, one thing that is clearly discernible is that the disallowance has been made on an adhoc basis without pointing out any particular item of expenditure which is relatable to the non-PSE division. It is also emerging from the record that the action of the Assessing Officer is based on similar addition made in assessment year 2008-09. Before us, nothing has been brought out to show the finality of the addition made in preceding assessment year 2008-09. However, additions made on mere conjectures and surmises are unsustainable. Be that as it may,

considering the entirety of circumstances, we deem it fit and proper to restore the matter back to the file of Assessing Officer, who shall reconsider the aforesaid addition afresh as per law, after allowing the assessee a reasonable opportunity of being heard in support of its stand. Thus, on this aspect assessee succeeds for statistical purposes.

17. In the result, appeal of the assessee is partly allowed.

Order pronounced in the open court on 31/01/2017

Sd/-
(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-
(G.S. PANNU)
ACCOCUNTANT MEMBER

Mumbai, Dated 31/01/2017

Vm, Sr. PS

Copy of the Order forwarded to :

1. The Appellant ,
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai