

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'B', BANGALORE**

**BEFORE SHRI. N. V. VASUDEVAN, JUDICIAL MEMBER
AND
SHRI. ABRAHAM P.GEORGE, ACCOUNTANT MEMBER**

**I.T(TP).A No.1447/Bang/2010
(Assessment Year : 2006-07)**

FCG Software Services (India) Private Limited
(Now merged with Computer Sciences Corporation
India Private Limited,
2nd and 3rd Floor, 3 SJR iPark,
EPIP-Zone-1, Whitefield Road,
Bangalore 560 066. ... Appellant
PAN : AABCP 5094K

v.

Income Tax Officer,
Circle 11(2), Bangalore. ... Respondent

Appellant by : Shri. Vikram Vijayaraghavan, Advocate
Respondent by : Ms.Neeru Malhotra, CIT-(DR)

Heard on: 4.1.2016
Pronounced on : 08.01.2016

ORDER

PER N. V. VASUDEVAN, JUDICIAL MEMBER :

This appeal by the assessee is against the order dated 18.10.2010 of the ITO, Ward 11(2), Bangalore, passed u/s. 143(3) r.w.s. 144C of the Act.

2. The Assessee is a subsidiary of FCG Software Service Inc., USA. The Assessee is engaged in providing software development services of its holding company. The said transaction was an international transactions with an Associated Enterprise (AE) and has to pass the Arm's Length Price (ALP) test as provided u/s.92 of the Income Tax Act,

1961 (Act). In this appeal the dispute is with regard to addition made consequent to determination of ALP and consequent upward revision and adjustment made to the price at which international transactions were carried out by the Assessee with its AE in respect of Software development Services.

3. Financial Results of the Assessee for the F Y 2005-06

Description	Amount
Operating Revenue	Rs.52,03,85,342
Operating Cost	Rs.45,11,93,191
Operating Profit (PBIT)	Rs. 6,91,92,151
Operating Profit to Cost Rati	15.33%

International Transactions (as mentioned in the 92 CE report) :

Software development Services - Rs. 52,02,48,242/-
Reimbursement received - Rs. 8,05,93,261/-

TP ADJUSTMENT RELATING TO IT SERVICES (Software Development Services)

4. The Assessee filed a Transfer Pricing Study in which he chose 44 companies as comparable companies whose arithmetic mean of profit margins operating profit to operating cost was 11% and claimed that its operating profit margin of 15.33% was within the (+) (-) 5% profit margin of comparable companies and therefore the price charged in the international transaction was at Arm's length. The TPO rejected the claim of the Assessee and he chose 20 comparable companies. The Comparable ultimately selected by TPO and their arithmetic mean was as follows:

Sl. No	Name of company	OP / TC (FY 2006-7)	Sales (Rs.Cr.)
1	Aztec Software Limited	18.09	128.61
2	Geometric Software Limited (Seg.)	6.70	98.59
3	Infosys Ltd	40.38	9028.00
4	KALS Info Systems Limited	39.75	1.97
5	Mindtree Consulting Ltd	14.67	448.79
6	Persistent Systems Ltd.	24.67	209.18
7	R.Systems International Ltd. (Seg.)	22.20	79.42
8	Sasken Communications Ltd. (Seg.)	13.90	240.03
9	Tata Elxsi Ltd (Seg.)	27.65	188.81
10	Lucid Software Ltd	8.92	1.02
11	Mediasoft Solutions Ltd	6.29	1.76
12	R S Software (India) Ltd	15.69	91.57
13	S I P Technologies & Exports Ltd	3.06	6.53
14	Bodhtree Consulting Ltd.	15.99	5.32
15	Accel Transmatic Ltd. (Seg.)	44.07	8.02
16	Synfosys Business solutions Ltd.	10.61	4.49
17	Flextronics Software Systems Ltd.	27.24	595.12
18	Lanco Global Solutions Ltd	5.27	35.63
19	Megasoft Ltd	52.74	56.15
20	iGate Global solutions Ltd.(Seg.)	15.61	527.91
Arithmetic Mean		20.68%	

5. The TPO finally passed an order u/s. 92CA of the Act and on the basis of the comparables set out above, arrived at arithmetic mean of 20.68%. After factoring the working capital adjustment of 0.24%, the adjusted arithmetic mean was determined at 20.44%. The computation of the ALP by the TPO in this regard was as follows:-

"19.6. Computation of Arms Length Price:

The arithmetic mean of the Profit Level indicators is taken as the arms length margin. (Please see Annexure B For details of computation of PLI of the comparables). Based on this, the arms length price of the software development services rendered by you is computed as under:

Arithmetic mean PLI	20.68%
Less: Working capital Adjustment(Annexure-C)	<u>2.24%</u>
Adj.Arithmetic mean PLI	<u>20.44%</u>
Arm's Length Price:	

Operating Cost (Rs.45,11,93,191 + Reimbursement of expenses Received of RS.8,05,93,261	Rs.53,17,86,452
Arms Length Margin	20.44% of the operating cost
Arms Length Price (ALP) At 118.44% of operating cost	Rs.64,04,83,603/-

19.7. Price received vis-à-vis the Arms Length Price:

The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length Price as under:

Arms Length Price (ALP) at 120.44% of operating cost	Rs.64,04,83,603
Price charged in the international transactions	Rs.60,09,78,603
Shortfall being adjustment u/s.92CA	Rs.3,95,05,000/-

The above shortfall of Rs.3,95,05,000/- is treated as transfer pricing adjustment u/s 92CA."

6. It can be seen from the aforesaid calculation given by the TPO that the operating cost has been increased by Rs.8,05,93,261 which was reimbursement of expenses received by the Assessee from its AE. According to the Assessee this sum ought not to have been added to the operating cost as it was reimbursement of expenses at actual costs incurred by the Assessee on behalf of AE which was reimbursed by the AE. The TPO has given the following reasons for not accepting the claim of the Assessee in this regard:

"2.5 International Transactions (as mentioned in the 92 CE report)

- Provision of software services Rs.520,248,242/-
- Reimbursement Received Rs. 80,593,261/-

The arm's length price has to be determined with reference to the above international transactions.

The tax payer received an amount of Rs.80,593,261/- in the form of reimbursement. In the 3CEB Report it was stated that 'with respect to reimbursements received, the assessee has certified that the actual costs incurred on behalf of the AE are recharged to the AE and are supported by relevant third party invoices. Consequently the amount received/receivable is deemed to be arms length price.' In the TP report, the taxpayer did not mention anything about the reimbursement of expenses.

Thus the taxpayer was asked vide this office letter dated 17-08-2009 as under regarding the recovery of expenses or reimbursement of expenses received.

"Further, you are requested to submit the following:-

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2. Details and nature of reimbursement of expenses. Also clarify whether such expenses are routed through the profit and loss account. If yes, please specify the head(s) under which it is shown. If no, please show why such expenditure should not be included as part of your operating cost and thus for mark-up)."

In response, the taxpayer in its letter dated 04/09/2009 stated as under:

'Your goodself has requested for clarification in respect of reimbursement of expenses. With respect of reimbursement of expenses received, your assessee would like to submit that these expenses pertains to certain third party costs incurred by FCG India on behalf of FCG Inc and were reimbursed on cost to cost basis (i.e. without any mark up).'

The tax payer did not give any details of third party costs incurred by it. Further, it is not clarified whether these expenses are incurred in connection with the business of the taxpayer. These expenses are also substantial forming almost 15.5% of revenues. Further, these expenses are not routed through the profit and loss account. By the above, the taxpayer only said that there is no mark up by the AE while paying the above amounts in the form of reimbursement of expenses. No third party would like to be reimbursed on cost basis for such services. Thus the reimbursement of expenses is treated as for the purpose of business of the taxpayer and hence the same are considered part of the cost and revenues. Thus for the TP analysis, an amount of Rs.8,05,93,261/- is added to the operating revenues and expenses.

The transactions pertaining to the software development services segment are analysed as under. As the method followed

by the TPO and the taxpayer is TNMM(as discussed below), these transactions are aggregated for the transfer pricing study.”

7. Against the said adjustment proposed by the TPO which was incorporated in the draft assessment order by the AO, the assessee filed objections before the DRP. The DRP rejected those objections and confirmed the transfer pricing adjustment suggested by the TPO. The adjustment confirmed by the DRP was added to the total income of the assessee by the AO in the fair order of assessment. Against the said order of the Assessing Officer, the assessee has preferred the present appeal before the Tribunal.

8. The assessee filed a chart before us showing as to how some of the comparable companies chosen by the TPO are not comparable (a) for the reason that the turnover of those companies were beyond Rs.200 crores and therefore cannot be compared with the Assessee whose turnover is only Rs.12.99 Crores, (b) for the reason that these companies were not functionally comparable; (c) for the reason that the related party transaction (RPT) carried out by the comparable companies during the previous year was beyond 15% of its revenue and hence ought not to be included as a comparable. The Chart also gives the cases decided by various Benches of the ITAT where the comparable companies have been held to be not comparable with that of an Assessee providing IT Software development Services. We will proceed to consider the comparability of companies chosen by the TPO and listed in para- 4 of this order.

9. The Id. counsel for the assessee brought to our notice that out of the 20 comparable companies chosen by the TPO, the following companies will have to be excluded as the turnover of these companies are more than Rs.200 crores and cannot be compared with the Assessee whose turnover is less than Rs.100 crores:

(1) Flextronics Software Systems Ltd.	595.12 crores
(2) iGate Global Solutions Ltd.	527.91 crores
(3) Mindtree Ltd.	448.79 crores
(4) Persistent Systems Ltd.	209.18 crores
(5) Sasken Communication Technologies Ltd.	240.03 crores
(6) Infosys Technologies Ltd.	9028.00 crores.

Our attention was drawn to the observations of the Tribunal in the case of Triology E-Business Software India Pvt.Ltd. (supra) (ITA No.1338/Bang/2010) for assessment year (07-08) on the application of turnover filter and it was submitted that the aforesaid comparable companies have to be excluded from the final list of comparable selected by the TPO.

10. The learned counsel for the Assessee further submitted that turnover as a criteria for selecting comparables was not specifically pleaded either before the TPO or the DRP or in the original grounds of appeal filed before the Tribunal and is being raised by the Assessee as an issue by way of additional ground of appeal. It is the plea of the Assessee in the application for admission of additional ground of appeal that the issue raised by the Assessee in the additional ground is purely a legal issue and can be decided on the basis of material already available on record and in the light of the decision of the Hon'ble Supreme Court in

the case of National Thermal Power Corporation Vs. CIT 229 ITR 383 (SC) a question of law which can be decided on the basis of facts already available on record should be admitted for adjudication to determine the correct tax liability.

11. The learned counsel for the Assessee apart from reiterating the stand taken as above in the application for admission of additional ground, further placed reliance on the decision of the Hon'ble Special Bench in the case of the ITAT Chandigarh Bench in the case of DCIT v. Quark Systems Pvt. Ltd. 38 SOT 207 wherein it was held that a taxpayer is not estopped from pointing out a mistake in the assessment though such mistake is the result of evidence adduced by the taxpayer.

12. The learned DR opposed the prayer for admission of additional ground. According to him the Assessee is taking a totally new plea for the first time before Tribunal by way of additional ground and the same should not be permitted.

13. We have given a very careful consideration to the rival submissions. We are of the view that the question as to whether the aforesaid two companies are comparable or not with the Assessee company in terms of FAR analysis, has to be decided on the basis of data which is available in the public domain i.e., published annual report of these two companies. Therefore facts necessary to apply the filter sought to be relied upon by the Assessee in the additional ground of appeal are already available on record. Therefore there can be no valid objection to deciding the question of applying the aforesaid filter, if otherwise it is found to be a

valid filter. We are of the view that the decision of the special Bench, Chandigarh in the case of Quark Systems (supra) clearly supports the plea of the Assessee. The Special Bench in the aforesaid decision in the case of Quark Systems (supra) has after considering the OECD Commentaries observed as follows:

"35. In para 4.16 of latest report, the OECD provides the following guidelines :

"In practice, neither countries nor taxpayers should misuse the burden of proof in the manner described above. Because of the difficulties with transfer pricing analysis, it would be appropriate for both taxpayers and tax administrations to take special care and to use restraint in relying on the burden of proof in the course of the examination of a transfer pricing case. More particularly, as a matter of good practice the burden of proof should not be misused by tax administrations or taxpayers as a justification for making groundless or unverifiable assertions about transfer pricing. A tax administration should be prepared to make good faith showing that its determination of transfer pricing is consistent with the arm's length principle even where the burden of proof is on the taxpayer, and the taxpayers similarly should be prepared to make good faith showing that their transfer pricing is consistent with the arm's length principle regardless of where the burden of proof lies."

36. The aforesaid decisions and guidelines may not be exactly on identical facts before us but they emphatically show that taxpayer is not estopped from pointing out a mistake in the assessment though such mistake is the result of evidence adduced by the taxpayer.

37. When substantial justice and technical considerations are pitted against each other, the cause of substantial justice deserves to be preferred. For the other side cannot claim to have a vested right in injustice being done due to some mistakes on its part.

38. Accordingly, on facts and circumstances of the case, we hold that taxpayer is not estopped from pointing out that Datamatics has wrongly been taken as comparable. While admitting additional ground of appeal raised by the assessee to require us to consider whether or not Datamatics should be included in the comparable, we make no comments on merit except observing that assessee from record has shown its prima facie case. Further claim may be examined by the Assessing

Officer. This course we adopt as objection to the inclusion of Datamatics as comparable has been raised now and not before revenue authorities. Therefore, we deem it fit and proper to remit the matter to the file of the Assessing Officer for consideration of claim of the taxpayer and make a de novo adjudication of the arm's length price after providing reasonable opportunity of being heard to the assessee. We order accordingly."

14. The question as to whether the turnover filter was a filter applied in determining ALP in Software Development Services, is a matter of judicial decisions rendered in several decisions of the Tribunal and Hon'ble High Courts. In the light of the later judicial pronouncement, the Assessee is entitled to rely on the same and claim that the said filter should be applied to exclude a company chosen as a comparable company by the TPO. As held by the Special Bench in the case of Quark Systems(supra), there cannot be any tax liability on the basis of admission and the determination of tax liability has to be in accordance with law. In the light of the aforesaid judicial pronouncement, we are of the view that the additional ground of appeal deserves to be admitted for adjudication. Accordingly, the additional ground is admitted for adjudication.

15. We have considered the submission of the learned counsel for the Assessee. In the case of Triology E-Business Software India (P) Ltd. (supra), this Tribunal on application of the turnover filter while selecting comparable companies for comparability analysis held as follows:

"(1) Turnover Filter

11. The ld. counsel for the assessee submitted that the TPO has applied a lower turnover filter of Q 1 crore, but has not chosen

to apply any upper turnover limit. In this regard, it was submitted by him that under rule 10B(3) to the Income-tax Rules, it was necessary for comparing an uncontrolled transaction with an international transaction that there should not be any difference between the transactions compared or the enterprises entering into such transaction, which are likely to materially affect the price or cost charged or paid or profit arising from such transaction in the open market. Further it is also necessary to see that wherever there are some differences such differences should be capable of reasonable accurate adjustment in monetary terms to eliminate the effect of such differences. It was his submission that size was an important facet of the comparability exercise. It was submitted that significant differences in size of the companies would impact comparability. In this regard our attention was drawn to the decision of the Special Bench of the ITAT Chandigarh Bench in the case of *DCIT v. Quark Systems Pvt. Ltd.* 38 SOT 207, wherein the Special Bench had laid down that it is improper to proceed on the basis of lower limit of 1 crore turnover with no higher limit on turnover, as the same was not reasonable classification. Several other decisions were referred to in this regard laying down identical proposition. We are not referring to those decisions as the decision of the Special Bench on this aspect would hold the field. Reference was also made to the OECD TP Guidelines, 2010 wherein it has been observed as follows:-

“Size criteria in terms of Sales, Assets or Number of Employees: The size of the transaction in absolute value or in proportion to the activities of the parties might affect the relative competitive positions of the buyer and seller and therefore comparability.”

12. The ICAI TP Guidelines note on this aspect lay down in para 15.4 that a transaction entered into by a Rs. 1,000 crore company cannot be compared with the transaction entered into by a Rs. 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate. The fact that they operate in the same market may not make them comparable enterprises. The relevant extract is as follows [on Rule 10B(3)]:

“Clause (i) lays down that if the differences are not material, the transactions would be comparable. These differences could either be with reference to the transaction or with reference to the enterprise. For instance, a transaction entered into by a Rs 1,000 crore company cannot be compared with the transaction entered into by a Rs 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate.”

13.It was further submitted that the TPO's range (Rs. 1 crore to infinity) has resulted in selection of companies like Infosys which is 277 times bigger than the Assessee (turnover of Rs. 13,149 crores as compared to Rs. 47.47 crores of Assessee). It was submitted that an appropriate turnover range should be applied in selecting comparable uncontrolled companies.

14.Reference was made to the decision of the ITAT Bangalore Bench in the case of *Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010*, wherein relying on Dun and Bradstreet's analysis, the turnover of Q 1 crore to Q 200 crores was held to be proper. The following relevant observations were brought to our notice:-

"9. Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which are (sic) making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1.00 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study."

15.It was brought to our notice that the above proposition has also been followed by the Honourable Bangalore ITAT in the following cases:

1.M/s Kodiak Networks (India) Private Limited Vs. ACIT (ITA No.1413/Bang/2010)

2.M/s Genesis Microchip (I) Private Limited Vs. DCIT (ITA No.1254/Bang/2010).

3.Electronic for Imaging India Private Limited (ITA No. 1171/Bang/2010).

16.It was finally submitted that companies having turnover more than Rs. 200 crores ought to be rejected as not comparable with the Assessee.

17. The Id. DR, on the other hand pointed out that even the assessee in its own TP study has taken companies having turnover of more than Q 200 crores as comparables. In these circumstances, it was submitted by him that the assessee cannot have any grievance in this regard.

18. We have considered the rival submissions. The provisions of the Act and the Rules that are relevant for deciding the issue have to be first seen. Sec.92. of the Act provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Sec.92-B provides that "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. Sec.92-A defines what is an Associated Enterprise. In the present case there is no dispute that the transaction between the Assessee and its AE was an international transaction attracting the provisions of Sec.92 of the Act. Sec.92C provides the manner of computation of Arm's length price in an international transaction and it provides:-

(1) that the arm's length price in relation to an international transaction shall be determined by any of the following methods,

being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price.

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

- (a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or
- (b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
- (c) the information or data used in computation of the arm's length price is not reliable or correct; or
- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Rule 10B of the IT Rules, 1962 prescribes rules for Determination of arm's length price under section 92C:-

“10B. (1) For the purposes of sub-section (2) of section 92C, the arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a).....

to

(d).....

(e)transactional net margin method, by which,—

(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm’s length price in relation to the international transaction.

(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical

location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction if—

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into :

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.”

A reading of the provisions of Rule 10B(2) of the Rules shows that uncontrolled transaction has to be compared with international transaction having regard to the factors set out therein. Before us there is no dispute that the TNMM is the most appropriate method for determining the ALP of the international transaction. The disputes are with regard to the comparability of the comparable relied upon by the TPO.

In this regard we find that the provisions of law pointed out by the Id. counsel for the assessee as well as the decisions referred to by the Id. counsel for the assessee clearly lay down the principle that the turnover filter is an important criteria in choosing the comparables. The assessee's turnover is Q 47,46,66,638. It would therefore fall within the category of companies in the range of turnover between 1 crore and 200 crores (as laid down in the case of *Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010*) . Thus, companies having turnover of more than 200 crores have to be eliminated from the list of comparables

as laid down in several decisions referred to by the Id. counsel for the assessee. Applying those tests, the following companies will have to be excluded from the list of 26 comparables drawn by the TPO viz.,

Turnover Q

(1)Flextronics Software Systems Ltd.	848.66 crores
(2) iGate Global Solutions Ltd.	747.27 crores
(3) Mindtree Ltd.	590.39 crores
(4) Persistent Systems Ltd.	293.74 crores
(5) Sasken Communication Technologies Ltd.	343.57 crores
(6) Tata Elxsi Ltd.	262.58 crores
(7) Wipro Ltd.	961.09 crores
(8) Infosys Technologies Ltd.	13149 crores"

16. The learned DR however relied on the decision of the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt.Ltd. Vs. DCIT (2015) 56 Taxmann.com 417 (Del) wherein at para-3 of the said judgment the Hon'ble Delhi High Court held that the mere circumstance of a company otherwise conforming to the stipulations in Rule 10B(2) of the IT Rules, 1962 (Rules) in all details, presenting a peculiar feature, such as huge profit or a huge turnover, ipso facto does not leads to its exclusion. The TPO, first, has to be satisfied that such differences do not "materially affect the price... or cost"; secondly, an attempt to make reasonable adjustment to eliminate the material effect of such differences has to be made. The learned counsel for the Assessee however submitted that the Hon'ble Court was only by way of an obiter dictum and the Hon'ble Court was concerned only with the issue of excluding high profit making or abnormally loss making companies from being regarded as comparable companies. He pointed out that in

any event the earlier decision of the Hon'ble Delhi High Court in the case of Agnity India Technologies Pvt.Ltd. ITA No.1204/2011 dated 10.7.2013 had taken the view that turnover was a relevant criteria in choosing comparable companies.

17. We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt.Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of CIT Vs. Pentair Water India Pvt.Ltd. Tax Appeal No.18 of 2015 judgment dated 16.9.2015 has taken the view that turnover is a relevant criteria for choosing companies as comparable companies in determination of ALP in transfer pricing cases. In doing so the Hon'ble Bombay High Court has followed the decision of the Hon'ble Delhi High Court in the case of Agnity India Technologies Pvt.Ltd. (Supra). There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view

favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 6 companies from the list of comparable companies chosen by the TPO on the basis of turnover and size. We hold that the following companies, viz.,

(1) Flextronics Software Systems Ltd.	595.12 crores
(2) iGate Global Solutions Ltd.	527.91 crores
(3) Mindtree Ltd.	448.79 crores
(4) Persistent Systems Ltd.	209.18 crores
(5) Sasken Communication Technologies Ltd.	240.03 crores
(6) Infosys Technologies Ltd.	9028.00 crores

having turnover above Rs.200 Crores should be excluded from the list of comparable companies. The AO is directed to compute the Arithmetic mean by excluding the aforesaid companies from the list of comparable.

18. **Improper selection of comparables:** It was submitted by the learned counsel for the Assessee that the following 2 companies are not functionally comparable with that of the Assessee.

- a) KALS Information Systems Limited
- b) Accel Transmission Limited.

In this regard our attention was drawn to the decision of the Hon'ble ITAT Bangalore Bench in the case of Triology E-Business Software India Pvt.Ltd. (supra) wherein these companies were held to be not functionally comparable with that of a pure software developer like the Assessee.

19. The following were the relevant observations of the Tribunal on the aforesaid comparable companies in the case of Triology E-Business Software India Pvt.Ltd.(supra):

“(d) KALS Information Systems Ltd.

As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Q 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of *Bindview India Private Limited Vs. DCI, ITA No. ITA No 1386/PN/10* wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

“16. Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of I T enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds.”

Based on all the above, it was submitted on behalf of the assessee that KALS Information Systems Limited should be rejected as a comparable.

We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly

software development service provider. We therefore accept the plea of the Assessee that this company is not comparable.”

“(e) Accel Transmatic Ltd.

48. With regard to this company, the complaint of the assessee is that this company is not a pure software development service company. It is further submitted that in a Mumbai Tribunal Decision of *Capgemini India (F) Ltd v Ad. CIT 12 Taxman.com 51*, the DRP accepted the contention of the assessee that Accel Transmatic should be rejected as comparable. The relevant observations of DRP as extracted by the ITAT in its order are as follows:

“In regard to Accel Transmatics Ltd. the assessee submitted the company profile and its annual report for financial year 2005-06 from which the DRP noted that the business activities of the company were as under.

(i) Transmatic system - design, development and manufacture of multi function kiosks Queue management system, ticket vending system

(ii) Ushus Technologies - offshore development centre for embedded software, net work system, imaging technologies, outsourced product development

(iii) Accel IT Academy (the net stop for engineers)- training services in hardware and networking, enterprise system management, embedded system, VLSI designs, CAD/CAM/BPO

(iv) Accel Animation Studies software services for 2D/3D animation, special effect, erection, game asset development.

4.3 On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different from the assessee company as it was engaged in the services in the form of ACCEL IT and ACCEL animation services for 2D and 3D animation and therefore assessee’s claim that this company was functionally different was accepted. DRP therefore directed the Assessing Officer to exclude ACCEL Transmatic Ltd. from the final list of comparables for the purpose of determining TNMM margin.”

Besides the above, it was pointed out that this company has related party transactions which is more than the permitted level and therefore should not be taken for comparability purposes. The submission of the Id. counsel for the assessee was that if the above company should not be considered as comparable. The Id. DR, on the other hand, relied on the order of the TPO.

50. We have considered the submissions and are of the view that the plea of the assessee that the aforesaid company should not be treated as

comparables was considered by the Tribunal in *Capgemini India Ltd (supra)* where the assessee was software developer. The Tribunal, in the said decision referred to by the Id. counsel for the assessee, has accepted that this company was not comparable in the case of the assessee engaged in software development services business. Accepting the argument of the Id. counsel for the assessee, we hold that the aforesaid company should be excluded as comparables.”

20. The facts and circumstances under which the aforesaid companies were considered as comparable is identical in the case of the Assessee as well as in the case of Triology E-Business Software India Pvt.Ltd. (supra). Respectfully following the decision of the Tribunal referred to above in the case of Triology E-Business Software India Pvt.Ltd.(supra), we direct that KALS InfoSystems Ltd. And Accel Transmatic Ltd. be excluded from the list of 20 comparable arrived at by the TPO.

21. As far as comparable companies chosen by the TPO viz., Aztec Software Limited and Geometric Software Ltd. (Seg.) and Megasoftware Ltd., are concerned, it is not in dispute before us that the related party transaction in the case of companies exceeds 15% and in view of the decision of the Tribunal in the case of 24 X 7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010, followed by this Tribunal in the case of Logica Private Ltd. (supra) wherein it was held that where the RPT exceeds 15%, such companies should not be taken as comparable companies. Following the said decision, we hold that the aforesaid companies referred to above be excluded from the list of comparable companies while working out the ALP.

22. As far as comparable company chosen by the TPO viz., Tata Elxsi Ltd., is concerned, the comparability of the aforesaid company with that of the software service provider such as the Assessee was considered by the Mumbai Bench of this Tribunal in the case of Logica Pvt.Ltd. IT (TP) 1129/Bang/2011 AY 07-08) wherein on the comparability of the aforesaid company, the Tribunal held as follows:-

"14. As far as comparable at Sl.No.6 & 24 are concerned, the comparability of the aforesaid two companies with that of the software service provider was considered by the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India Private Ltd. (supra)* wherein on the aforesaid two companies, the Tribunal held as follows:-

"7.7.Tata Elxsi Limited.:

From the facts and material on record and submissions made by the learned AR, it is seen that the 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 AR 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 fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties."

15. In view of the above, the Id. counsel for the assessee fairly admitted that comparable company at Sl.No.6 viz., Flextronics Software Systems Pvt. Ltd. should be taken as a comparable, while comparable at Sl.No.24 viz., Tata Elxsi Ltd. should be rejected as a comparable."

23. In view of the aforesaid decision, we hold that Tata Elxsi has to be excluded from the list of comparable chosen by the TPO.

24. The next submission of the learned counsel for the Assessee is on ground No.4.6 of the grounds of appeal before the Tribunal which reads thus:

“4.6 That the learned TPO erred in considering cost to cost receipt of reimbursement of expenses as part of the operating income and operating expenses for the purposes of determining the arm’s length price.”

25. The DRP in its order in para 4 to 4.2 has expressed the view that the same is part of the operating revenue in the software development service segment of the Assessee. The submission of the Assessee before the DRP was that these expenses were incurred by the Assessee on behalf of the holding company and are not in any way related to the operations of the Assessee in the software development service segment. The Assessee also pointed out that there was no mark-up and the reimbursements were on the basis of actual expenditure incurred by the Assessee on behalf of the holding company. Therefore the reimbursement of expenses should be evaluated independently and should not be separately added back to the cost base and the revenue for the purposes of determination of ALP.

26. Before us the learned counsel for the Assessee submitted that the details of the reimbursement of expenses were not filed before the TPO or the DRP as there was merger proceedings of the Assessee with other entities. The details were filed before us and the same is available at page 763 of the Assessee’s paper book-II filed before us. It was submitted that the aforesaid reimbursements had nothing to do with the

software development services rendered by the Assessee to its AE. It was further pointed out that in AY 2008-09 in Assessee's own case this Tribunal in IT (TP) A.No.1242/Bang/2012 order dated 21.8.2014 has held, following the decision of the Bangalore ITAT in the case of LG Soft India (P) Ltd. Vs. DCIT in IT(TP) A.No.1121/Bang/2011 dated 22.3.2013, that if the receipts are mere recovery of expenses without any service than the same should not be added back to the cost base for the purpose of mark up. Following the said decision the ITAT remanded to the TPO/AO to examine the facts with regard to reimbursement.

27. We are of the view that in the light of the aforesaid decision in Assessee's own case, that the issue needs re-examination by the TPO/AO in the light of the material now placed by the Assessee before the Tribunal. The TPO/AO shall consider the claim of the Assessee in this regard. The Assessee will provide the necessary supporting evidence to substantiate its claim. The TPO/AO will examine the claim of the Assessee after affording opportunity of being heard and in the light of the ruling of the ITAT in the case of LG Soft India (P) Ltd.(supra). We hold and direct accordingly.

28. The learned counsel for the Assessee has submitted before us that the TPO and the DRP have rejected the claim of the Assessee regarding risk adjustment. The Assessee has given detailed submissions in this regard in Ground No.12 raised before the DRP. The DRP has not given any findings in this regard. We are of the view that in the present case, the question of risk adjustment may not be required to be gone into in

view of the fact that many of the comparable companies chosen by the TPO have been deleted from the list of comparable companies for determination of arithmetic mean of profit margin of comparable companies to determine ALP. We therefore deem it fit and proper to leave this issue open for the present, with liberty to the Assessee to raise this issue, if circumstances warrant in some other AY. No other submissions were made on other grounds of appeal raised before us with regard to determination of ALP, except with regard to comparability analysis, reimbursement of expenses being treated as part of operating expenses and risk adjustment.

29. It was submitted by the learned counsel for the Assessee that after excluding the aforesaid comparable companies from the list of comparable chosen by the TPO and after considering the reimbursements received by the Assessee from its AE as not part of the operating revenue, the difference between the arithmetic mean of profit margin of the remaining comparable companies and the Assessee's profit margin to operating profit on cost would be within the + / - 5% range and thus the addition made by the TPO and confirmed by the DRP needs to be deleted. It was prayed that the addition made may be deleted. We direct the TPO to verify the claim of the Assessee in this regard after excluding the comparable companies which have been excluded and arrive at the ALP. The relevant grounds of appeal of the Assessee are treated as allowed.

30. The Assessee in the grounds of appeal No.5 to 7 projected its grievance regarding the action of the learned Assessing Officer and Honorable Dispute Resolution Panel in excluding, while computing deduction u/s.10A of the Act, lease-line expenses of Rs.33,51,238 from the export turnover on the ground that these expenses are attributable to delivery of software outside India from the export turnover. It is the plea of the Assessee that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee has also made an alternate prayer that expenses that are reduced from the export turnover should also be reduced from the total turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*,

31. We have heard the Id. counsel for the assessee and the Id. DR on the issues raised in this regard. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that it would be just and appropriate to direct the Assessing Officer to exclude telecommunication charges and insurance charges incurred be excluded both from export turnover and total turnover, as has been prayed for by the assessee in the alternative. In view of the acceptance of the alternative prayer, we are of the view that no adjudication is required on

the ground whether the aforesaid sums are required to be excluded from the export turnover.

32. The other grounds of appeal are purely consequential and the AO is directed to give consequential relief.

33. In the result the appeal by the Assessee is partly allowed.

Pronounced in the open court on this 08th day of January, 2016.

sd/-
(ABRAHAM P. GEORGE)
ACCOUNTANT MEMBER
Bangalore,
Dated, the 8th Jan. 2016.
/Eks/

sd/-
(N.V. VASUDEVAN)
JUDICIAL MEMBER

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore