

IN THE INCOME TAX APPELLATE TRIBUNAL  
BENGALURU BENCH 'A', BENGALURU

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER

AND

SHRI. S. JAYARAMAN, ACCOUNTANT MEMBER

I.T(TP).A No.44/Bang/2015  
(Assessment Year : 2010-11)

Cerner Healthcare Solutions P Ltd,  
Ground floor, Wing B, Block H2,  
Mountain Ash, Manyata Embassy Business Park,  
Outer Ring Road, Nagawara, Bengaluru 560 045 .. Appellant  
PAN : AACCC3795R

v.

Income Tax Officer,  
Ward – 11(1), Bengaluru .. Respondent

I.T (TP).A No.69/Bang/2015  
(Assessment Year : 2010-11)

Income Tax Officer,  
Ward – 11(1), Bengaluru .. Appellant

v.

Cerner Healthcare Solutions P Ltd,  
Ground floor, Wing B, Block H2,  
Mountain Ash, Manyata Embassy Business Park,  
Outer Ring Road, Nagawara, Bengaluru 560 045 .. Respondent

Assessee by : Shri.Chavali S. Narayan, CA  
Revenue by : Shri. Kamaladhar, Standing Counsel

Heard on : 20.10.2016  
Pronounced on : 16.01.2017

**ORDER**

**PER S. JAYARAMAN, ACCOUNTANT MEMBER :**

These are cross appeals filed by the assessee and the Revenue against the order dt.12.11.2014 of the CIT (A) –IV, Bengaluru, for the assessment year 2010-11.

2. Cerner Healthcare Solutions Private Limited, the assessee, is a captive service provider engaged in the business of rendering software development services to its Associated Enterprise ("AE") at cost plus 15% mark-up. During the year, its international transaction on provision of software development services was at Rs.84,73,05,146/-. The assessee undertook a Transfer Pricing ("TP") study, on a set of 15 comparables with weighted average operating profit/operating cost of 14.64% for software development services. The margin was arrived taking the average of three year data. The assessee's net margin of 15.35 percent was higher than the arm's length margin of comparable companies. However, the TPO on his TP study, rejected assessee's 10 comparables, retained 5 of them. In the TP proceedings, the TPO

- used single year data and modified certain filters
- undertook a restricted working capital adjustment of 1.98% (*actual working capital adjustment is 6.54%*)
- computed the operating margins of comparable companies by considering foreign exchange gain/losses as non-operating in nature.

The final set of 11 comparables selected by the TPO and its operating margin are as under :

Sl.no	Name of the Company	Operating Margin
1	ICRA Techno Analytics Limited (segmental)	24.94%
2	Infosys Technologies Limited	44.98%
3	Kals Information Systems Limited (segmental)	34.41%
4	Larsen &Toubro Infotech Limited	19.33%
5	Mindtree Limited (segmental)	14.83%
6	Persistent Systems & Solutions Ltd	15.38%
7	Persistent Systems Limited	30.35%
8	R S Software (India) Limited	10.29%
9	Sasken Communication Technologies Limited	17.36%

10	Tata Elxsi Limited (segmental)	20.93%
11	Thinksoft Global Services Limited	17.05%
	Arithmetic mean	22.71%
	Less: Working capital adjustment	1.98%
	Adjusted arithmetic mean	20.73%

03. On the corporate tax front, the AO found that the assessee paid Rs.3,47,42,280/- towards reimbursement of salaries, communication expenses, purchase of fixed assets and other miscellaneous expenses to Cerner Corporation , USA . The AO required the assessee to show cause as to why such payments be not treated as fee for technical services and why TDS was not made on such payments. After considering assessee's reply, relevant documents and other materials, the AO held that the assessee is a subsidiary of Cerner Corporation , USA and is engaged in software development. It required technical knowledge, experience & skill in order to carry on its business which was met by Cerner Corporation , USA by deputing its employees who possessed the necessary technical knowledge, experience & skill. They have imparted the knowledge & skill to the members of assessee which falls within the meaning of technical training as contemplated in the MOU & DTAA and hence the AO held that the reimbursement amount is chargeable to tax. Since the assessee has deducted TDS u/s192 at Rs.83,97,648/-, the AO disallowed the balance sum at Rs.2,59,96,977/-u/s40(a)(i). Further, the AO held that data communication, voice communication and cell phone expenses incurred in foreign currency is attributable to delivery of software outside India and hence it should be excluded from the export turn over while computing deductions u/s 10A & 10AA, respectively.

04. On an appeal, the CIT(A)-IV, Bangalore , intera alia,
- upheld the turnover filter of 1 to 200 crores and rejected 5 companies having turnover greater than Rs. 200 crores viz Infosys Ltd, Larsen & Toubro Infotech Ltd, Mindtree Ltd (seg) , Persistent System Ltd, Sasken communication Technologies and Tata Elxsi Ltd(seg) and directed the TPO to exclude them as comparable;
  - directed the TPO to rectify the error in the margin computation of Kals Information Systems Limited and errors in computation of receivable and payables of comparable companies for the purpose of working capital computation; and
  - directed the TPO to accept the claim of the assessee with respect to foreign exchange gain/loses as part operating revenue for computation of operating margins of the assessee and comparables.
  - Relying on the Jurisdictional High Court decision in CIT v Tata Elxsi 349 ITR 198, the CIT(A) held that while computing deductions u/s 10A & 10AA, respectively, data communication, voice communication and cell phone expenses incurred in foreign currency should be excluded from the export turn over as well from total turnover .
  - Following his decision rendered in ay 2009-10, the CIT(A) upheld the addition made u/s40(a)(i).

05. Aggrieved the assessee filed the appeal in IT (TP)A44/B/2015 with the following grounds :

Based on the facts and circumstances of the case and in law, Cerner Healthcare Solutions Private Limited (hereinafter referred to as "Cerner Healthcare" or the "Company" or the "Appellant"), respectfully craves leave to prefer an appeal against the appeal order passed by the learned Commissioner of Income-Tax (Appeals) – IV (hereinafter referred to as the "learned CIT(A)") under section 250 of the Income-tax Act, 1961 ("Act") on the following grounds:

On the facts and circumstances of the case and in law:

1. The order of the learned CIT(A) is based on incorrect interpretation of law and therefore is bad in law.

Grounds of appeal relating to Corporate tax grounds

2. The learned CIT(A) has erred in fact by holding that Appellant had no obligation to reimburse to Cerner Corporation, expenses in the nature of salary that had been incurred by Cerner Corporation on behalf of the Appellant.
3. The learned CIT(A) has erred in law and in fact by concluding that the expenses reimbursed by the Appellant to Cerner Corporation on account of expenses incurred on behalf of the Appellant cannot be treated as a pure reimbursement of expense.
4. The learned CIT(A) has erred in adjudicating on a ground which was not appealed by the Appellant and disregarded the fact that the expenses reimbursed by the Appellant to Cerner Corporation are in the nature of salary expense and have already been subject to applicable tax under Section 192 of the Act and accordingly should not suffer further tax under Section 195 of the Act.
5. The learned CIT(A) has erred in law and in fact by concluding that the reimbursement of expenses related to salaries by the appellant to Cerner Corporation would be in the nature of Fees for technical services under the Act as well as the India – USA Double Tax Avoidance Agreement.
6. The learned CIT(A) has erred in law and in fact by concluding that the above reimbursements of expenses related to salaries by the Appellant to Cerner Corporation would be liable to tax in India under Section 195 of the Act.
7. The learned CIT(A) has committed judicial impropriety and also erred in law in refusing to follow the order passed by the Appellate Tribunal on same issues in the Appellant's own case for AY 2006-07.

- B. The learned CIT(A) has erred in law and in facts by not adjudicating on the following grounds of the appeal raised by the Appellant in the appeal filed before the CIT(A):
- Ground No 6 - The learned AO has erred in law and in facts by holding that Appellant had no obligation to reimburse to Cerner Corporation ("Cerner Corp"), expenses (in the nature of communication expenses and other miscellaneous expenses) that had been incurred by Cerner Corp on behalf of the Appellant.
  - Ground No 7 - The learned AO has erred in law and in fact by concluding that the above expenses reimbursed by the Appellant to Cerner Corp on account of expenses incurred by Cerner Corp on behalf of the Appellant are subject to withholding tax provisions under Section 195 of the Act.
  - Ground No 8 - The learned AO has erred in law and in fact by concluding that the reimbursements amounting to Rs 2,58,96,977 should be disallowed under section 40(a)(i) of the Act.
  - Additional Ground No 1 - The learned AO has erred in law and in fact by treating the expenses reimbursed by the Appellant, as being in the nature of Fees for Technical Services under the Act and the India-USA Double Tax Avoidance Agreement ("India US DTAA") without analysing the taxability of each expense individually.
  - Additional Ground No 2 - The learned AO erred in law and in fact that even if the expenses are disallowed under Section 40(a)(i) of the Act, the business profits eligible for deduction under Section 10A and Section 10AA of the Act should be increased by the expenses disallowed under Section 40(a)(i) of the Act and a deduction under Section 10A and Section 10AA of the Act be computed on such increased amount.

Grounds of appeal relating to transfer pricing matters

9. The learned CIT(A) has erred in law and facts in enhancing the total income of the Appellant on account of adjustment in the arm's length price of the provision of software development services transaction, entered by the Appellant with its Associated Enterprises ("AEs");
10. The learned CIT(A) has erred in law and facts by not accepting the Appellant's plea entirely and confirming with the learned Assessing Officer ("AO"/Transfer Pricing Officer ("TPO") on not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Income-tax Rules, 1962 ("Rules"), and conducting a fresh economic analysis for the determination of the arm's length price in connection with the impugned international transaction and holding that the Appellant's international transaction is not at arm's length;
11. The learned CIT(A) has erred in law and facts by upholding the action of AO/TPO in determination of the arm's length margin/price using only FY 2008-10 data which was not available to the Appellant at the time of complying with the transfer pricing documentation requirements;
12. The learned CIT(A) has erred in law and facts by upholding the action of AO/TPO in rejecting certain comparables considered by the Appellant in the comparability analysis by applying different quantitative and qualitative filters:
- a) The learned CIT(A) has erred, in law and in facts, by not accepting the Appellant's plea that companies having different accounting year (i.e. companies having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months) should not be rejected.
  - b) The learned CIT(A) has erred, in law and in facts, by not accepting the Appellant's plea that companies should not be rejected using employee cost greater than 25 percent of the total revenues as a comparability criterion.

- c) The learned CIT(A) has erred, in law and in facts, by not accepting the Appellant's plea that rejecting companies using export sales less than 75 percent of the operating revenues as a comparability criterion in respect of the software development services transaction, is not appropriate.
13. The learned CIT(A) has erred, in law and in facts, by upholding the action of AO/TPO in accepting/ rejecting certain comparable companies based on unreasonable comparability criteria.
14. The learned CIT(A) has erred, in law and facts, by upholding the action of AO/TPO in restricting the benefit on account of working capital adjustment to 1.98 percent and not providing the actual adjustment.
15. The learned CIT(A) has erred, in law and facts, by not making suitable adjustments to account for differences in the risk profile of the Appellant vis-à-vis the comparables and concluding that once the working capital adjustment is granted, there is no necessity of providing any further adjustments.
16. The learned CIT(A) has erred, in law and facts, by not making suitable adjustments to account for differences towards marketing expenditure incurred by the comparables and concluding that once the working capital adjustment is granted, there is no necessity of providing any further adjustments.
17. The learned CIT(A) has erred, in law and facts, by not making suitable adjustments to account for differences in the Research and Development activities undertaken by the comparables and concluding that once the working capital adjustment is granted, there is no necessity of providing any further adjustments.
18. The learned CIT(A) has erred, in law and facts, by not making suitable adjustments to account for differences in the capacity utilization of the Appellant vis-à-vis the comparables and concluding that once the working capital adjustment is granted, there is no necessity of providing any further adjustments.
19. The learned CIT(A) has erred, in law and facts by, ignoring the fact that the Appellant is availing tax holiday under section 10A and 10AA of the Act, and there is no motive/ reason to shift the profits out of India, which is one of the basic intention of the introducing the transfer pricing provisions.
20. The learned CIT(A) has erred, in law and facts, in computing the ALP without giving benefit of +/- 5 percent under the proviso to section 92C(2) of the Act;

General Grounds of appeal

21. The learned CIT(A) has erred, in law and facts by not appreciating and considering the arguments put forth in the submissions made by the Appellant on the above issues.
22. The learned CIT(A) has erred, in law and facts, in confirming the imposition of interest under Sections 234B and 234D of the Act by the learned AO .
23. The learned CIT(A) has erred, in law and facts, in upholding initiation of penalty proceedings under section 271(1)(c) of the Act by the learned AO.

06. The Revenue filed its appeal in IT (TP) A69/B/2015 with the following grounds :

**GROUND OF APPEAL ON CORPORATE ISSUES**

- 1) The order of the Ld. CIT(A) is clearly opposed to law as far as the findings are perverse, contrary to the facts and circumstances of the case and hence not sustainable.
- 2) The CIT(A) erred in directing the AO to re-compute the deduction allowable u/s 10A/10AA of the IT Act after reducing an amount from the total turnover also.
- 3) The Ld.CIT(A) ought to have appreciated that there is no provision in section 10A which requires the concerned expenses, which are required to be reduced from the export turnover as per clause (iv) of the Explanation to Section 10A to be reduced from the total turnover also.
- 4) The Ld.CIT(A) erred in not considering the fact that the decision of the jurisdictional High Court in the case of Tata Elxsi Ltd. on which the CIT(A) has placed reliance in the instant case, has not been accepted by the department and SLP has been filed before the Hon'ble Supreme Court which is still pending.

**GROUND OF APPEAL ON TRANSFER PRICING ISSUES**

- a) The Ld.CIT(A) erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable and accordingly erred in excluding the comparables, Tata Elxsi Ltd., Sasken Communication Technologies Ltd., Persistent Systems Ltd., Mindtree Ltd.(seg), L & T Infotech Infosys Ltd. in Software development segment.
- b) The Ld.CIT(A) erred in excluding uncontrolled comparables having turnover more than Rs.200 crores in the absence of Turnover criterion prescribed in Rule 10B of the Income Tax Rules and also there being no correlation between turnover and profit margin.
- c) The Ld.CIT(A) erred in law in holding that foreign exchange loss/gain as well as forex gain/loss are to be treated as operating in nature even though the same have not been derived from operating activity even though they may be incidental and not critical to operational activities of the business conducted by the taxpayer.
- d) The Ld.CIT(A) erred in law in directing to include forex gains/loss as part of operating income/loss without ascertaining the nexus with the business activity of the taxpayer.

07. The AR submitted that the AO has not made any disallowances on reimbursement of salaries at Rs 8,397,648 under Section 40(a)(i) on the ground that the assessee has withheld and deposited taxes on Salary under Section 192. However, the CIT (A) has wrongly adjudicated on reimbursement of salaries, which was not the subject matter of appeal before the CIT (A) . Since the CIT (A) has wrongly adjudicated on the matter, which was never the subject matter of appeal before him, the CIT(A) order has to be quashed. Further, it was submitted that the AO has held that the reimbursement of expenses (other than salaries) is subject to withholding of taxes under Section 195. The CIT (A) has not adjudicated on the reimbursement of expenses though there was a specific ground of appeal raised before him . Further, the CIT (A) has not adjudicated on the following grounds raised in the appeal filed before him :

*- The AO has erred in law and in facts by holding that there is no obligation to reimburse to Cerner Corporation expenses (in the nature of communication and other miscellaneous expenses) that had been incurred on behalf of the Assessee.*

*- The AO has erred by concluding that the above expenses are subject to withholding taxes and hence disallowed under Section 40(a)(i) of the Act.*

*- The AO has erred by treating the expenses as FTS without analysing the taxability of each expense individually*

*- The AO has erred in computing the deduction allowed under Section 10A and 10AA by not considering the increased amount of profit after disallowance under 40(a)(i).*

08. The A R further submitted that for the similar issues, in the assessee's own case, the Hon'ble ITAT for AY 2006-07 [ITA No.627(Bang)/ 2011] has held that reimbursement of expenses is not liable to tax. Thus, the AR submitted that the CIT (A) has committed judicial impropriety and also erred in law in

refusing to follow the order passed by the Appellate Tribunal on same issues in the assessee's own case for AY 2006-07.

09. We have considered the rival submissions and gone through relevant documents. It is clear that the AO has not made any disallowances on reimbursement of salaries at Rs 8,397,648 under Section 40(a)(i) on the ground that the assessee has deducted and deposited taxes on salary u/s 192 and hence he added the balance sum at Rs.2,59,96,977/- only u/s 40(a)(i). It appears that the CIT (A), without considering the facts, the grounds of appeal before him and without properly applying his mind with reference to the ratios laid in the decision of this Tribunal in ITA No.627(Bang)/ 2011 in the assessee's case for ay 2006-07 which was brought to his notice, has extracted his earlier year order and concluded the matter that " My decision taken is hereby followed and the action of the AO is upheld" which resulted in the above impropriety. In the facts and circumstances, the matters connected in the assessee's appeal grounds nos 2 to 8 including the sub-grounds mentioned below ground no 8 are set aside to the CIT (A). The CIT (A) would decide them afresh after affording due opportunity to the assessee. Assessee's appeal grounds nos 2 to 8 are treated as allowed for statistical purposes.

10. On the TP matters, the AR submitted that the following comparables are to be rejected as they are functionally different from it and their turn over is more than 10 times of its turnover. The gist of his arguments and the cases relied on, are as under:

1. Infosys Technologies Ltd is functionally different, it owns significant intangibles and intellectual property. Differences in Risk levels assumed and has huge revenue from software products.

Case laws : Electronics for Imaging India P Ltd ay 2010-11 in IT (TP)A no. 212/Bang/2015 & CO No 94/ Bang/2015 dt 24.02.2016 , Ikanos Communications India Ltd ,ay 2010-11 in IT (TP)A no. 137/Bang/2015 & CO No 109/ Bang/2015 dt 10.11.2015, Finserv India - a y . 2009-10 ITA No 1822/Del/2014 etc

2. Larsen & Toubro Infotech Ltd is functionally different, it owns significant intangibles assets and also has huge brand value. Offers business analytics and system integration services, software products and its segmental breakup not available.

Case laws : Pegasystems Worldwide India P Ltd ay 2010-11 ITA No 1758/Hyd/2014 & 1936/Hyd/2014 etc

11. Further, the AR submitted that the following comparables are to be rejected as they are functionally different based on the judicial precedents. The gist of his arguments and the cases relied on, are as under :

1. ICRA Techno Analytics Ltd (seg) is functionally different, engaged in host of other services such as engineering, web development, hosting, business process outsourcing services as well as business analytics. Segmental information not available

Case laws : Electronics for Imaging India P Ltd, Ikanos Communications etc.

2. KALS Information Systems Ltd is functionally different, its revenue consists of revenue from sale of software products . Its segmental break up is not available.

Case laws : M/s. Mercedes Benz Research & Development India P Ltd, Electronics for Imaging India P Ltd, Ikanos Communications etc.

3. Persistent Systems Ltd is functionally different as it is providing product development and product design services. Earns revenue from licensing and sale of products and services. Its segmental breakup is not available.

Case laws : Electronics for Imaging India P Ltd , Equant Solutions India P Ltd etc

4. Tata Elxsi Ltd is functionally different, the "software development & services" segment includes various diversified services such as product designing, industrial

design and engineering, visual computing lab services and the sub-segment breakup of the same is not available.

Case laws : M/s. Mercedes Benz Research & Development India P Ltd , a y 2020-11 in IT(TP)A No 291/Bang/2015 & 427/Bang/2015,Electronics for Imaging India P Ltd etc

5. Sasken Communication Technologies Ltd is functionally different. Its revenue consists revenue from sale of software products. Segmental break up is not available. Further, the company undergone restructuring during the year hence not comparable for the year.

Case laws : Electronics for Imaging India P Ltd , ION Trading India P Ltd etc.

11. We have considered the rival submissions and gone through relevant materials. The relevant portion of the order from the case of Electronics for India Imaging India P Ltd ay 2010-11in IT (TP)A no. 212/Bang/2015 & CO No 94/ Bang/2015 dt 24.02.2016 is extracted as under :

*" 2. The assessee challenged the action of the TPO before the DRP and raised objections against some of the comparables selected by the TPO. The DRP in its directions rejected 8 out of 11 comparables selected by the TPO. Thus, the Revenue is aggrieved by the directions of the DRP insofar as the comparables are directed to be excluded from the set of comparables.*

*3. We shall deal with each comparable which has been disputed by the Revenue one by one as under:-*

*(1) ICRA Techno Analytics Ltd. (seg)*

*4. At the outset, we note that apart from having the related party revenue at 20.94% of the total revenue, this company was also found to be functionally not comparable with software development services segment of the assessee. The DRP has given its finding at pages 13 to 14 as under:-*

*"Having heard the contention, on perusal of the annual report, it is noticed by us that the segmental information is available for two segments i.e., services and sales. However, it is evident from the annual report that the service segment comprises of software development, software consultancy, engineering*

*services, web development, web hosting, etc. for which no segmental information is available and therefore, the objection of the assessee is found acceptable. Accordingly, Assessing Officer is directed to exclude the above company from the comparables."*

5. *We find that the facts recorded by the DRP in respect of business activity of this company are not in dispute. Therefore, when this company is engaged in diversified activities of software development and consultancy, engineering services, web development & hosting and substantially diversified itself into domain of business analysis and business process outsourcing, then the same cannot be regarded as functionally comparable with that of the assessee who is rendering software development services to its AE.*

6. *In view of the above facts, we do not find any error or illegality in the findings of the DRP that this company is functionally not comparable with that of a pure software development service provider.*

(2) Infosys Ltd.

2. *The assessee objected against the selection of this company on the ground that this company has a big name and brand value and therefore it has a bargaining power. It also contended that the turnover of this company is Rs.21,140 crores, which is 442 times higher than the assessee.*

3. *The DRP accepted the objections of the assessee and by following the decision of the Delhi Benches of the Tribunal in the case of Agnity India Pvt. Ltd. v. ITO [2015] 58 taxmann.com 167 (Delhi – Trib), directed the TPO to exclude this company from the list of comparables.*

4. *We have heard the Id. DR as well as Id. AR and considered the relevant material on record. We note that in the case of Agnity India Pvt. Ltd. (supra), the Delhi Bench of the Tribunal has considered the comparability of this company and the findings of the Delhi Bench of the Tribunal has been confirmed by the Hon'ble Delhi High Court. The Hon'ble Delhi High Court has observed that this company having brand value as well as intangible assets cannot be compared with an ordinary entity provide captive service. We further note that this company provides end to end business solutions that leverage cutting edge technology thereby enabling clients to enhance business performance. This company also provides solutions that span the entire software lifecycle encompassing technical consulting, design, development, re-engineering, maintenance, systems integration, package evaluation and implementation, testing and infrastructure management service. In addition, the company offers software product for banking industry. Thus, this company is engaged in diversified services including design as well as technical consultancy, consulting, re-engineering, maintenance, systems integration as well as products for banking industry.*

5. *In view of the above facts that Infosys Ltd. having a huge brand value and intangibles as well as having bargaining power, the same cannot be compared with the assessee who is providing services to its AE.*

(3) KALS Information Systems Ltd.

6. The assessee raised objections against this company on the ground that this company is engaged in the development of software and software products. Further, this company consists of STPI unit and also having a training centre engaged in training of software professionals on online products. Thus, when this company is having revenue from software services as well as software product, the same cannot be considered as comparable with software development service providing company.

7. The DRP has directed the AO to exclude this company from the list of comparables by taking note of the fact that there were inventories in the books of accounts of this company which shows that this company is in the software product business. Further, by following the decision of this Tribunal in the case of Trilogy e-business Software India Ltd. v. DCIT, ITA No.1054/Bang/2011 dated 23.11.2012, this company was found to be not comparable with that of the assessee.

8. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. The Id. DR has not disputed the fact that comparability of this company has been examined by this Tribunal in a series of decisions including in the case of Trilogy e-business Software India Ltd. (supra). We further note that in the balance sheet of this company as on 31.3.2010, there are inventories of Rs.60,47,977. Therefore, when this company is in the business of software products, the same cannot be compared with a pure software development services provider. Accordingly, we do not find any error or illegality in the impugned findings of the DRP.

(4) Persistent Systems Ltd.

9. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. The assessee raised objections against selection of this company on the ground that this company is functionally not comparable as engaged in the product development. The segmental information for services and product is not available. Further, the assessee has also pointed out that there was an acquisition and restructuring during the year under consideration.

10. The DRP has noted the fact that this company has reported the entire receipt from sales and software services and product. Therefore, no segmental information was found to be available for sale of software services and product. Further, the DRP has noted that as per Note 1 of Schedule 15, this company is predominantly engaged in outsource software development service. Apart from the revenue from software services, it also earns income from licence of products, royalty on sale of products, income from maintenance contract, etc. These facts recorded by the DRP has not been disputed before us.

11. Therefore, when this company is engaged in diversified activities and earning revenue from various activities including licencing of products,

royalty on sale of products as well as income from maintenance contract, etc., the same cannot be considered as functionally comparable with the assessee. Further, this company also earns income from outsource product development. In the absence of any segmental data of this company, we do not find any error or illegality in the findings of the DRP that this company cannot be compared with the assessee and the same is directed to be excluded from the set of comparables.

(5) Sasken Communication Technologies Ltd.

12. The assessee raised objection that this company has revenue from software services, software products and other services. The DRP has come to the conclusion that this company earned revenue from 3 segments. However, no segmental information is available. Accordingly, the DRP directed the AO to exclude this company from the comparables.

13. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. The DRP has reproduced the break-up of revenue in the impugned order as under:-

Amount in Rs. lakhs

	Year ended March 31, 2010	Year ended March 31, 2019
Software Services	37,736.22	40,531.20
Software products	2,041.00	6,146.43
Other services	372.77	1,297.05
Total revenues	40,150.89	47,974.68

14. Thus, there is no dispute that this company earns revenue from 3 segments. However, the segmental operating margins are not available. Therefore, in the absence of segmental relevant data and particularly operating margins, this composite data cannot be considered as comparable with the assessee for software development services segment. Accordingly, we do not find any error or illegality in the findings of the DRP.

(6) Tata Elxsi Ltd.

15. The assessee has raised objections against this company on the ground that the company is functionally different from the assessee. Though the TPO has considered the software development and services segment of this company as comparable to that of assessee, however, the assessee contended that even within the software segment, this company is engaged in diverse activities. The assessee placed reliance on the information in the annual report under the Directors Report and submitted before the DRP that even under the software development services segment, this company is engaged in various diversified activities including product design service,

*innovation design, engineering service, visual computing labs, etc. The assessee also placed reliance on the decision of Mumbai Bench of the Tribunal in the case of Telcordia Technologies Pvt. Ltd. v. ACIT, 137 ITD 1 (Mum).*

16. *The DRP found that this company is not functionally comparable with assessee company as it is engaged in diversified activities even in the software development services. The DRP has followed the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies Pvt. Ltd. (supra).*

17. *We have heard the Id. DR as well as Id. AR and considered the relevant material on record. We find that this company even in the software development segment is engaged in diversified activities of product design services, innovation design, engineering services, visual computing labs, etc. We further note that in the case of Telcordia Technologies Pvt. Ltd. (supra), the Mumbai Bench of the Tribunal vide its order dated 11.5.2012 in para 9.7 has held as under:-*

*“7.7 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 as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable parties.”*

18. *No contrary view has been brought to our notice regarding comparability of this company with that of a pure software development service provider. Accordingly, in view of the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies Pvt. Ltd. (supra), we do not find any reason to interfere with the finding of the DRP.”*

12. The relevant portion of the order from the case of Pegasystems Worldwide India P Ltd ay 2010-11 ITA No 1758/Hyd/2014 & 1936/Hyd/2014 dt 16.10.2015 is extracted as under :

*" L&T Infotech Ltd:*

14. *Assessee has objected before TPO that the department in earlier years is rejecting this comparable as it has revenue from software services and products and segmental information was not available. Further, company did not respond to the notice issued u/s. 133(6) and challenged the said notice before the Hon'ble Bombay High Court. It was further objected to on the reason that*

*company had less margin in earlier year and therefore, rejected by the department, however, margin is high in this year, the department proposed it as a comparable and there is no consistency. These objections were rejected by TPO vide his analysis in page 40 of the order and from the earnings in foreign exchange reported, TPO considered the company as involved in software development services. The same objections were reiterated before DRP, but DRP rejected."*

14.1. It was the submission of the Ld. Counsel that DRP at Hyderabad in the case of M/s. Sumtotal Systems India Pvt. Ltd., [PAN: AABCC9379C] for the same assessment year has excluded the same by stating as under:

*"We have gone through the submissions of the assessee, International Transactions involved, TP documentation of the Assessee, the most appropriate method adopted by TPO after rejecting the T P documentation of the Assessee, the filters used by TPO and also verified the financials of the comparables with reference to the notes on accounts & website notes. We noticed that certain notes on accounts made in certain cases do not do not match with that of the financials reported. We also noticed that meaning of the words used in the notes on accounts are not defined. Based on certain ITAT decisions, the earlier directions of this panel and other panels, the huge turnovers involved , huge brand value, their predominant presence in the market, in view o f incomplete details etc., this panel is of the view that the following comparables selected by TPO should be excluded from the list of final comparables chosen by TPO in the ALP computation.*

*i)Infosys Technologies Ltd.,*

*ii)L&T Infotech Ltd.,*

*We direct TPO to exclude the above referred comparables from the list of final comparables chosen by TPO in the ALP computation and re-compute the ALP accordingly".*

14.2. It was the submission that once DRP has accepted the objections of Assessee whereas in Assessee's case DRP did not exclude L&T Infotech while excluding Infosys Technologies Ltd., it was the submission that similar facts exist for both the companies and DRP has excluded only Infosys Technologies and not L&T Infotech Ltd.,

14.3. After considering the objections of Assessee and perusing the order of DRP in the case of M/s. Sumtotal Systems India Pvt. Ltd., (supra), as extracted above, we are of the opinion that this company cannot be selected as comparable by the same reasons which DRP in the above referred case

*accepted. Moreover, there are no segmental details and as seen from the annual report, revenues are reported from software development services and products, how much is from services and how much is from products could not be*

*analysed. Even though TPO considered the software exports reported in earning in foreign currency as that of software development services, we are not sure whether the software exports reported therein exclusively pertain to services or products. As there are no segmental details, it is very difficult to analyse whether the incomes earned by the said company do really pertain to the similar services rendered by Assessee. As also seen from the income schedules, engineering services reported in earlier year were not there in this year, therefore, it is very difficult to analyse whether the company is functionally similar or not? Keeping in view of the above difficulties in analyzing the data and considering the reasons given by DRP in the case of M/s. Sumtotal Systems India Pvt. Ltd., (supra), we are of the opinion that L&T Infotech Ltd., cannot be selected as a comparable company. AO/TPO is directed to exclude the same from the list of comparables. Ground No.4 is allowed for statistical purposes.*

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 .....  
 22. Ground No.2 pertains to rejection of Infosys Technologies Ltd., from the list of comparables by DRP. We have already considered the opinion of DRP which is consistent not only in Assessee's case but also in the case of M/s. Sumtotal Systems India Pvt. Ltd., (supra), extracted above while considering the exclusion of L&T Infotech Ltd. Since DRP's decision is consistent with the stand taken by the Revenue in other cases and also by the ITAT in a number of cases on reason of turnover, brand equity, functional dissimilarity, we are of the opinion that DRP is correct in excluding the above company from the list of comparables. Therefore, there is no merit in the Revenue's ground and the same is rejected."

13. We find that the CIT (A) accepted the assessee's plea by following the decisions of this Tribunal in *Genisys Integrating System v DCIT 15 ITR Trib 475*, *Kodiak Networks v ACIT 15 ITR Trib 610*, *Trilogy e-Business Software India v DCIT 23 ITR Trib 464* and held that those companies which are within the turnover range of Rs one crore to Rs two hundred crore only should be taken into consideration for the TP study and hence directed the TPO to exclude Infosys Ltd, Larsen & Toubro Infotech Ltd, Mindtree Ltd (seg) , Persistent System Ltd, Sasken communication Technologies and Tata Elxsi Ltd(seg) against which the Revenue filed appeals. However, from the decisions extracted , supra , the assessee has made out a case for the exclusion of ICRA Techno Analytics Ltd. (seg), Infosys Technologies Ltd., KALS Information Systems Ltd, Persistent Systems Ltd, Sasken Communication Technologies Ltd,

Tata Elxsi Ltd and L&T Infotech Ltd. Following them, we direct the TPO to exclude them from the list of comparables. To that extent, the assessee's appeal grounds are allowed and the Revenue's appeal grounds are dismissed. With regard to the comparable Mindtree Ltd (seg), since the assessee has not opposed the Revenue's appeal, the Revenue's appeal on that comparable is treated as allowed.

14. The next issue that the AR submitted that the TPO has considered foreign exchange fluctuations as non-operating in nature. Its foreign exchange gain should be considered as operating in nature. The CIT (A) has, inter alia, directed the TPO to accept the assessee's claim, on which, the Revenue is on appeal. We have considered the rival contentions. This issue is remitted back to the TPO to examine whether the foreign exchange loss / gain is out of current years's transactions or not. If that gain/ loss arises out of current year's transactions, then, it should be treated as operating in nature. To that extent Revenue's claim is allowed.

15. The next issue is that the AR submitted that the TPO has restricted the working Capital adjustment to 1.98% and relied on the decision of this Tribunal in Moong Controls India P Ltd ITA 551/Bang/2015 ay 2010 dt 27.11.2015, wherein this Tribunal directed the TPO to allow actual adjustment towards the differences in the of working capital position between the assessee and the entrepreneurial companies selected as comparable. We direct the TPO to follow this decision. To this extent, the assessee's appeal ground is allowed.

16. The next issue is Revenue's appeal against the decision of the CIT(A), who held that while computing deductions u/s 10A & 10AA, respectively, data communication, voice communication and cell phone expenses incurred in foreign currency should be excluded from the export turn over as well from total turnover on the basis of the Jurisdictional High Court decision in CIT v Tata Elxsi 349 ITR 98. We heard rival contentions. We do not find any infirmity in the decision of the CIT(A) and hence uphold it. To that extent, the Revenue's appeal grounds are dismissed.

17. In the result, the assessee's appeal is allowed /treated as allowed and the Revenue's appeal is partly allowed.

Order pronounced in the open court on 16<sup>th</sup> day of January, 2017.

Sd/-

Sd/-

(SUNIL KUMAR YADAV)  
JUDICIAL MEMBER

(S. JAYARAMAN)  
ACCOUNTANT MEMBER

MCN\*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income Tax
4. The Commissioner of Income Tax (A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar