

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

**BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
and
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

IT(TP)A No.1373/Bang/2010
(Assessment year: 2006-07)

M/s.Citrix R&D India Pvt. Ltd.,
No.33, Prestige Dynasty,
Ulsoor Road,
Bengaluru-560042. ... Appellant
PAN:AABCN 3639 C

Vs.

Income-tax Officer,
Ward 11(1),
Bengaluru. ... Respondent

Appellant by : Shri S.Raghunathan, Advocate.
Respondent by : Shri Bijoy Kumar Panda, CIT(DR)

Date of hearing : 25/01/2017
Date of pronouncement : 24/03/2017

O R D E R

Per INTURI RAMA RAO, AM :

This is an appeal filed by the assessee directed against the assessment order passed u/s 143(3) r.w.s. 144C Income-tax Act, 1961 ['the Act' for short] dated 30/09/2010 for the assessment year 2006-07.

2. Briefly facts of the case are that the assessee is a company duly incorporated under the provisions of the Companies Act,

1956. It is a subsidiary of M/s. Citrix Application Networking LLC, USA. It is engaged in the business of providing software development services and support services to its Associated Enterprises (AEs). Return of income for the assessment year 2006-07 was filed on 30/11/2006 declaring income of Rs.22,030/-. The assessee-company reported the following international transactions in its Form 3CB:

- i. Software development services ... Rs.15,96,66,504/-
- ii. Procurement of assets on loan basis ... Rs. 38,03,634/-
- iii. Travel expenditure ... Rs. 2,25,320/-

The assessee-company sought to justify the consideration received for the above international transactions entered into with its AEs to be at arm's length. The assessee-company also submitted that Transfer Pricing (TP) study adopting operating profit to operating cost (OP/OC) as profit level indicator for transfer pricing study. The assessee-company also applied TNMM which was considered to be most appropriate method for the purpose of bench marking international transaction. The assessee-company's profit margin was computed at 9.85% and the assessee-company claimed that the same was comparable with other companies rendering software development services. For the purpose of TP study, assessee-company had chosen the following 36 comparable entities whose profit margin was computed at 12.06%.

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Sl. No.	Name of the company
1	3i Infotech Ltd
2	Akshay Software Technologies Ltd
3	Aztec Software & Technology Services Ltd
4	Bangalore Softcell Ltd
5	Bristlecone India Ltd
6	Compucom Software Ltd
7	Datamatics Ltd
8	Encore Software Ltd
9	Flextronics Software Sytems Ltd
10	Four Soft Ltd
11	Future Software Ltd
12	Gebbs Infotech Ltd
13	Goldstone Technologies Ltd
14	Infosys Technologies Ltd
15	Intertec Communications Ltd
16	KPIT Cummins Infosystems Ltd
17	Lanco Global Systems Ltd
18	Larsen & Turbo Infotech Limited
19	Maars Software International Ltd
20	Melstar Information Technologies Ltd.
21	Mphasis BFL Ltd
22	Orient Information Technology Ltd.
23	Quintegra Solutions Ltd
24	R S Software (India) Ltd
25	Sasken Communication Technologies Ltd
26	Sasken Network Systems Ltd
27	Satyam Computer Services Ltd
28	SIP Technologies & Exports Ltd
29	Software Technology Group International Ltd
30	Sonata Software Ltd.
31	Subex Systems Ltd
32	Transworld Infotech Ltd
33	Tyche Industries Ltd
34	VJIL Consulting Ltd
35	VMF Softtech Ltd
36	Visualsoft Technologies Ltd

According to the assessee-company, its PLI was within range +/-5 of arithmetical mean of the comparable entity chosen.

Hence, it was claimed that its international transactions with its AEs are at arm's length.

3. The Assessing Officer referred the matter to the Transfer Pricing Officer (TPO). The TPO, by order dated 19/10/2009 passed u/s 92CA of the Act, computed TP adjustment at Rs.1,03,23,342/-. The TPO accepted TNMM adopted by the assessee-company but rejected the TP study report submitted by the assessee-company. Then TPO proceeded to identify different set of comparables by applying the following filters:

- i. Use of current year data only.
- ii. Companies whose software development services revenue is less than 75% of the total revenue are excluded.
- iii. Software development services revenue more than 75%.
- iv. Minimum ample cost more than 25% to sale
- v. Onsite filter of the companies whose onsite revenue exceeded 75% of export revenue are rejected.
- vi. Companies who have less than 25% of the revenue as export sales were excluded.
- vii. Companies who have diminishing revenue or persistent loss are excluded
- viii. Companies whose onsite revenue is more than 75% are excluded
- ix. Companies that are functionally different are excluded

Applying the above filters, TPO finally selected the following 20 comparables:

Sl. No.	Name of the company
1	Aztec Software & Technology Services Ltd
2	Geometric Limited (Seg)
3	i-Gate Global Solutions Ltd (Seg)
4	Infosys Technologies Ltd
5	KALS Information Systems Ltd (Seg)
6	Mindtree Consulting Ltd
7	Persistent Systems Ltd
8	R Systems International Ltd (Seg)
9	Sasken Communication Technologies Ltd (Seg)
10	Tata Elxsi Ltd (Seg)
11	Lucid Software Ltd
12	Mediasoft Solutions Ltd
13	R S Software (India) Ltd
14	SIP Technologies & Exports Ltd
15	Bodhtree Consulting Ltd
16	Accel Transmatic Limited (Seg)
17	Synfosys Business Solutions Ltd
18	Megasoft Ltd
19	Lanco Global Systems Ltd
20	Flextronics Software Sytems Ltd (Seg)

The TPO computed average profit margin of the comparables at 17.91%. On the above basis, the TPO computed TP adjustment as follows:

Arm's length mean margin	20.68%
Less: Working capital adjustment	2.71%
Adjusted mean margin after working capital adjustment	17.97%
Operating Cost (A)*	144,095,826
Arm's length price - 117.97% of operating cost (B)	169,989,846
Total operating Revenue (C)	159,666,504
Short fall being Adjustment u/s 92CA (B - C)	10,323,342

The AO passed draft assessment order dated 10/12/2009 incorporating above adjustment and also restricting benefit u/s 10A by reducing telecommunication expenditure incurred in foreign currency from export turnover only.

4. Being aggrieved by the draft assessment order, the assessee filed objections before the Disputes Resolution Panel (DRP) contending *inter alia* that the benefit of 10A deduction should be granted by telecommunication expenditure both from export turn over as well as total turnover. On the issue of TP pricing adjustment, it was contended that the TPO was not justified in using the current year's data and also contending that the TPO was not justified in rejecting the companies whose turnover is less than Rs.1 crore. The DRP confirmed the entire order of the TPO. Accordingly, the AO passed final assessment order dated 30/09/2010 u/s 143(3) r.w.s. 144C of the Act.

5. Being aggrieved, the assessee is before us in the present appeal raising the following grounds of appeal:

1 Assessment and reference to Transfer Pricing Officer are bad in law

- a) The final order issued by the Income Tax Officer – Ward 11(1) [‘ITO’ or ‘AO’], is bad on facts and in law, and is in violation of the principles of natural justice.

Without prejudice to the above, the order issued by the AO is bad in law insofar as the fact that the AO did not issue to Citrix R&D India Private Limited (‘the Appellant or ‘the Company’), a show cause notice, as per proviso to section 92C(3) of the Act.

- b) The AO has erred in law in making a reference to the Transfer Pricing Officer [‘TPO’], *inter alia*, since he has not recorded an opinion that any of the conditions in section 92C(3) of the Act, were satisfied in the instant case. The AO also erred in not following the provision contained in section 92CA(1) of the Act.

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2 The fresh comparable search undertaken by the TPO is bad in law

- a) The TPO erred on facts and in law in conducting a fresh benchmarking analysis using non contemporaneous data and substituting the Appellant's analysis with fresh benchmarking analysis on his own conjectures and surmises. Thus the Appellant prays that the fresh benchmarking analysis conducted by the learned TPO is liable to be quashed.
- b) On the facts and in the circumstances of the case and in law, the learned TPO erred in not demonstrating that the motive of the Appellant was to shift profits outside of India by manipulating the prices charged in its international transactions which is a pre – requisite condition to make any adjustment under the provision of Chapter X of the Act.

3 Comparability analysis adopted by the TPO for determination of arm's length price

- a) The AO/TPO grossly erred on facts in benchmarking the transactions of the risk-insulated captive software services of the Appellant with companies operating as full fledged entrepreneurs without considering the differences in the functions performed, assets employed and risk undertaken by the Appellant *vis-à-vis* comparable companies
- b) The AO/TPO erred on facts in rejecting the comparable companies arrived at in the Transfer Pricing Study.
- c) The AO/TPO erred in law in applying arbitrary filters to arrive at a fresh set of companies as comparables to the Appellant, without establishing functional comparability.
- d) The AO/TPO also erred on facts in arbitrarily accepting companies without considering the turnover and size of the Appellant and comparables.
- e) The AO/TPO grossly erred in law in deviating from the uncontrolled party transaction definition as per the Income-tax Rules and arbitrarily applying a 25% related party criteria in accepting / rejecting comparables.
- f) The AO/TPO also erred on facts and in law in arbitrarily rejecting companies with different year ending (i.e. other than 31 March 2006) and inconsistently applying such filter.
- g) The AO/TPO grossly erred on facts in arbitrarily rejecting companies having software development revenue less than 75% of total operating revenue and inconsistently applying such filter, without considering the specific segmental results.
- h) The AO/TPO also erred on facts in arbitrarily rejecting companies based on their financial results without considering the comparability.
- i) The AO/TPO erred on facts and in law in considering a set of 'secret data', i.e. data which was not available in public domain, in arriving at a fresh set of companies using his power under section 133(6), which is grossly unjustified.
- j) The AO/TPO also erred on facts and in law in excluding the foreign exchange gain or loss while calculating the net margins of the comparable companies.

k) The AO/TPO also erred on facts incorrectly computing the margins of certain comparable companies.

4 Erroneous data used by the AO/TPO

a) The AO/TPO has erred in law in using data, which was not contemporaneous and which was not available in the public domain at the time of conducting the transfer pricing study by the Appellant.

b) The AO/TPO erred in law in not applying the multiple-year data while computing the margin of alleged comparable companies.

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

The AO/TPO erred in law and on facts in not allowing appropriate adjustments under Rule 10B to account for, *inter alia*, differences in (a) accounting practices, (b) marketing expenditure, (c) research and development expenditure and (d) risk profile between the Appellant and the comparable companies.

6 Variation of 5% from the arithmetic mean

The AO/TPO erred in law in not granting the benefits of proviso to section 92C(2) of the Act available to the Appellant.

7 Deduction under section 10A of the Act

a) On the facts and circumstances of the case, the learned AO has erred in proposing and the Honourable DRP has further erred in confirming the reduction of expenses incurred towards communication expenses amounting to Rs. 5,21,228/- from export turnover while computing the deduction under section 10A of the Act.

b) Without prejudice to the above, on the facts and circumstances of the case, the learned AO has erred in reduction of communication expenses from export turnover without correspondingly reducing the said expenses from the total turnover.

8 Interest under section 234B of the Act

The learned AO has erred in levying interest under section 234B of the Act amounting to Rs. 18,71,195/-.

9 Penalty under section 271(1)(c)

The learned AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act.

10 Directions issued by the DRP

a) The Honourable DRP has erred in law and facts in not taking cognizance of the objections filed by the Appellant in relation to the draft assessment order issued by the AO/ TP order.

b) The Honourable DRP erred in facts and law in confirming the draft order of the AO/TPO.

11 **Relief**

- a) The Appellant prays that Directions be given to grant all such relief arising from the above grounds and also all relief consequential thereto.
- b) The Appellant craves leave to add to or alter, by deletion, substitution, modification or otherwise, the above grounds of appeal, either before or during the hearing of the appeal.
- c) Further, the Appellant prays that the adjustment in relation to Transfer Pricing matters made by the Learned AO/TPO and upheld by Honourable DRP be deleted.

6. The assessee also raised the following additional grounds of appeal:

- a) The learned TPO has erred in fact selecting Infosys Technologies Limited as comparable in the order u/s 92CA, without considering the differences in the functions and risks profile of Infosys Technologies Limited vis-à-vis the functions and risk profile of the Appellant. Accordingly, the said Company cannot be compared to the Appellant, being a pure software development services provider.
- b) The learned TPO has erred in selecting Infosys Technologies Limited, Sasken Communication Technologies Limited and Flextronics Software Systems Limited as comparables in the order u/s 92CA, without considering that the scale of operations of the companies cannot be compared with the turnover of the Appellant for FY 2005-06 (viz. INR 15.97 Crores). Accordingly, the said companies cannot be compared to the Appellant, on application of turnover filter of INR 200 Crores.

7. During the course of hearing, learned counsel for the assessee had not pressed the additional grounds of appeal urging that companies whose turnover is more than Rs.200 crores should be excluded. Learned counsel for the assessee argues that the comparables Aztec Software Technology Services Ltd., Zeometric Ltd., Megasoft Ltd., should be rejected as their RPT filter is more than 15% of the sales. It was mentioned that RPT filter in the case of Aztec Software Technology Services Ltd is 17.78% whereas in the case of Geometric Ltd., it is 19.34%.

Reliance in this regard was placed on the decision of the co-ordinate bench of Tribunal in the case of *LSI Technologies India (P) Ltd. vs. ITO* (2015) 59 taxmann.com 434(Bang.Trib.)

8. We heard rival submission and perused material on record. The only ground on which assessee is seeking exclusion of those companies is RPT of the said companies is more than 15%. It is undisputed fact that the TPO has applied RPT filter of 25%. The assessee-company had not contested the application of RPT filter of 25%. This Tribunal has been consistently upholding the decision of the TPO wherein the TPO had applied RPT filter in the range of 15% to 25%. In the present case, since assessee-company had not contested application of RPT filter of 25% by the TPO, now it is not open for the assessee-company to consider RPT filter of 25%. Accordingly, we uphold inclusion of these two companies.

9. As regards comparable Mindtree Consulting Ltd. Is concerned, the same was not pressed during the course of hearing, hence dismissed. The assessee is seeking exclusion of the following companies on the grounds of functional difference relying on the decision of the Tribunal in the case of *LCI Technologies India (P) Ltd.* (supra):

- i. Infosys Technologies
- ii. KALS Information Systems Ltd.,
- iii. Tata Elxsi ALtd.,
- iv. Lucid Software Ltd., - para 29 30
- v. Accel Transmatic Ltd., - 23 24

The issue of comparability of above entities in relation to software development services had come up for consideration before the co-ordinate bench of this Tribunal in the case of *LCI Technologies India (P) Ltd.* (supra). The relevant findings of the Tribunal are extracted below:

17. As far as comparable companies listed at Sl. No. 10, 24 & 26 of the final list of comparable companies chosen by the TPO viz., M/S. Infosys Technologies Limited, Tata Elxsi Ltd. (Seg.) & Wipro Limited are concerned, this Tribunal in the case of *Curam Software International (P.) Ltd. v. ITO* [2014] 149 ITD 458/[2013] 37 taxmann.com 141 (Bang - Trib.) has held that the aforesaid companies are not comparable companies in the case of software development services provider. The following were the relevant observations in the case of *Curam Software International (P.) Ltd.* (supra):

'12. (4) Infosys Technologies Ltd.

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

12.2 Before us, the assessee contended that this company is not functionally comparable to the assessee and in this context has cited various portions of the Annual Report of this company to this effect which is as under :ô

- (i) The company has an Intellectual Property (IP) Cell to guide its employees to leverage the power of IP for their growth. In 2008, this company generated over 102 invention disclosures and filed an aggregate 10 patents in India and the USA. Till date this company has filed an aggregate of 119 patent applications (pending) in India and USA out of which 2 have been granted in the US.
- (ii) This company has substantial revenues from software products and the break-up of the software product revenues is not available.
- (iii) This company has incurred huge research and development expenditure to the tune of approximately Rs.200 Crores.
- (iv) This company has a revenue sharing agreement towards acquisition of IPR in AUTOLAY, a commercial software product used in designing high performance structural systems.

(v) The assessee also placed reliance on the following judicial decisions :ô

- (a) ITAT, Delhi Bench decision in the case of Agnity India Technologies India Pvt. Ltd. (ITA No.3856/Del/2010) and
- (b) Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011)

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

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

“14.0 (6) Tata Elxsi Ltd.

14.1 This company was a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on several counts like, functional dis-similarity, significant R&D activity, brand value, size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.

14.2 Before us, it was reiterated that this company is not functionally comparable to the assessee as it performs a variety of functions under the software development and services segment namely

- (a) Product design services
- (b) Innovation design engineering and
- (c) visual computing labs.

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In the submissions made the assessee had quoted relevant portions from the Annual Report of the company to this effect. In view of this, the learned Authorised Representative pleaded that this company be excluded from the list of comparables.

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

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

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

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

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

18. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP. ö

“KALS Information Systems Ltd.

11. The learned DR however submitted before us that KALS Information Systems Ltd., cannot be considered as a software product company and on that ground be not held comparable with a software development service provider such as the Assessee. In this regard, he has filed before us a copy

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of the Annual report of the company for the period 2007-2008 which relates to subsequent assessment year 2008-09. He drew our attention to the segmental results of the company for the period 2006-07 as given in the aforesaid annual report and pointed out that segmental revenue as on 31.3.2007 was Rs. 2,00,09,937 from application software and Rs. 8,95,385 from training. According to him therefore the conclusion that KALS Information Systems Ltd. is a software product company may not be correct. Learned counsel for the Assessee however pointed out that this company has inventories worth Rs. 1,12,97,218 as on 31.3.2007 which itself is a reflection that this company is a software product company. He also pointed out that in Schedule 16 notes to Financial statements in Note 2 (b) it has been mentioned that the company derives its revenues primarily from software services and software products.

12. We have considered the rival submissions. It is seen from para 16.4.13 of the TPO's order at page 141 that the TPO has based his conclusions only on the basis of the reply given by this company in response to notice u/s.133(6) of the Act that it is a software development service provider. Therefore the conclusions drawn in the cases referred to above for excluding this company as a comparable company is found to be correct. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP. ”

15. *Accel Transmatics Ltd. (Seg.)*

15.1 Though this company was part of the T.P. analysis of the assessee and also part of the 44 comparables selected by the assessee itself for benchmarking its international transactions, however, the assessee objected the inclusion of this company in the list of comparables selected by the TPO on the ground that this company is functionally not comparable. The TPO as well as DRP rejected the contentions of the assessee.

15.2 Before us, the learned Authorised Representative of the assessee has submitted that the assessee is seeking exclusion of this company as this company provides software design and development product services. Since this is a software product company and therefore is functionally dis-similar to the assessee. Therefore, this company is not a good comparable for the purpose of determining the ALP. The learned Authorised Representative has submitted that as per the Annual Report of this company, it is engaged in the product manufacturing activity as well as diversified business activity like transmatic system, **technology**, Accel International Transactions Academy and Accel Studio. He has further contended that the functional comparability has been considered by the Tribunal in a number of cases and it was held that this company is functionally dis-similar to the software development services provider company. In support of his contention, he has relied upon the following decisions:ô

Cases Pertaining to Asstt. Year : 2006-07	Cases Pertaining to other Asstt. Years
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Cypress Semiconductor Technology India Private Limited IT (TP) A No 1167/Bang 2010	Conexant Systems India Pvt. Ltd. (AY 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011.
Verisign Services India Private Limited IT (TP) A No 1404 Bang 2010	Logica Pvt. Ltd. v. ACIT (ITA No. 1129/Bang/2011)
Misys Software Solutions India Private Limited IT (TP) A No. 1425/Bang/2010	Triology E-Business Software India Pvt. Ltd. v. DCIT in IT A No. 1054/Bang/2012 (AY - 2007-08)
Thought works Technologies (India) Private Limited IT (TP) A No. 1326/Bang/2010	

15.3 On the other hand, the learned Departmental Representative has submitted that this company was part of the T.P. analysis of the assessee and the assessee did not object the comparability of this company before the authorities below. Therefore, this company cannot be excluded from the list of comparables when the assessee itself has selected this company as a comparable. She has relied upon the orders of the authorities below.

15.4 We have considered the rival submissions as well as the relevant material on record. Though this company was part of the T.P. analysis of the assessee and also included in the comparables selected by the assessee however, the functional comparability of the company has been examined by this Tribunal in a series of decisions and it has been consistently held that this company cannot be considered as functional comparable to a pure software development services provider. The Tribunal in a number of decisions as relied upon by the assessee mentioned (*supra*) has given this consistent finding. In the case of *Misys Software Solutions Pvt. Ltd.* (*supra*), the functional comparability has been examined by the Tribunal in paragraphs 7.2 to 7.4.2 which is reproduced below :ô

"7.2 (5) *Accel Transmatics Ltd.*

This company was selected as a comparable by the TPO and was retained as a comparable even though the assessee objected to its inclusion before the DRP. It is the contention of the assessee that the above company is functionally different from the companies engaged in business of providing software development services to its AEs. It is submitted that apart from software development services, this company is engaged in provision of Accel Animation Studies Services in the form of ACCEL IT and ACCEL Animation Services for 2D and 3D Animation. It was also engaged in various business activities, some of which are Ushus **Technologies** - for offshore development centre for embedded software network system, imaging **technologies**; Accel IT Academy for training services in hardware and networking, VLSI designs, CAD/CAM/BPO, etc., the learned Authorised Representative for the assessee contends that in view of the

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above services rendered, it is evident that this company is functionally different from the assessee in the case on hand and therefore ought to be excluded from the list of comparables to the assessee. In support of this contention, the learned Authorised Representative for the assessee placed reliance on the decision of the co-ordinate bench of this Tribunal in the case of *Huawei Technologies India Pvt. Ltd.* for Assessment Year 2006-07 (*supra*).

7.3 Per contra, the learned Departmental Representative supported the orders of the TPO in including these two companies as comparables to the assessee in the case on hand.

7.4.1 We have heard the rival contentions and perused and carefully considered the material on record, including the judicial pronouncement relied on by the assessee. We find that the co-ordinate bench of this Tribunal in the case of *Huawei Technologies India Pvt. Ltd.* for Assessment Year 2006-07 (*supra*) has excluded these two companies from the list of comparables to assessee's engaged in the software development services as they are functionally different. At paras 12 and 13 of its order, the co-ordinate bench has held as under:ô

"12. Insofar Kals Info Systems *Ltd.*, and Accel Transmatics *Ltd.* chosen by the TPO as comparables, this Tribunal in the case of *Triology E-Business Software India Pvt. Ltd.* (*supra*) has taken a view that these companies are not comparable to the software service provider companies as they are functionally different. The following are the relevant observations of the Tribunal in this regard:ô

(d) *KALS Information Systems Ltd.*

46. 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 Rs. 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 v. DCI* 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

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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.

47. 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. Addl. CIT 12 taxmann.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, network 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."

49. 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."

13. In view of the aforesaid decision of the Tribunal, Kals Info Systems Ltd., and Accel Transmatics Ltd. are to be excluded for the purpose of comparison while determining the ALP of the impugned transaction in this appeal. It is ordered accordingly."

7.4.2 Following the aforesaid decision of the co-ordinate bench of this Tribunal in the case of *Huawei Technologies India Pvt. Ltd.* for Assessment Year 2006-07 (*supra*), we hold and direct that these two companies, namely KALS Infosystems Ltd. and Accel Telemetrics Ltd. are to be excluded from the set of comparable companies for the software development services segment of the assessee."

In view of the different business activities of this company as referred in the Annual Report of this company as well as the consistent finding of this Tribunal in the cases cited (*supra*), we direct the A.O./TPO to exclude this company from the list of comparables for the purpose of determining the ALP.

Lucid Software Ltd.

"8.3.1 We have heard the rival contentions and perused and carefully considered the material on record, including the judicial pronouncements relied on by the assessee. We find that the co-ordinate bench in the case of *Huawei Technologies India Pvt. Ltd.* for Assessment Year 2006-07 (*supra*) has excluded these two companies from the set of comparables holding as under at paras 14 & 15 thereof :ô

"14. As far as Lucid Software Ltd. and Tata Elxsi Ltd. chosen by the TPO as comparables, we find that the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India Pvt. Ltd.* (*supra*) while dealing with the case of software services provider like the assessee, considered the comparability of Lucid Software Ltd. with similar software services provider and the Tribunal held as follows :ô

"7.2 *Lucid Software Limited.*

It has been submitted before us that this company, besides doing software development services, is also involved in development of software product. The learned AR has tried to distinguish by pointing out that product development expenditure in this case is around 39% of the capital employed by the said company, and, therefore, such a company cannot be considered as tested party. Even as per the information received in response to notice under Section 133(6), the company has described its business as software development company or pure software development service provider. This information itself is very vague as the segmental details of operating revenue has not been made available to examine how much is the ratio of sale from software product and sale of software service and development. Looking to the fact that it has developed a software product named as "Muulam" which is used for civil engineering structures and the product development expenditure itself is substantial vis-à-vis the capital employed by the said company, this criteria for being taken as comparable party, gets vitiated. For the purpose of comparability analysis, it is essential that the characteristics and the functions are by and large similar as that of the assessee company and T.P. analysis/study can be made with fewest and most reliable adjustment. If a company has employed heavy capital in development of a product then profitability in the sale of product would be entirely different from the company, who is involved in service sector. Therefore, this company cannot be treated as having same function and profitability ratio.

In our view, due to non-availability of full information about the segmental details as to how much is the sale of product and how much is from the services, therefore, this entity cannot be taken into account for comparability analysis for determining arm's length price in the case of the assessee."

15. In view of the aforesaid decision of the Mumbai Bench of the Tribunal, which is in relation to A.Y. 2006-07, we are of the view that Lucid Software **Ltd.** and Tata Elxsi **Ltd.** are also to be excluded as comparables while determining the ALP of the international transaction impugned in this appeal."

8.3.2 As far as the company *Tata Elxsi **Ltd.***, is concerned, following the decision of the co-ordinate bench of this Tribunal in the case of *Huawei **Technologies India Pvt. Ltd.*** for Assessment Year 2006-07 (*supra*), we hold and direct that this company be excluded from the list of comparables for the software development services of the assessee. It is ordered accordingly."

In view of the above discussion, as well as the decision of the co-ordinate bench, we direct the A.O./TPO to exclude this company from the set of comparables for determining the ALP.

14. *Additional Grounds.*

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14.1 The assessee has also sought the exclusion of certain more companies from the list of comparables in the additional grounds raised before this Tribunal. The companies sought to be excluded are discussed as under:

14.2 As regards M/s. Aztec Software & Technology Services Ltd. & Megasoft Ltd, since these two companies have not satisfied with the filter of RPT at 15%, therefore, in view of the consistent view taken by the Tribunal and our finding in the foregoing paragraphs, these two companies stand excluded from the list of comparables.

14.3 In the additional grounds, the assessee is also seeking exclusion of some more companies on the ground of turnover filter. The turnover filter was neither applied by the assessee nor by the TPO for selecting comparable companies. Further, the assessee did not raise any such objection either before the TPO or before the DRP. Thus, this plea raised by the assessee does not pertain to any finding of the authorities below and therefore this issue does not emanate from the orders of the authorities below. Moreover, the assessee company sought exclusion of selected companies from the list of comparables of the TPO on the ground of turnover filter. If such a criteria has to be applied in selection of the comparables then, all the comparables selected by the TPO are to be tested by applying such filter of turnover. The assessee cannot be permitted to pick and choose certain companies on the ground of turnover filter which supports the interest of the assessee. Even otherwise, the turnover filter of Rs. 1 Crore to Rs. 200 Crores as sought by the assessee if applied will give absurd results which are not acceptable as per the minimum common logic. Applying such a filter of turnover of Rs. 1 Crore to Rs. 200 Crores, means that difference of 200 times of turnover is acceptable for selecting the company but at the same time it defies the said criteria when a company of Rs. 200 Crores turnover cannot be compared with that of a company of Rs. 201 Crores turnover despite the difference is only Rs. 1 Crore. Therefore, on this basic and fundamental analysis of this filter, it is apparent that if such filter of turnover is applied, it will give absurd results. Even otherwise, if 200 times multiple is accepted for selecting comparables and applied the same ratio to the turnover of the assessee which is above Rs. 18 Crores, a company of up to Rs. 3,600 crores would be considered as a good comparable which itself defies this filter of Rs. 1 Crore to Rs. 200 Crores. In view of the above facts and circumstances of the case on hand, we decline to grant leave to the assessee to raise this new plea of applying turnover filter on the selective companies.

14.4 However, the plea taken by the assessee in the additional ground regarding the functional dis-similarity even in respect of those comparables selected by the assessee itself cannot be rejected merely on the ground that the assessee has raised its plea for the first time at this stage because if a particular company is found functionally not comparable with the assessee ought to have been excluded from the set of comparables to avoid incorrect results. Even otherwise, in case if the assessee commits some mistakes in the assessment proceedings that results incorrect assessment of the tax liability then the assessee cannot be barred from raising such a plea at the appellate stage in order to assess correctly the tax liability of the assessee.

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We find that the functional comparability of these companies namely Accel Transmatics Ltd., Geometric Software Ltd., Flextronic Software System Ltd. and Infosys Technologies Ltd. has been examined in a number of cases by this Tribunal and therefore in view of the findings of the Tribunal on the issue of comparability of these companies, we incline to admit the additional grounds of the assessee raising objection on the ground of functional dis-similarity of these companies mentioned (*supra*) for deciding the issue on merits.

10. The learned DR has not filed any evidence controverting the finding of the Tribunal in the above cases. In the circumstances, respectfully following the decision of the co-ordinate bench in the case of *LCI Technologies India (P) Ltd.*, (*supra*), we hold that above comparable companies cannot be considered to be comparable on the ground of functionality. Hence, we direct the AO/TPO to delete these companies from the list of comparables.

11. Learned counsel for the assessee submitted that once these companies are excluded from the list of comparables, it comes within TP adjustment of +/-5%. Hence, had not pressed risk adjustment. Ground No.5 in this regard is dismissed as not pressed.

12. The issue raised in ground No.7 is that expenses incurred on communication expenses in foreign currency should be reduced both from export turnover and total turnover for the purpose of calculating benefit u/s 10A of the Act. This issue is now squarely covered in favour of the assessee by the decision of the jurisdictional High Court in the case of *CIT vs. Tata Elxsi* (349

ITR 98), wherein the Hon'ble Jurisdictional High Court held that the same is required to be reduced from export turnover as well as total turnover. Respectfully following the ratio of the decision of the Hon'ble jurisdictional High Court we direct that expenses incurred in foreign exchange towards communication are to be reduced both from export turnover as well as total turnover. Hence, this ground of appeal is allowed.

13. Ground Nos.8 and 9 are consequential in nature and do not require adjudication.

14. In the result, the appeal filed by the assessee-company is partly allowed.

Order pronounced in the open court on 24th March,2017.

Sd/-
(SUNIL KUMAR YADAV)
JUDICIAL MEMBER

Place : Bangalore
D a t e d : /03/2017
srinivasulu, sps

sd/-
(INTURI RAMA RAO)
ACCOUNTANT MEMBER

Copy to :

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

By order

Assistant Registrar
Income-tax Appellate Tribunal,
Bangalore