

IN THE INCOME TAX APPELLATE TRIBUNAL  
"B" BENCH : BANGALORE

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER  
AND SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

IT(TP)A Nos.1380 & 1381/Bang/2010

Assessment year : 2006-07

M/s. LSI Technologies India Pvt. Ltd., (formerly LSI Logic India Pvt.Ltd.), Global Technology Park – Block C, Marathahalli Outer Ring Road, Devarabeesanahalli, Bangalore – 560 103. <b>PAN:</b> AABCV 5892R	Vs.	The Income Tax Officer, Circle 11(2), Bangalore.
LSI Research & Development Pvt. Ltd., Global Technology Park – Block C, Marathahalli Outer Ring Road, Devarabeesanahalli, Bangalore – 560 103. <b>PAN:</b> AADCA 0425D	Vs.	The Income Tax Officer, Circle 11(2), Bangalore.
APPELLANT		RESPONDENT

Appellants by	:	Shri T. Suryanarayana, Advocate
Respondent by	:	Ms. Neera Malhotra, CIT(DR)

Date of hearing	:	11.04.2016
Date of Pronouncement	:	13.05.2016

**ORDER**

*Per Shri Vijay Pal Rao, Judicial Member :*

These two appeals by the related assesseees are directed against two separate assessment orders dated 28.9.2010 and 30.9.2010 passed in pursuance of the directions of DRP u/s. 144(C) of

the Income-tax Act, 1961 [hereinafter referred to as "the Act"] for the assessment year 2006-07.

2. Common grounds have been raised in both the appeals arising from identical facts and circumstances, therefore, for the sake of convenience these two appeals are heard together and disposed of by this composite order. For the purpose of recording the facts, appeal in IT(TP)A No.1380/Bang/2010 is taken as the lead case.

3. The assessee has raised the following grounds:-

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

a) *The final order issued by the Income Tax Officer – Ward 11(2) [‘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 LSI Technologies India Private Limited (‘the Appellant or ‘the Company’), a show cause notice, as per proviso to section 92C(3) of the Income-tax Act, 1961 [‘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.*

**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) *The TPO erred in introducing additional comparable companies in the final set, in addition to the companies proposed in the show cause notice, without giving an opportunity to the Appellant to make its submissions on the additional comparables.*

c) *On the facts and in the circumstances of the case and in law, the learned TPO erred in and the Hon’ble DRP further erred in upholding / confirming the*

*action of the TPO 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 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 erred on facts in arbitrarily rejecting companies earning less than 25% of revenue from exports.*
- i) *The AO/TPO also erred on facts in arbitrarily rejecting companies based on their financial results without considering the comparability.*
- j) *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.*
- k) *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.*
- l) *The AO/TPO also erred on facts incorrectly computing the margins of certain comparable companies.*

**4 Erroneous data used by the 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 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 in the circumstances of the case, the learned AO has erred in proposing and the Honourable DRP has further erred in confirming the reduction of leased line charges amounting to Rs. 11,177,385/- from export turnover while computing the deduction under section 10A of the Act.*

b) *Without prejudice to the above, on the facts and in the circumstances of the case, the learned AO has erred in proposing and the Honourable DRP has further erred in confirming the reduction of leased line charges amounting to Rs. 11,177,385/- only 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. 4,544,272/-.*

**9 *Interest under section 234D of the Act***

*The learned AO has erred in levying interest under section 234D of the Act amounting to Rs. 180/-.*

**10 *Directions issued by the DRP***

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

**11 *Initiation of penalty proceedings***

*The Assessee submits that based on the facts and circumstances of the case, there was no basis for the AO to propose to initiate proceedings under section 271(1)(c) of the Act.*

**12 *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 or otherwise, the above grounds of appeal, at any time before or during the hearing of the appeal.*

*c) The Appellant further prays that the adjustment in relation to Transfer pricing matters made by the Ld. A.O/TPO and upheld by the Hon'ble DRP be deleted."*

4. Ground Nos.1 to 6 are regarding TP adjustment. During the year under consideration, the assessee has recorded international transaction with its Associated Enterprises (AE) in respect of software development services as under:-

Particulars	Amount (Rs.)
Receipts for software development services	38,83,69,741
Reimbursement of expenses paid	4,31,66,693
Purchase of capital goods	54,89,609
Interest paid on ECB Loan	44,93,979

5. To benchmark its international transactions in respect of software development services provided to the AE, the assessee has adopted TNMM as most appropriate method and selected 44 comparables with arithmetic mean margin of 11% and after the working capital adjustment, net arithmetic mean was computed at 7%. Thus, the assessee claimed its international transaction having net margin of 10% at arm's length in comparison to the mean margin of the comparable at 7% (11%). The TPO rejected 41 comparable companies selected by the assessee out of 44 and accepted only 3 as under:-

- (1) Aztec Software & Development Services Ltd.
- (2) Megasoft Ltd.
- (3) Accel Transmatics Ltd.

6. The TPO carried out a fresh search and added 17 more companies in the set of comparables as under:-

Sl.No.	Name of the Company	Mark Up	
		Unadjusted (%)	WC adjusted (%)
1	Aztec Software Ltd.	18.09	17.55
2	Geometric Software Ltd. (Seg.)	6.70	4.73
3	iGate Global Solutions Ltd. (Seg.)	15.61	12.60
4	Infosys Ltd.	40.38	38.31
5	KALS Info Systems Ltd.	39.75	39.91
6	Mindtree Consulting Ltd.	14.67	12.36
7	Persistent Systems Ltd.	24.67	22.69
8	R Systems International Ltd.	22.20	19.14
9	Sasken Communication Ltd. (Seg.)	13.90	12.17
10	Tata Elxsi Ltd. (Seg.)	27.65	26.40
11	Lucid Software Ltd.	8.92	4.48
12	Mediasoft Solutions P. Ltd.	6.29	3.23
13	R S Software (India) Ltd.	15.69	14.16
14	SIP Technologies & Exports Ltd.	3.06	0.17
15	Bodhtree Consulting Ltd.	15.99	13.85
16	Accel Transmatics Ltd. (Seg.)	44.07	40.91
17	Synfosys Business Solutions Ltd.	10.61	6.37
18	Megasoft Ltd.	52.64	42.99
19	Lanco Global Solutions Ltd.	5.27	3.90
20	Flextronics Software Systems Ltd.	27.24	25.63
	Arithmetic Mean	20.68	18.08

7. The TPO has worked out the arithmetic mean of the comparables at 20.68 and after working capital adjustment adjusted the arithmetic mean margin of the comparables was arrived at 18.08%; in comparison to the mean margin of the assessee at 10%. Therefore, the TPO has proposed an upward adjustment of Rs.2,85,27,522 u/s. 92CA of the Act.

8. The assessee objected the action of the TPO/AO before the DRP, but could not succeed.

9. Before us, the assessee is seeking exclusion of 9 companies selected by the TPO from the set of comparables including 3 companies which were part of TP study analysis of the assessee. The assessee has filed additional ground for seeking exclusion of 4 companies, some of which were common in the list of assessee's set of comparables as well as TPO.

10. The additional ground raised by the assessee is as under:-

*" 3(m) That Accel Transmatic Ltd., KALS Info Systems Ltd. and Lucid Software Ltd. ought to stand rejected in view of them being functionally dissimilar to the appellant.*

*3(n) That Megasoft Ltd. ought to stand rejected in view of tis related party transactions exceeding 15% of its sales."*

11. Thus, by way of additional ground, assessee is seeking exclusion of Accel Transmatics Ltd., KALS Infosystems Ltd. and Lucid Software Ltd. on functional dissimilarity as well as Megasoft Ltd. on the ground of Related Party Transaction (RPT) exceeding 15% of its sales.

12. We have heard the Id. AR as well as Id. DR and considered the relevant material on record on the issue of admission of additional ground.

13. The Id. AR has pointed out that assessee raised objections against the inclusion of these 4 companies including 3 companies which are part of TP analysis study. Since these companies are functionally not comparable to that of the assessee, therefore the same should be excluded from the list of comparables. He has relied on the decision of the Special Bench of the Tribunal in the case of *DCIT v. Quark Systems (P.) Ltd. [2010] 38 SOT 307 (CHD) (SB)* and submitted that even in case the assessee has committed a mistake in including the companies in the comparables list, there is no bar in raising the objections against such companies if these are found functionally dissimilar to that of assessee.

14. On the other hand, the Id. DR has objected to the additional ground of the assessee and submitted that when the assessee itself has selected these companies by considering the comparability, then the assessee cannot raise this issue, after the TPO has accepted those comparable companies and included in the final set of comparables.

15. Having considered the rival submissions as well as relevant material on record, we find that the functional comparability of these 3 companies have been examined by this Tribunal in a series of decisions and therefore once these companies are found to be functionally not comparable to that of software development services provider in the capacity of captive service provider, then mere inclusion of these companies in the TP study analysis would not bar the assessee from raising such a plea before the DRP as well as this Tribunal. Accordingly, following the decision of the Special Bench in the case of *DCIT v. Quark Systems (P.) Ltd. [2010] 38 SOT 307 (CHD) (SB,)* we admit the additional ground raised by the assessee for adjudication on merits.

16. On the comparability of 9 companies, Id. AR of assessee has submitted that out of these 9 companies, 3 companies are having more than 15% related party revenue, therefore in view of the settled proposition on the issue of threshold limit of RPT, these 3 companies cannot be included in the list of comparables. The Id. AR has pointed out that the following 3 companies are having more than 15% RPT:-

1. Aztec Software Ltd.
2. Geometric Software Ltd. (Seg.)
3. Megasoft Ltd.

17. He has further submitted that an identical issue has been considered by the coordinate Bench of this Tribunal in the case of *Textron India Pvt. Ltd. v. DCIT vide order dated 13.01.2016 in IT(TP)A No.1228/Bang/2010.*

18. On the other hand, the Id. DR has submitted that the TPO has applied RPT filter of 25% and therefore none of these companies have exceeded the RPT filter applied by the TPO.

19. We have considered the rival submissions as well as material on record. At the outset, we note that an identical issue of applying RPT filter at 15% or 25% has been considered by the coordinate Bench of this Tribunal in the case of *Textron India Pvt. Ltd. (supra)* in paras 12 & 13 as under:-

12. We have considered the rival submissions as well as the relevant material on record. In strict sense, the ALP has to be determined by considering uncontrolled comparable prices which means uncontrolled, unrelated comparable prices has to be taken into account to benchmark the international transactions which are the control and RPTs. However, 0% RPTs of the comparable price is an impossible situation and therefore a reasonable tolerance range of the revenue from RPT can be considered for selecting the uncontrolled comparables. There cannot be a single criteria / parameter which can be applied as a general rule in all cases. Therefore, this tolerance range varies from case to case and depending upon the availability of the comparables. If the comparables of international transactions are easily available, then, this tolerance of RPT should be

restricted to minimum. There is no specified tolerance range in the Act or Rules under the Transfer Pricing provisions, however, in due course of discussion and adjudication of this issue in a series of decisions of this Tribunal, commonly accepted tolerance range of 5% to 25% of the total revenue from RPT has been considered as reasonable depending upon the facts and circumstances of each case. In the case on hand, the availability of the comparables is abundant in number as the assessee selected 44 comparables whereas the TPO selected 20 comparables by applying the filter of 25% of revenue from related parties. Therefore, in this case, good number of comparables are available and there is no difficulty in searching the comparables. Accordingly, in order to determine the ALP by considering the comparable uncontrolled transactions, it should be kept in mind that the uncontrolled transactions should be least influenced by the RPT. **In the case of DCIT Vs. Textron Global Technology Centre Pvt. Ltd.** in IT(TP)A No.29/Bang/2012 & C.O. No.40/Bang/2012 Dt.20.3.2015 for the Assessment Year 2005-06. The Tribunal has held in para 17 as under :-

*“ 17. In view of the conclusion above that exclusion of comparable companies with RPT of less than zero percent is not valid, and that companies where RPT is less than 15% alone can be considered, then the comparable rejected by the CIT (Appeals) on the basis of the said filter will have to be included along with the four comparable retained by the CIT (Appeals). Although 12 comparable which were rejected on the basis of RPT being more than zero percent, one comparable viz., Four Soft Ltd, will have to be excluded since the RPT is at 19.89% and thus in excess of 15%. Sathyam Computers Ltd. and Infosys Technologies Ltd. will get excluded for the reason that the financial results are not reliable in the case of Sathyam Computers Ltd. and for the reason that the high turnover, brand value, high risks etc. The remaining 9 comparable companies which were excluded by the CIT (Appeals) by applying the RPT filter of 0% related party transaction will not have to be included. Their comparability with the assessee in terms of other filters will be discussed in the following paragraphs.”*

In view of the facts and circumstances of the case when there is good number of comparables available then, we concur with the view of the coordinate bench that the RPT filter of 15% is proper in the case of the assessee. Accordingly we direct the Assessing Officer/TPO to exclude the comparable companies having the revenue of more than 15% from related parties. The learned Authorised Representative of the assessee has referred Annexure A to TPO order which mentions the percentage of RPTs. Thus as per the Annexure A of the TPO's order, the following companies having more than 15% of RPT are directed to be excluded.

<u>Sl. No.</u>	<u>Comparable Company Name</u>	<u>% of RPT Over sales</u>
1.	Aztec Software Limited	17.78
2.	Geometric Software Limited	19.34
3.	Megasoft Limited	17.08

13. The assessee has also raised objections against the other comparables selected by the TPO which we will deal with one by one as under :-

### 13.1 Kals Infosystems Ltd.

13.1.1 The learned Authorised Representative of the assessee has submitted that this company is into a product business and has earned revenue from sale of software product. Therefore this company is not functionally comparable with the assessee which is purely a software development service provider to its parent company. In support of his contention, he has referred the Annual Report of this company and submitted that it engaged in the software product as stated in the Annual Report and also incurred sales and marketing expenditure. The learned Authorised Representative has pointed out that comparability of this company has been examined by this Tribunal in a series of decisions and it has been held that this company cannot be considered as functionally comparable with the software development service provider company. He has relied upon the following decisions :-

<u>CASES PERTAINING TO ASSTT. YEAR :</u> <u>2006 - 07</u>	<u>CASES PERTAINING TO OTHER ASSTT. YEARS</u>
Cypress Semiconductor technology India Private Limited IT (TP) A No. 1167/Bang 2010	Trilogy E . Business Software India Pvt. Ltd vs. DCIT (AY : 2007-08) ITA No. 1054/BANG/2012.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010	Conexant Systems India Pvt. Limited (AY : 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011).
Misys Software Solutions India Private Limited . IT(TP) A No.1425/Bang/2010	Symbol Technologies India Private limited Vs IT (TP) (AY 2007-08) A No. 1352/Bang/2010.
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.1.2 On the other hand, the learned Departmental Representative has relied upon the orders of the authorities below and submitted that the TPO has considered the objections of the assessee and has decided that this company is functionally comparable with the assessee. The DRP has also upheld the finding of the TPO about the functional comparability of this company.

13.1.3 We have considered the rival contentions as well as the relevant material on record. At the outset we note that the functional comparability of this company to that of software development service provider has been examined by this Tribunal in a series of decisions as relied upon by the assessee and referred (supra). In the case of **Triology e-Business** Vs. DCIT in ITA No.1054/Bang/2012 (supra), the Tribunal has dealt with this issue in paragraphs 46 & 47. We further note that in the case of Misys Software Solutions (India) Pvt. Ltd. in IT(TP)A No.1425/Bang/2010 Dt.23.9.2015, the Tribunal has again considered functional comparability of this company in paragraphs 7.1 to 7.4.2 as under :-

**" 7.1 (4) KALS Infosystems 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 this company is into software products, and training apart from provision of software development services and therefore being functionally different, from the assessee who is purely into provision of software development services, ought to be excluded from the list of comparable companies. In support of this contention for exclusion of this company from the list of comparables, the learned Authorised Representative of the assessee placed reliance on the decision of the co-ordinate bench of the Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra)."*

13.1.4 The learned Departmental Representative has not disputed the facts considered by the co-ordinate bench of this Tribunal regarding the nature of functions and business, revenue earned by this company from the sale of software products. Therefore, by following the decisions of the co-ordinate bench (supra), we direct the A.O./TPO to exclude this company from the list of comparables.

**13.2 Tata Elxsi Ltd. (Seg.)**

13.2.1 The learned Authorised Representative of the assessee has submitted that this company is functionally not comparable with the assessee as it fails the test of R&D expenditure to sale which is more than 3% filter. He has further contended that the company is engaged in the R&D activity resulting in creation of Intellectual Property Rights (IPRs). This company is not only into software products as explained in the Annual Report of this company but also is engaged in the embedded product development based on current and emerging technologies such as Multi-media, Wimax, Imaging, Imaging Process etc. The company actively engaged in developing house expertise in current and emerging markets through house development products and training. Further the software

development business segment of this company also comprising of diversified activities such as hardware design, industrial design, engineering design and visual computing. Even this company in its response to notice under Section 133(6) has accepted that this company is not comparable with the software development services provider. In support of his contention, he has relied upon the following decisions :-

<u>CASES PERTAINING TO ASSTT. YEAR : 2006 - 07</u>	<u>CASES PERTAINING TO OTHER ASSTT. YEARS</u>
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. Vs ACIT (ITA No. 1129/Bang/2011) (Page 20-21, Para 14)
Misys Software Solutions India Private Limited . IT(TP) A No.1425/Bang/2010	Telcordia Technologies India Pvt. Ltd. Vs ACIT (AY 2007-08)
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.2.2 We have considered the rival submissions as well as the relevant material on record. At the outset we note that this company is not in the activity of pure software development services but engaged in the diversified product development activity which includes Multi-media, Wimax, Imaging and Imaging Process. Further, this company is also involved in the activities such as hardware design, industrial design, engineering design and visual computing. Therefore, the diversified activities as mentioned above are not comparable with the software development services provider like the assessee. The identical issue has been considered by the co-ordinate bench of this Tribunal in the case of **Misys Software Solutions (India) Pvt. Ltd.** (supra) in paragraphs 8.3.1 to 8.3.2 as under :

" 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 :-

" 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 :-

" 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.+

20. In view of the consistent opinion of this Tribunal on this issue, we concur with the view of the coordinate Bench that when a sufficient number of comparable companies are available for determination of arm's length price (ALP), then the tolerance limit of RPT at 15% is proper in the case of assessee. Accordingly, we direct the AO/TPO to exclude the following three companies from the list of comparables having more than 15% RPT.

1. Aztec Software Ltd.
2. Geometric Software Ltd. (Seg.)
3. Megasoft Ltd.

21. Now we will deal with the issue of comparability of 6 other companies against which the assessee has raised its objections. These companies are as under:-

1. Infosys Ltd.
2. KALS Infosystems Ltd.
3. Tata Elxsi Ltd. (Seg.)
4. Lucid Software Ltd.

5. Accel Transmatics Ltd. (Seg.)
6. Flextronics Software Ltd.

22. We have heard the Id. AR as well as the Id. DR and considered the relevant material on record.

23. The Id. AR of the assessee has submitted that out of these 6 comparable companies, the Tribunal in the case of *Textron India Pvt. Ltd. (supra)* has considered and decided the comparability of 5 companies in paras 13 to 17.4 as under:-

13.1 **Kals Infosystems Ltd.**

13.1.1 The learned Authorised Representative of the assessee has submitted that this company is into a product business and has earned revenue from sale of software product. Therefore this company is not functionally comparable with the assessee which is purely a software development service provider to its parent company. In support of his contention, he has referred the Annual Report of this company and submitted that it engaged in the software product as stated in the Annual Report and also incurred sales and marketing expenditure. The learned Authorised Representative has pointed out that comparability of this company has been examined by this Tribunal in a series of decisions and it has been held that this company cannot be considered as functionally comparable with the software development service provider company. He has relied upon the following decisions :-

<u>CASES PERTAINING TO ASSTT. YEAR : 2006 - 07</u>	<u>CASES PERTAINING TO OTHER ASSTT. YEARS</u>
Cypress Semiconductor technology India Private Limited IT (TP) A No. 1167/Bang 2010	Trilogy E . Business Software India Pvt. Ltd vs. DCIT (AY : 2007-08) ITA No. 1054/BANG/2012.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010	Conexant Systems India Pvt. Limited (AY : 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011).
Misys Software Solutions India Private Limited . IT(TP) A No.1425/Bang/2010	Symbol Technologies India Private limited Vs IT (TP) (AY 2007-08) A No. 1352/Bang/2010.
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.1.2 On the other hand, the learned Departmental Representative has relied upon the orders of the authorities below and submitted that the TPO has considered the objections of the assessee and has decided that this company is functionally comparable with the assessee. The DRP has also upheld the finding of the TPO about the functional comparability of this company.

13.1.3 We have considered the rival contentions as well as the relevant material on record. At the outset we note that the functional comparability of this company to that of software development service provider has been examined by this Tribunal in a series of decisions as relied upon by the assessee and referred (supra). In the case of **Triology e-Business** Vs. DCIT in ITA No.1054/Bang/2012 (supra), the Tribunal has dealt with this issue in paragraphs 46 & 47. We further note that in the case of Misys Software Solutions (India) Pvt. Ltd. in IT(TP)A No.1425/Bang/2010 Dt.23.9.2015, the Tribunal has again considered functional comparability of this company in paragraphs 7.1 to 7.4.2 as under :-

**" 7.1 (4) KALS Infosystems 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 this company is into software products, and training apart from provision of software development services and therefore being functionally different, from the assessee who is purely into provision of software development services, ought to be excluded from the list of comparable companies. In support of this contention for exclusion of this company from the list of comparables, the learned Authorised Representative of the assessee placed reliance on the decision of the co-ordinate bench of the Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra)."*

13.1.4 The learned Departmental Representative has not disputed the facts considered by the co-ordinate bench of this Tribunal regarding the nature of functions and business, revenue earned by this company from the sale of software products. Therefore, by following the decisions of the co-ordinate bench (supra), we direct the A.O./TPO to exclude this company from the list of comparables.

**13.2 Tata Elxsi Ltd. (Seg.)**

13.2.1 The learned Authorised Representative of the assessee has submitted that this company is functionally not comparable with the assessee as it fails the test of R&D expenditure to sale which is more than

3% filter. He has further contended that the company is engaged in the R&D activity resulting in creation of Intellectual Property Rights (IPRs). This company is not only into software products as explained in the Annual Report of this company but also is engaged in the embedded product development based on current and emerging technologies such as Multi-media, Wimax, Imaging, Imaging Process etc. The company actively engaged in developing house expertise in current and emerging markets through house development products and training. Further the software development business segment of this company also comprising of diversified activities such as hardware design, industrial design, engineering design and visual computing. Even this company in its response to notice under Section 133(6) has accepted that this company is not comparable with the software development services provider. In support of his contention, he has relied upon the following decisions :-

<u>CASES PERTAINING TO ASSTT. YEAR : 2006 - 07</u>	<u>CASES PERTAINING TO OTHER ASSTT. YEARS</u>
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. Vs ACIT (ITA No. 1129/Bang/2011) (Page 20-21, Para 14)
Misys Software Solutions India Private Limited . IT(TP) A No.1425/Bang/2010	Telcordia Technologies India Pvt. Ltd. Vs ACIT (AY 2007-08)
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.2.2 We have considered the rival submissions as well as the relevant material on record. At the outset we note that this company is not in the activity of pure software development services but engaged in the diversified product development activity which includes Multi-media, Wimax, Imaging and Imaging Process. Further, this company is also involved in the activities such as hardware design, industrial design, engineering design and visual computing. Therefore, the diversified activities as mentioned above are not comparable with the software development services provider like the assessee. The identical issue has been considered by the co-ordinate bench of this Tribunal in the case of **Misys Software Solutions (India) Pvt. Ltd.** (supra) in paragraphs 8.3.1 to 8.3.2 as under :

" 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 :-

" 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 :-

" 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.**

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. 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.

## **15. Accel Transmatics Ltd. (Seq.)**

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 bench marking 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 :-

<u>CASES PERTAINING TO</u> ASSTT. YEAR : 2006 - 07	<u>CASES PERTAINING TO OTHER</u> ASSTT. YEARS
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. Vs 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. Vs DCIT in IT A No. 1054/Bang/2012 (AY . 2007-08)
Thoughtworks 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 :-

" 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 off shore 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 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 :-*

ō12. In so far 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 :-

(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 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.

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 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:

öIn 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.ö

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 ld. counsel for the assessee was that if the above company should not be considered as comparable. The ld. 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 ld. 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 ld. counsel for the assessee, we hold that the aforesaid company should be excluded as comparables.ö

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.ö

*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.

**16. Infosys Technologies Ltd.**

16.1 The learned Authorised Representative of the assessee has submitted that the assessee had opposed inclusion of this comparable before the TPO on the ground that this company has substantial intangible assets, profits earned predominantly due to brand value and has large focus on R&D apart from substantial selling and marketing expenses. This company has a finance BPO and there is no sub-segment in the software segment. The learned Authorised Representative has referred to the Annual Report of this company and submitted that this company has brands and intangibles having diversified operations at large scale. Further this company is engaged in the development of mixed products like Finacle. This company is carrying out a large scale R&D activities and therefore cannot be considered as a good comparable with the assessee. The learned Authorised Representative has relied upon the following decisions :-

<b><u>CASES PERTAINING TO ASSTT.</u></b> <b><u>YEAR : 2006 - 07</u></b>	<b><u>CASES PERTAINING TO OTHER</u></b> <b><u>ASSTT. YEARS</u></b>
Cypress Semiconductor technology India Private Limited IT (TP) A No 1167/Bang 2010	Triology E . Business Software India Pvt. Ltd vs. DCIT ITA No. 1054/BANG/2012 (AY : 2007-08)
Agnity India Technologies Pvt Ltd ITA No. 3856(Del ITAT)/2010 (AY 2006-07)	24/7customer.com vs DCIT (AY : 2004-05) ITA No.227/Bang/2010
Agnity India Technologies P. Ltd. (ITA No. 1204/2011)(Del HC)	Adaptec India Private Limited (AY : 2007-08) ITA No. 1801/Hyd/09.
Misys Software Solutions India Private Limited . IT(TP) A No.1425/Bang/2010 . Turnover	Mercedes Benz R & D India Pvt. Ltd. (AY : 2007-08) ITA No. 1222/Bang/2011.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010 - Turnover	CSR India Pvt. Ltd. (AY : 2007-08) ITA No. 1119/Bang/2011, [2013]
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010 - Turnover	Witness Systems Software India Pvt Ltd (AY : 2007-08) ITA No. 1366/Bang/2011.
	<b>FOR CASES INVOLVING JOINT OPERATION, LARGE INTANGIBLES, HIGH BRAND VALUE, RISK BEARING</b>

& HIGH PROFIT MARGIN CASES	
	Agnity India Technologies Pvt Ltd ITA No. 3856(Del)/2010], ITAT Delhi" This ruling has been upheld by the High Court (ITA No. 1204/2011, dated July 2013). Scale of operation, brand value etc.
	NTT Data India Enterprise Application Services Pvt. Ltd. [ITA No. 1612/Hyd/2010.]
	Motorola India Electronics Private Limited vs. ACIT ITA No. 1274 & 1413/Bang/2008.
	Logica Pvt. Ltd. Vs ACIT (ITA No. 1129/Bang/2011

16.2 On the other hand, the learned Departmental Representative has submitted that the TPO has taken the segmental data of this company which are functionally similar to that of the assessee. She has relied upon the orders of the authorities below.

16.3 We have considered the rival submissions as well as the relevant material on record. There is no dispute that Infosys Technologies Ltd. has big brand value and intangibles and also engaged in diversified operations at large scale apart from the software development services. This company also engaged in the development of mixed products. Therefore, the revenue earned by this company in this segment is from various diversified activities including the development of product which is owned by this company. Apart from this, it is also engaged in the R&D activity and therefore this company is not functionally comparable with the assessee which is purely software development services provider company and does not have any brand or intangibles. The co-ordinate bench of this Tribunal in the case of Cypress Semi-conductor Ltd. has considered the functional comparability of this company in paragraphs 15 & 16 are as under :-

¶5. As far as the comparable chosen by TPO viz., Infosys Limited is concerned, it has been held by the co-ordinate bench of ITAT Bangalore in the case of Logica Pvt.Ltd. Vs. ACIT ITA No.1129/Bang/2011 (AY 07-08) that this company is a full fledge risk assuming entrepreneur, holds technology and marketing intangible and is functionally different providing end-to-end solutions encompassing technical consulting, design, development, re-engineering, maintenance, systems integration and package evaluation and implementation. The company generates around 3.96% of its revenue from software products. The relevant observations of the Tribunal in the case of Logical Pvt. Ltd. (supra) were as follows:

¶3. So also, the comparables listed at Sl.Nos. 10, 14 and 26 have to be rejected as functionally not comparable with that of the assessee in view of the decision of the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India Private Ltd. in ITA No.7821/MUM/2011*, wherein it was held as under:-

¶2 Lucid Software Limited

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#### 7.4 Infosys Technologies Ltd.:

The parameter for identifying comparable entity has to be seen from the angle of functions formed by the company, size of the company in terms of the sale revenue, stage of business cycle and company's growth cycle. In the case of Infosys, there are huge intangible assets which as per the information provided by the learned AR are valued at Rs.69,522 crores, which comprises of brand value itself at Rs.22,915 crores. Based on such fund valuation, the profit of Infosys is predominantly due to its premium branding. It is India's No.2 software service exporter and Third in the World as an IT Service company. It is a giant company which is evident from its revenue fund from the sales which itself is more than Rs.13145 crores and expenditure on advertisement/sales promotion and expenditure on R&D is at Rs.69 crores and Rs.167 crores respectively, whereas in the case of the assessee the revenue is only 10.7 crores with no expenditure on advertisement, sales and promotion etc., which are borne by the associated enterprises. Even from the test of  $\frac{\text{AR}}{\text{qie}}$  function performed, assets employed and risk assumed, comparability analysis miserably fails in this case. The comparison of function and profile as has been reproduced in para 6(iv) above, mostly shows that the profit level indicators in relation to return of cost, return of sales and return of assets are huge between Infosys and the assessee company and therefore, the Infosys cannot be treated as comparable entity for making comparability analysis with the assessee company. The comparability of Infosys Technology of the company as that of an assessee has been dealt with ITAT Delhi Bench in the case of  $\frac{\text{Agnity India Technologies Private Limited}}{\text{q}}(\text{ITA No.3856/Delhi/2010})$ , wherein it was held that Infosys is a giant in the area of development of software and it assumes all risks, leading to higher profit and cannot be compared with the company which is a captive unit of its parent company assuming only limited currency risk. In view of the above finding, we hold that the Infosys cannot be taken as a comparable for determining the arms length price in the case of the assessee.+

16. Respectfully following the decision of the Tribunal referred to above, we direct Infosys Limited should be excluded from the list of comparable companies chosen by the TPO. We order accordingly.+

Thus it was found that this company is functionally dis-similar to the software development service provider company as it provides end to end solutions in technical consultancy, design, development, re-engineering, maintenance, system integration and implementation. This company also generates revenue from the software products and has brand value and

huge intangible assets. In view of the above facts and circumstances as discussed above, this company is functionally not comparable with that of the assessee. Accordingly, we direct the A.O./TPO to exclude this company.

**17. Flextronics Software System Ltd.**

17.1 The assessee has opposed inclusion of this comparable before the TPO on the ground that it is engaged in the R&D development activity giving rise to IPR. The TPO did not accept the contention of the assessee and obtained the information by invoking the provisions of section 133(6) of the Income Tax Act, 1961 (in short 'the Act'). The TPO held that this comparable has a software development services segment and therefore is functionally similar to the business activity of the assessee in providing software development services. The DRP has concurred the view of the TPO.

17.2 Before us, the learned Authorised Representative of the assessee has submitted that apart from the turnover dis-similarity, this company is also not functionally comparable with the assessee.

17.3 On the other hand, the learned Departmental Representative has submitted that the TPO has used the segmental data of this company and given a finding that this company is functionally comparable with the assessee. He has relied upon the orders of the TPO and DRP.

17.4 Having considered the rival submissions and relevant material on record, we note that the objection raised by the assessee regarding the activity of this company in R&D and also acquiring IPRs has not been dealt with by the authorities below. Accordingly, in the facts and circumstances of the case, we direct the A.O./TPO to re-adjudicate this issue after considering the objections of the assessee on functional dis-similarity.+

24. Since the functional comparability of 5 companies which are in dispute before us have been discussed by the coordinate Bench of this Tribunal in case cited *supra* for the assessment year under consideration, therefore in view of the finding of the coordinate Bench of this Tribunal, we direct the AO/TPO to exclude 4 companies from the list of comparables for determination of ALP and re-examine

the comparability of Flextronics Software Ltd. in light of the directions given by the coordinate Bench.

25. Another company which is sought to be excluded by the assessee is Lucid Software Ltd. The Id. AR of the assessee has submitted that functional comparability of this company has been examined by the coordinate Bench of this Tribunal in the case of *Cypress Semiconductor Technology India (P) Ltd. v. DCIT, order dated 27.3.2015, 57 taxmann.com 69 (Bang. Trib.)*. Thus, the Id. AR has submitted that this company being in software product and having no segmental result, cannot be considered as a good comparable for the purpose of determining the ALP in respect of software development services of the assessee. Thus, Id. AR has submitted that this company may be excluded from the list of comparables.

26. On the other hand, the Id. DR has submitted that assessee has not furnished the complete details to support the claim that this company is in the software product and segmental data are not available.

27. In the rejoinder, the Id. AR has submitted that this company is selected by the TPO and as per the balance sheet and profit & loss

account of this company available in the public domain, this company is having work-in-progress as well as product development expenses, therefore this company is engaged in product development and no separate data for software development services are available.

28. We have considered the rival submissions as well as relevant material on record. At the outset, we note that the functional comparability of this company has been considered by the coordinate Bench of this Tribunal in the case of *Cypress Semiconductor Technology India (P) Ltd. (supra)* in para 20 as under:-

“20. The learned counsel for the Assessee brought to our notice that the comparable company chosen by the TPO viz., Lucid Software Limited, has to be excluded as functionally not comparable with that of the assessee in view of the decision of the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India Private Ltd. in ITA No.7821/MUM/2011*, which was followed by the ITAT Bangalore Bench in the case of *Logica Private Ltd. ITA No.1129/Bang/2011* for AY 07-08, wherein it was held as under:-

“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-a-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 arms length price in the case of the assessee.”

29. The Tribunal has followed the finding of the coordinate Bench of Tribunal in the case of *Telcordia Technologies India Private Ltd. v. ACIT, 137 ITD 1*, wherein the Tribunal has given the reasons for functional dissimilarity of this company viz., Lucid Software Ltd. being in the product development.

30. We find from the profit & loss account of this company that there is work-in-progress during the year under consideration as well as in the earlier year, therefore it supports the finding given by the Tribunal that this company is in the software product and in the absence of segmental data, the financial results of software development services as well product cannot be compared with the assessee's transaction of software development services. Accordingly, in view of the decision of coordinate Bench of the Tribunal cited *supra*, we direct the AO/TPO to exclude this company, Lucid Software Ltd. from the list of comparables.

31. Since we have directed exclusion of 8 companies from the list of comparables, and re-examination of one company viz., Flextronics Software Ltd., therefore, TPO is required to recomputed the ALP on the basis of remaining set of comparables and also considering the benefit of tolerance range of +5% / (-) 5% as per proviso to section 92C of the Act.

32. Ground No.7 is regarding exclusion of leased line charges from the export turnover for the purpose of computing deduction u/s. 10A.

33. We have heard the Id. DR and the Id. AR as well as considered the material on record. At the outset, we note that this issue is covered by the Hon'ble jurisdictional High Court in the case of ACIT v. Tata Elxsi Ltd., 349 ITR 98 [Karn], wherein the Hon'ble High Court has held as under:-

**“10.** The Bombay High Court had an occasion to consider the meaning of the word 'total turnover' in the context of Section 10-A, in the case of *CIT v. Gem Plus Jewellery India Ltd.* [2011] 330 ITR 175 [2010] 194 Taxman 192 (Bom.). Interpreting sub-Section (4) of Section 10-A, it is held as under:

$$\frac{\text{Profits derived from export of articles or things or Computer software} \times \text{Export turnover in respect of the articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}}$$

"Under sub-section (4) the proportion between the export turnover in respect of the articles or things, or, as the case may be, computer software exported, to the total turnover of the business carried over by the under-taking is applied to the profits of the business of the undertaking in computing the profits of the business of the undertaking in computing the profits derived from export. In other words, the profits of the business of the undertaking are multiplied by the export turnover in respect of the articles, things or, as the case may be, computer software and divided by the total turnover of the business carried or by the undertaking. The formula which is prescribed by sub-section (4) of section 10A is as follows:

The total turnover of the business carried on by the undertaking would consist of the turnover from export and the turnover from local sales. The export turnover constitutes the numerator in the formula prescribed by sub-section (4). Export turnover also forms a constituent element of the denominator inasmuch as the export turnover is a part of the total turnover.

The export turnover, in the numerator must have the same meaning as the export turnover which is a constituent element of the total turnover in the denominator. The legislature has provided a definition of the expression "export turnover" in *Explanation 2* to section 10A by which the expression is defined to mean the consideration in respect of export by the undertaking of articles, things or computer software received in, or brought into India by the assessee in convertible foreign exchange but so as not to include *inter alia* freight, telecommunication charges or insurance attributable to the delivery of the articles things or software outside India. Therefore in computing the export turnover the Legislature has made a specific exclusion of freight and insurance charges.

The submission which has been urged on behalf of the Revenue is that while freight and insurance charges are liable to be excluded in computing export turnover, a similar exclusion has not been provided in regard to total turnover. The submission of the Revenue, however, misses the point that the expression "total turnover" has not been defined at all by Parliament for the purposes of section 10A. However the expression "export turnover" has been defined. The definition of "export turnover" excludes freight and insurance. Since export turnover has been defined by Parliament and there is a specific exclusion of freight and insurance, the expression "export turnover" cannot have a different meaning when it forms a constituent part of the total turnover for the purposes of the application of the formula. Undoubtedly, it was open to Parliament to make a provision to the contrary. However, no such provision

having been made, the principle which has been enunciated earlier must prevail as a matter of correct statutory interpretation. Any other interpretation would lead to an absurdity. If the contention of the Revenue were to be accepted, the same expression viz. "export turnover" would have a different connotation in the application of the same formula. The submission of the Revenue would lead to a situation where freight and insurance, though it has been specifically excluded from "export turnover" for the purposes of the numerator would be brought in as part of the "export turnover" when it forms an element of the total turnover as a denominator in the formula. A construction of a statutory provision which would lead to an absurdity must be avoided."

The special bench of the Tribunal, in the case of *ITO v. Sak Soft Ltd.* [2009] 313 ITR (AT) 353/ 30 SOT 55 (Chennai) also had an occasion to consider the meaning of the word 'total turnover'. After referring to the various judgments of the High Court as well as the Supreme Court held as under:

"53. For the above reasons, we hold that for the purpose of applying the formula under sub-section (4) of Section 10-B, the freight telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or the expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula."

The formula for computation of the deduction under Section 10-A would be as under:

$$\frac{\text{Profits of the business X export turnover}}{\text{Total turnover}}$$

From the aforesaid judgments, what emerges is that, there should be uniformity in the ingredients of both the numerator

and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10-A is a beneficial section. It is intended to provide incentives to promote exports. The incentive is to exempt profits relatable to exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the case of Section 80HHC, the export profit is to be derived from the total business income of the assessee, whereas in Section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. The export turnover would be a component or part of a denominator, the other component being the domestic turnover. In other words, to the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. In view of the commonality, the understanding should also be the same. In other words, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in Section 10-A, there is nothing in the said Section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. Though when a particular word is not defined by the legislature and an ordinary meaning is to be attributed to the same, the said ordinary meaning to be attributed to such word is to be in conformity with the context in which it is used. When the statute prescribes a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same

meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. If that were the intention of the legislature, they would have expressly stated so. If they have not chosen to expressly define what the total turnover means, then, when the total turnover includes export turnover, the meaning assigned by the legislature to the export turnover is to be respected and given effect to, while interpreting the total turnover which is inclusive of the export turnover. Therefore, the formula for computation of the deduction under Section 10-A, would be as under:

$$\text{Profits of the business of the undertaking} \times \frac{\text{Export turn over}}{(\text{Export turnover + domestic turn over})}$$

Total Turn Over

**11.** In that view of the matter, we do not see any error committed by the Tribunal in following the judgments rendered in the context of Section 80HHC in interpreting Section 10-A when the principle underlying both these provisions is one and the same. Therefore, we do not see any merit in these appeals. The substantial question of law framed is answered in favour of the assessee and against the revenue.”

34. Following the judgment of Hon'ble jurisdictional High Court in the case of *Tata Elxsi Ltd. (supra)*, we direct the AO to reduce the leased line charges from the total turnover as well.

35. Ground Nos. 8 & 9 are regarding levy of interest u/s. 234B and 234D of the Act which are mandatory and consequential in nature. We direct the AO to give consequential effect.

36. In appeal No.ITA 1381/Bang/2010, the assessee has raised identical grounds including additional ground as in the case of ITA No.1380/Bang/2010. We find that identical set of comparables were selected by the assessee for benchmarking its transactions. The TPO has also considered identical set of comparables for determining the ALP. Therefore in view of identical facts and circumstances involved in this case as in the case of appeal No.ITA 1380/Bang/2010, we direct the AO/TPO to exclude the 8 comparables and re-examine another company viz., Flextronics Software Ltd. and then recompute the ALP as per our directions in ITA No.1380/Bang/2010.

37. The other issues are also identical and therefore stand adjudicated in terms of our findings in ITA No.1380/Bang/2010.

38. In the result, both the appeals are partly allowed.

Pronounced in the open court on this 13th day of May, 2016.

Sd/-  
( INTURI RAMA RAO )  
Accountant Member

Sd/-  
(VIJAY PAL RAO )  
Judicial Member

\* Reddy gp

Copy to:

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

By order

Assistant Registrar,  
ITAT, Bangalore.