

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH " A "**

**BEFORE SHRI N.V. VASUDEVAN, JUDICIAL MEMBER AND
SHRI JASON P. BOAZ, ACCOUNTANT MEMBER**

I.T.(T.P) A. No.73/Bang/2012 (Assessment Year : 2005-06)		
M/s. Multitech Software Systems India Pvt. Ltd. No.170, 8 th Cross, 10 th Main, Indiranagar, 2 nd Stage, Bangalore-560 038 PAN AAACM 9615Q	Vs.	Assistant Commissioner of Income Tax, Circle 12(1), Bangalore.
Appellant		Respondent.

I.T.(T.P) A. No.175/Bang/2012 (Assessment Year : 2005-06)		
Assistant Commissioner of Income Tax, Circle 12(1), Bangalore.	Vs.	M/s. Multitech Software Systems India Pvt. Ltd., Bangalore-560 038
Appellant		Respondent.

Assessee By : Shri V. Sridhar, Advocate.

Revenue By : Shri C.H. Sundar Rao, CIT-I (D.R)

Date of Hearing : 26.2.2015.

Date of Pronouncement : 30.04.2015.

O R D E R

Per Shri Jason P. Boaz, A.M. :

These are cross appeals, one by the assessee and one by Revenue, directed against the order of the Commissioner of Income Tax (Appeals)-IV, Bangalore dt.30.11.2011 for Assessment Year 2005-06. The assessee has also filed cross objections in the matter.

2. The facts of the case, briefly, are as under :-

2.1 The assessee company, in the business of providing software development services, filed its return of income for Assessment Year 2005-06 on 29.10.2005 declaring total income of Rs.24,93,540 after claiming deduction of Rs.1,50,41,210 under Section 10A of the Income Tax Act, 1961 (in short 'the Act'). The return was processed under Section 143(1) of the Act and the case was subsequently taken up for scrutiny. The Assessing Officer observed from the Form No.3CEB that the assessee had reportedly entered into international transactions with its Associated Enterprises ('AEs') in the year under consideration and made a reference to the Transfer Pricing Officer ('TPO') under Section 92CA of the Act for determination of the Arm's Length Price ('ALP') thereof, the details of which are as under :-

(1) Export of Software Development Services :	Rs.4,99,98,250.
(2) Reimbursement of Expenses :	Rs.1,59,320.

The TPO passed an order under Section 92CA of the Act dt.31.10.2008 in respect of the aforesaid international transactions, proposing an adjustment of Rs.42,81,608 to the ALP of the international transactions of the assessee in respect of its software development services.

2.2 After receipt of the order of the TPO under Section 92CA of the Act, the Assessing Officer completed the assessment under Section 143(3) of the Act vide order dt.16.12.2008 wherein the income of the assessee was determined at Rs.76,39,441 as against the returned income of Rs.24,93,540 by making the following additions/disallowances thereto :-

(i) Disallowance on account of computation of deduction u/s.10A : Rs.8,64,293.

(ii) T.P. Adjustment : Rs.;42,81,608.

3. Aggrieved by the order of assessment for Assessment Year 2005-06 dt.16.12.2008,

the assessee preferred an appeal before the CIT (Appeals) - IV, Bangalore. The learned CIT (Appeals) disposed off the assessee's appeal vide order dt.30.11.2011, allowing the assessee partial relief.

4. Aggrieved by the order of the CIT (Appeals)-IV, Bangalore dt.30.11.2011, Revenue is in appeal before this Tribunal raising the following grounds :-

"1. The order of the learned CIT (Appeals) in so far as it relates to the following grounds is opposed to law and facts of the case.

2. The learned CIT (Appeals) erred in holding that expenditure of Rs.48,64,083 incurred towards telecommunication expenses attributable to delivery of software are to be excluded from total turnover as well whereas such exclusion is permitted to arrive at the export turnover only as per the definitions given in Sec. 10A of the Act and total turnover has not been defined in the section.

3. On the facts and in the circumstances of the case, the learned CIT (Appeals) erred in holding that the TPO erred in not excluding comparables having any related party transactions.

4. The learned CIT (Appeals) erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable, and accordingly erred in excluding M/s. Infosys Technologies Ltd., M/s. iGate Global Solutions Ltd., Flextronics Software Systems Ltd. and L&T Infotech Ltd. and Satyam Software Services Ltd. as comparables.

5. The learned CIT (Appeals) erred in holding that profit on cost of more than 50% of the comparable company(ies) is abnormal without giving reasons how functions discharged, assets deployed and risks assumed of such companies were different from that of the appellant company.

6. The learned CIT (Appeals) erred in holding that the assessee is eligible for a standard deduction of 5% from the ALP under the proviso to Section 92C(2) of the IT Act, 1961.

7. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT (Appeals) in so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.

8. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above."

IT(T.P)A No.73/Bang/2012 - Assessee's appeal for A.Y. 2005-06.

5. In the assessee's appeal in respect of the order of the CIT (Appeals) - IV, Bangalore dt.30.11.2011 for Assessment Year 2005-06, the following grounds have been raised :-

" 1. The order of the CIT (Appeals) IV, Bangalore-560 001 dt.30.11.2011 in ITA No.04/Range-12/10-11, for the above mentioned assessment year is contrary to law, facts, and in the circumstances of the case.

2. The CIT (Appeals) IV erred in excluding the comparables which were showing operating profit lesser than the margin shown by the appellant in the determination of ALP without assigning proper reasons and justification.

3. The CIT (Appeals) IV in not allowing marketing expenses to the appellant in the determination of ALP without assigning proper reasons and justification.

4. The CIT (Appeals) IV ought to have considered the submission made by the appellant in this regard for allowing the marketing expenditure as per the percentage of expenses met by the comparables in the determination of ALP.

5. The CIT (Appeals) IV erred in disallowing the miscellaneous income without granting the opportunity to the appellant and without assigning proper reasons and justification.

6. The CIT (Appeals) ought to have appreciated that the reimbursement of expenses was debited at the time of expenses incurred by the appellant and further ought to have considered that the said expenses were credited to the miscellaneous income account when the same was reimbursed by the client(s). Hence the CIT (Appeals) IV ought to have considered the miscellaneous income for arriving the operating profit margin in the determination of ALP.

7. The CIT (Appeals) IV ought to have considered that accelerated depreciation was debited to the profit and loss as compared to the rate given in Schedule IV and hence ought to have considered further that the said claim should be restated to make the comparable with the other comparables inasmuch as the CIT (Appeals) IV without assigning proper reasons went wrong in disallowing the same in the determination of ALP.

8. The CIT (Appeals) IV erred in excluding the majority of samples while retaining only the few sample in arriving at ALP which according to the appellant was wrong, incorrect and unjustified, erroneous and not sustainable both facts and in law.

9. The CIT (Appeals) IV failed to appreciate that the re-determination of ALP in the recomputation of the adjustment required relating to the transaction with the AEs in the computation of taxable total income was wrong, incorrect, invalid, unjustified, erroneous and not sustainable both on facts and in law.

10. The CIT (Appeals) IV failed to appreciate that there was no proper opportunity was given before passing the impugned order / the TPO's order and any order passed in violation of the principles of natural justice is nullity in law.

11. The appellant craves leave to file additional grounds / arguments at the time of hearing."

Transfer Pricing Issues.

6.0 Before proceeding to deal with the above grounds of appeal on T.P. issues, the approach of the TPO vis-a-vis that of the assessee in its T.P. Study submitted before the TPO is briefly summarised as under.

7.0 The assessee is engaged in the provisions of software development services. For the year under consideration, the assessee has reported the following international transactions in its 3CEB report :-

(i) Software Development Services :	Rs.4,99,98,250.
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(ii) Reimbursement of expenses :	Rs.1,59,320.
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The assessee in its T.P. Study has adopted CUP Method as the Most Appropriate Method (MAM) and compared the price charged by it to its AEs with the price charged by it to third parties to justify the ALP of its international transactions. As the assessee had selected CUP Method by considering the price charged by it to its AEs vis-à-vis the price charged to unrelated parties, there was no search process involved.

8. The TPO's Approach.

8.1 The TPO, rejected the methodology adopted by the assessee, for justifying ALP of its international transactions, adopted TNMM as the MAM and proceeded to conduct his own fresh search for comparables using Prowess and Capitaline. The TPO adopted TNMM as the MAM. The TPO adopted the following 17 Companies as comparable companies :-

S.No.	Name of the comparable company	OP/OC (%)
1.	Bodhtree Consulting Ltd.	24.85
2.	Lanco Global Systems Ltd.	13.65
3.	Exensys Software Solutions Ltd.	70.67
4.	Sankhya Infotech Ltd.	27.38
5.	Sasken Network Systems Ltd.	16.63
6.	Four Soft Ltd.	22.98
7.	Thirdware Solution Ltd.	66.09
8.	R.S. Software (India) Ltd.	8.07
9.	Geometric Software Solutions Co. Ltd.	20.33
10.	Tata Elxsi Ltd. (Software Devt. Services - Seg)	24.343
11.	Visual Soft Technologies Ltd. (Seg)	23.51
12.	Sasken Communication Technologies Ltd. (Seg)	14.41
13.	iGate Global Solutions Ltd. (Seg)	4.32
14.	Flextronics (Seg)	32.19
15.	L&T Infotech Ltd.	10.33
16.	Satyam Computers Services	29.44
17.	Infosys Ltd.	42.83

8.2 The arithmetic mean of these 17 comparables was computed at 26.59%. After allowing working capital adjustment of (-) 0.06%, the adjusted arithmetic mean of these comparables was adopted at 26.65%. The resultant shortfall in the price amounting to Rs.42,81,608 was taken at the T.P. adjustment to the ALP of the international transactions of the assessee with its AEs and added to the income of the assessee.

9.1 In the impugned order, the learned CIT(A) after considering the submissions of the assessee disposed off the assessee's appeal excluding certain companies chosen by the TPO as comparables to the assessee. While deciding on the exclusion of certain companies from the 17 comparable companies chosen by the TPO, the learned CIT(A) adjudicated on the following issues as under.

9.2 Companies with Related Party Transactions ('RPF')

The learned CIT(A) relying on the decision of the co-ordinate bench of this Tribunal in the case of Phillips Software Centre Pvt. Ltd. V ACIT (26 SOT 226), held that companies with any RPT are to be excluded from the set of comparable companies and accordingly 6 of the 17 companies selected by the TPO were excluded from the set of comparable companies which are as under :-

1. Sasken Network Systems Ltd.
2. Four Soft Ltd.
3. R.S. Software India Ltd.
4. Geometric Software Solutions Ltd.
5. Tata Elxsi Ltd.
6. Sasken Communication Technology Ltd.

As seen from the order of the learned CIT(A) in case of some of the comparable companies, the assessee had argued against their inclusion on grounds of there being functionally dis-similarity also. We find that the learned CIT(A) has not adjudicated on this aspect, as the companies had been excluded from the list of comparables on the ground of RPT.

9.3 Companies with abnormal profits

Relying on the various decisions cited in the impugned order, the learned CIT(A) held that companies showing extra-ordinary profits have to be excluded from the list of comparables. Accordingly, the learned CIT (Appeals) excluded two companies, namely (i) Exensys Software Solutions Ltd. and (ii) Thirdware Solutions Ltd. showing profits of 70.68% and 66.09% from the set of comparable companies chosen by the TPO.

9.4 Companies with High Turnover.

Relying on the decision of the co-ordinate bench of this Tribunal in the case of *Genisys Integrating Systems (India) P. Ltd. V DCIT (2011) TaxCorp (TP) 3848*, in which it was held that the turnover range of Rs.1 Crore to Rs.200 Crore was to be applied, the learned CIT (Appeals) held that companies having turnover exceeding Rs.200 Crores should be excluded from the final set of comparable and thereby excluded the following companies from the list of comparables :-

1. iGate Global Solutions Ltd.
2. Flextronics Software Solutions Ltd. (Seg)
3. L&T Infotech Ltd.
4. Satyam Services Ltd.
5. Infosys Technologies Ltd.

The learned CIT (Appeals) also held that Satyam Computer Services Ltd. should be excluded on grounds of unreliable financial results. The learned CIT (Appeals) further held that Lanco Global Ltd. should be excluded from the set of comparable companies on grounds of low margins.

9.5 Computation of Deduction u/s.10A of the Act.

In respect of the assessee's claim for deduction u/s.10A of the Act, the learned CIT(A) relying on the decision of the Hon'ble High Court of Karnataka in the case of *Tata Elxsi Ltd. (349 ITR 98)* and of the Special Bench of the Chennai ITAT in the case of *Sak Soft Ltd. (313 ITR 353)*, directed the Assessing Officer to recompute the same by

reducing from the "total turnover", the communication expenses by which the "export turnover" has been reduced.

10.1 In the proceedings before us, the learned Departmental Representative challenged the impugned order of the learned CIT(A) on the issue of RPT, upper turnover filter and abnormal profit, raised at Grounds 3, 4 and 5 of the appeal; placing reliance on later decisions of the co-ordinate benches of this Tribunal in support of the stand of revenue. On the contrary, the learned Authorised Representative of the assessee assailed the impugned order of the learned CIT(A) in confirming part of the TP Adjustment and submitted paper books containing case laws and other details which were taken on record. The learned Authorised Representative also filed a chart in which it has been submitted that the following companies ought to be excluded from the set of comparable companies, for the reasons given therein :-

S.No.	Name of the company	Reasons given by assessee for exclusion.
1.	Exensys Software Solutions Ltd.	Excluded by TPO in A.Y. 2006-07 as product company.
2.	Four Soft Ltd.	RPT more than 15%.
3.	Thirdware Solutions Ltd.	Super normal profit.
4.	iGate Global Solutions Ltd. (Seg.)	Turnover in excess of Rs.200 Crores.
5.	Flextronics Software Solutions Ltd. (seg.)	-do-
6.	L&T Infotech Ltd.	-do-
7.	Satyam Computer Services Ltd.	-do-
8.	Infosys Technologies Ltd.	-do-

10.2 We have heard both parties, perused and carefully considered the order of the TPO under section 92CA of the Act, the order of assessment, the impugned order of the learned CIT(A), the submissions of both the learned Departmental Representative for

revenue and the learned Authorised Representative of the assessee, including the judicial decisions cited and placed reliance upon. We now proceed to consider the various issues raised by Revenue and the assessee.

Revenue's appeal in IT(TP)A No.175/Bang/2011 for A.Y. 2005-06.

11. The Grounds raised by Revenue at S.Nos.1, 7 & 8 are general in nature and no adjudication being called for thereon, are dismissed as infructuous.

12. **Ground No.2 : Computation of Deduction u/s.10A of the Act.**

12.1 Revenue challenges the order of the learned CIT(A) in directing the Assessing Officer to recompute the eligible deduction to the assessee u/s.10A of the Act by reducing the expenditure incurred in foreign currency towards communication expenses from both 'export turnover' as well as 'total turnover'. The learned Departmental Representative was heard in support of the ground raised.

12.2 Per contra, the learned Authorised Representative supported the impugned order of the learned CIT(A) on this issue, submitting that the issue is now covered in favour of the assessee by the decision of the Hon'ble High Court of Karnataka in the case of Tata Elxsi Ltd. (supra). The learned A.R. contends in view of this, Revenue's appeal on this Ground is liable to be dismissed.

12.3 We have heard the rival submissions and perused and carefully considered the material on record. We find, as submitted by the learned Authorised Representative, that the Hon'ble High Court of Karnataka in the case of Tata Elxsi Ltd. (supra) has held that while computing the deduction under section 10A of the Act, if the export turnover in the

numerator is to be arrived at after excluding certain expenditure, then the same expenditure should also be excluded from the total turnover also. Respectfully following the same, we dismiss this ground of revenue and direct the Assessing Officer to exclude the expenditure incurred in foreign currency towards daily allowance, support allowance and travel both from export turnover as well as from total turnover for computing deduction under section 10A of the Act. Accordingly, Ground No.2 raised by revenue is dismissed.

13. **Ground No.3 : Related Party Transactions (RPT)**

13.1 In this ground, revenue assails the decision of the learned CIT (Appeals) in the impugned order in holding that companies having any RPT have to be excluded from the list of comparable companies.

13.2.1 We have heard the rival contentions of both the learned Departmental Representative for revenue and the learned Authorised Representative of the assessee on this issue and perused and carefully considered the material on record. The learned Authorised Representative of the assessee has referred to the decision of the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010 while making submissions on the RPT filter in the case of Four Soft Ltd.. We find that the co-ordinate bench of this Tribunal, in the aforesaid case, has directed that companies with RPT in excess of 15% of total revenues are to be excluded from the set of comparables. The operative paragraph 13, thereof is extracted hereunder :-

" 13.0 RELATED PARTY TRANSACTIONS

In respect of the ground raised at S.No.1 regarding acceptance of comparable companies having related party transactions as proposed by the TPO, the learned counsel for the assessee argued that the transfer pricing regulations do not stipulate any minimum limit of related party transactions which form the threshold for exclusion as a comparable. In this regard, the learned counsel for the assessee objected to the TPO's setting a limit of 25% on related party transactions. He objected to the inclusion of comparables being related party transactions in excess of 15% of sales / revenue. In support of this proposition, the learned counsel for the assessee placed reliance on the decision of the Hon'ble Bench of the ITAT, Delhi in the case of Sony India (P) Ltd. reported in 2008-TIOL-439-ITAT-Delhi dt.23.12.2008. The learned counsel for the assessee drew our attention to para 115.3 of the order wherein the Tribunal has held that -

" We are further of the view that an entity can be taken as uncontrolled if its related party transactions do not exceed 10 to 15% of total revenue. Within the above limit, transactions cannot be held to be significant to influence the profitability of the comparables. For the purpose of comparison what is to be judged is the impact of the related party transactions vis-à-vis sales and not profit since profit of an enterprise is influenced by large number of other factors"

Respectfully following the decision of the Tribunal in the case of Sony India (P) Ltd (supra), the Assessing Officer / TPO are directed to exclude after due verification those comparables from the list with related party transactions or controlled transactions in excess of 15% of total revenues for the financial year 2003-04."

13.2.2 In the light of the above decision of the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (supra), we find that the decision of the learned CIT (Appeals) in excluding those companies with any RPT is not in keeping with the above decision of the co-ordinate bench of this Tribunal. Respectfully following the above decision, we hold that the learned CIT (Appeals) was not correct in holding that companies with any RPT have to be excluded from the set of comparable companies, and direct the TPO / A.O. to apply the RPT filter at 15% of total revenues for including / excluding the comparable companies, excluded by the learned CIT (Appeals), in the final set of comparables. Consequently Ground No.3 raised by revenue is partly allowed.

13.2.3 In view of the decision of the co-ordinate bench of this Tribunal in 24/7 Customer.Com Pvt. Ltd. (supra), out of the 6 companies excluded by the learned CIT (Appeals), five companies, namely (1) Sasken Network Systems Ltd. (2) R.S. Software India Ltd. (3) Geometric Software Solutions Ltd. (4) Tata Elxsi Ltd. and (5) Sasken Communications Technology Ltd. are restored to the list of comparable companies as they have RTP of less than 15%. Only one company, namely, similarly, Four Soft Ltd. at S.No.6 of the TPO's list of comparables is to be excluded as a comparable company, on the ground that it has RPT in excess of 15%. In the T.P. Order, the percentage of RPT over sales for this company has been mentioned as 19.89%. Therefore, following the decision of the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (supra), we hold and direct that the company Four Soft Ltd. shall be excluded from the set of comparable companies chosen by the TPO.

Consequently Ground No.3 raised by Revenue is partly allowed.

14. **Ground No.4 - Turnover Filter of Rs.200 Crores.**

14.1 The learned CIT (Appeals) in the impugned order, relying on the decision of the co-ordinate bench of this Tribunal in the case of Genisys Integrating Systems (India) Pvt. Ltd. V DCIT (2011) Tax Corp (T.P) 3848, in which it was held that the turnover range of Rs.1 Crore to Rs.200 Crore is to be applied, held that companies which were having turnover exceeding Rs.200 Crores should be excluded from the set of comparables. In that view of the matter, the following companies were excluded from the TPO's list of comparables :-

Sl.No.	Name of the company	Turnover in Crores (Rs.)
1.	IGate Global Solutions Ltd. (Seg)	406.00
2.	Flextronics Software Systems Ltd.	457.45
3.	L&T Infotech Ltd.	562.45
4.	Satyam Computer Services Ltd.	3,464.20
5.	Infosys Technologies Ltd.	6,859.70

14.2 The learned Departmental Representative for Revenue has challenged the decision of the learned CIT (Appeals) in holding that size and turnover are deciding factors for treating a company as a comparable.

14.3 We have heard the rival contentions and perused and carefully considered the material on record, including the judicial decisions cited and placed reliance upon. We find that a co-ordinate bench of this Tribunal in the case of *Genisys Integrating Systems (India) Pvt. Ltd. (supra)* has held that turnover is an important filter of comparability which has to be adopted for determination of ALP and has determined the upper limit of the turnover filter to be applied at Rs.200 Crores in cases where the turnover of the assessee is less than Rs.200 Crores. In the case on hand, the turnover of the assessee being approx. Rs.7.97 Crores only, falls within the range of Rs.1 Crore to Rs.200 Crores. Therefore, following the decision of the co-ordinate bench of this Tribunal in the case of *Genisys Integrating Systems (India) Pvt. Ltd. (supra)*, we hold and direct that only those companies having a turnover of Rs.1 Crore to Rs.200 Crores be taken as comparable companies and consequently uphold the decision of the learned CIT (Appeals) in excluding

the above mentioned five companies, listed at para 14.1 of this order from the TPO's list of comparables. Consequently, Ground No.4 of Revenue's appeal is dismissed.

15. **Ground No.5 : Companies with Abnormal Profits.**

15.1 In Ground No.5, revenue assails the decision of the learned CIT (Appeals) in the impugned order in excluding companies with profit margin of more than 50% from the final set of comparable companies by holding the profit margin in excess of 50% to be abnormal.

15.2.1 We have heard the rival contentions of both the learned Departmental Representative for revenue and the learned Authorised Representative of the assessee. This is an issue on which there have been conflicting decisions of various Tribunals. However, the Special Bench of the ITAT, Mumbai in the case of *Maersk Global Centres (India) Pvt. Ltd.*, in ITA No.7466/Mum/2012 has held that companies cannot be excluded from the set of comparables only because the margins are high and the matter in such cases would require further investigation to ascertain the reasons for unusually high profits in order to establish whether the entities with such high profits can be taken as comparables or not. The operative portion of this order at paras 97 to 99 thereof are extracted hereunder :-

" 97. At the time of hearing before us, both the sides have cited several decisions of the Tribunal in support of their corresponding stand taken on this issue. After going through all these decisions of the Division Benches of this Tribunal, we find that the issue relating to exclusion of high profit margin entities from comparables has been decided in favour of the assessee in the cases cited by Shri Porus Kaka without taking into consideration some vital aspects including the relevant TP Regulations in India. It is observed that the decision initially taken in one case without

much meaningful discussion has been invariably followed by the Tribunal in other cases decided thereafter. On the other hand, it is observed that the Tribunal, in some of the cases cited by Shri Ajeet Kumar Jain, the Id. CIT DR, has passed well discussed and well reasoned orders after taking into consideration not only the relevant TP regulations in India but even the relevant OECD guidelines. For instance, in the case of BP India Services Private Limited (supra), it was held by the Mumbai Bench that the very rationale of having average in case of more than one comparables is to iron out the effect of extreme cases and find the profit margin as a representative of the whole lot. It was also held by the Tribunal that the higher or lower profit rate has not been prescribed as the determinative factor in the relevant Rules i.e. Rule 10B(2) and 10B(3) to make a case incomparable. The Tribunal observed that the profit rate in any case cannot be such determinative factor in itself as it is a consequence of the effect of the various factors. In the case of 24/7 Customer.Com Pvt. Ltd. (supra), the Bangalore Bench of this Tribunal considered the relevant OECD guidelines in this respect and held that the exclusion of companies with abnormal profits from the comparables may be in line with the principles enumerated in the OECD guidelines, but the same cannot be said to be in tune with the Indian TP Regulations. The Tribunal noted that there was a deviation in the TP Rules specifically from OECD guidelines by specifying the arithmetic mean for determining the ALP as against the quartile method suggested in the OECD guidelines which excludes the companies that fall in the extreme quartiles for comparability. To the similar effect is another -- decision of Bangalore Bench in the case of Trilogy E-Business Software India Ltd. (supra) wherein it was held that the TP Regulations provide arithmetic mean method for determining the ALP wherein all companies that are in the sample are considered without exception and the average of all the companies is considered as ALP. In the case of Stream International Services Pvt. Ltd.(supra), the Mumbai Bench of ITA T held that comparability is judged primarily by seeing the functional similarity and then the capital employed and risks undertaken but

the higher or lower profit rate is not and can never be a relevant criteria to judge the comparability.

98. As noted by the Division Benches of the Tribunal in the cases discussed above, the OECD guidelines suggest quartile method which excludes the companies that fall in the extreme quartiles for comparability and there is deviation in this respect in T.P. Regulations in India which specify the Arithmetic Mean for determining the ALP. Nevertheless, the OECD TP Guidelines have considered and dealt with the situation of extreme results in the context of comparability consideration in section A.7.3 of chapter III and it is suggested in para 2.63 that where one or more of potential comparables have extreme results consisting loss or unusual high profits, further examination would be needed to understand the reasons for extreme results. After taking into consideration this guidance provided in OECD Transfer Pricing Guidelines and on analyzing the decisions rendered by the Division benches of this Tribunal on this issue after taking into consideration inter alia the T.P. Regulations in India as discussed above, we are of the view that the potential comparables cannot be excluded merely on the ground that their profit is abnormally high. In our opinion, the matter in such case would require further investigation to ascertain the reasons for unusual high profit and in order to establish whether the entities with such high profit can be taken as comparables or not.

99. The question No. 2 referred to this Special Bench is as to whether, in the facts and circumstances of the case, companies earning abnormally high profit margin should be included in the list of comparable cases for the purpose of determining arm's length price of an international transaction. As already observed, the issue involved in this question has become infructuous in so far as the case of the assessee before the Special Bench is concerned and the same therefore no more survives for consideration in the present case. In generality, we are of the view that the answer to this question will depend on the facts and circumstances of each case inasmuch as potential comparable earning abnormally high profit margin should trigger further investigation in order to

establish whether it can be taken as comparable or not. such investigation should be to ascertain as to whether earning of high profit reflects a normal business condition or whether it is the result of some abnormal conditions prevailing in the relevant year. The profit margin earned by such entity in the immediately preceding year/s may also be taken into consideration to find out whether the high profit margin represents the normal business trend. The FAR analysis in such case may be reviewed to ensure that the potential comparable earning high profit satisfies the comparability conditions. If it is found on such investigation that the high margin profit making company does not satisfy the comparability analysis and or the high profit margin earned by it does not reflect the normal business condition, we are of the view that the high profit margin making entity should not be included in the list of comparable for the purpose of determining the arm's length price of an international transaction. Otherwise, the entity satisfying the comparability analysis with its high profit margin reflecting normal business condition should not be rejected solely on the basis of such abnormal high profit margin. Question No. 2 referred to this special bench is answered accordingly."

15.2.2 As held by the Special Bench of the ITAT in the case of *Maersk Global Centres (India) Pvt. Ltd.* (supra), the question of whether such companies are to be included or excluded from the final set of comparables will depend on the facts and circumstances of each case; in as much as a potential comparable company earning abnormally high profits margins should trigger further investigation as to whether earning of high profits reflects a normal business condition or whether it is the result of some abnormal condition prevailing in the relevant period to establish whether it can be taken as a comparable or not. The comparable company satisfying the comparability analysis with its high profit should not be rejected solely on the basis of such abnormally high profit margins.

15.2.3 We find from a perusal of the impugned order that the learned CIT (Appeals) has excluded two companies namely, (1) Enensys Software Solutions Ltd. ;and (2) Thirdware Solutions Ltd., from the list of comparables merely because they have high profits, without examining whether these companies satisfy the comparability analysis. In this factual matrix, respectfully following the decision of the Special Bench of the ITAT, Mumbai in the case of Maersk Global Centres (India) Pvt. Ltd.(supra), we hold that the learned CIT (Appeals) was wrong in excluding the companies merely because of high profit margins, reverse his finding in the matter and restore the matter to the file of the TPO. The TPO is directed to re-examine and decide on the comparability of the companies excluded by the learned CIT (Appeals) on grounds of abnormal profit in the light of our observations in this order after affording the assessee adequate opportunity of being heard and filing details in the matter. Consequently, Ground No.5 of Revenue's appeal is allowed as indicated above.

16. **Ground No.6 : Standard deduction 5%.**

16.1 Ground No.6 of revenue's appeal contends that the impugned order of the learned CIT (Appeals) is erroneous in granting standard deduction of 5% in computing the ALP of the international transactions, by citing various judicial pronouncements.

16.2.1 We have heard the rival contentions of both the learned Departmental Representative for revenue and the learned Authorised Representative of the assessee. The fact of the matter is that the assessee sought for the benefit of + / - 5% standard deduction as per the proviso to section 92C(2) of the Act, which was granted by the

learned CIT (Appeals) citing several judicial decisions in support of this proposition. Prior to the amendment made by Finance (No.2) Act, 2009 and Finance Act, 2012, the proviso to section 92C(2) of the Act provided that the ALP would be taken to be the Arithmetic Mean ('AM') or at the option of the assessee, a price which may vary from the AM by an amount not exceeding 5% of such AM. Thus, the ALP was + / - 5% of such AM.

16.2.2 This issue is now more of academic nature and the judicial decisions cited and relied on by the learned CIT (Appeals) in the impugned order are not applicable as the Act has been amended with retrospective effect from 1.4.2002 by the introduction of the clarificatory amendment in which section 92C(2A) of the Act was inserted as per Finance Act, 2012 and reads as follows :-

" 92C(2A) : Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No.2) Act, 2009 (33 of 2009), is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds five per cent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso."

16.2.3 The new section 92C(2A) of the Act mandates that if the Arithmetic Mean Price falls beyond + / - 5 % from the price charged in international transactions, then the assessee does not have any option referred to in section 92C(2) of the Act. Thus, as per this amendment, it is clear that the + / - 5 % variation is allowed only to justify the price charged in the international transactions and not for adjustment / standard deduction purposes. The aforesaid amendment has settled the issue and accordingly the 5% standard deduction is not allowable to the assessee in the case on hand. The various

judicial decisions cited pertain to the period prior to the retrospective amendment by way of insertion of section 92C(2A) of the Act by Finance Act, 2012 and are therefore not of any help to the assessee. In this view of the matter, we hold that the learned CIT (Appeals) erred in allowing the assessee the benefit of 5% standard deduction and accordingly reverse this order of this issue in view of the retrospective amendment w.e.f. 1.4.2002 brought about by the insertion of Section 92C(2A) of the Act by Finance Act, 2012. Consequently, we allow the ground raised by revenue at S.No.6.

17. In the result, revenue's appeal for Assessment Year 2005-06 is partly allowed.

Assessee's appeal for A.Y. 2005-06 in IT(TP)A No.74/Bang/2012.

18. The Grounds raised at S.Nos.10 & 11 of the assessee's appeal are general in nature and not being urged before us in the course of appeal hearings, are dismissed as infructuous.

19. The Grounds raised at S.Nos.1 to 4 : In the course of appeal proceedings, the learned Authorised Representative of the assessee submitted that these grounds are not being pressed. In view of these grounds not being pressed, they are rendered infructuous and are accordingly dismissed.

20.1 Grounds No.5 & 6 are related to Miscellaneous Income. In Ground No.5, the assessee has assailed the decision of the authorities below in excluding miscellaneous income for arriving at the operating margin without granting the assessee opportunity to present its case and also in holding so, without assigning any reasons whatsoever for their decisions in the matter. In Ground No.6, the assessee contends that miscellaneous income

should be considered for arriving at the operating margin in the determination of ALP of international transactions.

20.2 We have considered the submissions made. On a perusal of the orders of the Assessing Officer / TPO, we find that there is no discussion or finding therein on the issues raised by the assessee. In this view of the matter, in the interest of equity and justice, we remand the matter back to the file of the Assessing Officer / TPO to examine the matter and decide the issue in accordance with law after affording the assessee adequate opportunity of being heard and to file details and submissions required. It is ordered accordingly. Consequently, Grounds No.5 & 6 of the assessee's appeal are treated as allowed for statistical purposes.

21.1 Ground No.7 is related to depreciation adjustment in respect of the assessee vis-à-vis the comparables. The assessee contends that the learned CIT (Appeals) ought to have considered the assessee's request to grant depreciation adjustment as the rate of depreciation of the assessee vis-à-vis that of the comparable companies are different. In this regard, it is submitted that the assessee has debited accelerated depreciation in its books of account as compared to the rates specified in Schedule - IV.

21.2 We have heard both the learned Authorised Representative and learned Departmental Representative in the matter and perused the material on record. On an appreciation of the issue before us, we think it would be appropriate to remand the issue back to the file of the Assessing Officer / TPO to examine and verify the depreciation policy of the comparable companies and adopt a single common policy for both the assessee

and the comparable companies after affording the assessee adequate opportunity of being heard and to file submissions / details required. It is accordingly directed. Consequently, Ground No.7 of the assessee's appeal is treated as allowed for statistical purposes.

Grounds No. 8 & 9 - Comparability Analysis.

22.0 Exclusion of Certain Comparables.

22.1 As discussed in the issues raised in Revenue's appeal in the case on hand, earlier in this order, the learned CIT (Appeals) had adjudicated on the issues of RPT Filter, Turnover Filter and Abnormal Profit Margins and then deleted / excluded certain companies from the list of 17 comparables chosen by the TPO. It is however observed that the learned CIT (Appeals) has not adjudicated on other issues of non-comparability, such as some of the companies chosen by the TPO as comparables are claimed to be functionally not comparable to the assessee.

22.2 Before us, the assessee had submitted a chart explaining its stand on each of the companies which as per the assessee are required to be excluded from the set of 17 comparable companies adopted by the TPO. The learned Authorised Representative submitted that the assessee accepts 9 of the comparable companies adopted by the TPO at S.Nos.1, 2, 4, 5, 8, 9, 10, 11 and 12 of the TPO's list of 17 comparable companies. The assessee has filed a chart giving the reasons why the other 8 companies are required to be excluded and the judicial decisions of various Tribunals in support of its contentions.

23.0 **Turnover Filter of Rs.200 Crores.**

23.1 The learned Authorised Representative of the assessee has furnished a chart wherein the names of the 5 companies which have turnovers in excess of Rs.200 Crores in the relevant period are indicated. It is submitted that in the relevant period, the assessee's turnover is approximately Rs.7.97 Crores only. It was contended that these companies with turnover in excess of Rs.200 Crores ought to be excluded from the list of comparables as held by the co-ordinate bench of this Tribunal in the case of Genisys Integrating Systems (India) Pvt. Ltd. reported in 152 TTJ 215.

23.2 While dealing with Revenue's appeal we have already adjudicated on this issue at para 14.1 to 14.3 of this order and the same holds good in respect of the assessee's submissions.

24. **RPT Filter - Four Soft Ltd.**

24.1 Before us, the assessee made detailed submissions to the effect that M/s. Four Soft Ltd., the comparable company chosen by the TPO, ought to be excluded from the list of comparables on the ground that its RPT was 19.89%, since the co-ordinate bench of the Bangalore Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (supra) has held that companies having RPT in excess of 15% are to be excluded from the list of comparables. It is submitted that the co-ordinate bench followed the decision of the Delhi Bench of the ITAT in the case of Sony India (P) Ltd. reported in 2008-TIOL-439-ITAT-Delhi dt.23.12.2008. The learned Authorised Representative contends that in view of the above this company ought to be excluded from the final set of comparables.

24.2 While dealing with Revenue's appeal, we have, at para 13.1 to 13.2.3 of this order, already directed the Assessing Officer / TPO to exclude this company, Four Soft Ltd., from the list of comparables as the RPT of this company is in excess of 15% and the same also holds good in respect of the assessee's submissions.

25. **Exclusion on grounds of Super Profits.**

25.1 The assessee contends that Thirdware Solutions Ltd. should be excluded from the list of comparable on the grounds that it has earned super normal profits. While dealing with Revenue's appeal, at para 15.1 to 15.2.3 of this order, we have already held that comparable companies cannot be excluded only on the ground that they have earned super profits and have held that the comparability of Thirdware Solutions Ltd. is to be restored to the file of the Assessing Officer / TPO for re-examination after affording the assessee adequate opportunity of being heard, and the same holds good in respect of the assessee's submissions.

26. **Exclusion on grounds of being functionally different.**

26.1 The assessee has sought the exclusion of M/s. Exensys Software Solutions Ltd. from the list of comparables, in respect of which submissions were put forth before us. It was submitted that this company is a product company and therefore it is not comparable to the assessee in the case on hand, who is providing software development services. It was also submitted that the TPO has himself excluded this company from the list of comparables in the next Assessment Year 2006-07 and therefore following this, M/s. Exensys Software Solutions Ltd. ought to be excluded from the list of comparables.

26.2 We have heard the rival contentions and perused and carefully considered the material on record. As contended by the assessee, we find that the TPO has excluded this company from the final set of comparables in Assessment Year 2006-07. We are, however, of the view that there is a requirement for examining whether the facts of the case on hand and that of the comparable company i.e. Exensys Software Solutions Ltd. in the period under consideration, i.e. Assessment Year 2005-06 was similar to that of Assessment Year 2006-07. In this view of the matter, we deem it appropriate to remand the issue back to the file of the TPO to verify the comparability of this company, in the light of the decision taken by the TPO in Assessment Year 2006-07.

27. In the result, the assessee's appeal for Assessment Year 2005-06 is partly allowed.
Order pronounced in the open court on 30th April, 2015.

Sd/-
(N.V.VASUDEVAN)
Judicial Member

Sd/-
(JASON P BOAZ)
Accountant Member

*Reddy gp

Copy to :

1. Appellant
2. Respondent
3. C.I.T.
4. CIT(A)
5. DR, - A Bench.
6. Guard File.

(True copy)

By Order

Asst. Registrar, ITAT, Bangalore