

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

**BEFORE SHRI A.K.GARODIA, ACCOUNTANT MEMBER  
AND  
SHRI VIJAY PAL RAO, JUDICIAL MEMBER**

**IT(TP)A No.1008(BNG.)/2014  
(Assessment year : 2009-10)**

M/s Infinera India Pvt.Ltd.,  
Unit no.401, Level-4, Prestige Solitaire,  
6, Brunton Road,  
Bangalore-560 025

**PAN No.AABCI1411R**

Appellant

**Vs**

The Income Tax Officer,  
Ward-11(2),  
Bangalore

Respondent

**And  
IT(TP)A No.977(BNG)/2014  
(Assessment year : 2009-10)  
(By Revenue)**

**Assessee by : Shri P.K.Prasad,& Shri Umashankar, CA  
Revenue by : Dr. Shankar Prasad, JCIT**

**Date of hearing : 05-05-2016**

**Date of pronouncement : 30-06-2016**

**O R D E R**

**PER SHRI A.K GARODIA, AM**

These are cross appeals filed by the assessee and the revenue which are directed against the order of the Id. CIT(A)-IV, Bangalore dated 29-05-2014 for the assessment year : 2009-10.

2. The grounds raised by the assessee in its appeal are as under;  
2.

*"The grounds mentioned herein taken by the Appellant are without prejudice to one another.*

*1. That the order passed by the Learned Commissioner of Income Tax (Appeals) - IV, Bangalore [CIT (A)], to the extent prejudicial to the Appellant, is bad in law and liable to be quashed.*

**Transfer Pricing related**

*3. That the learned CIT(A) erred both in facts and law in confirming the action of the learned Transfer Pricing Officer's ("TPO") / Learned Assessing Officer ("AO") of making an adjustment to the transfer price of the Appellant in respect of contract Software Development services provided to its associated enterprises holding that the international transactions do not satisfy the arm's length principle envisaged under the Income Tax Act, 1961 (the 'Act')*

*4. That the learned CIT(A) erred in upholding the learned TPO approach of rejecting the Transfer Pricing ("TP") documentation maintained by the Appellant.*

*5. That the learned CIT(A) erred in upholding inclusion of companies in the comparability analysis, which are different from Appellant in functions, assets and risk profile and rejection of the companies that are similar to the Appellant, while performing comparability analysis by the learned TPO and in doing so also erred in ignoring the limited risk nature of the software development services provided by the Appellant and not providing adjustment on account of risk differential with entrepreneurial comparables, as required while determining the arm's length price of the international transactions of the Appellant.*

*6. That the learned CIT(A) erred in upholding application of different quantitative and qualitative filters by the learned TPO and in doing so grossly erred in:*

*a. Upholding the learned TPO's approach of rejecting certain comparable companies identified by the Appellant by applying employee cost greater than 25% of total revenue as a comparability criterion;*

*b. Upholding the learned TPO's approach of rejecting certain comparable companies identified by the Appellant by applying export earnings greater than 75% of sales as a comparability criterion;*

*c. Upholding the learned TPO's approach of rejecting certain comparable companies identified by the Appellant for having different accounting year (i.e. companies having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months);*

*d. Upholding the learned TPO's approach of applying the turnover < 1 crore for rejection of comparable companies;*

*6. That the learned CIT(A) erred in upholding rejection of the quantitative*

*and qualitative filters applied by the Appellant and in doing so grossly erred in:*

*a.Rejecting certain comparable companies identified by the Appellant by applying export earnings greater than 25% of sales as a comparability criterion;*

*b.Accepting certain comparable companies rejected by the Appellant by applying exceptional year(s) of operations as a comparability criterion.*

*7.That the learned CIT(A) erred in upholding the learned TPO's approach of not applying multiple year / prior year data for comparable companies while determining the arm's length price and in doing so also erred in using the data as at the time of assessment proceedings, instead of that available during IT 2008-09, wherein the Appellant was required to prepare and maintain the TP documentation.*

*8.That the learned CIT(A) erred in upholding the rejection of 2 comparable companies, Thinksoft Global Services Limited and F C S Software Solutions Limited, by the learned TPO by stating that the working capital adjustment resulted in reduction of profit margins by more than 4%.*

*9.That the learned CIT(A) erred in upholding the computation of working capital adjustment by considering the incorrect operating costs, receivables and payables amount of certain comparable companies.*

*10.That the learned CIT(A) erred in upholding the action of the learned AO/ learned TPO in limiting the working capital adjustment while determining the arm's length price.*

*11.That the learned CIT(A) erred in upholding the action of the learned TPO in inclusion of companies with huge turnover as comparable to the Appellant.*

*12.That the Appellant prays to allow the benefit of range of +/-5% as provided in proviso to Section 92C(2) of the Act, while determining the arm's length price.*

*13.That the Appellant prays to compute the arm's length price by considering correct operating margins of some of the comparable companies.*

*That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein above or produce further documents before or at the time of hearing of this Appeal”.*

3. The assessee has also raised two additional grounds which are as under:

*“ 14. That the ld. ITO, Ward-1(2), Bangalore (AO) and the ld. CIT(A) erred in confirming the action of the ld. DCIT, TP-V, Bangalore of accepting Persistent Systems Ltd/ which fails the test of comparability and thus not comparable to the appellant in respect of its software development services.*

*15. That the ld. AO and the ld CIT(A) erred in confirming the action of the ld. TPO of erroneously computing the operating profit margin of certain companies (Sasken Communication Technologies Ltd, Persistent Systems Ltd., and Larsen & Toubro Infotech Ltd.,*

*The appellant craves leave to add, alter, amend or withdraw all or any of the grounds of appeal and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing”.*

4. The grounds raised by the revenue are as under

*“ 1. The order of the CIT (Appeals), revenue, is opposed to law and the facts and circumstances of the case.*

*2. The CIT(A) erred in following the ratio laid down by the Hon'ble High Court in the case of Tata Elxsi Limited 349 ITR 98 and in directing the AO to exclude internet charges of Rs.16,03,232/- and travel expenses incurred in foreign currency of Rs.35,20,042/- from the total turnover also while computing the deduction u/s. 10A of the I.T. Act as the decision of the High Court is binding, without appreciating the fact that there is no provision in Section 10A that such expenses should be reduced from the total turnover also, as clause (iv) of the explanation to Section 10A provides that such expenses are to be reduced only*

*from the export turnover.*

*3. The CIT(A) erred in not appreciating the fact that the jurisdictional High Court's decision in the case of Tata Elxsi Limited 349 ITR 98 has not been accepted by the department and an appeal has been filed before the Hon'ble Supreme Court.*

*4. The CIT(A) erred in holding that the TPO shall verify the claim of the assessee that some of the assessee's comparables satisfy the RPT and Export earnings filters but nevertheless were not excluded from the final set of comparables with a further direction to include the comparables satisfying his very own filters without appreciating that the directions of the CIT(A) cannot be given effect to without giving an opportunity to the assessee and without re-examining all the comparables and the directions of the CIT(A) are beyond the powers of the CIT(A) subsequent to the amendment to the provisions of Section 251(1)(a), withdrawing the powers of setting aside.*

*5. The CIT(A) erred in directing the AO to compute the margin of both the assessee as well as the comparable companies by including the foreign exchange gains or loss without appreciating the fact that the foreign exchange loss or gain though attributable to operating activity is not derived by the operating activity.*

*6. The CIT(A) erred in directing the AO to compute the margin of both the assessee as well as the comparable companies by including the foreign exchange gains or loss without appreciating the fact that operational expenses are those expenses which are incurred to earn that income and that foreign exchange loss or gain cannot be said to be one derived from international transaction though they may be attributable to the international transactions and therefore they should be excluded while determining the operating cost.*

7. *The CIT(A) erred in not appreciating the fact that if any filter or criteria applied by the assessee is accepted or if any filter or criteria applied by the TPO is relaxed, the entire accept / reject matrix changes resulting in a new set of comparables including those comparables which are neither taken by the assessee or the TPO and which do not find a place in the order under Section 92CA.*

8. *The CIT(A) erred in directing the AO to verify whether the assessee / comparable have been claiming bad debts over the past three years and thereafter apply the principles emerging from the orders of the Delhi Bench of the Hon 'ble Tribunal in Haworth (India) Pvt. Ltd. v Deputy Commissioner of Income-tax (11 ITR (Trib) 757) and The Bangalore Bench of the Hon'ble Tribunal in Trilogy E-Business Software v Deputy Commissioner of Income-tax (23 ITR(Trib) 464) without appreciating the fact that the directions issued are beyond the mandate of the provisions of Section 251(1)(a) of the LT. Act which does not empower the CIT(A) to set aside the issue.*

9. *For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.*

10. *The appellant craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal". .*

5. First we take up the revenue's appeal. Regarding ground no.1,2 & 3, it was agreed by both sides that these issues are covered in favour of the assessee by the judgment of the Hon'ble Karnataka High Court rendered in the case of M/s Tata Elxi Ltd., 349 ITR 98(Kar.). In this case, it was held by the Hon'ble Karnataka High Court that the total turnover is sum total of

export turnover and domestic turnover and therefore, if any amount is reduced from the export turnover, the total turnover is also to be reduced by the same amount as a consequence thereof. Under these facts, we find no reason to interfere in the order of the ld. CIT(A) on this issue.

6. Ground no.1 to 3 of the revenue are rejected.

7. Regarding ground no. 4 to 8 of the revenue's appeal, it was submitted by the ld. DR of the revenue that he ld.CIT(A) has no power to restore the matter back to the file of the AO and therefore, the order of the ld. CIT(A) is not sustainable. As against this, it was submitted by the ld.AR of the assessee that if considered proper, these issues may be restored back to the file of the AO by the Tribunal.

8. We have considered the rival submissions. We find force in the submissions of the ld. DR of the revenue that the ld. CIT(A) has no power to restore the matter back to the file of the AO and instead of restoring the matter back to the file of the AO, he should have decided the issue himself after obtaining remand report from the AO if required. But considering this fact that more than two years have already lapsed by this time and the AO might have given effect to the order of the ld. CIT(A), we feel it proper that

instead of restoring this matter back to the file of Id. CIT(A) for deciding the issues afresh after obtaining remand report from the AO, it is better to restore this matter back to the file of the AO for fresh decision after providing reasonable opportunity of hearing to the assessee. We order accordingly.

9. Ground no.4 to 8 are allowed for statistical purposes.

10. Ground no.9 & 10 are general and they do not require any specific adjudication.

11. Regarding assessee's appeal, it was submitted by the Id.AR of the assessee that ground no.1 is general and in respect of ground no.2 to 13, it was submitted by him that these are in respect of Transfer Pricing (TP) issues. He submitted a chart as per which the assessee is requesting for exclusion of certain comparables as noted hereunder;

<b><u>Sl. No.</u></b>	<b><u>Name of the Co.</u></b>	<b><u>PLI %age</u></b>	<b><u>Basis for seeking exclusion.</u></b>
1	M/s Kals Information Systems Ltd.,	13.89	Functional Dissimilarity
2.	M/s Bodhtree Consulting Ltd.,	62.27	"
3.	M/ Tata Elxsi Ltd.,	20.28	"
4.	M/s Persistent systems Ltd.,	41.40	"
5.	M/s Infosys Tech. Ltd.,	45.61	"

In addition to this, the assessee has also requested in the chart for consideration of correct operating margin in the case of M/s Sakaen Communication Tech Ltd., and M/s Larsen & Toubro infotech Ltd.

12. Regarding the first aspect i.e. exclusion of some comparables on the basis of functional dissimilarity we deal this issue company wise as under;

**1) M/s Kals Information Systems Ltd.**, For exclusion of this company, reliance has been placed on the Tribunal order rendered in the case of M/s Onward technologies Ltd., Vs DCIT as reported in 26 ITR (Trib) 734(ITAT, Mum.). It was pointed out that copy of the judgment is available on pages 1 to 19 of the Case Law Compendium and our attention was drawn to para no.23 of this Tribunal order. Ld. DR of the revenue supported the order of the authorities below.

13. We have considered rival submissions. We find that in para-23 of this Tribunal order, cited by the ld.AR of the assessee i.e. in the case M/s Onward technologies Ltd., Vs DCIT (Supra), it is noted by the Tribunal that this company i.e. M/s Kals information Systems Ltd., functions in the field of consultancy, information provider and general insurance sector. In the present case, the assessee company is providing software development

services to its AE who is engaged in business of software products as well as of optical net working equipment to telecommunication provider and therefore, it has to be accepted that there is functional dissimilarity because, the assessee is not engaged in general insurance sector as Kals Information System. In the same chart, the assessee also placed reliance on the Tribunal order rendered in the case of M/s Cisco Systems (Ind.) Pvt.Ltd., in IT(TP)A No.271(Bang)/2014. Copy of the order is available on pages 82 to 142 of Case Law Compendium. In particular, our attention was drawn to para-26.3 of the order on pages 101 to 103. In this case, the Tribunal has followed another Tribunal order rendered in the case of M/s Trilogy e-business Software India Pvt. Ltd., I ITA No.1054(Bang)/2011. Copy available on pages 20 to 81 of the paper book.

14. The ld. DR of the revenue could not point out any difference in facts in the present case and in these cases of the Tribunal orders and therefore, respectfully following these Tribunal orders, we direct the AO/TPO to exclude these companies from the final list of comparables.

**2) M/s Bodhtree Consulting Ltd.**, For exclusion of this company also, reliance has been placed on the same Tribunal order rendered in the case of M/s Cisco Systems (Ind.) Pvt.Ltd.,(Supra) and in particular, our attention

was drawn to para-26.1 available on page no.98 to 99 of Case Law Compendium. In this case, it is noted by the Tribunal that this company is in the business of software product and was engaged in providing open and end to end web solutions software consultancy and design and development of software using latest technology and therefore, the same cannot be considered as a comparable in the case of companies rendering software development services, as in the present case. Therefore, by respectfully following this Tribunal order, we hold that this company is also excluded from the list of final comparables.

**3. M/s Tata Elxsi Ltd.**, For exclusion of this company also, reliance has been placed on the same Tribunal order rendered in the case of M/s Cisco Systems (Ind.) Pvt.Ltd.,(Supra) and our attention was drawn to para-26.4 to 26.5 of the order available on pages 103 to 105 of the case law compendium. For the sake of ready reference these paras are reproduced hereunder;

*“26.4 Tata Elxsi Ltd.:- As far as this company is concerned, it is not in dispute before us that in assessee’s own case for the A.Y. 2007-08, this company was not regarded as a comparable in its software development services segment in ITA No.1076/Bang/2011, order dated 29.3.2013. Following were the relevant observations of the Tribunal:-*

**II. UNREASONABLE COMPARABILITY CRITERIA :**

19. *The learned Chartered Accountant pleaded that out of the six comparables shortlisted above as comparables based on the turnover filter, the following two companies, namely (i) Tata Elxsi Ltd; and (ii) M/s. Flextronics Software Systems Ltd., deserve to be eliminated for the following reasons :*

(i) *Tata Elxsi Ltd., : The company operates in the segments of software development services which comprises of embedded product design services, industrial design and engineering services and visual computing labs and system integration services segment. There is no sub-services break up/information provided in the annual report or the databases based on which the margin from software services activity only could be computed. The company has also in its response to the notice u/s.133(6) stated that it cannot be considered as comparable to any other software services company because of its complex nature. Hence, Tata Elxsi Ltd., is to be excluded from the list of comparables.*

(ii) *Flextronics Software Systems Ltd. : The learned TPO has considered this company as a comparable based on 133(6) reply wherein this company reflected its software development services revenues to be more than 75% of the "software products and services" segment revenues. Flextronics has a hybrid revenue model and hence should be rejected as functionally different. Based on the information provided under "Revenue recognition" in its annual report, it can be inferred that the software services revenues are earned on a hybrid revenue model, and the same is not similar to the regular models adopted by other software service*

*providers. The learned representative pleaded that a regular software services provider could not be compared to a company having such a unique revenue model, wherein the revenues of the company from software/product development services depends on the success of the products sold by its clients in the marketplace. Hence, it would be inappropriate to compare the business operations of the assessee with that of a company following hybrid business model comprising of royalty income as well as regular software services income, for which revenue break-up is not available. He finally submitted that this was a good reason to exclude this company also from the list of comparables.*

*20. On the other hand, the learned DR supported the order of the lower authorities regarding the inclusion of Tata Elxsi and Flextronics Software Systems Ltd., in the list of comparables. He reiterated the contents of para 14.2.25 of the TPO's order. He also read out the following portion from the TPO's order :*

*"Thus as stated above by the company, the following facts emerge :*

*1. The company's software development and services segment constitutes three sub-segments i) product design services; ii) engineering design services and iii) visual computing labs.*

*2. The product design services sub-segment is into embedded software development. Thus this segment is into software development services.*

3. *The contribution of the embedded services segment is to the tune of Rs.230 crores in the total segment revenue of Rs.263 crores. Even if we consider the other two sub-segments pertain to IT enabled services, the 87.45% (>75%) of the segment's revenues is from software development services.*

4. *This segment qualifies all the filters applied by the TPO."*

*Regarding Flextronics Software Systems, the following extract from page 143 of TPO's order was read out by him as his submissions :*

*"It is very pertinent to mention here that the company was considered by the taxpayer as a comparable for the preceding assessment year i.e., AY 2006-07. When the same was accepted by the TPO as a comparable, the same was not objected to it by the taxpayer. As the facts mentioned by the taxpayer are the same and these were there in the earlier FY 2005-06, there is no reason why the taxpayer is objecting to it. How the company is functionally similar in the earlier FY 2005-06 but the same is not functionally similar for the subsequent FY 2006-07 even when no facts have been changed from the preceding year. Thus the taxpayer is arguing against this comparable as the company was not considered as a comparable by the taxpayer for the present FY 2006-07."*

*21. We have heard the rival submissions and considered the facts and materials on record. After considering the submissions, we find that Tata Elxsi and Flextronics are functionally different from that of the assessee and hence they deserve to be deleted from the list of six*

*comparables and hence there remains only four companies as comparables, as listed below:”*

*26.5. Following the aforesaid decision of the Tribunal, we hold that M/S.Tata Elxsi Ltd. should not be regarded as a comparable”.*

15. Since ld. DR of the revenue could not point out any difference in facts, respectfully following these Tribunal orders, we direct the AO/TPO to exclude this company also from the list of final comparables.

**4. Persistent Systems Ltd.,** For exclusion of this company, reliance has been placed on the Tribunal order rendered in the case of M/s Unisys India Pvt.Ltd., in IT(TP)A No.67(Bang)/2015, copy available on pages 210 to 246 of case law compendium and in particular, our attention was drawn to para 36 to 37 of the Tribunal order. These paras are reproduced as under:-

*“36. As far as Persistent Systems Ltd. a comparable by the assessee in his TP study but was objected by the assessee before the TPO as not comparable, this Tribunal in the case of IT(TP)A No.108(Bang)/21014 order dated 12-12-2014 in the case of Yodlee Infotech Pvt. Ltd. Vs ITO held as follows:*

*“5.12..... This Tribunal in the case of 3DPLM Software Solutions Ltd., Vs DCIT (IT(TP)A No. 1303(Bang)/2012 dated 28-11-2013) has also held that Persistent Systems Pvt.Ltd., was in product designing services and into*

*software product development. In the same decision it was also held that M/s Infosys Technologies Ltd., had considerable intangibles like IPR, and was also into software product development. It was also held that M/s Tata Elxsi Ltd., was developing niche products and into product designing services. Hence, these companies would in any case have to be excluded from the comparables being functionally different”.*

*37. Following the said decision, we direct that Persistent Systems Ltd., be excluded from the final list of comparable companies chosen by the TPO”.*

The ld. DR of the revenue supported the orders of the authorities below;

16. We have considered the rival submissions. We find that in this case, the Tribunal has followed another Tribunal order rendered in the case of M/s Yodlee Infotech Ltd., Vs ITO in IT(TP)A No.108(Bang)/2014. The relevant portion of that Tribunal order is reproduced above and as per the same, this company i.e. M/s Persistent Systems Ltd., was in product designing services and into software product development. Since the present assessee company is only providing software development services to the AE, this company cannot be considered as a comparable in the present case. Since the ld. DR of the revenue could not point out any difference in facts, by respectfully following this Tribunal order, we direct the AO/TPO for exclusion of this company from the final list of comparable.

5. M/s Infosys Technologies Ltd., For exclusion of this company, reliance has been placed on the judgment of the Hon'ble Delhi High Court rendered in the case of M/s Aginity India Technologies Pvt.Ltd., in ITA No.1204/2011 dated 10-07-2013 and in particular, our attention was drawn to para-6 of the judgment as available inpage-386 of the case law compendium and the same is reproduced hereunder:-

*“ 6. Learned counsel for the revenue has submitted that the Tribunal after recording the aforesaid table has not affirmed or given any finding on the differences. This is partly correct as the Tribunal has stated hat Infosys Technologies Ltd., should be exclude from the list of comparables for the reason latter was giant company in the area of development of software and it assumed all risks leading to higher profits, whereas the respondent assessee was a captive unit of the parent company and assumed only a limited risk. It has also stated that Infosys Technologies Ltd. cannot be compared with the respondent- assessee as seen from the financial data etc. to the two companies mentioned earlier in the order i.e. the chart. In the grounds of appeal the Revenue has not been able to controvert or deny the data and differences mentioned in the tabulated form. The chart has not been controverted”.*

17. From the above para of the judgment of the Hon'ble Delhi High Court, it is seen that this company is a giant company in the area of software and it assumed all risks leading to higher profits, whereas the assessee company was a captive unit of the parent company and assumed only a limited risk. In the present case also, the assessee company is providing services to the parent company and therefore, assuming only limited risk and hence, respectfully following this judgment of the Hon'ble Delhi High Court, we direct the AO/TPO to exclude this company also from the list of final comparables. As per the TPO's order Annexure-B, 11 companies have been considered as final comparables with arms length mean margin of 24.32%. As per the above discussion, we have held that 5 companies should be excluded from the list of final comparables. i.e.....

1. *M/s Kals Information Systems Ltd.,*
2. *M/s Bodhtree Consulting Ltd.,*
3. *M/ Tata Elxsi Ltd.,*
4. *M/s Persistent systems Ltd.,*
5. *M/s Infosys Tech. Ltd.,*

18. The mean margin of these 5 companies is 36.69. After exclusion of these 5 companies, arithmetic mean of the remaining 6 companies

(comparables) will be only 14.02% as against PLI of the tested party i.e. the assessee company 17.63% and as a result no, TP adjustment is called for after exclusion of these 5 comparables and therefore, we do not go into the claim of the assessee regarding adoption of correct operating profit of two companies i.e. M/s Sasken Communication and M/s Larsen & Toubro Ltd., because the same is of academic interest only.

19. In the result, the appeal of the assessee is allowed.

20. In the combined result, the revenue's appeal is partly allowed for statistical purposes whereas the appeal of the assessee is allowed.

Order pronounced in the open court on the date mentioned on the caption page.

**(VIJAYPAL RAO)**  
**JUDICIAL MEMBER**  
**Bangalore:**  
**D a t e d :       -06-2016**  
**am**

**(A.K.GARODIA)**  
**ACCOUNTANT MEMBER**

**Copy to :**

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

*By order*  
AR, ITAT, Bangalore

1.	Date of Dictation .....
2.	Date on which the typed draft is placed before the dictating Member .....
3.	Date on which the approved draft comes to the Sr. P. S. ....
4	Date on which the order is placed before the dictating Member for pronouncement .....
5.	Date on which the order comes back to the Sr. P.S. ....
6.	Date of uploading the order on website .....
7.	If not uploaded, furnish the reason for doing so.....
8.	Date on which the file goes to the Bench Clerk .....
9.	Date on which order does for Xerox & endorsement .....
10.	Date on which the file goes to the Head Clerk.....
11	The date on which the file goes to the Assistant Registrar for signature on the order.....
12	The date on which the file goes to the dispatch section for dispatch of the Tribunal order.....
13	Date of dispatch of order.....