

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI ABRAHAM P. GEOGE, ACCOUNTANT MEMBER
AND SHRI VIJAY PAL RAO, JUDICIAL MEMBER

IT(TP)A No.212/Bang/2015
Assessment year : 2010-11

The Deputy Commissioner of Income Tax, Circle 3(1)(2), Bangalore.	Vs.	M/s. Electronics for Imaging India Pvt. Ltd., Kalyani Platina, 4 th Floor, Block-I, No.24, EPIP Zone, Phase II, Whitefield, Bangalore – 560 066. PAN: AAACG 6053E
APPELLANT		RESPONDENT

CO No.94/Bang/2015
[A/o IT(TP)A No.212/Bang/2015]
BY ASSESSEE

Revenue by	:	Ms. Neera Malhotra, CIT(DR)
Assessee by	:	Shri Padamchand Khincha, CA

Date of hearing	:	08.02.2016
Date of Pronouncement	:	24.02.2016

ORDER

Per Vijay Pal Rao, Judicial Member

The appeal by the Revenue and the Cross Objection by the assessee are directed against the order dated 30.12.2014 passed by the Assessing Officer u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [“the Act”] in pursuance of the directions of the DRP dated 25.11.2014 for the assessment year 2010-11.

2. The Revenue has raised the following grounds in its appeal:-

“1. The directions of the Dispute Resolution Panel are opposed to law and facts of the case.

2. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in law in directing the AO to exclude reimbursement of specific expenditure both from the export turnover as well as from total turnover for the purpose of computation of deduction u/s 10A, without appreciating the fact that the statute allows exclusion of such expenditure only from export turnover by way of specific definition of export turnover as envisaged by Sub- clause (4) of Explanation 2 below Sub-section (8) of Section 10A and the total turnover has not been defined in this Section.

3. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in directing the AO to compute deduction u/s 10A in the above manner by placing reliance on the decision of Hon’ble High Court of Karnataka in the case of M/s Tata Elxsi Ltd., which has not become final since the same has not been accepted by the Department and SLPs are pending before the Hon’ble Supreme Court.

4. On the facts and in the circumstances of the case, the Dispute Resolution Panel erred in directing the TPO/AO to exclude the comparable M/s ICRA Techno Analytics Ltd., M/s Infosys Ltd., M/s KALS Information Systems Ltd., M/s Persistent System Ltd., M/s Sasken Communication Technologies Ltd., M/s HCCA Business Services Pvt. Ltd. & M/s Killick Agencies & Marketing Ltd. without considering the facts discussed by the TPO for selection of the comparables in the case of assessee and without appreciating the fact that these are qualifying all the qualitative and quantitative filters applied by the TPO.

5. On the facts and in the circumstances of the case, the Dispute Resolution Panel erred in directing the TPO/AO to exclude the comparable Tata Elxsi Ltd., without appreciating the fact that the selection of comparables in a case depends on assessee specific FAR analysis and this is functionally

comparable company which qualifies all the qualitative and quantitative filters applied by the TPO.

6. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in holding that foreign exchange loss/gain is operating in nature without ascertaining its nexus with the business activity of the assessee and without appreciating the fact that such loss/gain that is attributable to the operating activity is not derived from the operating activity.

7. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in concluding that forex gain/loss are to be treated as operating in nature as while they may be incidental but cannot be deemed as operating in nature since, they are not critical to operational activities of the business conducted by the assessee.

8. For these and other grounds that may be urged at the time of hearing, it is prayed that the directions of the Dispute Resolution Panel in so far as it relates to the above grounds may be reversed.

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

3. Ground No.1 is general in nature and does not require adjudication.

4. Ground Nos. 2 & 3 are regarding exclusion of expenditure incurred in foreign exchange from export turnover as well as from total turnover.

5. 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 49 [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:

"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:

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

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:

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

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.”

6. Following the judgment of Hon'ble jurisdictional High Court in the case of *Tata Elxsi Ltd. (supra)*, we do not find any error or illegality in the impugned order of the authorities below, *qua* decision.

7. Ground Nos.4 & 5 are regarding exclusion of certain comparables by the DRP for the purpose of determining the arm's length price [ALP] in respect of international transactions in software development services.

8. The assessee is a company and engaged in the business of developing software solution services as well as rendering sales and support services for its products. The assessee provides two category of services; software development and sales & marketing support services. The assessee has entered into separate agreements for provision of software development as well as sales & marketing services to its group EFI. The assessee has reported financial results along with segmental financials as per TP documentation for the assessment year under consideration, which are reproduced by the TPO in para 3 page 2 as under:-

Financial results for the FY 2009-10 as per the P&L A/C

Service income (excl'd other income)	478,078,605
Total Expenditure	417,751,509
Less: Finance expenses	2,021,113
Operating Expenditure	415,730,396
Operating Profit	62,348,209
OP/OC	15.00%

Segmental financials as per TP document

Description	Software Development Services	Sales and Marketing Services
Revenue	454,764,558	23,314,047
Exchange fluctuation gain	2,394,282	116,760
Total	457,158,840	23,430,807
Total Operating Cost	396,424,459	21,822,966
Operating Profit	60,734,381	1,607,841
OP/OC	15.32%	7.37%

9. The TPO has recalculated the margins of the assessee by excluding the forex gain as the same is treated as non-operating revenue. The revised margins computed by the TPO are at 14.72% and 6.83% for software development services and sales & marketing services respectively. The assessee has reported international transactions during the year under consideration as per its report as under:-

Description	Amount
Software development services	454,764,558
Sales and marketing services	23,314,047
Interest paid on ECB loan	2,021,113
Cross charge of language translation fees, sales promotion and options cash payout (received)	8,259,293
Cross charge of employee deputation expresses (payment)	75,413
Purchase of fixed assets	6,983,240
Remittance of money collected from employee towards purchase of ESOP/ESPP	6,398,105

10. The assessee has bench-marked its international transactions in software development services segment by selecting 16 comparables. The TPO rejected the TP analysis study of the assessee on the ground that

assessee has used multiple year data instead of current financial year data and further applied the filter of less than 25% of revenue from exports as well as related party transactions. The TPO therefore rejected 14 comparables out of 16 selected by the assessee and retained only 2 comparables, though the margins were taken as per current financial year data. The TPO has carried out fresh search and selected total 11 comparables including 2 comparables from the list of the assessee. The final set of comparables selected by the TPO for determining the ALP is as under:-

Sl. No.	Name of the company	Operating Margin on Cost	W. Cap adjusted margin
1	ICRA Techno Analytics Ltd. (seg)	24.94%	25.91%
2	Infosys Ltd.	44.98%	46.00%
3	Kals Information Systems Ltd. (seg)	34.41%	31.68%
4	Larsen & Toubro Infotech Ltd.	19.33%	20.66%
5	Mindtree Ltd. (seg)	14.83%	13.96%
6	Persistent Systems & Solutions Ltd.	15.38%	16.37%
7	Persistent Systems Ltd.	30.35%	29.33%
8	R S Software (India) Ltd.	10.29%	11.68%
9	Sasken Communication Technologies	17.36%	17.65%
10	Tata Elxsi (Seg)	20.93%	18.42%
11	Thinksoft Global Services Ltd.	17.05%	15.19%
	Arithmetic Mean	22.71%	22.44%

11. Thus, the TPO has computed the arithmetic mean at 22.71% and after working capital adjustment at 22.44%. There is no dispute regarding TNMM as the most appropriate method as well as OP/TC as PLI. The TPO has proposed an adjustment of Rs.3,06,17,550 in respect of international transactions in software development segment.

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

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

(1) ICRA Techno Analytics Ltd. (seg)

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

“Having heard the contention, on perusal of the annual report, it is noticed by us that the segmental information is available for two segments i.e., services and sales. However, it is evident from the annual report that the service segment comprises of software development, software consultancy, engineering services, web development, web hosting, etc. for which no segmental information is available and therefore, the objection of the assessee is found acceptable. Accordingly, Assessing Officer is directed to exclude the above company from the comparables.”

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

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

(2) Infosys Ltd.

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

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

19. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. We note that in the case of *Agnity India Pvt.*

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

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

(3) KALS Information Systems Ltd.

21. The assessee raised objections against this company on the ground that this company is engaged in the development of software and software products. Further, this company consists of STPI unit and also having a

training centre engaged in training of software professionals on online products. Thus, when this company is having revenue from software services as well as software product, the same cannot be considered as comparable with software development service providing company.

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

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

(4) Persistent Systems Ltd.

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

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

26. Therefore, when this company is engaged in diversified activities and earning revenue from various activities including licencing of products, royalty on sale of products as well as income from maintenance contract, etc., the same cannot be considered as functionally comparable with the assessee. Further, this company also earns income from outsource product development. In the absence of any segmental data of this

company, we do not find any error or illegality in the findings of the DRP that this company cannot be compared with the assessee and the same is directed to be excluded from the set of comparables.

(5) Sasken Communication Technologies Ltd.

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

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

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

29. Thus, there is no dispute that this company earns revenue from 3 segments. However, the segmental operating margins are not available. Therefore, in the absence of segmental relevant data and particularly operating margins, this composite data cannot be considered as

comparable with the assessee for software development services segment. Accordingly, we do not find any error or illegality in the findings of the DRP.

(6) Tata Elxsi Ltd.

30. The assessee has raised objections against this company on the ground that the company is functionally different from the assessee. Though the TPO has considered the software development and services segment of this company as comparable to that of assessee, however, the assessee contended that even within the software segment, this company is engaged in diverse activities. The assessee placed reliance on the information in the annual report under the Directors Report and submitted before the DRP that even under the software development services segment, this company is engaged in various diversified activities including product design service, innovation design, engineering service, visual computing labs, etc. The assessee also placed reliance on the decision of Mumbai Bench of the Tribunal in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT, 137 ITD 1 (Mum)*.

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

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

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

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

34. Ground Nos. 6 & 7 are regarding foreign exchange loss/gain treated as operating revenue for the purpose of determining the ALP. The TPO has accepted foreign exchange gain/loss while computing operating margin

of comparable companies. However, in the case of assessee, foreign exchange loss has been considered as non-operating in nature. Thus, the assessee raised an objection before the DRP that exchange gain/loss arises on account of factors like realization of sales, payment to suppliers and restatement of value of assets & liability are operating in nature. The assessee placed reliance on the decision of coordinate Bench of this Tribunal in the case of *SAP Labs India Pvt. Ltd. v. ACIT (2010-TII-44-ITAT-BANG-TP)* wherein it has been held that foreign exchange gain need to be considered as operating in nature, if it arises on realization of sale proceeds or on payment against supplies. The DRP has accepted the contention of the assessee by following the decision in the case of *SAP Labs India Pvt. Ltd. (supra)* and accordingly directed the AO to consider the foreign exchange fluctuation in respect of assessee company as well as comparables as operating in nature.

35. We have considered the rival submissions as well as the relevant material on record. There is no quarrel on the point that if the foreign exchange fluctuation gain/loss arises in relation to the realization of sale proceeds or payment against supplies, then it will be in the nature of operating gain/loss. Only in the case where the foreign exchange gain/loss pertains to non-trading receipts or payment, the same cannot be considered as part of the operating margins. Similar view has been taken by the coordinate Bench of this Tribunal in the case of *Obopay Mobile Technology India Pvt. Ltd. in IT(TP)A No.469/Bang/2015 vide order dated*

8.1.2016. Accordingly, we direct the AO/TPO to verify the actual source of foreign exchange gain/loss in the case of assessee as well as in the case of comparables and if the foreign exchange gain/loss arises on account of realization of sale, payment to suppliers or revaluation of the other trade assets, then the same is to be considered as part of the operating profit margin.

36. Accordingly, the AO/TPO is directed to recompute the ALP in respect of international transactions in software development service segment in the light of the above findings and observations.

Sales and support services

37. In the TP analysis, the assessee has bench marked its international transactions in marketing and sale supporting services segment by selecting a set of 7 comparables with arithmetic mean margin of 9.5%. Since the assessee used multiple year data, the TPO rejected the TP analysis of the assessee and also rejected 5 of 7 companies selected by the assessee. Thus, the TPO has retained only two companies from the list of assessee's comparables. The comparable companies selected by the assessee are as under:-

1. Amrit International Ltd.
2. ICRA Management Consulting Services Ltd.
3. ICC International Agencies Ltd.
4. IDC (India) Ltd.
5. Killick Agency & Marketing Ltd.
6. Priya International Ltd.
7. S K Consultants Ltd.

38. The TPO has carried out a fresh search and determined the ALP by considering 6 comparables as under:-

Sl No.	Name of the Company	OP/Cost (%)
1	Asian Business Exhibition & Conferences Ltd.	58.64
2	Cyber Media Research Ltd.	19.52
3	H C C A Business Services Pvt. Ltd.	19.11
4	Hindustan Housing Co. Ltd.	19.59
5	ICC International Agencies Ltd.	13.27
6	Killick Agencies & Mktg. Ltd.	16.77
Average		24.48

39. Thus, the TPO has arrived at the mean margin of 24.48% as against the assessee's margin in this segment at 6.83%. Accordingly the TPO proposed an upward adjustment of Rs.38,51,181 as per provisions of section 92CA.

40. The assessee challenged the action of TPO before the DRP. The DRP excluded 3 out of 6 comparable companies selected by the TPO against which Revenue has filed appeal before us. We will discuss comparability of two companies which are excluded by the DRP and challenged by the Revenue as under:-

(1) HCCA Business Services Pvt. Ltd.

41. The assessee objected against inclusion of this company in the list of comparables on the ground that this company is engaged in providing

payroll process services and therefore it is functionally different. In support of its contention, the assessee referred to Notes to the Accounts wherein the company's operations comprise of payroll processing services is mentioned and hence it is not possible to give the quantitative details of sales and certain information separately.

42. The DRP after considering the annual report noted that except the Note 2.14, there is no other observation in the annual report from which it can be established that the company is engaged in marketing and sales support services comparable to the assessee. Accordingly, the DRP directed the AO to exclude the said company from the comparables.

43. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. The DRP has considered the fact that payroll processing services was main part of the operations of the company and quantitative details of sales and certain information as required under Part II of Schedule VI to Companies Act was not possible. Thus, in the absence of any contrary fact on record brought before us, we do not find any reason to interfere with the finding of the DRP, when the functions and business activity of this company was found to be different from marketing and sales support services of the assessee. Accordingly, the objection of the Revenue is rejected.

(2) Killick Agencies & Marketing Ltd.

44. The assessee objected against this company on the ground that commission/service charges income of this company is Rs.2,19,00,000 out of the operating revenue of Rs.3,39,00,000. Therefore, the commission/service charges income constitute about 65% of the operating revenue which is less than 75% of the operating revenue filter applied by the TPO. In the absence of segmental results, this company was sought to be excluded from the set of comparables.

45. The DRP found that this company conducts business as an agent of the foreign principal and deal in maritime equipments. Further, the receipts are mainly in the nature of commission income and service charges. Therefore, this company was functionally dissimilar to that of assessee.

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

47. The Id. DR has submitted that the TPO has considered the relevant information as reported in the annual report of the company and it was found that this company is acting as an agent for various foreign principals for sale of dredgers, dredging equipment and also offers after sales service. Therefore, this company was found to be in the business of marketing support services which is similar to the assessee.

48. On the other hand, the Id. AR has submitted that this company is engaged in the business of construction equipments and earth moving machinery and is not into marketing support services.

49. Having considered the rival submissions as well as relevant material on record, we note that in the profit & loss account for the year under consideration, this company has shown sales (export of Rs.1,18,00,000 and commission/service charges of Rs.2,19,00,000. Therefore, export income revenue of this company is less than 75% of the total revenue, a filter applied by the TPO. Once the TPO has applied a filter of 75% of export sale, then this company which fails the filter applied by the TPO cannot be considered as a good comparable. Further, we note that this company is entirely in a different activity with that of the assessee. Undisputedly, this company is acting as agent for various foreign principals for sale of dredgers, dredging equipment, steerable rudder propulsions and other equipments and machineries. Accordingly, we do not find any error or illegality in the findings of the DRP and direct the AO to exclude this company from the comparables.

CO No.94/B/15 (By assessee)

50. The assessee has raised various objections in the CO. However, we find that the only effective ground raised by the assessee in the marketing support segment is regarding Asian Business Exhibition &

Conference Ltd., a comparable selected by the TPO and retained by the DRP.

51. The assessee objected against this company on the ground that this company is functionally different as it is engaged in organizing exhibitions and conferences. The DRP did not accept the contention of the assessee and held that this company received income in the nature of consultancy for organizing exhibitions and events. Therefore this company is functionally similar to the functions carried out by the assessee.

52. Before us, the Id. AR of the assessee has submitted that functional comparability of this company has been examined by the Mumbai Bench of the Tribunal in the case of *RGA Services India Pvt. Ltd. vide order dated 20.11.2015 in ITA No.22/Mum/2015* and submitted that the Mumbai Tribunal has held that the operation of organizing exhibition and events is not comparable with support services provided by the assessee to its AE in respect of reinsurance and actuarial activities. Thus, the Id. AR has submitted that this company cannot be considered as functionally comparable with the assessee's activity of providing sales and marketing services to its AE.

53. We have considered the rival submissions and considered the relevant material on record. As it is clear that the assessee is providing sales and marketing services to its AE which includes identifying potential customers by conducting road shows, presentation and the like, the

working also includes educating potential users of the benefit and features of the AEs range of products. However, products for which the assessee is providing sales and marketing services is only software/information technology products. Therefore, Asian Business Exhibition & Conference Ltd. which is mainly engaged in the organization of exhibitions and events as well as conducting conferences on behalf of the various clients for their various products and businesses. The functions of this company are entirely different from the assessee who is providing sales and marketing support services to its AE for software/IT products. The Mumbai Bench of the Tribunal in the case of *RGA Services India Pvt. Ltd. (supra)* while considering the functional comparability of this company has held at paras 11 and 12 as under:-

“11. We have considered the submission of the parties and perused the relevant material on record. On perusal of the order passed by the TPO it is noticed that the TPO while dealing with assessee’s objection with regard to selection of Asian Business Exhibition and Conferences Limited as a comparable has admitted that the nature of function performed by this company is event management. It is further relevant to observe, on perusal of annual report of this company it is seen that as per directors report, the main operation is organizing exhibition and events. Further, schedule 12 of the profit and loss account as well as notes to the accounts reveals, revenue earned by the company is from sponsorship, delegates attending conferences, events and entry fees charged from visitors for visiting exhibition, sale of stall place etc.

12. Thus, on overall analysis of facts and materials placed on record it is very much clear that the business model of the assessee and Asian Business Exhibition and Conferences Limited are totally different. While assessee undoubtedly is providing support services to its overseas AE’s, Asian Business Exhibition and Conferences Limited is primarily and fundamentally engaged

in event management. Thus, under no circumstances it can be considered as a comparable to the assessee. Therefore, for the aforesaid reasons the DRP, in our view, was justified in excluding this company as a comparable. As far as the contention of learned DR that reasons on which this company was excluded equally applies to other comparables retained by the DRP, we may observe, such argument of learned DR is not at all relevant as the issue raised by the department in the present appeal is confined to exclusion of Asian Business Exhibition and Conferences Limited as a comparable. As far as objection of learned departmental representative that assessee itself has selected this company as a comparable, we may observe, that cannot be the sole criteria to reject assessee's objection with regard to selection of a comparable. At the time of preparing T.P. Study report assessee had selected some comparables by considering multiple year data and information available at the relevant time. However, if subsequently on the basis of information available in public domain it is found on the basis of functionality or some other reason a company is not at all comparable, assessee cannot be precluded from objecting to selection of the company as a comparable. This legal proposition is fairly well settled by the decision in case of DCIT V/s. Quark Systems (P) Ltd. (2010)132TTJ(Chd)(SB)1 as well as decisions relied upon by the counsel for the assessee. In view of the aforesaid, we do not find any infirmity in the directions of DRP in excluding Asian Business Exhibition and Conferences Limited as a comparable. The ground raised is therefore dismissed.”

54. In view of the above facts as well as decision of the Mumbai Bench of the Tribunal, this company cannot be considered as a good comparable with the assessee.

55. Accordingly, we direct the AO/TPO to recompute the ALP in marketing support services segment by excluding Asian Business Exhibition & Conference Ltd. from the comparables.

56. In the CO, the assessee has also raised objection against Larsen & Toubro Infotech Ltd., Mindtree Ltd. and rejection of R.S. Software (India) Ltd. and Persistent Systems & Solutions Ltd. by the DRP.

57. The Id. AR has submitted that the assessee did not raise any objection against R.S. Software (India) Ltd., however, the DRP on its own rejected this comparable.

58. The DRP has taken note of the fact that expenses of foreign branches incurred is to the extent of Rs.12.42 crores which is 82% of the expenses of Rs.15 crores debited in the profit & loss account. Thus, it was concluded by the DRP that this company is predominantly onsite software development company and therefore cannot be retained as comparable.

59. We have heard the Id. AR as well as Id. DR and considered the relevant material on record. At the outset, we note that this company has reported expenditure in foreign currency at Rs.124.2 crores as against earning in foreign currency at Rs.158.3 crores. Therefore, it is clear that more than 80% of the expenditure has been incurred by this company in foreign branch expenditure, which shows that the company has main activity of onsite software development. In view of the above fact, we do not find any error or illegality in the finding of the DRP in excluding this company from the list of comparables. This ground is dismissed.

Persistent Systems & Solutions Ltd.

60. The assessee has the grievance against rejection of this company by the DRP. The Id. AR has submitted that assessee did not raise any objection against this company, however, the DRP has rejected the said company. Therefore, the said company should be retained in the list of comparables.

61. Having considered the rival submissions as well as relevant material on record, at the outset, we note that the DRP has examined the functional comparability of this company by considering the relevant details as given in the annual report of this company. The DRP has given the finding that the entire revenue has been earned by this company from the sale of software services and products and in the absence of segmental details, it cannot be considered as comparable with software services segment. We find that this company has shown the income from sale of software services and products to the tune of Rs.6.67 crores. We further note that as per Schedule 11, the entire revenue has been shown under one segment i.e., sale of software services and products. Therefore, no separate segment has been given in respect of software services. Accordingly, the composite data of revenue as well as margins of this company pertaining to the sale of software services and products cannot be considered as comparable with the software development services segment of the assessee. In view of the above facts and circumstances, we do not find any error or illegality in the directions of the DRP in

excluding this company from the list of comparables. This ground of CO is dismissed.

Larsen & Toubro Infotech Ltd.

62. The assessee has raised objection against this company on the basis of high turnover in comparison to the assessee. It was also contended that related party transaction (RPT) of this company is 18.66%. The DRP rejected objections of the assessee on the ground that TPO has applied 25% filter of RPT and annual report of the company does not show any other services rendered other than software development services provided by this company. Thus the DRP held that software development segment is comparable to the assessee and therefore this company has to be retained as comparable.

63. We have heard the Id. AR as well as Id. DR and considered the relevant material on record. The Id. AR has submitted that this company is having 18.66% RPT and further this company earns revenue from both services and products. Thus, the Id. AR submitted this company is also in the software products and therefore cannot be considered as good comparable. He has further contended that in a series of decisions, the Tribunal has applied 15% RPT filter and since this company is having more than 15% RPT, the same cannot be considered as a good comparable.

64. On the other hand, the Id. DR has submitted that TPO has applied RPT filter of 25% and therefore only for this company, the RPT cannot be

reduced to 15%. Further, the DRP has examined annual report of this company and found that this company earns revenue from software development services and accordingly is comparable.

65. We have considered the rival submissions and relevant material on record. We find that in the normal circumstances the tolerance range of RPT should not be more than 15%. In the case of the assessee, the availability of the comparable is not an issue and therefore we do agree with the view taken by the coordinate Benches of the Tribunal that the threshold limit of tolerance range should not exceed 15% as far as RPT revenue is concerned. Therefore, we direct the AO/TPO to apply 15% RPT filter in respect of all the comparables.

66. As regards the functional comparability of this company is concerned, the assessee has referred to the income under the head software development services and products. However, it is not clear from the details whether any revenue is earned from products or entire revenue is from the software development services. Therefore, in the facts and circumstances of the case, we direct the AO/TPO to verify the details of the revenue earned by this company and if the revenue earned of this company during the year consists of software development services as well as product, then in the absence of segmental data, this company cannot be considered as functionally comparable to the software development services segment of the assessee.

Mindtree Ltd.

67. The TPO stated in the order that assessee has accepted this company as comparable, however, the assessee raised objection before the DRP against comparability of this company. The assessee has raised objection on twofold that turnover filter should be applied and further this company has bad debts written off to the tune of Rs.3.89 crores which was treated by the TPO as non-operative. The DRP rejected the objections of the assessee.

68. We have heard the Id. AR as well as Id. DR and considered relevant material on record. As regards turnover filter, as far as objection of the assessee is concerned, in the absence of the relevant details and argument on this point, we do not find this objection has any substance. The second objection is regarding bad debts written off treated as non-operating nature. We find that it is not the case of the assessee that bad debts written off during the year were pertaining to the transaction entered into during the financial year under consideration. Therefore, in case the bad debts pertaining to the earlier years have been written off during the year, then the same cannot be considered as operating in nature for the year under consideration. Accordingly, we do not find any error or illegality in the finding of the DRP on this issue.

69. After exclusion of the companies from the set of comparables in both segments in terms of directions of the DRP as well as this order, the

remaining comparables would be very less, therefore, the AO/TPO and assessee are free to bring more comparable companies for determining the ALP on the basis of good number of comparables, subject to the parameters discussed above.

70. In the result, the appeal of the Revenue and the CO of the assessee are partly allowed.

Pronounced in the open court on this 24th day of February, 2016.

Sd/-

(ABRAHAM P. GEORGE)
Accountant Member

Sd/-

(VIJAY PAL RAO)
Judicial Member

Bangalore,
Dated, the 24th February, 2016.

/D S/

Copy to:

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

By order

Assistant Registrar,
ITAT, Bangalore.