

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

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

IT(TP)A No.1186/Bang/2012
Assessment year : 2008-09

M/s. Actiance India Private Limited (Formerly known as FaceTime Communications India Private Limited), Le Parc Richmonde, 51, Richmond Road, Bangalore – 560 025. <b>PAN : AABCV2926N</b>	Vs.	The Income Tax Officer, Circle 11(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Chavali S.Narayan, C.A.
Respondent by	:	Shri C.H. Sundar Rao CIT-((DR)

Date of hearing	:	07.04.2015
Date of Pronouncement	:	10.04.2015

**ORDER**

*Per N.V. Vasudevan, Judicial Member*

This appeal by the assessee is against the order dated 31.7.2012 of the ITO, Ward 11(2), Bangalore passed u/s. 143(3) r.w.s. 144C of the Act, in relation to A.Y.2008-09.

2. Ground No.1 is general in nature and calling for no specific adjudication. Grounds No.2 to 4 raised by the Assessee project the grievance of the Assessee regarding the action of the learned Assessing Officer and Honorable Dispute Resolution Panel excluding expenses incurred on travel expenses in foreign currency and expenses incurred towards telecommunication expenses from export turnover on the ground that these expenses are incurred in rendering technical services rendered to clients outside India, while computing deduction under section 10A. It is the plea of the Assessee that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee has also made an alternate prayer that expenses that are reduced from the export turnover should also be reduced from the total turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*.

3. We have heard the Id. counsel for the assessee and the Id. DR on the issues raised in ground Nos.2 to 4. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that it would be just and appropriate to direct the Assessing Officer to exclude expenses incurred in foreign currency towards travelling and expenses

incurred towards telecommunication both from export turnover and total turnover, as has been prayed for by the assessee in ground No.4. In view of the acceptance of the alternative prayer in ground No.4, we are of the view that no adjudication is required on ground No.2 & 3.

4. Ground No.5 to 13 raised by the assessee are with regard to the addition to the total income by way of adjustment to the Arms' Length Price ("ALP") to an international transaction carried out by the assessee u/s. 92CA of the Act. At the time of hearing of the appeal it was submitted that Ground No.10 raised by the Assessee in the grounds of appeal challenging the comparability of comparable companies with that of the Assessee alone need be adjudicated and the other grounds of appeal may not require adjudication and kept open. The comparable companies chosen by the TPO and the addition made by the AO in the draft assessment order which was confirmed by the DRP are identical to the case decided by the Tribunal in ITA No.1303/Bang/2012 for AY 08-09 in M/S.3DPLM Software Solutions Ltd. Vs. DCIT order dated 28.11.2013. It was also submitted that the business profile of the Assessee and that of the Assessee in the case of M/S.3DLPM Software Solutions Ltd. (supra) are also identical. This submission was found to be correct at the time of hearing. With this background we will now consider the factual basis of the present case and the decision rendered in the case of M/S.3DLPM (supra).

5. The assessee is a company. It is a wholly owned subsidiary of M/S.Face Time USA. It rendered software development research and development services to its holding company. It was remunerated on a cost plus 10% mark up for services rendered to its holding company. It is not in dispute before us that the transaction of providing software research & development support services by the Assessee to its holding company was an international transaction with the Associated Enterprise (**AE**) and therefore the price at which the assessee renders services to its AE has to pass the Arm's Length Price (ALP) test as laid down by section 92C of the Act. During the financial year 2008-09, the assessee provided software research & development support services to its AE and was remunerated on a 'cost plus' basis. The total value of international transaction with respect to the provision of software research & development support services by the assessee to its AE was Rs. 15,54,90,786.

6. In support of the assessee's claim that the price charged by it for services rendered to its AE was at arms' length, the assessee filed a report as required by the provisions of section 92E of the Act in Form 3EB together with detailed analysis. The assessee adopted Transaction Net Margin Method (TNMM) as the most appropriate method for determining the ALP. Operating profits to cost was adopted as the Profit Level Indicator ("**PLI**"). The PLI of the assessee was arrived at as follows:-

Operating Revenue	Rs.15,54,90,786
Operating Cost	Rs.13,52,09,383
Operating Profit	Rs.2,02,81,403
Op.pr/cost%	15.00%

7. The TPO arrived at a final set of 20 comparables. The set of 20 comparables is as follows:-

Sl. No.	Name of the company	OP/TC %
1	Avani Cincom Technologies	25.62
2	Bodhtree Consulting Ltd	18.72
3	Celestial Biolabs	87.94
4	e-zest Solutions Ltd.	29.81
5	Flextronics (Aricent)	7.86
6	iGate Global Solution Ltd.	13.99
7	Infosys	40.37
8	Kals Information Systems Ltd (Seg)	41.94
9	LGS Global Ltd.	27.52
10	Mindtree Ltd (seg)	16.41
11	Persistent Systems Ltd.	20.31
12	Quintegra Solution Ltd.	21.74
13	R Systems International (Seg)	15.30
14	R S Software (India) Ltd.	7.41
15	Sasken CommunicationTechnologies Ltd. (Seg)	7.58
16	Tata Elxsi (Seg)	18.97
17	Thirdware Solution Ltd.	19.35
18	Wipro Ltd. (Seg)	28.45
19	Softsol India Ltd.	17.89
20	Lucid Software Ltd.	16.50
	<b>AVERAGE</b>	23.65

8. The assessee raised various objections to the methodology adopted and the reasons assigned by the TPO for rejecting the comparables

chosen by the assessee in its TP study. In the course of proceedings before the TPO, notice u/s. 133(6) has been issued to the companies that were chosen as comparable by the assessee as well as the TPO and on the basis of the replies received in response to such notices, certain inferences were drawn by the TPO. The action of the TPO in relying on some of those information was also challenged by the assessee. The TPO finally passed an order u/s. 92CA of the Act and on the basis of the comparables set out as aforementioned, arrived at arithmetic mean of 23.65%. After factoring the working capital adjustment of 0.39%, the adjusted arithmetic mean was determined at 23.26%. The computation of the ALP by the TPO in this regard was as follows:-

**“4.4. Computation of Arms Length Price:**

The arithmetic mean of the Profit Level indicators is taken as the arms length margin. (Please see Annexure B for details of computation of PLI of the comparables). Based on this, the arms length price of the software development services rendered by the taxpayer to its AE(s) is computed as under:-

Arm’s length mean margin on cost	23.65%
Less: Working capital adjustment (as per Annexure-C)	0.39%
Adjusted mean margin of the comparables	23.26%
Operating Cost	13,52,09,383
Arms Length Price (ALP @ 23.26% of operating cost)	16,66,59,085
Price Received	15,54,90,786
<b>Shortfall being adjustment u/s. 92CA</b>	<b>1,11,68,299</b>

The above shortfall of Rs.1,11,68,299 is treated as transfer pricing adjustment u/s. 92CA in respect of software development segment of the taxpayer’s international transactions.”

9. Against the said adjustment proposed by the TPO which was incorporated in the draft assessment order by the AO, the assessee filed objections before the DRP. The DRP rejected those objections and confirmed the transfer pricing adjustment suggested by the TPO. The adjustment confirmed by the DRP was added to the total income of the assessee by the AO in the fair order of assessment. Against the said order of the Assessing Officer, the assessee has preferred the present appeal before the Tribunal.

10. The Id. counsel for the assessee brought to our notice that out of the 20 comparable companies chosen by the TPO, the following companies will have to be excluded.

11. It was pointed out that Avani Cimcon Technologies Ltd., has to be excluded as not functionally comparable with a software development service provider such as the Assessee. In this regard, our attention was drawn to the following observations of the Tribunal in the case of 3DPLM Software Solutions Ltd., (supra):

“7.0 Avani Cincom Technologies Ltd.

7.1 This company was selected by the TPO as a comparable. The assessee objects to the inclusion of this company as a comparable on the ground that this company is not functionally comparable to the assessee as it is into software products whereas the assessee offers software development services to its AEs.

The TPO had rejected the objections of the assessee on the ground that this comparable company has categorized itself as a pure software developer, just like the assessee, and hence selected this company as a comparable. For this purpose, the TPO had relied on information submitted by this company in response to enquiries carried out under section 133(6) of the Act for collecting information about the company directly.

7.2 Before us, the learned Authorised Representative reiterated the assessee's objections for the inclusion of this company from the list of comparable companies on the ground that this company is not functionally comparable to the assessee as it is into software products. It is also submitted that the segmental details of this company are not available and the Annual Report available in the public domain is not complete. It was further contended that the information obtained by the TPO under section 133(6) of the Act, on the basis of which the TPO included this company in the final list of comparable companies, has not been shared with the assessee. In support of this contention, the learned Authorised Representative placed reliance on the following judicial decisions :

i) Trilogy E-Business Software India Pvt. Ltd. V DCIT (ITA No.1054/Bang/2011)

ii) Telecordia Technologies India Pvt Ltd V ACIT (ITA No.7821/Mum/2011)

It was also submitted that this company has been held to be functionally not comparable to the assessee by a co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013.

7.3 The learned Authorised Representative further submitted that the facts pertaining to this company has not changed from the earlier year (i.e. Assessment Year 2007-08) to the period under consideration (i.e. Assessment Year 2008-09). In support of this contention, it was submitted that :-

(i) The extract from the Website of the company clearly indicates that it is primarily engaged in development of software products. The extract mentions that this company offers customised solutions and services in different areas;

(ii) The Website of this company evidences that this company develops and sells customizable software solutions like “DX Change, CARMA, etc.

7.4 The learned Authorised Representative submitted that a co-ordinate bench of the Tribunal in its order in Curram Software International Pvt. Ltd., in its order in ITA No.1280/Bang/2012 dt.31.7.2013 has remanded the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh, by making the following observations at paras 9.5.2 and 9.5.3 thereof :-

*“9.5.2 As regards the submission of the learned Authorised Representative, we are unable to agree that this company has to be deleted from the list of comparables only because it has been deleted from the set of comparables in the case of Trilogy E-Business Software India Pvt. Ltd. (supra). No doubt this company has been deleted as a comparable in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) and this can be a good guidance to decide on the comparability in the case on hand also. This alone, however, will not suffice for the following reasons :-*

*(i) The assessee needs to demonstrate that the FAR analysis and other relevant facts of the Trilogy case are equally applicable to the facts of the assessee's case also. Unless the facts and the FAR analysis of Trilogy case is comparable to that of the assessee in the case on hand, comparison between the two is not tenable.*

*(ii) After demonstrating the similarity and the comparability between the assessee and the Trilogy case, the assessee also needs to demonstrate that the facts applicable to the Assessment Year 2007-08, the year for which the decision in case of Trilogy E-Business Software India Pvt. Ltd. (supra) was rendered are also applicable to the year under consideration i.e. Assessment Year 2008-09.*

*9.5.3 It is a well settled principle that the assessee is required to perform FAR analysis for each year and it is quite possible that the FAR analysis can be different for each of the years. That being so, the principle applicable to one particular year cannot be extrapolated automatically and made applicable to subsequent years. To do that, it is necessary to first establish that the facts and attendant factors have remained the same so that*

*the factors of comparability are the same. Viewed in that context, the assessee has not discharged the onus upon it to establish that the decision rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) can be applied to the facts of the case and that too of an earlier year i.e. Assessment Year 2007-08. The assessee, in our view, has not demonstrated that the facts of Trilogy E-Business Software India Pvt. Ltd. (supra) are identical to the facts of the case on hand and that the profile of the assessee for the year under consideration is similar to that of the earlier Assessment Year 2007-08. In view of facts as discussed above, we deem it fit to remand the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh by considering the above observations. The TPO is directed to make available to the assessee information obtained under section 133(6) of the Act and to afford the assessee adequate opportunity of being heard and to make its submissions in the matter, which shall be duly considered before passing orders thereon. It is ordered accordingly.”*

The learned Authorised Representative submits that this company was selected as a comparable by the TPO not by any FAR analysis or as per the search process conducted by the TPO, but only as an additional comparable for the reason that it was selected as a comparable in the earlier year i.e. Assessment Year 2007-08 on the basis of information obtained under section 133(6) of the Act. In this regard, the learned Authorised Representative took us through the relevant portions of the TP order under section 92CA of the Act and the show cause notices for both the earlier year i.e. Assessment Year 2007-08 and for this year and contended that the selection of this company as a comparable violates the principle enunciated in Curram Software International Pvt. Ltd. (supra) that a company can be selected as a comparable only on the basis of FAR analysis conducted for that year and therefore pleaded for its exclusion. The learned Authorised Representative also submitted that he has brought on record sufficient evidence to show that the functional profile of this company remains unchanged from the earlier year and hence the findings rendered by the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) and in other cases like Trilogy E-Business Software India Pvt.

Ltd. (supra) are applicable to the year under consideration as well.

7.5 Per contra, the learned Departmental Representative supported the order of the TPO / DRP for inclusion of this company Avani Cincom Technologies Ltd. in the final set of comparables.

7.6.1 We have heard both parties and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the final set of comparables only on the basis of information obtained under section 133(6) of the Act. In these circumstances, it was the duty of the TPO to have necessarily furnished the information so gathered to the assessee and taken its submissions thereon into consideration before deciding to include this company in its final list of comparables. Non-furnishing the information obtained under section 133(6) of the Act to the assessee has vitiated the selection of this company as a comparable.

7.6.2 We also find substantial merit in the contention of the learned Authorised Representative that this company has been selected by the TPO as an additional comparable only on the ground that this company was selected in the earlier year. Even in the earlier year, it is seen that this company was not selected on the basis on any search process carried out by the TPO but only on the basis of information collected under section 133(6) of the Act. Apart from placing reliance on the judicial decision cited above, including the assessee's own case for Assessment Year 2007-08, the assessee has brought on record evidence that this company is functionally dis-similar and different from the assessee and hence is not comparable. Therefore the finding excluding it from the list of comparables rendered in the immediately preceding year is applicable in this year also. Since the functional profile and other parameters by this company have not undergone any change during the year under consideration which fact has been demonstrated by the assessee, following the decisions of the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013, and in the case of Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011), we direct the A.O./TPO to omit this company from the list of comparables.”

12. The learned DR relied on the orders of the Revenue authorities. In our view the issue is squarely covered in favour of the Assessee by the aforesaid decision of the Tribunal. Respectfully following the aforesaid decision, we direct the AO to exclude Avani Cimcon Technologies Ltd., from the list of comparable companies for arriving at the Arithmetic mean of comparable companies profit margin while determining ALP.

13. The learned counsel for the Assessee next point out that Celestial Biolabs Ltd., KALS Information Systems Ltd. (Seg.), Infosys Technologies Ltd., Wipro Limited and TATA Elxsi Ltd., chosen as comparable companies by the TPO should be excluded as functionally not comparable with a company engaged in software development services such as the Assessee, as laid down by the Hon'ble ITAT, Bangalore Bench in the case of 3DPLM Software Solutions Ltd. (supra), wherein it was held as follows:

“9. Celestial Biolabs Ltd.

9.1 This comparable was selected by the TPO for inclusion in the final list of comparables. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables for the reasons that it is functionally different from the assessee and that it fails the employee cost filter. The TPO, however, brushed aside the objections raised by the assessee by stating that the objections of functional dissimilarity has been dealt with in detail in the T.P. order for Assessment Year 2007-08. As regards the objection raised in respect of the employee cost filter issue, the TPO rejected the objections by observing that the employee cost filter is only a trigger to know the functionality of the company.

9.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable, as

the company is into bio-informatics software product / services and the segmental break up is not provided. It was submitted that :-

(i) This company is engaged in the development of products in the field of bio-technology, pharmaceuticals, etc. and therefore is not functionally comparable to the assessee;

(ii) This company has been held to be functionally incomparable to software service providers by the decision of the co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra);

(iii) The co-ordinate bench of this Tribunal in its order in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) at para 43 thereof had observed about this company that –

*“ ..... As explained earlier, it is a diversified company and therefore cannot be considered as comparable functionally with the assessee. There has been no attempt to identify, eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustments, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the assessee in this regard.”*

(iv) The rejection / exclusion of this company as a comparable for Assessment Year 2007-08 for software service providers has been upheld by the co-ordinate benches of this Tribunal in the cases of LG Soft India Pvt. Ltd. in ITA No.112/Bang/2011, CSR India Pvt. Ltd. in IT(TP)A No.1119/Bang/2011 and by the ITAT, Delhi Bench in the case of Transwitch India Pvt. Ltd. in ITA No.6083/Del/2010.

(v) The facts pertaining to this company has not changed from Assessment Year 2007-08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the instant case and hence ought to be rejected. In support of this contention, the assessee has also referred to and quoted from various parts of the Annual Report of the company.

9.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparable companies. The learned Departmental Representative submitted that the decisions cited and relied on by the assessee are for Assessment Year 2007-08 and therefore there cannot be an assumption that it would continue to be applicable for the period under consideration i.e. Assessment Year 2008-09.

9.4.1 We have heard both the parties and perused and carefully considered the material on record. While it is true that the decisions cited and relied on by the assessee were with respect to the immediately previous assessment year, and there cannot be an assumption that it would continue to be applicable for this year as well, the same parity of reasoning is applicable to the TPO as well who seems to have selected this company as a comparable based on the reasoning given in the TPO's order for the earlier year. It is evidently clear from this, that the TPO has not carried out any independent FAR analysis for this company for this year viz. Assessment Year 2008-09. To that extent, in our considered view, the selection process adopted by the TPO for inclusion of this company in the list of comparables is defective and suffers from serious infirmity.

9.4.2 Apart from relying on the afore cited judicial decisions in the matter (supra), the assessee has brought on record substantial factual evidence to establish that this company is functionally dissimilar and different from the assessee in the case on hand and is therefore not comparable and also that the findings rendered in the cited decisions for the earlier years i.e. Assessment Year 2007-08 is applicable for this year also. We agree with the submissions of the assessee that this company is functionally different from the assessee. It has also been so held by co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) as well as in the case of Trilogy E-Business Software India Pvt. Ltd. (supra). In view of the fact that the functional profile of and other parameters of this company have not changed in this year under consideration, which fact has also been demonstrated by the assessee, following the decision of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 and Trilogy E-Business Software India Pvt. Ltd. in ITA No.1054/Bang/2011, we hold that this company

ought to be omitted from the list of comparables. The A.O./TPO are accordingly directed.

10. KALS Information Systems Ltd.

10.1 This is a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on grounds of functional differences and that the segmental details have not been provided in the Annual Report of the company with respect to software services revenue and software products revenue. The TPO, however, rejected the objections of the assessee observing that the software products and training constitutes only 4.24% of total revenues and the revenue from software development services constitutes more than 75% of the total operating revenues for the F.Y. 2007-08 and qualifies as a comparable by the service income filter.

10.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee and ought to be rejected / excluded from the list of comparables for the following reasons :-

(i) This company is functionally different from the software activity of the assessee as it is into software products.

(ii) This company has been held to be functionally not comparable to software service providers for Assessment Year 2007-08 by the co-ordinate bench of this Tribunal in the assessee's own case. This company has been held to be different from a software development company in the decision of the Tribunal in the case of Bindview India Pvt. Ltd. V DCIT in ITA No.1386/PN/2010.

(iii) The rejection of this company as a comparable has been upheld by co-ordinate benches of the Tribunal in the case of –

Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011).

LG Soft India Pvt. Ltd. (IT (TP) A No.112/Bang/2011)

CSR India Pvt. Ltd. (IT (TP) A No.1119/Bang/2011) and

Transwitch India Pvt. Ltd. (IA No.6083/Del/2010)

(iv) The facts pertaining to this company has not changed from Assessment Year 2007-08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the case on hand and hence ought to be excluded from the list of comparables. In support of this contention, the learned Authorised Representative drew our attention to various parts of the Annual Report of this company.

(v) This company is engaged not only in the development of software products but also in the provision of training services as can be seen from the website and the Annual Report of the company for the year ended 31.3.2008.

(vi) This company has two segments; namely,

- a) Application Software Segment which includes software product revenues from two products i.e. 'Virtual Insure' and 'La-Vision' and
- b) The Training segment which does not have any product revenues.

10.3 Per contra, the learned Departmental Representative contended that the decision of the co-ordinate bench of the Tribunal in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) was rendered with respect to F.Y.2006-07 and therefore there cannot be an assumption that it would continue to be applicable to the year under consideration i.e. A.Y. 2008-09. To this, the counter argument of the learned Authorised Representative is that the functional profile of this company continues to remain the same for the year under consideration also and the same is evident from the details culled out from the Annual Report and quoted above (supra).

10.4 We have heard both parties and perused and carefully considered the material on record. We find from the record that the TPO has drawn conclusions as to the comparability of this company to the assessee based on information obtained u/s.133(6) of the Act. This information which was not in the public domain ought not to have been used by the TPO, more so when the same is contrary to the Annual Report of the company, as pointed out by the learned Authorised Representative. We also find that the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) and in the case of

Trilogy E-Business Software India Pvt. Ltd. (supra) have held that this company was developing software products and was not purely or mainly a software service provider. Apart from relying of the above cited decisions of co-ordinate benches of the Tribunal (supra), the assessee has also brought on record evidence from various portions of the company's Annual Report to establish that this company is functionally dis-similar and different form the assessee and that since the findings rendered in the decisions of the co-ordinate benches of the Tribunal for Assessment Year 2007-08 (cited supra) are applicable for this year i.e. Assessment Year 2008-09 also, this company ought to be excluded from the list of comparables. In this view of the matter, we hold that this company i.e. KALS Information Systems Ltd., is to be omitted form the list of comparable companies. It is ordered accordingly.

#### 11.0 Infosys Technologies Ltd.

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

11.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee in the case on hand. The learned Authorised Representative drew our attention to various parts of the Annual Report of this company to submit that this company commands substantial brand value, owns intellectual property rights and is a market leader in software development activities, whereas the assessee is merely a software service provider operating its business in India and does not possess either any brand value or own any intangible or intellectual property rights (IPRs). It was also submitted by the learned Authorised Representative that :-

(i) the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010 has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any intangible and hence does not have an additional advantage in the market. It is

submitted that this decision is applicable to the assessee's case, as the assessee does not own any intangibles and hence Infosys Technologies Ltd. cannot be comparable to the assessee ;

(ii) the observation of the ITAT, Delhi Bench in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856 (Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and market leader assuming all risks leading to higher profits cannot be considered as comparable to captive service providers assuming limited risk ;

(iii) the company has generated several inventions and filed for many patents in India and USA ;

(iv) the company has substantial revenues from software products and the break up of such revenues is not available ;

(v) the company has incurred huge expenditure for research and development;

(vi) the company has made arrangements towards acquisition of IPRs in 'AUTOLAY', a commercial application product used in designing high performance structural systems.

In view of the above reasons, the learned Authorised Representative pleaded that, this company i.e. Infosys Technologies Ltd., be excluded from the list of comparable companies.

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

11.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt.

Ltd. (supra) for Assessment Year 2007-08 is applicable to this year also. We are inclined to concur with the argument put forth by the assessee that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly.

## 12. Wipro Ltd.

12.1 This company was selected as a comparable by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables on several grounds like functional dis-similarity, brand value, size, etc. The TPO, however, brushed aside the objections of the assessee and included this company in the set of comparables.

12.2 Before us, the learned Authorised Representative of the assessee contended that this company i.e. Wipro Ltd., is not functionally comparable to the assessee for the following reasons:-

(i) This company owns significant intangibles in the nature of customer related intangibles and technology related intangibles, owns IPRs and has been granted 40 registered patents and has 62 pending applications and its Annual Report confirms that it owns patents and intangibles.

(ii) the ITAT, Delhi observation in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856(Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and a market leader assuming all risks leading to higher profits, cannot be considered as comparable to captive service providers assuming limited risk;

(iii) the co-ordinate bench of the ITAT, Mumbai in the case of Telecordia Technologies India Pvt. Ltd. (ITA No.7821/Mum/2011) has held that Wipro Ltd. is not functionally comparable to a software service provider.

(iv) this company has acquired new companies pursuant to a scheme of amalgamation in the last two years.

(v) Wipro Ltd. is engaged in both software development and product development services. No information is available on the segmental bifurcation of revenue from sale of products and software services.

(vi) the TPO has adopted consolidated financial statements for comparability purposes and for computing the margins, which is in contradiction to the TPO's own filter of rejecting companies with consolidated financial statements.

12.3 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

12.4.1 We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison.

12.4.2 We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company

from the set of comparable companies in the case on hand for the year under consideration.

13. Tata Elxsi Ltd.

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

13.2 Before us it was reiterated by the learned Authorised Representative that this company is not functionally comparable to the assessee as it performs a variety of functions under software development and services segment namely – a) product design, (b) innovation design engineering and (c) visual computing labs as is reflected in the annual report of the company. The learned Authorised Representative submitted that,

(i) The co-ordinate bench of the Mumbai Tribunal in the case of Telecordia Technologies Pvt. Ltd. (supra) has held that Tata Elxsi Ltd. is not a functionally comparable for a software development service provider.

(ii) The facts pertaining to Tata Elxsi Ltd. have not changed from the earlier year i.e. Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09 and therefore this company cannot be considered as a comparable to the assessee in the case on hand.

(iii) Tata Elxsi Ltd. is predominantly engaged in product designing services and is not purely a software development service provider. In the Annual Report of this company the description of the segment 'software development services' relates to design services and are not to software services provided by the assessee.

(iv) Tata Elxsi Ltd. invests substantial funds in research and development activities which has resulted in the 'Embedded Product Design Services Segment' of the company to create a portfolio of reusable software components, ready to deploy frameworks, licensable IPs and products.

The learned Authorised Representative pleads that in view of the above reasons, Tata Elxsi Ltd. is clearly functionally different / dis-similar from the assessee and therefore ought to be omitted from the list of comparables.

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

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

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

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

As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company

is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.”

14. The learned DR relied on the orders of the Revenue authorities. In our view the issue is squarely covered in favour of the Assessee by the aforesaid decision of the Tribunal. Respectfully following the aforesaid decision, we direct the AO to exclude Celestial Biolabs Ltd., Kals Information Systems Ltd., Infosys Technologies Ltd., Wipro Ltd., and TATA Elxsi Ltd., from the list of comparable companies for arriving at the Arithmetic mean of comparable companies profit margin while determining ALP.

15. The learned counsel for the Assessee next point out that Thirdware Solutions Ltd., Lucid Software Ltd., chosen as comparable companies by the TPO should be excluded as functionally not comparable with a company engaged in software development services such as the Assessee, as laid down by the Hon'ble ITAT, Bangalore Bench in the case of 3DPLM Software Solutions Ltd. (supra), wherein it was held as follows:-

“15. Thirdware Solutions Ltd. (Segment)

15.1 This company was proposed for inclusion in the list of comparables by the TPO. Before the TPO, the assessee objected to the inclusion of this company in the list of comparables on the ground that its turnover was in excess of Rs.500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable for the reason that apart from software development services, it is in the business of product development and trading

in software and giving licenses for use of software. In this regard, the learned Authorised Representative submitted that :-

(i) This company is engaged in product development and earns revenue from sale of licences and subscription. It has been pointed out from the Annual Report that the company has not provided any separate segmental profit and loss account for software development services and product development services.

(ii) In the case of E-Gain communications Pvt. Ltd. (2008-TII-04-ITAT-PUNE-TP), the Tribunal has directed that this company be omitted as a comparable for software service providers, as its income includes income from sale of licences which has increased the margins of the company.

The learned A.R. prayed that in the light of the above facts and in view of the aforesaid decision of the Tribunal (supra), this company ought to be omitted from the list of comparables.

15.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

15.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the material on record that the company is engaged in product development and earns revenue from sale of licenses and subscription. However, the segmental profit and loss accounts for software development services and product development are not given separately. Further, as pointed out by the learned Authorised Representative, the Pune Bench of the Tribunal in the case of E-Gain Communications Pvt. Ltd. (supra) has directed that since the income of this company includes income from sale of licenses, it ought to be rejected as a comparable for software development services. In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the Pune Tribunal (supra), we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.

16. Lucid Software Ltd.

16.1 This company was selected as a comparable by the TPO. Before us, the assessee has objected to the inclusion of this company as a comparable on the grounds that it is into software product development and therefore functionally different from the assessee. In this regard, the learned Authorised Representative submitted that –

(i) This company is engaged in the development of software products.

(ii) This company has been held to be functionally different and therefore not comparable to software service providers by the order of a co-ordinate bench of the Tribunal in the assessee's own case for Assessment Year 2007-08 (IT(TP)A No.845/Bang/2011), following the decision of Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (ITA No.7821/Mum/2011).

(iii) The rejection of this company as a comparable to software service providers has been upheld by the co-ordinate benches of this Tribunal in the cases of LG Soft India Pvt. Ltd. (ITA No.1121/Bang/2011) and CSR India Pvt. Ltd. [ IT(TP)A No.1119/Bang/2011 ] and by the Delhi Bench of the Tribunal in the case of Transwitch India Pvt. Ltd. (ITA No.6083/Del/2010).

(iv) The factual position and circumstances pertaining to this company has not changed from the earlier Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09 and therefore on this basis, this company cannot be considered as a comparable in the case on hand.

(v) The relevant portion of the Annual Report of this company evidences that it is in the business of product development.

The learned Authorised Representative prays that in view of the factual position as laid out above and the decisions of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 and other cases cited above, it is clear that this company being into product development cannot be considered as a comparable to the assessee in the case on hand

who is a software service provider and therefore this company i.e. Lucid Software Ltd., ought to be omitted from the list of comparables.

16.2 per contra, the learned Departmental Representative supported the action and finding of the TPO in including this company in the list of comparables.

16.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that the company i.e. Lucid Software Ltd., is engaged in the development of software products whereas the assessee, in the case on hand, is in the business of providing software development services. We also find that, co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 (IT(TP)A No.845/Bang/2011), LG Soft India Pvt. Ltd. (supra), CSR India Pvt. Ltd. (supra); the ITAT, Mumbai Bench in the case of Telecordia Technologies India Pvt. Ltd. (supra) and the Delhi ITAT in the case of Transwitch India Pvt. Ltd. (supra) have held, that since this company, is engaged in the software product development and not software development services, it is functionally different and dis-similar and is therefore to be omitted from the list of comparables for software development service providers. The assessee has also brought on record details to demonstrate that the factual and other circumstances pertaining to this company have not changed materially from the earlier year i.e. Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09. In this factual matrix and following the afore cited decisions of the co-ordinate benches of this Tribunal and of the ITAT, Mumbai and Delhi Benches (supra), we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.”

16. The learned DR relied on the orders of the Revenue authorities. In our view the issue is squarely covered in favour of the Assessee by the aforesaid decision of the Tribunal. Respectfully following the aforesaid decision, we direct the AO to exclude Thirdware Solutions Ltd., and Lucid

Software Ltd., from the list of comparable companies for arriving at the Arithmetic mean of comparable companies profit margin while determining ALP.

17. The learned counsel for the Assessee submitted before us that if the aforesaid 8 comparable companies are excluded from the list of 20 comparable companies chosen by the TPO, then the profit margin of the Assessee would be well within the (+) (-) 5% range of the arithmetic mean of the remaining comparable companies and therefore the price received by the Assessee would be considered as at Arm's Length. He prayed for a limited direction to the TPO on the lines set out above and determine the ALP. It also submitted that the other issues raised by the Assessee in the grounds of appeal need not be gone into.

18. We are of the view that the prayer sought for by the learned counsel for the Assessee is acceptable and accordingly, the TPO is directed to compute ALP after excluding the 8 comparable companies dealt with in this order.

19. The other grounds of appeal regarding charging of interest is purely consequential and the ground of appeal regarding initiation of penalty proceedings u/s.271(1)(c) of the Act is not appealable. These grounds are decided accordingly.

20. In the result, the appeal by the Assessee is partly allowed.

Pronounced in the open court on this 10<sup>th</sup> day of April, 2015.

Sd/-

( JASON P. BOAZ )  
Accountant Member

Sd/-

( N.V. VASUDEVAN )  
Judicial Member

Bangalore,  
Dated, the 10<sup>th</sup> April, 2015.

/D S/

Copy to:

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

By order

Assistant Registrar/  
Senior Private Secretary  
ITAT, Bangalore.