IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'A'

BEFORE SHRI N BARATHVAJA SANKAR, VICE PRESIDENT
AND SHRI GEORGE GEORGE K, JUDICIAL MEMBER

IT(TP)A No.1119/Bang/2011
(Assessment year 2007-08)

M/s CSR India Pvt. Ltd., 11th Floor, Block C, IBC Knowledge Park, Bannerghatta Main Road, Bangalore-29. **PA No.AAACU 4714 E**	vs	The Income Tax Officer, Ward-11(1), Bangalore.
(Appellant)		(Respondent)

Date of Hearing	:	15.01.2013
Date of Pronouncement	:	29.01.2013

Appellant by	:	Shri K P Kumar, Sr. Counsel
Respondent by	:	Shri S K Ambastha, CIT (DR-I), ITAT

ORDER

PER GEORGE GEORGE K :

This appeal, at the instance of the assessee company, is directed against the order of assessment passed under section 143(3) rws 144C of the Act dated 30/9/2011. The relevant assessment year is 2007-08.

2. Briefly stated, the facts are as follows:-

The assessee is a company, which is a wholly owned subsidiary of UBiNietics VPT Limited, United Kingdom ('UL'). The assessee company is a captive service provider and is engaged in the business of rendering software development services to its holding company. It had entered into a

Research and Development Sub-contracting agreement with its holding company (UL) in terms of which, it had undertaken software development activity solely for UL in the field of wireless communications, Bluetooth technology and cellular 3G protocol solutions. During the financial year relevant to the assessment year 2007-08, the assessee company had international transactions with its associated enterprises. Since the international transaction entered into by the assessee with its Associated Enterprise (AE) exceeded the prescribed limit, reference was made under the provisions of section 92CA of the Income Tax Act, 1961 by the Assessing Officer to the Transfer Pricing Officer (TPO). The TPO, after taking cognizance of various submissions made by the assessee company, made an adjustment of Rs.3,77,22,565/- under section 92CA of the Act. Further, the Assessing Officer had re-computed the deduction under section 10A of the Act as claimed by the assessee company in its return of income.

2.1 Aggrieved by the adjustment of the Arm's Length Price (ALP) of the international transaction and the re-computation of deduction under section 10A of the Act in the draft assessment order, the assessee company had filed application before the Dispute Resolution Panel (DRP).

2.2 The assessee had filed comprehensive objections before the DRP on various grounds. After providing an opportunity of being heard to the assessee, the DRP passed an order on 16/9/2011, upholding the adjustment to the ALP as suggested by the TPO and the re-computation of deduction under section 10A of the Act. Thereafter, the Assessing Officer passed an order dated 30/9/2011 incorporating the direction of the DRP.

2.3 Aggrieved by the assessment order dated 30/9/2011, the assessee company is in appeal before us.

2.4 The assessee has raised elaborate grounds with reference to the transfer pricing adjustment and re-computation of deduction under section 10A of the Act.

(I) Transfer Pricing Adjustment

3. During the financial year 2006-07 relevant to the assessment year 2007-08, the assessee company had entered into the following international transactions with its AE:-

RECEIPTS	**Rs.**
Provision of software development services	27,74,73,875/-
Interest on loan	24,02,907/-
Reimbursement of expenses	2,31,342/-
PAYMENTS	**Rs.**
Purchase of fixed assets	3,23,16,889/-
Reimbursement of expenses	1,04,38,784/-

The transfer pricing issue before the Tribunal relates to the amounts received by the assessee company on account of software development services, amounting to Rs.27.74 crores. With regard to the other receipts and payments mentioned above, no adjustments were made to the International transaction with the AE.

3.1 The assessee company, in order to justify its transfer pricing study, had adopted Transaction Net Margin Method (TNMM) as the most appropriate method and selected 17 companies as comparables. The operating/net margin of the assessee was arrived at 13.22%, which was inclusive of the gains of Rs.86,96,431/- on account of foreign exchange fluctuation. With reference to the comparable companies, the data for the years 2005, 2006 and 2007 was taken and the arithmetical mean of the net margin was arrived at 10.86%. Therefore, according to the assessee company, since its margin was at 13.22% and that of the comparables being at 10.86% the price at which the assessee had entered with its AE was at Arms Length Price (ALP).

3.1.1 The details of the net margin on cost earned by the assessee company, the comparables selected by the assessee and the arithmetical mean of the comparable companies, in the assessee's TP study, are as follows:-

Operating Income	Rs.28,61,70,306/-
Operating Expenses	Rs.25,27,43,515/-
Operating Profit (Op. Income – Op. Expenses)	Rs.3,34,26,791/-
Operating/Net margin (OP/TC)	13.22%

Sl. No	Name of the Company	2005	2006	2007	Average
1	Akshay Software Technologies Limited	7.68%	7.07%	NA	7.38%
2	BrelsInfotech Limited	2.46%	NA	NA	2.46%
3	Dynacons Systems	2.83%	3.17%	NA	3.00%
4	MelstarInfotech	-9.06%	1.39%	NA	-3.84%
5	Orientation Information Technology Limited	15.37%	-16.66%	NA	-0.65%
6	Quintegra Solution Limited	12.81%	14.95%	NA	13.88%
7	RS Software (India) Limited	8.08%	15.69%	13.55%	14.44%
8	Ranklin Solution	5.80%	7.55%	NA	6.68%
9	SIP Technology & Exports Limited	NA	21.99%	NA	21.99%
10	Sankhya Infotech Limited	27.33%	25.81%	NA	26.77%
11	Shree Tulsi Online.com Limited	1.75%	2.82%	NA	2.29%
12	Systemlogic Solutions Limited	26.52%	3.94%	NA	28.73%
13	Tutis Technologies Limited	7.28%	10.85%	NA	9.07%
14	V & K Softech Limited	16.33%	1.49%	NA	8.91%
15	VJIL Consulting Limited	8.26%	9.86%	NA	9.06%
16	Visualsoft Technologies Limited	16.10%	13.29%	NA	14.70%
17	Bodhtree Consulting Limited	26.47%	17.18%	NA	21.83%
	Arithmetic Mean	**11.03%**	**10.46%**	**13.55%**	**10.86%**

3.1.2 When the matter was referred to the TPO, the TPO undertook his own study and accepted certain filters adopted by the assessee company. The methodology adopted by the TPO was the same as that of the assessee, namely, TNMM. Twenty-six companies were selected as comparables by the TPO and the arithmetical mean of the comparables was fixed at 25.14%.

After providing for the working capital adjustment, the arithmetical mean arrived at by TPO was at 24.71%. By adopting 24.71% of ALP of the operating cost, the adjustment was made under section 92CA of the Act amounting to Rs.3,77,22,565/-. The comparables selected by the TPO, their arithmetical mean, the computation of the ALP and the adjustment made are as follows:-

Sl. No.	**Name of the Company**	Unadjusted	WC adjusted
1	Accel Transmatic Ltd.(Segment)	21.11	21.73
2	Avani Cimcom Technologies Ltd	52.59	52.29
3	Celestial Labs Ltd.	58.35	55.34
4	Datamatics Ltd	1.38	1.29
5	E-Zest Solutions Ltd.	36.12	37.40
6	Flextronics Software Systems Ltd. (Segment)	25.31	26.57
7	Geometric Ltd. (Segment)	10.71	11.37
8	Helio & Matheson Information Technology Ltd.	36.63	35.81
9	iGate Global Solutions Ltd	7.49	7.42
10	Infosys Technologies Ltd	40.30	40.28
11	Ishir Infortech Ltd.	30.12	31.85
12	KALS Information Systems Ltd.	30.55	24.96
13	LGS Global Ltd.	15.75	16.84
14	Lucid Software Ltd	19.37	18.69
15	Media Soft Solutions Pvt. Ltd	3.66	3.45
16	Megasoft Ltd	60.23	52.44
17	Mindtree Ltd	16.90	17.03
18	Persistent Systems Ltd	24.52	24.97
19	Quintegra Solutions Ltd	12.56	10.99
20	R S Software (India) Ltd	13.47	14.83
21	R Systems International Ltd(Segment)	15.07	14.95
22	Sasken Communication Technologies Ltd(Segment)	22.17	22.66
23	S I P Technologies & Exports Ltd	13.90	12.45
24	Tata Elxsi Ltd (Segment)	26.51	27.69
25	Thirdware Solutions Ltd. (Segment)	25.12	23.09
26	Wipro Ltd (Segment)	33.65	35.89
	ARITHMETIC MEAN	**25.14**	**24.71**

Arm's Length Mean Margin	25.14
Less: Working Capital Adjustment	0.43
Adjusted mean margin of the comparables	24.71
Operating Cost	25,27,43,517/-
Arms Length Margin (24.71% of Operating Cost)	
Arms Length Price (ALP) 124.71% of Operating Cost	31,51,96,440/-
Price charged in international transactions*	27,74,73,875/-
Short fall being adjustment u/s. 92CA	**3,77,22,565/-**

3.1.3 The computation made by the TPO, which was affirmed by the DRP, was incorporated in the assessment order.

3.1.4 Aggrieved by the assessment order dated 30/9/2011, the assessee has raised broadly the following issues before us:-

- TPO's action in rejecting the use of multiple year' contemporaneous data due to non-availability of current year data in public domain at the time of TP study is erroneous.
- TPO's action in taking recourse to Section 133(6) that too without giving an opportunity of cross-examination to the Assessee is erroneous.
- TPO's action in applying the filter of Related Party Transactions >25% is against the reasonable limit of 15% fixed by the Hon'ble Tribunal in the case of *24/7 Customer Com Private Ltd.*
- TPO's action in not applying an upper limit to the sales turnover is against the law laid down by the Hon'ble Tribunal in the case of *Genisys Integrating Systems India Limited* and *Trilogy E-business Software India Pvt. Ltd.*
- TPO's action in selecting comparables with abnormally high margin is against the ruling of this Hon'ble Tribunal in the case of *SAP Labs India Private Limited.*

- TPO's action in selecting functionally dissimilar comparables is against the ruling of the Hon'ble Tribunal in the case of *Telcordia Technologies India Private Limited* and *Trilogy E-business Software India Pvt. Ltd.*
- TPO erred in applying the filter of onsite turnover > 75% to reject otherwise comparable companies.
- TPO erred in holding that gains on account of foreign exchange fluctuation do not form part of operating revenues which is against the ruling of this Hon'ble Tribunal in the case of *SAP Labs India Private Limited* and *Trilogy E-business Software India Pvt. Ltd.*

3.2 The learned Senior Counsel Shri K P Kumar has filed written submissions. The content of the same is summarized below:-

"C1 <u>Submission regarding operating income as reckoned by TPO</u>

While the Appellant, in its TP documentation, had reckoned gains on account of foreign exchange fluctuation of Rs.86,96,431/- as part of its operating revenues in computing its margin (page 1187 of paper book), the TPO excluded the said gain from the operating revenue of Rs.28,61,70,306/- on the ground that foreign exchange fluctuation gains would not form part of operating revenue. He therefore arrived at an operating income of Rs. Rs.27,74,73,875/- and computed the margin of the Appellant to be 9.78% instead of 13.22% as computed by the Appellant in its TP report. Computation of net margin on cost as done in the TP Report and by the TPO is as under:

	As per TP report	***As per TPO***
Operating revenues	*Rs.28,61,70,306/-*	*Rs.27,74,73,875/-*
Operating Expenses	*Rs.25,27,43,515/-*	*Rs.25,27,43,515/-*
Operating Profit (Op. revenue – Op. Expenses)	*Rs.3,34,26,791/-*	*Rs.2,47,30,358/-*
Operating/Net margin (OP/TC)	***13.22%***	***9.78%***

The TPO did the same while arriving at the final transfer pricing adjustment of Rs.3,77,22,565/- as well (refer page 455 of the paper book). It is submitted that gains on account of foreign exchange fluctuation are an integral part of sale proceeds and cannot be excluded in computing the operating margin of the company. The Appellant places reliance on the decisions of this Hon'ble Tribunal in SAP Labs India Pvt. Ltd. and Trilogy E-Business Software India Pvt. Ltd. where foreign exchange fluctuation gains have been held to be part of sale proceeds (operating revenue). Hence, operating revenue of Rs. 28,61,70,306/- as reckoned by the Appellant is correct and in line with the legal position".

C2 <u>Submission on the comparables selected by the TPO</u>

Relying on the decisions of this Hon'ble Tribunal in the cases of Trilogy E-Business Software India Pvt. Ltd., Telcordia Technologies India Private Ltd., and 24/7 Customer Com Private Ltd., the Appellant seeks rejection of 14 of the 26 comparables selected by the TPO. The following would be the Accept / Reject matrix if the Appellant's submission is accepted".

It was submitted that the 8 comparables are to be rejected from the TPO's list on account of the turnover filter. The learned AR relies on the following orders of the Tribunal for the above proposition:-

i) M/s. Kodiak Networks (I) Pvt. Ltd v. ACIT – ITA No.1413/Bang/2010;
ii) M/s. Genesis Microchip (I) Pvt. Ltd v. DCIT – ITA No.1254/Bang/2010;
iii) M/s. Trilogy E-Business Software India Pvt. Ltd v. DCIT – ITA No.1054/Bang/2011 dated 23.11.2012.

It was, further, submitted that 5 companies are to be excluded on account of functional dissimilarity. For the above argument, the learned Sr. Counsel relied on the orders of the Tribunal in the case of (i) M/s. Trilogy E-Business Software India Pvt. Ltd.; (ii) Mumbai Tribunal in the case of Telcordia Technologies India Private Limited. Lastly it was submitted that Ishir Infotech Ltd. (the comparable of the TPO) also should be rejected since it was having related transaction exceeding 15% of the total turnover and for this contention, reliance was placed on the order of the Bangalore Tribunal in the case of 24/7 Customer Com Private Ltd. (ITA No.227/Bang/2010 dated 9/11/2012). In conclusion, it was argued by the learned Sr. Counsel that the arithmetic mean of 12 remaining of the 26 comparables would be 16.15 after providing for working capital adjustment and factoring in Foreign exchange fluctuation and that of the assessee being at 13.22%, the same would be within the range of +/-5% of the assessee's net margin and thus, no transfer pricing adjustment is required and therefore, the TP adjustment made by the TPO is liable to be set aside.

3.2.1 On the other hand, the learned D R had supported the findings of the authorities below. It was, further, submitted that the learned TPO had analyzed the various factors, as recorded in his order u/s 92CA of the Act, to arrive at a conclusion that the assessee's international transactions had resulted in an adjustment to the extent of Rs.3,77,22,656/- which has been duly sustained by the DRP in its directions u/s 144C of the Act. It was, therefore, pleaded that there was no infirmity in the order of the AO warranting any interference of this Bench.

3.2.2 We have heard the rival submissions and perused the materials on record. Before we proceed to consider the issues, it is to be mentioned that the line of business of the assessee in this case and that of three case laws (Trilogy, Telecordia & 24/7 Customer) are similar, namely, development of software and the size/turnover was also similar to that of the assessee in the instant case. Moreover, the assessment year 2007-08 was subject matter of consideration in the case of Trilogy E-Business Software India Pvt. Ltd. and Telcordia Technologies India Private Ltd. and the comparables selected by the TPO in those cases are identical to that of the instant case. Now we shall proceed to dispose of the issues as under:-

(i) Turnover Filter

3.3 We have heard the rival submissions and perused the materials on record. The TPO had, while selecting the above 26 comparables, applied a lower turnover filter of Rs.1 crore but preferred not to apply any upper turnover limit. The size of the comparable is an important factor in comparability. The ICAI TP guidance note has observed that the transaction entered into by a Rs.1000 crores company cannot be compared with the transaction entered into by a Rs.10 crores company and the two most obvious reasons are the size of the two companies and related economies of scale under which they operate. The TPO's range had resulted in selection of companies as comparable such as Infosys which was 277 times bigger than that of the assessee. The Bangalore Bench of the Tribunal in the case of M/s. Genisys Integrating Systems (India) Pvt. Ltd. v. DCIT – ITA No.1231/Bang/2010 relying on Dun and Bradstreet's analysis had held that turnover range of Rs.1 crore to 200 crores is appropriate. The said proposition has followed by the earlier Benches of this Tribunal in the following cases:

(i) M/s. Kodiak Networks (I) Pvt. Ltd v. ACIT – ITA No.1413/Bang/2010;
(ii) M/s Genesis Microchip (I) Pvt. Ltd. DCIT – ITA NO.1254/Bang/2010;
(iii) Electronic for Imaging India Pvt. Ltd – ITA NO.1171/Bang/2010; &
(iv) M/s. Trilogy E-Business Software India Private Ltd. v. DCIT – ITA No.1054/Bang/2011 dated 23.11.2012.

3.3.1 In the case of M/s.Genisys Integrating Systems (India) Pvt. Ltd. v. DCIT (supra), relying on Dun and Bradstreet', has observed as under:

> *"9. ………….we find that the TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the*

companies which also have turnover of 1.00 to 200 crores only should be taken into consideration for the purpose of making TP Study."

3.3.2 The above view has been followed in the recent order of the Tribunal in the case of Trilogy E –Business (supra). The relevant findings of the Tribunal are extracted as under:

> *"20. In this regard we find that the provisions of law pointed out by the ld. counsel for the assessee as well as the decisions referred to by the ld. counsel for the assessee clearly lay down the principle that the turnover filter is an important criteria in choosing the comparables. The assessee's turnover is Rs.47,46,66,638. It would therefore fall within the category of companies in the range of turnover between 1 crore and 200 crores (as laid down in the case of Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010) . Thus, companies having turnover of more than 200 crores have to be eliminated from the list of comparables as laid down in several decisions referred to by the ld. counsel for the assessee. Applying those tests, the following companies will have to be excluded from the list of 26 comparables drawn by the TPO viz.*

	Turnover Rs.
(1) Flextronics Software Systems Ltd.	*848.66 crores*
(2) iGate Global Solutions Ltd.	*747.27 crores*
(3) Mindtree Ltd.	*590.39 crores*
(4) Persistent Systems Ltd.	*293.74 crores*
(5) Sasken Communication Technologies Ltd.	*343.57 crores*
(6) Tata Elxsi Ltd.	*262.58 crores*
(7) Wipro Ltd.	*961.09 crores.*
(8) Infosys Technologies Ltd.	*13149 crores"..*

3.3.3 In view of the above said reasoning and the orders of the Benches of Bangalore Tribunal cited supra, the following 8 companies will have to be eliminated from the list of comparables selected by the TPO, namely:

- Flextronics Software Systems Limited;
- iGate Global Solutions Limited;
- Mindtree Limited;
- Persistent Systems Limited;
- Sasken Communication Technologies Limited;
- Tata Elxsi Limited;
- Wipro Limited; &
- Infosys Technologies Limited.

It is ordered accordingly.

(ii) Functional Dissimilarity

3.4 We shall now deal with the improper selection of comparables by the TPO for the reasons that they were functionally different.

A. Accel Transmatic Ltd. (Seg):

The selection of this company as comparable by the TPO was duly considered by the Tribunal in the case of Trilogy E-Business and the reason recorded in its finding is extracted as under:

> *"50. We have considered the submissions and are of the view that the plea of the assessee that the aforesaid company should not be treated as comparables was considered by the Tribunal in Capgemini India Ltd (supra) where the assessee was software developer. The Tribunal, in the said decision referred to by the ld. counsel for the assessee, has accepted that this company was not comparable in the case of the assessees engaged in software development services business. Accepting the argument of the ld. counsel for the assessee, we hold*

that the aforesaid company should be excluded as comparables".

B. Avani Cimcon Technologies Ltd:

The selection of this company as comparable by the TPO was rejected by the earlier Bench of the Tribunal in Trilogy E-Business for the reasons that-

> *"41. We have given a careful consideration to the submissions made on behalf of the Assessee and are of the view that the same deserves to be accepted. The reasons given by the Assessee for excluding this company as comparable are found to be acceptable. The decision of ITAT (Mumbai) in the case of Telcordia Technologies Pvt. Ltd. v. ACIT (supra) also supports the plea of the assessee. We therefore accept the plea of the Assessee to reject this company as a comparable".*

C. Celestial Labs. Ltd:

This Company was also selected by the TPO as comparable. However, on due consideration of the issue, the earlier Bench of this Tribunal in Trilogy E-Business had opined that this company cannot be as comparable on the ground that –

> *"45. ………………………………………………………………………………………*
> *We are of the view that in the light of the submissions made by the Assessee and the fact that this company was basically/admittedly in clinical research and manufacture of bio products and other products, there is no clear basis on which the TPO concluded that this company was mainly in the business of providing software development services. We therefore accept the plea of the Assessee that this company ought not to have been considered as comparable".*

D. <u>KALS Information System Ltd (Seg):</u>

Incidentally, the selection of this company as comparable by the TPO was rejected by the Tribunal in the case of Trilogy E-Business on the premise that the information obtained by the TPO by issuance of notice u/s 133(6) of the Act was not, however, available in public domain. The reasons recorded, for appreciation of facts, are extracted hereunder:

> *"47. We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly software development service provider. We therefore accept the plea of the Assessee that this company is not comparable".*

3.4.1 In conformity with the findings of the coordinate Bench of the Tribunal in the case of Trilogy E-Business, we are of the considered view that (i) Accel Transmatic Ltd (Seg); (ii) Avani Cimcon Technologies Ltd; (iii) Celestial Labs. Ltd., & (iv) KALS Information Systems Ltd (seg) cannot qualify as comparables in the case of the assessee under consideration. It is ordered accordingly.

E) Lucid Software Limited

3.4.2. The above company has been rejected as comparable in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT (supra)*. The submissions and the finding of the Hon'ble Mumbai Tribunal is reproduced below:-

> *"7.2 Lucid Software Limited:*
>
> *It has been submitted before us that this company, besides doing software development services, is also involved in development of software product. The learned AR has tried to distinguish by pointing out that product development expenditure in this case is around 39% of the capital employed by the said company, and, therefore, such a company cannot be considered as tested party. Even as per the information received in response to notice under section 133(6), the company has described its business as software development company or pure software development service provider. This information itself is very vague as the segmental details of operating revenue has not been made available to examine how much is the ratio of sale from software product and sale of software service and development. Looking to the fact that it has developed a software product named as "Muulam" which is used for civil engineering structures and the product development expenditure itself is substantial vis-à-vis the capital employed by the said company, this criteria for being taken as comparable party, gets vitiated. For the purpose of comparability analysis, it is essential that the characteristics and the functions are by and large similar as that of the assessee company and T.P. analysis/study can be made with fewest and most reliable adjustment. If a company has employed heavy capital in development of a product then profitability in the sale of product would be entirely different from the company, who is involved in serve sector. Therefore, this company cannot*

be treated as having same function and profitability ratio.

In our view, due to non-availability of full information about the segmental details as to how much is the sale of product and how much is from the services, therefore, this entity cannot be taken into account for comparability analysis for determining arms length price in the case of the assessee".

3.4.3 The objections raised by the assessee for inclusion of Lucid Software Ltd. as a comparable is placed at pages 244 to 248 of the paper book filed by the assessee. We find identical objection has been raised against the inclusion of Lucid Software in case of Telcordia Technologies. Since the facts and the assessment year are identical, following the order of the Tribunal in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT (supra),* we direct the Assessing Officer/TPO not to include Lucid Software Limited as a comparable.

3.4.4 After excluding from the TPO's list of comparables, the companies having turnover exceeding Rs.200 crores and five companies which are functional dissimilar to that of the assessee, the following thirteen companies in TPO list are retained as comparables:-

Sl. No.	Name of the company
1.	Datamatics Limited
2.	E Zest Solutions Limited
3.	Geometric Ltd. (seg)
4.	Helios & Matheson Information Technology Ltd
5.	Ishir Infotech Ltd
6.	LGS Global Ltd (Lanco Global Solutions Ltd)
7.	Mediasoft Solutions Pvt. Ltd

8.	Megasoft Ltd (Seg)
9.	Quintegra Solutions Ltd
10.	R S Software (India) Ltd
11.	R Systems International Ltd (Seg)
12.	SIP Technologies & Exports Ltd
13.	Thirdware Solutions Ltd (Seg)

3.4.5. The above companies have been retained as comparables in conformity with the findings of the earlier Bench in the cases of Trilogy E-Business and Telcordia Technologies Pvt. Ltd. (supra). It is to be noted that in the case of Trilogy E-Business, the Tribunal turned down the plea of the assessee that M/s. Megasoft Ltd should be rejected as comparable. However, the Tribunal accepted the alternative submission of the assessee that the segmental profit margin is to be reckoned with instead of entity level margin and held that *the profit margin of 23.11% which is the margin of the software service segment be taken for comparability.* The discussion and the findings of the Bench with regard to the acceptance of the alternative submission of the assessee to adopt the segmental margin of 23.11% are reproduced below:

> "37. *The next plea of the Assessee is that if at all this company is considered as a comparable then the segmental margin of 23.11% (which is the margin for software service segment) alone should be considered for comparability. On the above submission, we find that the TPO considered the segmental margin (Software service segment) in the case of Geometric, Kals Info systems, R Systems, Sasken Communication and Tata Elxsi. Before DRP the Assessee pointed out that the segmental margin of 23.11% alone should be taken for comparability. The DRP has not given any specific finding on the above plea of the Assessee. Perusal of the order*

of the TPO shows that the TPO relied on information which was given by this company in which this company had explained that it has two divisions viz., BLUEALLY DIVISION and XIUS-BCGI DIVISION. Xius-BCGI Division does the business of product software (developing software). This company develops packaged products for the wireless and convergent telecom industry. These products are sold as packaged products to customers. While implementing these standardized products, customers may request the company to customize products or reconfigure products to fit into their business environment. Thereupon the company takes up the job of customizing the packaged software. The company also explained that 30 to 40% of the product software (software developed) would constitute packaged product and around 50% to 60% would constitute customized capabilities and expenses related to travelling, boarding and lodging expense. Based on the above reply, the TPO proceeded to hold that the comparable company was mainly into customization of software products developed (which was akin to software development) internally and that the portion of the revenue from development of software sold and used for customization was less than 25% of the overall revenues. The TPO therefore held that less than 25% of the revenues of the comparable are from software products and therefore the comparable satisfied TPO's filter of more than 75% of revenues from software development services. Having drawn the above conclusion, the TPO did not bother to quantify the revenues which can be attributed to software product development and software development service but adopted the margin of this company at the entity level. In terms of Rule 10B(3)(b) of the Rules, an uncontrolled transaction shall be comparable to an international transaction if—

(i) none of the differences, if any, between the transactions being compared, or between the

enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

38. Neither the TPO nor the DRP have noticed that there is bound to be a difference between the Assessee and Megasoft and the profit arising to the Megasoft as a result of the existence of the software product segment and no finding has been given that reasonably accurate adjustments can be made to eliminate the material effects of such differences. For this reason, we are inclined to hold that the profit margin of 23.11% which is the margin of the software service segment be taken for comparability……….".

3.4.6 In conformity with the findings of the earlier Bench (supra), we are of the considered view that the TPO was justified in selecting M/s. Megasoft Ltd as comparable. However, the AO/TPO is directed to take segmental margins of 23.11% for comparability. It is ordered accordingly.

(iii) Related party transaction:

3.5 Ishir Infotech Limited: The assessee had objected to the inclusion of Ishir Infotech Limited as a comparable being related party transaction in excess of 15% of total sales/revenue. The TPO had set a limit of 25% on the related party transaction. According to the assessee, the recent order of the Tribunal in the case of 24/7 Customer Com Private Ltd.

had held that if comparable company has related party transaction exceeded 15% of the total sales/revenue, the same should not be comparable.

3.5.1 The learned DR present was duly heard.

3.5.2 The Tribunal in the case of 24/7 Customer Com Private Ltd. had held that if the related party transaction exceeded 15% of the total sales/revenue, the same cannot be taken as a comparable. The relevant contention that was raised and the finding of the Tribunal read as follows:-

> *"13.0 <u>RELATED PARTY TRANSACTIONS</u>*
>
> *<u>In respect of the ground raised at S. No.1 regarding acceptance of comparable companies having related party transactions</u> as proposed by the TPO, the learned counsel for the assessee argued that the transfer pricing regulations do not stipulate any minimum limit of related party transactions which form the threshold for exclusion as a comparable. In this regard, the learned counsel for the assessee objected to the TPO's setting a limit of 25% on related party transactions. He objected to the inclusion of comparables being related party transactions in excess of 15% of sales/revenue. In support of this proposition, the learned counsel for the assessee placed reliance on the decision of the Hon'ble Bench of the ITAT, Delhi in the case of Sony India (P) Ltd. reported in 2008-TIOL-439-ITAT-Delji dt.23.12.2008. The learned counsel for the assessee drew our attention to para 115.3 of the order wherein the Tribunal has held that –*
>
> > *".......We are further of the view that an entity can be taken as uncontrolled if its related party transactions do not exceed 10 to 15% of total revenue. Within the above*

> *limit, transactions cannot be held to be significant to influence the profitability of the comparables. For the purpose of comparison what is to be judged is the impact of the related party transactions vis-à-vis sales and not profit since profit of an enterprise is influenced by large number of other factors …."*

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

3.5.3 Following the Coordinate Bench order of the Tribunal in the case cited supra, we direct the Assessing Officer/TPO to exclude, after due verification, those comparables from the list with the related party transactions or controlled transactions in excess of 15% of the total revenue for the financial year 2006-07. It is to be mentioned here, Geometric Ltd. is also to be removed from the comparable list, since that company was having RPT at 19.98% (going by assessee's own calculation), however, no argument was raised for its exclusion by the assessee, probably, on account of low margin of Geometric Ltd.

(iv) <u>Foreign Exchange gain/loss impact</u>

3.6 The Tribunal in the case of Trilogy E-Business had directed that the foreign exchange gain or loss should be considered as operating revenue or cost while computing the operating margin of the asssessee as well as the comparable. The relevant finding of the Tribunal read as follows:

> "79……………………………………………………………………………………………
>
> *(B) ……………………………………………………………………………………*
>
> *As far as foreign exchange gain/loss being considered as not forming part of the operating cost, the reasoning of the revenue is that such loss or gain cannot be said to be one realized from international transaction though they may form part of the gain/loss of the enterprise and therefore they should be excluded while determining operating cost. On the above issue we find that the Bangalore Bench of ITAT in the case of Sap Labs India (P) Ltd. Vs. ACIT (2011) 44 SOT 156 (Bang.) has taken the view that Foreign Exchange Fluctuation gains are required to be added to operating revenue. Following the same, the AO is directed to accept the claim of the Assessee in this regard…………………".*

3.6.1 In conformity with the above finding, we direct the AO/TPO to consider the foreign exchange gain or loss as part of the operating cost or revenue, as the case may be, for both the assessee as well for the comparable companies.

3.7 It is to be noted that no submissions/arguments were raised in the course of hearing with regard to other issues of TP adjustment, apart from the above discussed issues. Hence, the issue related to rejection of use of non-contemporaneous data, the TPO's action in taking recourse under section 133(6) without giving an opportunity of cross examination to the assessee, filter of onsite turnover >75% etc. are not considered/ adjudicated.

3.7.1 In conclusion, the Assessing Officer/TPO is directed to work out the ALP of the assessee in accordance with the directions of this Bench (supra) and if found that the differential in the margin of the assessee and the comparables is beyond 5% bandwidth recognized in proviso to section 92C(2) of the Act, then adjustment is required to be made to the reported value of the assessee's transaction with its AE. It is ordered accordingly.

II. Deduction under section 10A of the Act

4. The assessee had claimed deduction under section 10A of the Act amounting to Rs.3,19,98,038/-. In computing the deduction, the assessee company had reduced telecommunication expenses (internet access charges) of Rs.8,15,037/- both from the export turnover as well as from the total turnover. The Assessing Officer re-computed the deduction by reducing from the export turnover a sum of Rs.8,15,037/-, being the telecommunication expenses without making corresponding exclusion from the total turnover, and, hence, the claim of deduction under section 10A of the Act was reduced by Rs.91,394/-.

4.1 Before us it was submitted by the learned AR that the issue in question is squarely covered by the judgment of the Hon'ble jurisdictional High Court in the case of CIT v Tata Elxsi Ltd. (2012) 349 ITR 98 (Kar.).

4.2 The learned DR was unable to controvert the submissions made by the learned AR.

4.3 We have heard the rival submissions and perused the materials on record. The Hon'ble jurisdictional High Court in the case cited supra had held that when the expenses are reduced from the export turnover while computing deduction under section 10A of the Act, the same should also be reduced from the total turnover in order to maintain parity between the numerator and the denominator. In the light of the above judgment, we direct the Assessing Officer to reduce a sum of Rs.8,15,037/- from the export turnover as well as from the total turnover while computing deduction under section 10A of the Act. It is ordered accordingly.

5. In the result, the assessee's appeal is partly allowed as indicated above.

The order is pronounced on the 29th day of January, 2013 at Bangalore.

Sd/-	Sd/-
(N BARATHVAJA SANKAR)	(GEORGE GEORGE K)
VICE PRESIDENT	JUDICIAL MEMBER

Copy to :

1. The Revenue 2. The Assessee 3. The CIT concerned. 4. The CIT(A) concerned. 5. DR 6. GF

MSP/ By order

Senior Private Secretary, ITAT, Bangalore.