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

BEFORE SHRI N BARATHVAJA SANKAR, VICE PRESIDENT
AND SHRI GEORGE GEORGE K, J.M

ITA No.1235/Bang/2010
(Assessment year 2006-07)

M/s Tally Solutions Private Ltd.,

331-336, Raheja Arcade,

Koramangala, Bangalore.

- Appellant

Vs

The Deputy Commissioner of Income Tax,

Circle-12(4), Bangalore. - Respondent

Appellant by : Shri Arvind V Sonde, C.A.

Respondent by : Shri Etwa Munda, CIT-III

Date of hearing : 15/9/2011

Date of pronouncement :26/09/2011

ORDER

PER GEORGE GEORGE K :

This appeal instituted by the assessee company – Tally Solutions Pvt. Ltd – is directed against the order of the Ld. AO passed u/s 143(3) r.w.s.144C of the Act dated: 20.10.2010 for the assessment year **2006-07**.

2) The assessee company in its grounds of appeal had raised **thirteen** grounds under various captions in an illustrative and extensive

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manner. However, on scrutinizing the same attentively, it was noticed that the grievances of the assessee are chiefly confined to the following issues, namely:

(i) that the impugned order passed by the Ld. AO requires to be quashed; or in the alternative –

(a) the deficiencies/shortcomings in the process be made good/rectified;

(b) the adjustments made by the TPO/AO and confirmed by the DRP varying the reported value of the international transaction be deleted; &

(c) interest charged u/s 234B and s.234D of the Act be deleted.

2.1) Charging of interest u/s 234B of the Act is mandatory and consequential in nature and, thus, this ground is not maintainable and, accordingly, dismissed as **not maintainable.** The levy of interest u/s 234D is a legal ground which is chargeable for the AY 2006-07, following the finding of the Hon'ble Delhi E Special Bench in the case of ITO v. Ekta Promoters P. Ltd. reported in (2008) 113 ITD 719. It is ordered accordingly.

2.2) The assessee company's assertions that the lower authorities erred in passing the impugned orders –

(i) ***without considering all the submissions and/or without appreciating properly the facts and circumstances of the case and the law applicable;***

(ii) in a mechanical manner and without application of mind;

(iii) at the fag end of the limitation period; and

(iv) without affording a proper opportunity of being heard to the assessee

are found to be **wanting** as the records testify that the assessee company was provided with as many as eighteen opportunities during the course of assessment proceedings by the Ld. AO and at a glance at the impugned orders of the Ld. TPO as well as DRP, it was noticed that while passing the orders, the authorities concerned have duly taken cognizance of the relevant facts in arriving at such conclusions which cannot be merely termed as *the orders have since been passed in a mechanical manner without application of mind*. As no concrete evidence was forth-coming to suggest that the impugned orders were suffered from those short-comings, we venture to dismiss this ground of the assessee company as not sustainable.

3) We shall now proceed to deal with the primary issues raised by the assessee company in the following paragraphs:

4) Briefly stated, the assessee company ['the assessee' henceforth] has been engaged in the business of software development, marketing and sales of Tally Brand Financial Accounting and Management Software. The assessee has Associated Enterprises (AE) in UK, Dubai and other countries. In Dubai's AE, the assessee has 40% shareholding. During the year under dispute, the assessee sold intellectual property held by it including patent, copy rights and trade marks to Tally Solutions FZLLC, Dubai (Tally Dubai) on 31-1-2006 for a total consideration of Rs.38.50 crores. It was claimed that after restructuring, for the first 10 months of FY 2005-06, the assessee

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continued to carry on its business of sale of license for the right to use of its software products and later two months, it provided software services to Tally Dubai.

4.1) The assessee's case was referred to the TPO for computation of arm's length price u/s 92CA of the Act. After consideration of the details furnished by the assessee, the TPO proposed to adopt various comparables for software segments to determine the ALP with reference to sale of Intellectual Property Right (IPR) and brushing aside the assessee's objections in response to the said proposal, the TPO determined the ALP at Rs.501.46 crores [as enumerated at page 171 of his impugned order] with respect to sale of IPR to its AE at Dubai.

5) Aggrieved, the assessee took up the issue with the Dispute Resolution Panel [DRP] for relief. Taking cognizance of the assessee's contentions, the DRP in its impugned order directed the TPO to reconsider the objections of the assessee on the issue and submit a fresh valuation report with regard to the sale of IPR. The TPO furnished a revised valuation of the IPR at Rs.260.63 crores which was upheld by the DRP and, accordingly, directed the AO to make the adjustment on the basis of the revised working of the TPO at Rs.222.13 crores (260.63 crores – ALP of Rs.38.50 crores). The AO passed the final order on 20.10.2010 in pursuance of the directions of the DRP dated 30-9-2010.

6) Agitated, the assessee has come up with the present appeal against the adjustment made by the TPO which was upheld by the DRP to the valuation of IPR sold by the assessee to its AE - Tally Dubai - and incorporated by the AO in his final order cited supra.

6.1) During the course of hearing, the submissions made by the Ld. A.R are summarized as under:

(1) **The assessee challenges the legality of reference to TPO the AO without forming 'a considered opinion':**

The assessee challenges the legality of the reference made by the AO to the TPO as according to the Ld. AR, a reference has been made by the AO to the TPO without forming "a considered opinion" on the issues under reference. The AO referred the matter to TPO, following CBDT Instruction No.3 of 2003 dated 20/5/2003. The said instruction provides that the AO after forming prima-facie belief on the details available on record with reference to the international transactions, refer the case to TPO, if the aggregate value of these transactions exceeds Rs.5 crores, after obtaining the approval of the CIT. The said instruction further provides that the AO shall give final opportunity to the assessee after receipt of the order of the TPO, that prior to the amendment made by the FA 2007 to sub-section (4) of sec 92CA of the Act, the AO could make reference to TPO on arriving at a "prima facie opinion" on the international transaction and could reach "a considered opinion" after receipt of the report from the TPO after providing opportunity to the assessee. As per sub-section (4) prior to its amendment, the AO could proceed to compute the total income of the assessee "having regard to the Arms Length Price determined under sub-section (3) of the TPO". Thus, it was contended that there was always a scope for the assessee to put forth its

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objection before the AO concerning the contents of the TPO report and the AO, after considering the objection of the assessee, could either agree with the TPO report or agree with the objection of the assessee and reject or modify the TPO report while passing the assessment order u/s 143 of the I.T. Act.

- Under the circumstances, it was justified that the AO could make reference to the TPO u/s 92CA (1) merely by arriving at the "prima facie opinion" as he could reach "a considered opinion" after receipt of the TPO's report. This aspect of forming prima facie opinion before a reference to TPO and considered the opinion after receipt of the TPO report.

- Relies on the ruling of the Hon'ble Delhi High Court in the case of Sony India P. Ltd. vs. CBDT And Another [288 ITR 52(2007)] (Del).

- However subsequent to the amendment in sub-section (4) of section 92CA of the Act by the FA, 2007, the AO has to pass the order "in conformity with the arms length price as so determined by the Transfer Pricing Officer" and, hence, post amendment, the AO has no option but to pass the assessment order in conformity with the ALP determined by the TPO.

Section 92CA reads as under:

92CA. (1) Where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer considers it <u>necessary or expedient</u> so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer.

(2) ……………………

(3) ……………………..

(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.]

(5) ……………………..

(6) ………………………

(7) ………………………..

Sub-section(4) of section 92CA has been amended by Finance Act, 2007 w.e.f. 1.6.2007 and prior to its substitution, sub-section(4) read as under :

"(4) on receipt of the order under sub-section(3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C <u>having regard to the arms length price determined under sub-section (3) by the Transfer Pricing Officer".</u>

- The CBDT's Instruction No.3 of 2003 was challenged in Sony India (P) Ltd vs. CBDT & ANR [288 ITR 52(Del)]. The Hon'ble Delhi High Court after considering the provisions as they stood at the relevant time upheld the instructions as correct and consistent with section 119 of the IT Act and observed thus -

"The exercise of the discretion by the Assessing Officer is required to be preceded by the formation of an opinion by the Assessing Officer of the necessity or expediency of making such a reference. However, what is not apparent is the nature of such opinion. <u>Is this a prima facie opinion or a considered opinion after examining all available materials ?</u> The answer to this will determine the stage at which the reference can be made to the Transfer Pricing Officer. This will have to be understood from the wording of the statute itself. A reading of section 92C and section 92CA

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does not indicate that the Assessing Officer is required to form a prior considered opinion after considering all the available materials even before making a reference to the Transfer Pricing Officer. For instance, section 92CA(1) can be contrasted with section 55A of the Act where again the Assessing Officer is empowered to refer to the Valuation Officer the question of ascertaining the fair market value of a capital asset. The wording of section 55A is unambiguous that the Assessing Officer has to first form an opinion that the value declared is less than the fair market value before he can refer the question to the Valuation Officer. If he does not, then the reference is itself bad. Turning to section 92CA, the question is whether the reference to the Transfer Pricing Officer by the Assessing Officer has to be made by the Assessing Officer only after he is satisfied by going through the steps enlisted at section 92C (1) to (3) and concluding that the price declared by the assessee is not to be accepted or can he make such a reference at an anterior stage?

There is nothing in section 92CA itself that requires the Assessing Officer to first form a considered opinion in the manner indicated in section 92C (3) before he can make a reference to the Transfer Pricing Officer. In our view, it is not possible to read such a requirement into section 92CA (1). However, it will suffice if the Assessing Officer forms a prima facie opinion that it is necessary and expedient to make such a reference. One possible reason for the absence of such a requirement of formation of a prior considered opinion by the Assessing Officer is that the Transfer Pricing Officer is expected to perform the same exercise as envisaged under :

Section 92C (1) to (3) while determining the ALP under section 92CA (3). The latter part of section 92CA(3) unambiguously states that the Assessing Officer shall "by order in writing, determine the arm's length price in relation to the international transaction in accordance with sub-

section (3) of the section 92C." It will be pointless to have a duplication of this exercise at two stages one after the other. On the other hand, the scheme is that after the Transfer Pricing Officer determines the ALP the matter revives before the ALP at section 92C(4) stage where, in terms of section 92CA(4) the Assessing Officer will compute the total income "having regard to" the ALP determined by the Transfer Pricing Officer.

The two aspects require to be taken note of in this context. The Assessing Officer will necessarily have to give an opportunity to the assessee after receiving the report of the Transfer Pricing Officer and before he finalizes the assessment computing the total income. Secondly, the provisions do not mandate that the Assessing Officer is bound to accept the ALP as determined by the Transfer Pricing Officer. And for good reason because the Assessing Officer has himself not made up his mind at the stage about the ALP. He has, in a sense, only "outsourced" this exercise to the Transfer Pricing Officer. He can always be persuaded by the assessee at that stage to reject the Transfer Pricing Officer's report and proceed to still determine the ALP himself. It must be recalled that it is the Assessing Officer who is the authority to finalize the assessment and that power cannot be usurped, as it were, by the Transfer Pricing Officer or any other authority contrary to the scheme of the Act. If on the other hand one were to interpret the provisions to require the Assessing Officer to first form a considered opinion on the ALP before referring the matter to the Transfer Pricing Officer, then the Assessing Officer will thereafter have no option but to accept the report of the Transfer Pricing Officer and to that extent the Assessing Officer's final say on the ALP while computing the total income gets diluted. By preserving the power of the Assessing Officer to determine the ALP even after the determination by the Transfer Pricing Officer, full effect can be given to the

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words "having regard to" occurring in both section 92C(4) and section 92CA(4).

……………………………………………..……………………………………………..

"In view of the settled legal position, we are of the view that the expression "having regard to" in section 92C(4) and section 92CA(4) enables the Assessing Officer to consider not only the report of the Transfer Pricing Officer but any other material that may be placed before him by the assessee to arrive at a different conclusion. This also strengthens the position that the report of the Transfer Pricing Officer is not binding on the Assessing Officer".

……………………………………………..……………………………………………………

The salient points emerging from the above discussion may be recapitulated thus:

(a) The discretion of the Assessing Officer to refer the matter of computation of ALP to the Transfer Pricing Officer is not unfettered. It is trite that any misuse of such exercise of discretion can be corrected by way of judicial review by statutory appellate authorities and ultimately the courts.

(b) The words "necessary and expedient" occurring in other provisions of the Act and other statutes have been interpreted judicially to admit of a strict construction permitting the power to be used only in the manner and subject to the conditions stipulated in the provision.

(c) The words "necessary and expedient" posit the formation of an opinion by the Assessing Officer of the need to make such a reference. However, a reading of section 92C and section 92CA does not indicate that the Assessing Officer is required to form a prior considered opinion after considering all the available materials even before making a reference to the Transfer Pricing Officer. A prima facie opinion would suffice at the stage of making the reference.

(d) The Transfer Pricing Officer is expected to perform the same exercise as envisaged under section 92C(1) to (3) while determining the ALP under section 92CA(3).

(e) The Assessing Officer is not bound to accept the ALP as determined by the Transfer Pricing Officer. He can always be persuaded by the assessee at that stage to reject the Transfer Pricing Officer's report and proceed to still determine the ALP himself. This is how the expression "having regard to" occurring in both sections 92C (4) and 92CA(4) can be given full effect.

(f) This interpretation does not prejudice the assessee because in effect the assessee gets two opportunities to demonstrate that the ALP declared by it requires acceptance. The first is before the Transfer Pricing Officer in terms of section 92CA (3) and the second before the Assessing Officer under section 92C (4)' (emphasis supplied).

- *On reading of sec 92CA of the Act and Delhi High Court judgment in the case of Sony India (P) Ltd, it is very clear that the AO can make reference to the TPO following the instructions of the CBDT by forming a prima facie opinion as he is not bound by the report of TPO and can form a considered opinion with reference to the issues under reference before finalizing the assessment. It is an admitted position in law that AO has the authority to finalize the assessment and his power cannot be usurped by the TPO or any other authority contrary to the Act. The AO can only outsource the exercise of determination of arms length price to the TPO by arriving at a prima facie opinion and can form the considered opinion after receipt of the TPO's order. However, there has been a change in the provisions of the law w.e.f 01.06.2007. The AO has to compute total income of the assessee in conformity with the arms length price determined by the TPO. Under these circumstances mere forming the prima facie opinion before*

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making reference to the TPO is not sufficient as otherwise AO will have no opportunity to form a considered opinion on the issues under reference. AO has to pass the order 'in conformity with" the ALP determined by the TPO and if he has not formed any considered opinion before making reference to the TPO then the powers of AO have been usurped by the TPO. The Hon'ble Delhi High Court has upheld the instruction no.3 of 2003 and held that prima facie opinion would be sufficient for making reference to TPO as AO will have considered opinion on receipt of the TPO's order. But now after the amendment to sec 92CA (4), the AO has to pass the order in conformity with the order passed by the TPO and, hence, the AO has to have considered opinion before making reference to the TPO.

It is , therefore, submitted that the Hon'ble Bench shall ascertain whether the AO has formed a considered opinion before making reference to the TPO u/s.92CA(1) of the Income-tax Act, 1961 and the Commissioner has accorded his approval for the reference after due consideration as the mechanical approval can not be considered to be valid approval under the Act.

(2) The TPO followed excess earning method which is not a prescribed method under the Act or Rules:

- that the TPO has followed excess earning method and not Comparable Uncontrolled Price Method (CUP) as there was no comparables available with reference to the IPR sold by the Assessee. The Excess Earning Method is part of the Draft guidance not issued by the International Valuation Standard Council in April, 2009, that the TPO determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR. However, as per section 92C of the Act the ALP in relation to an international transaction has to be determined with reference to the prescribed method the relevant part of section 92C of the Act.

- ***The TPO has to determine the ALP only by following one or more of the most appropriate method referred to in section 92C(1) of the Act read with Rule 10B and in the manner prescribed under Rule 10C of the Rules. The Excess Earning Method followed by the TPO is not one of the methods specified in the Act read with the rules. The Assessee therefore submitted that however authentic and well accepted the Excess Earning Method may be, the AO could not adopt the same as it is not one of those method recognized by the Income Tax Act The assessee further submits that irrespective of the validity of the Excess Earning Method the same can not be applied for determination of ALP under the I.T. Act as it is not one of the specified method u/s 92C of the I.T. Act.***

- that the ALP of IPR shall be accepted at Rs.38.50 cr. as stated by the assessee. Moreover since there was no comparable uncontrolled transaction of similar nature available and no other method can be taken to be most appropriate method for determination of ALP of the IPR u/s 92C(1) of the Act, the value of the IPR declared by the assessee shall be accepted to be the ALP of the International transaction by the AO.

- Reliance ***placed in the case of CA Computer Associates Pvt. Ltd. vs. DCIT (2010) 37 SOT 306(Mum)] wherein the Hon'ble Bench has held:***

> ***"The manner in which the ALP is to be determined by any of the method prescribed in section 92C is provided in rule 10B of the Income Tax Rules, 1962. After examining the parameters prescribed in rule 10B, it can be seen that bad debts written off can not be factor to determine the arm's length price of nay international transaction. In our opinion, the TPO has exceeded his limitation by following the method which is not authorized under the Act or Rules. We***

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therefore, hold that the arm's length price determined by the TPO and adopted by the AO to the extent of royalty payable to the CA Inc Management, USA is not as per the procedure prescribed and same can not be sustained. We therefore direct the AO to adopt the arm's length price of the royalty payable to CA Inc Management, USA as declared by the assessee in both the years".

- that in the absence of appropriate method for determination of ALP of IPR, the provision cannot be applied and value of IPR declared by the assessee shall be accepted as ALP. The CUP presupposes an existence of comparable transaction and in the absence of any such comparable the CUP method cannot be applied for determination of ALP, that there is no other method which can be applied for determination of ALP, the provision relating to determination of ALP can not be applied to the transaction of the assessee.

- relies on the ruling of the Supreme Court in the case of CIT vs. Official Liquidator, Palai Central Bank Ltd.[150 ITR 544] wherein it was held that if the provision of a particular Act are incapable of its application, the charge of such section fails and the same can not be applied. The Hon'ble Court was dealing with application of provisions contained in Super Profits Tax Act, 1963 in respect of the company in liquidation subsequent to the date of its winding up. The court following its earlier judgment has held as under :

"In CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294, this court pointed out that under the scheme of the I.T. Act, 1961, charge of tax will not get attracted unless the case or transaction falls under the governance of the relevant computation provisions. "

The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section, there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. "Exactly similar being the scheme of the Super Profits Tax Act, 1963, the above observations fully apply to the case before us. Hence, it has to be held that inasmuch as the provisions contained in the Act for computing the capital of the company and its reserves cannot have any application in respect of a company in liquidation and, consequently, the " standard deduction " is incapable of ascertainment, the charge of super profits tax under s. 4 of the Act is not attracted to such a case. The judgment of the High Court does not, therefore, call for any interference".

That in view of the above the sale value declared by the assessee at Rs.38.50 cr. of IPR transferred to Tally Dubai, shall be directed to be accepted as ALP for computation of income from international transaction.

***(3)** <u>**On merits, it was contended that the Order of the TPO suffers from the following infirmities:**</u>*

(i) T*he TPO has relied on estimates and surmises in projecting the future cash flows while completely disregarding documentary evidence in the form of audited financial statements that were available at the time of framing the order.*

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Such documents emphatically rebut the presumptions made by the TPO

(ii) The TPO has erred in excluding license revenues for the period 01-4-2005 to 31-1-2006 in computing the value of the IPRs. Since the IPRs were sold on 31-1-2006, license revenues till the date of sale of IPRs have to be considered in determining the value of the IPRs

(iii) The TPO has erred in ignoring sales returns of AY 2005-06 amounting to Rs.111.,03 crores. Since the basis of the TPO's estimation of future revenues is sales of AY 2005-06, non-consideration of such sales returns grossly inflates the future earnings potential derived from the model adopted by the TPO

(iv) Compounded Annual Growth Rate (CAGR) is a function of two variables in a given range, i.e the first and last variable. Values within the given range, i.e. other than the first and last value, do not have a bearing on the CAGR. This being the case, CAGR is not a good metric to measure growth, especially so in the case of the Appellant where growth has been uneven, erratic and also negative in a few years;

(v) The choice of CAGR adopted by the learned TPO is whimsical, illogical and wholly unfounded

(vi) Useful life of the IPR, which is inextricably linked with technology, has been wrongly estimated by the TPO to be six years whereas in reality, useful life is inarguably less than three years. Inherent flaws in the IPR, which could potentially cripple and further reduce the

useful life of the IPR, have not been taken cognizance of by the TPO

(vii) The TPO has followed the principles of convenience rather than established and well settled principles in determining the discount factor

(viii) Working capital ratio has been incorrectly computed by the learned TPO

In the light of the above, it was submitted that -

(a) WDV of the IPRs be considered the Arm's Length Price of such IPRs; or

(b) The revenues of AY 2005-06 be reduced by the amount of subsequent sales returns of Rs.111.4 crores, implicit period for revenue projection be considered from 01-4-1999 to 31-1-2006, useful life of the IPR be taken at three years, discount factor of 23.14% be considered and in computing the return on working capital, all current assets and current liabilities be taken into consideration.

The above contentions on merits were elaborated by giving the following submissions:

1. *Computation of future cash flows:*

- *The learned TPO as a first step estimated the future turnover of the appellant. The TPO has estimated the future turnover till 2012 based on the past performance as well as data available in public domain (page 163 of the TP order). The appellant's past sales are considered as follows(page 165 of the TP order):*

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Table I
(Rs. in Crores)

Assessment Year	*Total Operating Revenue*
2000-01	*7.84*
2001-02	*20.20*
2002-03	*26.22*
2003-04	*56.71*
2004-05	*35.27*
2005-06	*198.15*
Total	***344.39***

Based on the above, the CAGR works out to 90.80% but the learned TPO has taken the CAGR at 20.39%. This growth rate is assumed for future years and accordingly future revenues as estimated by the learned TPO are as below:

Table 2

(Rs in Crores)

Assessment Year	**Total Operating Revenue**
2007-08	287.20
2008-09	345.75
2009-10	416.26
2010-11	501.13
2011-12	603.31
2012-13	726.32
Total	**2,879.97**

with respect to computation of future revenues

- The learned TPO has considered the sales of the appellant from A.Y 2000-01 to 2005-06. Based on this data, the TPO has computed CAGR and then estimated the future

revenue, that the methodology adopted by the TPO gives absurd results. To demonstrate this, the figures of actual sales are tabulated below.

Table -3

COMPARISON OF ACTUAL REVENUES WITH TPO'S ESTIMATED REVENUES				
Assessment year	Indian License Revenue	Global Revenue	TPO's Estimates	No. of Times Overvalued
2007-08	18,63,30,924	27,73,70,160	287,19,63,050	10
2008-09	86,98,16,178	99,65,09,130	345,75,56,316	3
2009-10	94,66,53,438	102,48,61,182	416,25,52,049	4
2010-11	91,70,80,310	91,70,80,310	501,12,96,411	5

As can be seen from the above, as per the TPO, the assessee would have cumulative turnover of around Rs. 2,880 crores. As per the TPO in AY 10-11, the appellant would have had Rs.501 crores of turnovers. In reality the turnover is Rs.91.70 crores. There is no product company in India which has turnover of 500 crores to 700 crores. The figures being unrealistic are liable to be rejected; that instead of adopting unrealistic projections, the actual sales figure available from the audited financial statements should be adopted.

- With respect to appellant's contention that actual sales figure should be adopted, the TPO has contended that to arrive at sale price of IPR one needs to look at the revenue potential at the time of sale. He has further contended that the MD of the appellant has made a statement that the sales of the company would be Rs. 5,000 crore by March 2012. In this regard, the appellant submits that then if this is true the TPO has completely ignored the fact that the assessee sales have never shown a linear growth. The TPO has assumed that the sales of the appellant will keep growing despite the fact that appellant's revenues dipped in A.Y. 2004-05 and A.Y 2006-07. This aspect has

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not been factored in revenue projections. Further after stating that events after sale are not relevant, the TPO is relying on the statement of the MD of the appellant which is made on March 17, 2009 (page 146 of the TP Order). The appellant submits that same is not relevant for AY 2006-07. If the statement is relevant, then the actual sales figure are also relevant and should be considered while computing ALP of IPR sale. Even otherwise MD's statement is a vision and not reality. Such vision or dream cannot authorize the TPO to make incredibly high projections which are bereft of reality. The determination of ALP has to be based on the law prevailing and not vision or dream of the MD. Accordingly, the appellant submits that the ALP should be computed based on actual sales and not projections.

The TPO has considered the sales of the appellant from A.Y. 2000-01 to 2005-06. Based on this data, the TPO has computed CAGR and then estimated the future revenue. The year under consideration is AY 2006-07. The IPR was sold on 31.01.06. The sales (license revenue) for 10 month period (April 05 to Jan 06) is Rs. 60,17,36,844, that since the sale of IPR is on 31.01.06, sales data of the current year should also be included to compute the future revenues. The appellant submits that considering appropriate sales data is vital for correct projections. The current year sales data is critical because it reflects the sales of period immediately preceding the sale of IP and therefore reflects the true earning potential of the IP at the time of sale.

- that the TPO in the remand report (page 11 of the remand report) has stated that current year data was not taken since the same involved the related party transactions and the transaction involving IPR took place in this year. In this regard, the appellant submits that the sale of Tally licenses is to third parties and not to related parties as contended by the TPO. What is sold by the appellant is IPR. IPR generates license revenues. Therefore to value

IPR what needs to be considered is revenue from Tally licensees which are sold to third parties. The other related party transactions have no relevance for this purpose. The situation in AY 2006-07 is similar to situation in all the years considered by the TPO. Therefore this reason of the TPO is baseless. With respect to TPO's contention that the transaction involving IPR took place in this year and therefore current year data is excluded, the appellant submits that since the sale is in current year, it is more so important to consider current year sales. This is also in accordance with provisions of Rule 10B(4) which mandates use of current year data which should be used to estimate future revenues.

- that the sales for A.Y. 2005-06 are considered by the TPO at Rs.198.15 crores. The TPO has considered this year as the base for computing CAGR and future revenues. It can be noticed from the table above that there is a substantial jump in the turnover during the AY 2005-06. In the immediately preceding year and immediately succeeding year, there is a dip in turnover. The TPO has completely ignored the extra-ordinary circumstances giving rise to this turnover.

- that the State Governments in India introduced VAT with effect from April 1, 2005. The appellant sensed a huge business opportunity with the proposed change in the business environment. With VAT being introduced, more and more traders would require automated systems to support the increased work. This also provided an opportunity to convert pirated users to licensed versions. The distributors were forced to off-take greater quantities of the software package. The same was accounted as turnover in the books of the appellant. In the last three months of A.Y. 2005-06, the sales accounted were almost 100% not received. In fact 95% of sales of A.Y. 2005-06 were in the month of March. The debtor outstanding as on March 31, 2005 was at Rs. 197.14 crores. Receivable constituted almost 100%

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of sales. The appellant had dumped the stock with the dealers in anticipation of good off- take due to introduction of VAT. Though the appellant's accounted revenues increased in A.Y. 2005-06, the dealers could not sell the whole stock. The same were returned by the dealers to the assessee. There was a sales return to the extent of Rs. 111.04 crores in the pertaining to sales made in A.Y. 2005-06. The turnover as reported did not materialize. To assume a growth rate on unrealized figures is bad in law. This is especially so when the CAGR is substantially influenced by the figure of turnover for the A.Y. 2005-06. When the "contributory figure" to the derivation of the rate of growth has not fructified, the very assumption of the TPO is vitiated. The projection of the future turnover on the basis of such vitiated turnover is therefore bad in law and, thus, the sales return must be excluded from the turnover of A.Y. 2005-06.

- With respect to this contention of the appellant, the TPO on page 10 of the remand report has contended that sales figures have been taken from annual report of the appellant and therefore sales return have been taken care of. The TPO has further contended that he has been very conservative and taken CAGR at 20.39% instead of 90.80%. The TPO has contended that lower CAGR takes care of all possible adverse effects on future cash flows.

- With respect to TPO's contention that sales return have been taken care of, the appellant submits that sales returns have not been reduced from the year to which they pertain.. Therefore the question of same being considered does not arise. Going by TPO's own admission that sales return and that sale of A.Y. 2005-06 should be accordingly adjusted.

- With respect to TPO's contention on CAGR, the appellant submits that if CAGR of 90.80% is adopted, the total sales projection as per TPO's method would be Rs. 37,535.55

crores. This reflects the absurdity of the TPO's calculation. CAGR of 90.80% is not possible in real life. This ought to have put the TPO on guard to make further analysis and investigation. Instead the TPO states that he has been lenient. The law of transfer pricing is not based on concession. Benevolence would not lend credence to an order otherwise bereft of legal substance or basis. The order is therefore bad in law.

- attention was drawn to Illustrative CAGR chart submitted during the course of hearing. The assessee submits that the CAGR varies drastically based on the value of first year and last year even though the total sales remain same. The high CAGR in appellant's case is attributed to sales in AY 2005-06, which never materialized. High CAGR has resulted in higher revenue projection for future years without considering ups and downs which is reality in appellant's case. This has resulted in high valuation of the IP. The appellant submits that the choice of CAGR adopted by the TPO is illogical and wholly unfounded

2) Useful Life:

- The TPO has estimated future revenues for six years. Why six years were selected has not been stated. No reason or rationale is available in the order justifying the adopting a six year period.

- Para 5.8 of the Exposure Draft (as relied by the TPO) states as follows:

> **"The forecast period needs to be assessed appropriately so that it is consistent with the expected useful life of the subject intangible asset. As the life of an intangible asset may be finite or assumed to be infinite, forecast cash flows may be for a finite period or may run into perpetuity."**

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As per the Exposure Draft, the value of intangible asset is to be determined based on the cash flows attributable to the subject intangible asset. It is to be based on expected useful life of the subject intangible asset.

The IPR was originally acquired by the appellant during the previous year relevant to A.Y. 2000-01. Tally is an accounting package which has to be updated year after year to suit the requirements of the market and the customer. Right from A.Y. 2000-01 upto A.Y. 2006-07 during which period the IPR was sold, various versions have been developed and marketed. Each version has been in the market for a very short period and most of the times for a span not exceeding a year. For example Tally version 3 or version 4 released in 1990's does not have any market today. Tabulated below are the release dates of newer versions:

Table 4

Version	Release Date
7.2	01.03.2005
8.1	07.07.2006
9.0	01.12.2006

As evident from the above Table, newer versions need to be released at regular intervals to suit the market requirements. In case newer versions are not released, the demand for the products will fall. What was transferred is IP of the existing products, i.e Tally 7.2. The market for the existing product is not six years. Its life is much shorter.

The base product without upgrades and newer versions would not sell in the market. The accounting packages have to continuously evolve. Continuous development is the key to ensure suitability of the package to adapt to changing requirements of the user. Their shelf life is very short. Competition in the field is intense. Obsolescence is fast

paced. Client loyalty is fickle. Under the circumstances the IPR of an accounting package has hardly any value. The appellant therefore submits that useful life of IPR should be considered at three years and accordingly future revenues should be estimated for three years.

Attention was drawn to the preamble (also extracted by the TPO on page 142 of the TP Order) of the Intellectual Property Sale Agreement with the JV Partner (Global Capital Partners, Dubai – an unrelated party and majority shareholder in Tally Dubai). The permeable reads as follows:

> *"TSPL[1] is convinced that 'Tally' as an accounting software product in the current form has certain inherent flaws in its features and suffers from weak market acceptance against several competing products presently available in the market; that it calls for intense development inputs of very high magnitude on a continuous basis on the product design, technology and security features and other value added modules; that it necessitates deep study and greater insight into customer and geographical requirements from the market standpoint; that the development of its intellectual property in the current form has reached saturation point, requires fresh and innovative approach in product design and development, either alone or in combination with other value added modules and features; that there is need for greater penetration into markets, development of new market territories to drive bigger volumes to justify the increase in the development efforts undertaken; that it does not have the resources in terms of finance, technology, alternative value added features for integrating with core product strengths and requisite know-how in terms of market knowledge."*

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As can be seen from the above, there were various reasons for sale of IPR. The same are summarized below:

(i) The appellant was convinced that there were certain inherent flaws in the features of the existing product. When the Tally package was introduced, the appellant was the only player (or probably one of the very few) in the market. Over a period of time many other players entered the market with their packages. If the inherent flaws were not corrected the appellant would have lost the market share. For example, the existing product did not have security features leading to large scale piracy. The Tally package was amenable to copying as the security system in the product was weak. Many pirated versions came into the market which was available at a far lesser price.

(ii) To correct the above flaws intense development inputs of very high magnitude were required on a continuous basis on the product design, technology and security features and other value added modules. The continuous development would necessitate deep study and greater insight into customer and geographical requirements from the market standpoint. The assessee's products targets small and medium businesses. Most of them are run by individuals or small firm. Understanding their individual and multitude requirements and preferences and translating that into product requires deep study.

(iii) In the initial years, the Tally product was just an accounting package. To expand the market, various others features were required to be integrated. Medium sized businesses require features like inventory, payroll, e-TDS, service tax returns, cost centres, FBT etc. The customers want one-stop solution for all the requirements. When assessee sold the IP, version 7.2 was in vogue. In the latter versions, the product consisting of FBT, VAT Returns, interest calculations, stock valuation, service tax returns etc feature were released. Adding these features

required in depth study of requirements, innovative design and development techniques. The same required funds. The appellant therefore formed a JV with the Global Capital Partners. The JV partners arranged a loan of USD 5,110,500 to the Associated Enterprise of the Appellant. The same was used for development of newer versions. The appellant initially had a small team of software developers. The team was expanded to 332 employees by 31 March 2005. The team was further expanded to 814 employees by 31 January 2006. This would not have been possible without the funds and inputs provided by the JV partners.

As can be seen from the above, Tally software had various flaws at the time of the sale. The same required intense development inputs of very high magnitude on a continuous basis. Without these development efforts, the product would not be able to sell in the market. Therefore, the base product as sold on 31.01.06 would not last long in the market. Therefore, it would not be appropriate to consider the shelf life and revenue projection for six years. The appellant submits that in the facts and circumstances of the case, three year revenue projections would be appropriate.

3. Calculation of Discount Factor

Beta: 4.1.1 For computing the Beta, the learned TPO has adopted Beta of a "similar company". It is stated on page 163 of the TP order that Sankhya Infotech Limited is a similar company. The said company is engaged in development and sale of software products for aviation industry. It is difficult to fathom how a company developing software product for aviation industry can be compared to appellant which is developing software for accounting.

Further, the learned TPO has considered 3 companies as comparable to the appellant's segment of distribution of products. These companies are Lifetree Convergence

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Limited, Exensys Software Solutions Limited and Sankhya Infotech Limtied (page 139 of the TP order). Out of these three, only Sankhya Infotech's Beta has been considered. Why the other two companies are not considered is not clear. The appellant submits without prejudice that Beta should be computed after considering all the three companies. The average Beta of three companies would be 1 (computation of Beta on pages 408 to 414 of the paper book).

Risk Premium

While computing the discount rate, the learned TPO (page 166 of the TP Order) has taken the risk premium at 8.80%. It is stated that risk premium of Bench Mark BSE Index has been considered. In this regard, the appellant submits that it is engaged in the business of software development and comparing return of BSE Index which is composition of companies from various industries is not appropriate. The Risk Premium should be based on return of companies engaged in software industry. Therefore the appellant submits that "Market Return on Capital Employed" from Capitaline Database of software industry (Medium and Small Companies) being 11.61% should be adopted.

Rate of Inflation

The TPO has considered the average inflation rate at 4%. It is stated that the inflation rate is on the basis of RBI's future projection of inflation (page 167 of the TP Order). There is no further substantiation. In this regard, the appellant submits that the inflation rate as adopted by the TPO is on the lower side. The appellant submits that inflation rate should be considered at 5.45% being average of A.Y. 2005-06 and 2006-07 . This is based on Economic Survey 2009-10

<u>Calculation of Working Capital</u>

While computing working capital (page 169 of the TP Order) the learned TPO has considered sundry debtors, work in progress and sundry creditors only. The learned TPO has not considered cash &bank balances, other current assets (except inter-corporate deposits) and provisions. The assessee submits that same should be considered while computing working capital ratio.

<u>WDV is an appropriate ALP</u>

Tally Dubai was JV between the appellant and Global Capital Partners. The JV partner is in no way related to the appellant. Global Capital Partners was not a minority shareholder. It was in fact a majority shareholder. The value for transfer of IPR was arrived at after due negotiations and deliberations. The JV partner had 60% stake in Tally Dubai. The appellant cannot be imputed with a motive to under sell the IPR's. This would have been a financial loss to the appellant. Nobody would invite an actual financial loss solely driven by tax avoidance motive, especially when the transaction involves a third party. In such circumstances paying taxes would be a far smaller cost then the loss of the money itself through an undervalued sale.

The OECD Guidelines indicate that the presence of minority shareholders as an indication of arm's length condition. This presumption would act much strengthened that in the instant case the third party is a majority shareholder.

In this regard, the assessee invites your honour's attention to the following extracts from the Proposed Amendments to OECD Guidelines:

> ***"3.26 The presence of minority shareholders may be one factor leading to the outcomes of a taxpayer's***

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> ***controlled transactions being closer to arm's length, but it is not determinative in and of itself. The influence of minority shareholders depends on a number of factors, including whether the minority shareholder has a participation in the capital of the parent company or in the capital of a subsidiary, and whether it has and actually exercises some influence on the pricing of intra-group transactions"***

The TPO has not appreciated the business, commercial and economic realities. In the facts and circumstances of the case, the IPR being transferred at WDV is to be considered as at arm's length.

To support its contention, the appellant relies on the Bangalore ITAT decision in the case of Intel Asia Electronic Inc v ADIT 2011-TII-14-ITAT-BANG-TP. In this case, the assessee had sold its PE as a going concern to its AE. The Hon'ble ITAT held that the only reasonable approach would be value the assets by applying the depreciation rates as provided by the Income Tax Act. The relevant extracts are as follows:

> **"12. To break the ice in such a situation, the only reasonable approach would be to value the assets by applying the depreciation rates as provided by the Income Tax Act for it is more dynamic and so schemed to bring in a notional charge on the profit and loss account to arrive at the actual income of an assessee keeping in view of the depletion of the assets".**

Based on the above, the appellant submits that the IPR being transferred at WDV is to be considered as at arm's length.

During the course of hearing, the appellant submitted Chart containing 6 alternative computations. Method I is the computation as done by the TPO. In Method II, the computation proceeds taking the correct CAGR (90.80%). As per this method, the total sales come to Rs. 37,535.55 crores and value of IPR comes to Rs. 2,871.96. As already submitted this reflects the absurdity of TPO's method.

Assuming without admitting that the method adopted by TPO is correct, the appellant submits Method III to VI for consideration.

Method III – Following changes made to TPO's computation:

1. Subsequent sales return in AY 2007-08 reduced from sales of AY 2005-06.

Changes in working capital as detailed above made Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.
Working capital changes as detailed above.
Based on the above changes, the ALP comes to Rs. 19.12 crores

Method IV – Following changes made to TPO's computation:

Implicit period changed 01.04.99 to 31.01.06 (upto date of sale of IPR).
Changes in working capital as detailed above made
Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.
Working capital changes as detailed above.
Based on the above changes, the ALP comes to Rs. 30.77 crores

Method V – Following changes made to TPO's computation:

Actual sales (of Tally Dubai) figures for AY 2007-08 to 2010-11 considered. Sales for AY 2011-12 and AY 2012-13 are estimated based on CAGR computed based on AY 2000-01 to AY 2010-11.

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Changes in working capital as detailed above made
Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.
Working capital changes as detailed above
Based on the above changes, the ALP comes to Rs. 14.70 crores

Method VI – Following changes made to TPO's computation:

Implicit period changed 01.04.99 to 31.01.06 (upto date of sale of IPR). Actual sales (of Tally Dubai) figures for AY 2007-08 to 2010-11 considered. Sales for AY 2011-12 and AY 2012-13 are estimated based on CAGR computed based on AY 2000-01 to AY 2010-11.
Changes in working capital as detailed above made.
Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.
Working capital changes as detailed above. Based on the above changes, the ALP comes to Rs. (12.64) crores

- *that under every method the arm's length price is less than Rs. 38.50 crores being the price received (Rs. 11.81 crores being sale price + Rs. 26.69 crores amounts received towards improvement till the date of sale). Therefore, the additions made by the TPO are without basis.*

6.2) The Ld. A R came up with various case laws in support of his stand and also furnished a voluminous paper book containing 1 – 414 pages which consist of inter alia copies of (i) extracts of financial statements, (iii) written submissions and correspondences with various authorities etc.,

6.3) On the other hand, the Ld. D R argued that the Ld.AO was within his realm to refer the assessee's case to the TPO for computation of ALP u/s 92C of the Act. Also, on his part, the TPO had,

after due consideration of the issue at length and also analyzing the issue from various angles, arrived at a conclusion in a judicious manner which has been upheld by the DRP with suitable modification as enumerated in its final directions. It was, therefore, pleaded that the impugned order of the Ld. AO u/s 143(3) r.w.s. 144C of the Act requires to be sustained in toto. The Revenue has given specific rebuttals to the certain points raised by the assessee which are extracted in the course of this order.

7) We have carefully examined the rival submissions, diligently perused the relevant case records and also the voluminous documentary evidences coupled with various case laws advanced by either party to drive home their respective stand.

8) We shall first take up the legal issues raised by the assessee.

I. <u>Referring the case to TPO u/s 92CA of the Act</u>.

8.1) It was the contention of the assessee that the reference of its case to the TPO by the AO was not in accordance with the law since, according to the assessee, as per the ruling of Hon'ble Delhi High Court in the case of Sony India P. Ltd. v. CBDT reported in [2007] 288 ITR 52 (Del), *a prima facie satisfaction is only applicable when the taxpayer is given a 'second innings' to explain his case before the AO after the TPO reference is received.'*

This was countered by the Revenue thus –

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(1) In the case of Sony India referred supra, the Hon'ble Court clearly held that -

'A discretion is given to the assessing officer to refer the question of computation of the arm's length price to the Transfer Pricing Officer, if he considers that it is suitable, appropriate, profitable or convenient to the Revenue. The two words 'necessary or expedient' are separated by the word 'or' and not by the word 'and' and, therefore, should not be read as 'necessary and expedient'.

There is nothing in s.92CA itself that requires the AO to first form a considered opinion in the manner indicated in s. 92C (3) before he can make a reference to the TPO. In our view, it is not possible to read such a requirement into s.92CA(1). However, it will suffice, if the AO forms a prima facie opinion that it is necessary and expedient to make such a reference. One possible reason for the absence of such a requirement of formation of as prior considered opinion by the AO is that the TPO is expected to perform the same exercise as envisaged under s.92C(1) to (3) while determining the ALP under s.92CA(3). The latter part of s.92CA (3) unambiguously states that the AO shall by an order in writing; determine the arm's length price in relation to the international transaction in accordance with sub-section (3) of s.92C. it will be pointless to have a duplication of this exercise at two stages one after the other. On the other hand, the scheme is that after the TPO determines the ALP the matter revives before the ALP at the s.92C (4) stage where in terms of s.92CA(4) the AO will compute the total income having regard to the ALP determined by the TPO".

(2) Thus, even as per the decision of Sony India's case, the AO has to make only a prima facie opinion that it is necessary or expedient to refer as case to the TPO. This applies to all case immaterial or aggregate value of international transactions.

(3) *As per Instruction No.3/2003 the CBDT decided that wherever the aggregate value of international transactions exceeds Rs.5 crores, the case should be picked up for scrutiny and reference u/s 92CA be made to the TPO. Thus, it is mandatory for the AO to refer all the cases wherever the aggregate value of international transactions is more than Rs.5 crores. These instructions are binding on all the AOs. In these cases, there is no need for the AO to make a prima facie opinion, except that he/she needs to examine the 3CEB report to see the aggregate value of international transactions. As the Board issued instruction u/s 119(2)(a), the CBDT felt it necessary and expedient to refer all the cases wherein the aggregate value of international transactions exceed Rs.5 crores. In the instant case, as the aggregate value of international transactions, based on 3CEB report filed by the taxpayer before the AO, exceeded Rs.5 crores, he referred the case to the TPO and is as per the law.*

(4) *Referring to the finding of the Hon'ble Delhi Tribunal in the case of Ranbaxy Laboratories Ltd. V. Addl. CIT - (2008) 299 ITR 175 (Delhi), it was argued that Instruction No.3/2003 of the CBDT is binding on the AO and there is no need to make any prima facie opinion before the AO can make a reference to the TPO in all cases where the aggregate value of international transactions exceed Rs.5 crores.*

8.2) We have attentively considered the rival submissions and also with due regards perused the ruling of Hon'ble Delhi High Court as well as the Hon'ble Delhi Tribunal cited supra on a similar issue. More significantly, the Hon'ble Tribunal held thus -

> *"71. We are astonished at the submission of Shri Vohra to the effect that it is still open to the assessing officer even in cases where value of international transaction exceeded Rs. 5 crore to refer or not to refer the matter to the TPO as the instructions did not affect discretion vested in the assessing*

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officer. If it was so, then what was the need to challenge the instructions and its classifications before the Hon'ble High Court? Shri Vohra stated that perhaps the petitioner in that case did not correctly interpret the relevant statutory provision and instructions and, therefore, rushed to the Court. We are unable to agree with above submission of Shri Vohra. It is not possible for us to hold that instructions issued by CBDT u/s 119 of the Act to regulate assessment proceeding can be treated as a waste paper by officers functioning under the Board (CBDT). If such a view is taken, it would lead to chaos in the country. If various guidelines issued by CBDT for administration of Income-tax Department and for regulation of assessment etc., are not adhered to or made optional, then all schemes of assessment may fail and jeopardize the working of the department. This is neither the law of land not there is any justification to accept such an argument. We are, therefore, of the view that assessing officer, in the light of instruction of CBDT, was duty bound to refer the matter to TPO, having regard to the purpose of specialized cell created by the revenue department to deal with complicated and complex issue arising under the transfer pricing mechanism. This case itself is a good example as to how department can be hoodwinked unless case is properly examined by persons having knowledge of principles of transfer pricing…"

8.3) Taking into account the submission of the assessee which was effectively countered by the Revenue we are of the view that the decision to make a reference does not in any manner visit the assessee with any civil consequence. The decision is to be taken by the assessing officer having regard to the question whether it will be proper for the assessing officer himself to determine the arm's length price or it will be expedient to have it determined by the Transfer Pricing Officer. There is the safeguard of seeking prior approval of the Commissioner. Whether computation of the arm's length price is made by one officer

or by the other does not in any manner affect the assessee. Even though the assessing officer may in view of the latest amendment be bound by the computation by the Transfer Pricing Officer, the assessee has opportunity to challenge the same at higher levels as per hierarchy laid down in the Statute. There is nothing in section 92CA to suggest that the assessing officer should hear the assessee or record reasons before making a reference to the TPO nor is there anything in the section to suggest that the AO should ask the assessee whether he should himself proceed to determine the arm's length price or should involve the TPO for this purpose. The reference is a step in the collection of material which might be useful for making assessment. No violation of any civil rights of the assessee is involved here. Mere reference does not tantamount to any adverse assessment or use of adverse material. Moreover, by virtue of Board's Instruction No.3 of 2003 dated 20.5.2003 the CBDT decided that wherever the aggregate value of international transactions exceeds Rs.5 crores, the case should be picked up for scrutiny and reference u/s 92CA be made to the TPO. Thus, it is mandatory for the AO to refer all the cases wherever the aggregate value of international transactions is more than Rs.5 crores. These instructions are binding on all the AOs. In these cases, there is no need for the AO to make a prima facie opinion, except that he/she needs to examine the 3CEB report to see the aggregate value of international transactions. In the instant case, as the aggregate value of international transactions, based on 3CEB report filed by the taxpayer before the AO, exceeded Rs.5 crores, he referred the case to the TPO. Therefore, we see no infirmity in referring the matter to

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TPO without forming "a considered opinion". In the light of the above reasoning, the first legal point raised by the assessee, namely, the reference to the TPO by the AO without forming "a considered opinion" does not stand the test of law and cannot be sustained, and, therefore, this plea of the assessee is rejected. It is ordered accordingly.

II. The TPO adopted a non-statutory method for valuating IPR, which is a method not known to law.

8.4) The other legal grievance of the assessee being that the TPO has followed Excess Earning Method and not Comparable Uncontrolled Price Method (CUP) as there was no comparables available with reference to the IPR sold by the Assessee. It was submitted that the TPO wrongly relied on an exposure draft of the International Valuation Standard, which is a non-statutory body, and moreover, the draft is dated 2009, after the date of sale of Tally by the assessee in 2006. It is further submitted that the TPO determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR. However, as per section 92C of the Act, the ALP in relation to an international transaction has to be determined only with reference to the prescribed method.

8.5) When this was posed before the Revenue, it was explained by the Revenue that –

> *The IVSC is a well-recognised body for valuers, having been in existence for 25 years. It is recognized by several reputed agencies such as the UK Financial Services Authority, the*

Hongkong Securities and Futures Commission, the SEBI and the European Public Real Estate Association, among others.

Moreover, the valuation method adopted is not part of Exposure Draft, but the final Guidance Note No.34 (Para 4.20) released in February, 2010.

Sale of an IPR is not a routine transaction involving regular purchases and sales. It is a highly specialized process and valuation is the key. In this case, the taxpayer itself admits that there are no comparables. So, the TPO has used an established method [Excess Earnings Method] which is recognized widely. In fact, this method supplements the valuation which in effect is done by the CUP method with the final valuation determined being the comparable.

The TPO applied only CUP method. Excess Earnings Method is used only to arrive at the CUP price, the price at which the taxpayer would have sold in an uncontrolled condition. For applying CUP method, we require comparable uncontrolled transaction (CUT). As in this case, there is no external comparable price available in the public domain, as no independent entity sold any software product similar to that of the taxpayer. In such circumstances, indirect method is used to see the price that would have been arrived at, if the taxpayer sold the same Tally Software Product to an independent entity. All the factors that are considered by an independent party, when it sells similar software product are considered by the TPO while arriving at the comparable uncontrolled price. What is important is the arm's length standard. The methods are only tools to see the arm's length standard. The methods should not bind the TPO while arriving at the arm's length price. The main issue to be seen here is whether the TPO applied arm's length principle correctly. The decisions quoted by the taxpayer are not relevant as in those cases, the TPO did not apply any method in this case, and the TPO applied CUP method.

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With regard to the assessee's accusation that the arm's length price was determined without considering any comparable cases, for which, the Revenue came up with an answer that –

> ***(i) In the absence of uncontrolled independent comparable companies, the TPO tried to apply internal CUP method, wherein it is seen what is the price for which the same product would have been sold by the taxpayer to an independent entity. All the data considered by the TPO from FY 1999-2000 to 2004-05 is based on uncontrolled transactions between the taxpayer and independent entities. For the same reason, the TPO did not consider the data for the FY 2005-06, as there are substantial related party transactions during FY 2005-06 with its associated enterprises;***
>
> ***(ii) in fact, the Hon'ble Tribunal upheld that valuation method can be adopted to arrive at the CUP price in the case of*** **Intel Asia Electronics Inc. v. ADIT (2011-TII-14-ITAT-BANG-TP).**

8.6) Rival submissions are carefully considered. It is to be pointed out in this case the sale of IPR is not a routine transaction involving regular purchase and sale. The assessee itself admits that there is no comparable and the assessee has arrived at the sale consideration at Rs.38.50 crores based on its own valuation. The TPO has used an established method (Excess Earning Method) and this kind of valuation is upheld by the U.S Courts. In fact, this method supplements the valuation which in effect done by CUP method, with a final valuation determined being the comparable. The Bangalore Bench of the Tribunal in the case of Intel Asia Electronics Inc. v. ADIT cited

supra had upheld that the valuation method can be adopted to arrive at CUP price. The relevant finding of the Tribunal is extracted as under:

> ***"11. In the instant case, this is an isolated transaction of sale of then assessee's permanent establishment (PE) as a 'going concern' to the assessee's AE and, therefore, there are no similar transactions in an uncontrolled situation to compare with the controlled situation. However, the contentions of the assessee are justifiable that the actual market value of the asset has to be determined in an uncontrolled situation to determine the ALP in this case. In order to determine the actual market value, in the absence of any such identical transaction/transactions, as opted by the assessee, the valuation determined by the registered valuer could be the most appropriate means under CUP method."***

8.7) In the light of the above, it can be stated that the TPO had applied only the CUP method. The excess earning method is used only to arrive at the CUP price, the price at which the assessee would have sold in an uncontrolled condition. In the above circumstances, the second legal issue raised by the assessee - the TPO had adopted a method of valuation of IPR which is not a method prescribed under the Act or Rules – is dismissed.

9) **Let us now turn our attention to the issues raised by the assessee on merits.**

I. The assessee's grievance was that *the TPO should have considered the actual values of sale of software licenses during the future years as the data is available up-to March, 2010 and these figures are much lower than the figures adopted by the TPO.*

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When this was placed before the Revenue, the Revenue came up with a claim that –

> ***Firstly, when an intangible is sold, the risk of future income potential lies with the buyer ie., the AE. Secondly, when the Tally software Product was sold in 2006, there was no forecast, not even any iota doubt about global economic recession. That the subsequent dip in sales due to global economic slow down does not have relevance at the time of sale as this was not contemplated or comprehended at the time of sale. For example, if a mango orchard is sold to a buyer and there is a crop failure for the next two to three years due to heavy rains at the time of flowering, this risk is that of the buyer and in no way determines the price on the date of sale, as these events are not comprehended at the time of sale;***
>
> ***Further, even if the Hon'ble Tribunal considers actual revenues, the revenues of assessee company along cannot be considered as subsequent to the sale of Tally Software, the taxpayer is responsible for selling in Asia alone. As the taxpayer has distributors all over the world and these distributors are buying directly from the AE, after January, 2006, it was pleaded that the Bench be pleased to afford an opportunity to verify the figures submitted by the taxpayer.***

II. It was contended by the assessee that the TPO had erred in excluding license revenues for the period 1.4.2005 to 31.1.2006 in computing the value of the IPRs. Since the IPRs were sold on 31.1.2006, license revenues till the date of sale of IPRs have to be considered in determining the value of the IPRs.

It was countered by the Revenue that all the data considered by the TPO from FY 1999-2000 to 2004-05 is based on uncontrolled transactions between the taxpayer and independent entities. For the same reason, the TPO did not consider the data for the FY 2005-06, as there are substantial related party transactions during FY 2005-06 with its associated enterprises.

III. In respect of various alternative calculations suggested by the assessee for the valuation of the intangible, the Revenue submitted that -

> ***(i) the taxpayer considered the data from the FY 1999-2000 to FY 2005-06 whereas the TPO considered the data from the FY 1999-2000 to FY 2004-05 as the TPO consciously did not consider the data for the FY 2005-06 as in this year, there are substantial related party or controlled party transactions and, thus, the financials may not be reliable;***
>
> ***(ii) the taxpayer considered the inflation for the FY 2003-04 and 2004-05. But, the relevant inflation rate is the rate for the prospective or future years. The TPO considered the projected inflation rate based on the study carried by the RBI;***
>
> ***(iii) there are various other parameters that are tinkered by the taxpayer without giving any valid reasons; &***
>
> ***(iv) It was the plea of the Revenue that it may be afforded an opportunity to verify all the figures submitted by the taxpayer before any decision is taken on the quantum.***

10) We have duly considered the rival submissions and perused the materials on records. The TPO, by enumerating the EEM in

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his impugned order, the value of intangible asset was computed by applying the formula, namely:

The value of intangible asset = A-B-C-D-E = F

A = the future cash flows as reduced by the cost of improvement are discounted using WACC as discounting factor to arrive at total net present value of the cash flows of the business for the years from FY 2006-07 to FY 2011-12

B = Return of fixed assets: the discounted return on capital is computed based on average depreciation charge on sales for the period from FY 1999-2000 to 2004-05 and applying the same for the future years and discounted to the net present value of return on fixed assets;

C = Return on working capital: To consider the return on working capital, the average Working Capita levels as a percentage of sales have been computed for the years from FY 1999-00 to 2004-05. based on the past history, the same ratio is applied for the future years and discounted at the above discount rate [WACC] to arrive at the present value of working capital requirements. The SBI's PLR rate for short term working capital loans for the FY 2005-06 at 10.25% per annum is considered as return on working capital. Based on the above rate, the return on net present value on working capital value has been arrived at.

D = Return on human capital: The average employee cost as percentage of sales for the FY 1999-2000 to FY2004-05 has been considered and

applied for future years to arrive at the estimated cost of human capital. Such exercise is done for the future years from FY2006-07 to 2011-1d2. The said cost of human capital is discounted to the present value using the above discounting factor (WACC) for each of the future years.

The value of intangible assets sold = Net discounted cash flow after considering the cost of improvement (A) – return on fixed assets(B) – return on working capital (C)-return on human capital (D).

Net discounted cash flow after considering the cost of improvement (A)	Rs.666,92,37,810
Less: Return on fixed assets	100,27,51,104
Return on working capital(C)	57,32,27,882
Return on Human Capital (D)	7,86,25,072
The value of intangible	Rs.501,46,33,752

Price received vis-à-vis the arms Length Price:

The consideration received by the taxpayer = Rs.11,81,03,800/- (sale of intellectual property rights as per the agreement dated 31.3.2006)+Rs.26,69,43,026/- (expenditure incurred by the taxpayer on development of Tally ascent software during the period 1.4.2005to 31.1.2006 reimbursed by the AE). Thus, the total payments by the AE towards the purchase of the IPR were Rs.38,50-,46,826/-. The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length price as under:

Arms Length price as arrived at	**Rs.501,46,33,752**
Price shown in the international transactions	**38,50,46,826**
Short fall being adjustment u/s 92CA	**Rs.462,95,86,926**

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Total adjustment arrived at Rs.466,47,93,251/- has been brought down to Rs.260,63,921,602/- as per revised valuation dated: 23.9.2010 at the instance of DRP. Since there were, admittedly, no comparables available with reference to the IPR sold by the assessee, the TPO had determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR.

10.1) The DRP initially rejected the TPO's conclusion in arriving at the adjustment of Rs.466.47 crores. On being directed by the DRP on the basis of the assessee's strong objection, the TPO came up with a revised valuation report which suggests that the adjustment to be made at Rs.222.13 crores. As the DRP was unable to bring the warring groups [as the Ld. TPO as well as the Ld. AR have disagreed to narrow down their differences to the revised valuation report of the TPO] to fore, it came up with a via media, according to which, the assessee was asked to submit its own valuation of the IPR. The assessee had arrived at the value on first method at Rs.40.42 crores and by a second method at Rs.64.05 crores with a fervent submission to adopt Rs.52.23 crores being average of the first and second methods which was, however, not found favour with the Revenue. Strangely, the DRP upheld the revised valuation report of the Ld. TPO by terming the valuation reports furnished by the assessee as **'extremely perfunctory'** with no illustration as to how the report of the assessee had become as such. The adjustment to be made on the basis of the revised working of the TPO was opted at Rs.222.13 crores as against Rs.466.47 crores adopted in the draft assessment order. To demonstrate further the

genuineness in the transaction, the assessee, during the course of hearing, came up with alternative computation as detailed in its submission cited supra. According to various method adopted, the arm's length price was less than what was the price received as admitted by the assessee at Rs.38.50 crores. It is true that it is difficult to value business more particularly to value a closely-held concern because each company has its own unique characteristics. Often, consideration has to be given to the future profits the company will be able to earn. The valuation may be influenced by the reason for it. For example, a different approach may be appropriate for divorce litigation compared to the price to pay for a targeted company compared to valuation for estate tax purposes. Thus, valuation depends on the purpose at hand. The valuation process is an art and not a science, since everyone's perception is slightly different. In litigation matters, the valuation method selected should be logically consistent, reasonable, cost-effective and simply explained.

10.2) The excess earning method is the method that is adopted by the TPO. We see no infirmity in adoption of this method for the simple reason that the relevant data is available with reasonable accuracy, closing in on real valuation of a software product. This valuation is upheld by the US courts while arriving at the sale value of a software product. Further, the valuation under the method mainly revolves around discounted cash flow (DCF) analysis which is known to economists for the times immemorial. Thus, the TPO used a reasonable well accepted method of valuation of intangibles including software

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products and accepted by courts in the countries like in USA, where the TP regime is well developed. At the risk of repetition, the excess earning method followed by the TPO is summarized as under:-

- The excess earning method determines the value of an intangible asset as the present value of the cash flows attributable to the subject. Intangible asset after excluding the proportion of the cash flows that are attributable to the other assets.
- The method involves forecasting the cash flows expected to arise from the business or the businesses that uses the subject Intangible.
- From the above forecast of the cash flows a deduction is made in respect of the contribution of the cash flow that is made by the assets tangible or intangible and the financials, other than the subject intangible asset.
- Forecast cash flows are brought to the capital value by applying the present value techniques and the suitable discount rates.
- The contributory asset charges are derived as follows:-

    1. For the return on the tangible asset, a notional depreciation charge is used as a surrogate for the return of the asset.
    2. A fair return on the working capital is discounted to the present value.
    3. Return on the work force is determined as a return changed on the fair value of the work force asset. Work force asset is usually valued using the work cost approach.
    4. A fair return on the other Intangible assets by the way of hypothetical royalty rate that would be changed to lease the asset.

For discussing the net present value (NPV), a uniform discount rate is used to arrive at the discounted cash flow. Often the weighted average cost of the capital (WACC) is used as the discounting factor.

The WACC is the weighted average of the cost of the debt and the cost of the equity.

In the case of the taxpayer, there is no active market in identical or near similar intangible asset. Therefore, the IPR sold by the taxpayer is to be valued primarily using an income capitalization method. In the Income Capitalization method, the TPO used the Excess Earnings Method (EEM) as described above. This is because qualitative and subjective adjustments are required to apply the transaction data from the non-identical assets, which adversely affect reliability.

To sum up, the intangibles i.e. the sale of the *Tally* software products along with its copyright and trade marks are valued by the following steps under Excess Earnings Method:

Step 1 : Estimating future turnover till 2012 based on the past performance as well as the data available in the public domain.

Step 2 : The cash flows (EBIDTA – earning before interest-tax, depreciation and amortization) are estimated in the future years based on the performance of the taxpayer in terms of EBIDTA to sales from F.Y. 1999-2000 to F.Y. 2004-2005. The data for the FY 2005-2006 was not considered as the intangibles is transferred during the year and there are related party transactions during the year which may initiate the reliability of the data.

Step 3 : The future cash flow are discounted to the present value by using a constant discounting factor which is WACC

WACC = We Ce + Wd Cd
Where We = Weight of Equity
Ce = Cost of Equity
We = Weight of Debt

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Cd = Cost of Debt
The Ce = Rf + BxRf
Where Rf = Risk Free Return or Return on long term Government Bonds
B = B of the taxpayer

As the taxpayer is not a listed company, the B of a similar company, Sankhya Infotech Ltd. has been considered. This company is in development and sale of software products for aviation industry. B has been taken from BSE Index which is 0.58.

Rp = Risk Premium of the Index (that is BSI Index)
= 8.8 (as verified from the public sources).
Cost of Debt = prevalent PI R rate of SBI (10.57%)
Equity = average of paid of share capital and reserves & surpluses
Debt = average of long term borrowings (secured loans).

Step 4: PRESENT VALUE OF IMPROVEMENTS

The expected cost of improvement in the future years is computed based on the past expenditure on R&D on capital account. As the R&D on revenue account stands already considers while computing the cash flows in terms of EBIDA as the taxpayer is charging the entire R&D expenditure on revenue account to the Profit & Loss Account. Based on the average cost of improvement, the cost of improvement for the future years from FY 2006-07 to FY 2011-12 are estimated and discounted by the above discounting factor (WACC) to arrive at the present value of cost of improvement.

Step 5 : (A) The above future cash flows as reduced by the cost of improvement are discounted using WACC as discounting factor to arrive at total net present value of the cash flows of the business for the years from FY 2006-07 to FY 2011-12.

Step 6 : (B) RETURN ON FIXED ASSETS

The discounted return on capital is computed based on average depreciation charge on sales for the period from FY 1999-2000 to FY 2004-05 and applying the same for the future years and discounted to the net present value of return on fixed assets.

Step 7 : (C) RETURN ON WORKING CAPITAL

To consider the return on working capital, the average working capital levels as a percentage of sales have been computed for the years from FY 1999-2000 to FY 2004-05. Based on the past history, the same ratio is applied for the future years and discounted at the above discount rate (WACC) to arrive at the present value of working capital requirements. The State Bank of India's PLR rate for short term working capital loans for the FY 2005-06 at 10.25% per annum is considered as return on working capital. Based on the above rate, the return on net present value on working capital value has been arrived at.

Step 8 : (D) RETURN ON HUMAN CAPITAL

The average employee cost as percentage of sales for the FY 1999-2000 to FY 2004-05 has been considered and applied for future years to arrive at the estimated cost of human capital. Such exercise is done for the future years from FY

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> 2006-07 to 2011-12. The said cost of human capital is discounted to the present value using the above discounting factor (WACC) for each of the future years.
>
> To consider the return on human capital, various article have been read. As for the Annual Report of the Infosys Technology Ltd. for the FY 2005-06, the company earned 5% return on its human capital. The same return has been applied in the case of the tax payer on the above arrived value of human capial.
>
> Thus, the value of intangible asset is computed as under:
>
> The value of intangible asset = A-B-C-D-E = F
>
> The arm's length price of the intangible asset is therefore F as computed above.

We agree with the TPO in adopting the above method and having concluded in the preceding paragraph that the excess earning method adopted by the TPO to arrive at the ALP is correct, we reject the assessee's contention that the ALP should be computed based on actual sales and not projection adopted by TPO. The reasons for rejecting the above contention of the assessee are as follows:

i) When an intangible is sold, the risk of future income potential lie with the buyer.

ii) When tally software was sold in 2006, there was no forecast about the global economy recession. The subsequent dip in sale due to global economic slow down does not have relevance at the time of sale as this is not contemplated or comprehended at the time of sale.

iii) The essence of excess earning method is to project the future revenue earning, based on past year data.

10.3) However, we disagree with certain figures adopted by the TPO in arriving at the value of ALP of the sale of IPR. To arrive at the ALP the TPO had taken the actual total operating revenue for the assessment years 2000-01 to 2005-06 and based on the same, he had computed CAGR at 20.39% and the projected expected revenue for the period from the AYs 2007-08 to 2011-12. The TPO had ignored the actual facts that the revenues for the AYs 2004-05 and 2006-07 were dipped, instead, the TPO assumed theoretically that the sales will keep growing. The IPR was sold only on 31.1.2006, therefore, the sales for ten months i.e., from 1.4.2005 to the date of sale should have been included for computing the future revenues. This has been ignored by the TPO. The TPO in his remand report had stated that the current year [AY 2006-07] data was not taken since the same involved the related party transactions and the transaction involving IPR took place this year. This stand of the TPO was hotly contested by the assessee that the sales of tally licenses were to third parties and not to related parties as portrayed by the TPO. It was, further, claimed by the assessee that what was sold by assessee was IPR which generates license revenues and, thus, to value IPR what needs to be considered was revenue from Tally licenses which were sold to third parties. The other related party transactions have no relevance factors. The situation in the AY 2006-07 was similar to situation in all the years considered by the TPO. Therefore, it was claimed by the assessee that

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the reasoning of the TPO was baseless. Refuting the TPO's reasoning that the transaction involving IPR took place in this year and, therefore, current year data was excluded, the assessee submitted that since the sale was in the current year, it was more so important to consider the current year's sales which, according to the assessee, in consonance with the provisions of rule 10B (4) which mandate use of current year's data. It was, therefore, contended by the assessee that the current year data should have been used to estimate future revenues. There is force in the contention of the assessee that the sale data for the period from April, 2005 to Jan 2006 was vital to arrive at correct projection which reflects the true earning potential of the IPR at the time of sale. Therefore, in the course of this order, we are directing the TPO to include the figure for AY 2006-07 for arriving at the value of ALP.

10.4) In the AY 2005-06, it was the claim of the assessee that there has been a sale return of Rs. 111.04 crores. The sale return has to be reduced while calculating CAGR which is, in our view, reasonable and justifiable. This vital fact has been given a go-by. The TPO had considered the sales for the AY 2005-06 at Rs.198.15 crores which was termed by the TPO as the base for computing CAGR and future revenues. It was true that there was a substantial upward trend in the turnover during the AY 2005-06, however, in the immediately preceding and succeeding AYs there was plunge in the turnover [source: Figures supplied by the assessee]. This vital fact should have been taken cognizance of while computing CAGR and estimating future

revenues by the TPO. During the course of hearing, it was submitted that with the introduction of VAT across the country w.e.f. 1.4.2005, more traders were required to automated systems to support the increased work and, thus, distributors were forced to off-take large quantities of software package which was accounted for as turnover in the assessee's books. However, in the last three months of the AY 2005-06, the sales accounted for were almost 100% not received and, in fact, 95% of sales for 2005-06 were in the month of March and the debtor outstanding as on 31.3.2005 was to the tune of Rs.197.14 crores. Though the assessee's accounted revenue increased in the AY 2005-06, the dealers could not sell the whole stocks which were dumped by the assessee with them in anticipation of favourable climate in sales. There was a sale return to the tune of Rs.111.04 crores pertaining to the sales made in AY 2005-06. It was claimed that the turnover as reported did not materialize. These facts have not been taken care of by the TPO while assuming the future turnover projection. It was, further, contended that the TPO's contention that he was very conservative and taken CAGR at 20.39% instead of 90.80% that the lower CAGR takes care of all possible effects on future cash flows was termed by the assessee a mere assumption and presumption on the part of the TPO and nothing else. As stated earlier, we are of the view that sale return, as arrived above, has to be reduced while calculating CAGR. Further, we add that the actual CAGR is to be considered for projection without any discount.

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10.5) We also find prima facie flaw in the calculation of discount factor given by the TPO. The TPO has considered 3 companies as comparable to the assessee's segment of distribution of products. These companies are Lifetree Convergence Limited, Exensys Software Solutions Limited and Sankhya Infotech Limited (page 139 of the TP order). Out of these three, only Sankhya Infotech's Beta has been considered. Why the other two companies are not considered is not clear. We are of the view that Beta should be computed after considering all the three companies. The average Beta of the three companies, it was submitted, would be 1 and the computation of Beta is furnished at page 408 to 414 of the paper book (submitted by the assessee). This computation needs to be examined by the TPO. While calculating the working capital, the TPO has not considered the cash and bank balances and other current assets (except inter-corporate deposits) and provisions. Further, it is directed that the sale returns of Rs.111.04 crores has to be reduced from the sundry debtors while calculating the working capital. We are of the view the same should also be considered while computing working capital ratio.

11) Taking into account the rival submissions, diligent perusal of the relevant records and also the documentary evidences adduced by either party, the TPO is directed to recalculate the ALP keeping in view the following specific directions of this Bench, namely:

I. Method of valuation of ALP:

(i) Considering the nature of transaction and in the absence of uncontrolled independent comparable companies, we are of the considered view that the Excess Earning Method [EEM] adopted by the TPO in the present circumstance is reasonable and, therefore, he is directed to adopt the same EEM while recalculating the ALP;

(ii) The reason for adopting EEM method that it is only an internal CUP method, wherein, it is seen what is the price for which the same product would have been sold by the assessee to an independent entity. This price also reflects the price at which the assessee would have sold in an uncontrolled condition, but, as there were no comparable prices available in the public domain for sale of IPR produce similar to that of the assessee, this EEM is used to determine the price that would have been arrived at, if the assessee sold the IPR to an independent entity.

While calculating the ALP under EEM, the TPO is directed to adhere the following steps, namely:

II. Estimating future turnover based on the past performance:

(i) with reference to the actual operating revenue from the AY 1999-2000 to 2006-07, the sale return of Rs.111.04 crores for the AY 2005-06 has to be reduced from the operating revenue and only the net has to be taken as this is the correct accounting standard to be followed for arriving at CAGR. As can be seen from the records, the revenue for the AY 2005-06 looks abnormal compared to other AYs and

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there was also revenue to the extent of Rs.111.04 crores which did not materialize due to distributors being not able to sell the stocks which was forced on them in a greater quantity with an anticipation of good revenues due to introduction of VAT. In the same calculation, the revenue for the year 2006-07 has to be adopted. As the date of valuation of IPR was on 31.1.2006, the actual revenues upto January, 2006 has to be taken and the next two months will have to be projected based on the performance of the previous ten months. As the assessee had sold only IPR and the calculation of revenues are from Tally Licenses which were sold to third parties, the sale of IPR to a related party transaction has no relevance for this sale of Tally license. Hence, the current year data i.e., AY 2006-07 has to be included as they relate to third party transactions and the projections have to be made for the future years based on the revenues of AY 2006-07 which is also in accordance with the provisions of rule 10B(iv) which mandate the use of current year data. The projection has to be made for next six years which has rightly been adopted by the TPO. Further, the assessee's contention to adopt the actual revenues for the future years which are available now cannot be accepted now for a simple reason that the ALP was calculated on the date of sale which was in January, 2006 itself and also under EEM future revenues will be projected based on the previous year data keeping the current year's data as the base which has got no relevance on the actual revenues during the future years. We also make it clear that the actual CAGR shall be adopted by the TPO without any discount.

(ii) **Estimation of future cash flows:** We are in agreement with the method adopted by the TPO in estimating the cash flows except that the revenues for the AY 2006-07 has to be considered and is to be taken as the base year for future projection of revenue for the reasons recorded supra [Para (i)].

(iii) **Estimation of discounted future cash flows**: We are in total agreement with the TPO in estimating of **discounted** future cash flows except in calculation of BETA where the TPO, even after having considered three companies as comparable to the assessee's segment of distribution of products, had wrongly took only one company's Beta which, in our considered view, was not reasonable. Therefore, an average of three companies' beta has to be taken for calculation.

(iv) present value of improvement: we agree with the TPO on this score.

(v) Future cash flows: We agree with the TPO on this point.

(vi) Return on fixed assets: We agree with the stand of the TPO on this issue.

(vii) Return on working capital: we do agree with the TPO's working except that the sale return of Rs.111.04 crores has to be reduced from sundry debtors for the AY 2005-06 and the cash, bank balances and other current assets have to be considered for calculation of '**current assets**' for all the years.

(viii) Return on human capital: We are in agreement with the TPO's working.

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After following the above formulae, the TPO should calculate the ALP accordingly. If the amount so arrived at were to be higher than the total actual consideration [Rs.38.50 crores] received, the TPO should adopt the higher price arrived at.

With regard to the calculation of IPR as on 31.1.2006 as compared to repurchase of IPR by the assessee on **30.9.2008** for a sum of Rs.53,67,52,505/- [source: P 385 of PB AR], we are in agreement with the contention of the Revenue that the value paid by the assessee to AE for subsequent purchase of the same software product cannot be considered as uncontrolled transaction as the said transaction was between two associated enterprises. Further, as there was a long gap of almost three years between the two transactions; we are of the view that the point raised by the assessee for comparison is unreasonable due to the subsequent value additions made to the IPR and discounting factors.

12. In view of the above, the appeal filed by the assessee is partly allowed for statistical purposes.

The order pronounced on Monday, the 26th day of September, 2011 at Bangalore.

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

Asst. Registrar, ITAT, Bangalore.

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