

IN THE INCOME TAX APPELLATE TRIBUNAL  
MUMBAI BENCH 'J' MUMBAI

**BEFORE SHRI D.K. AGRAWAL, JUDICIAL MEMBER AND  
SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER**

ITA No.3514/Mum/2010  
Assessment Year-2005-06

The ACIT-7(2), Aayakar Bhavan, Mumbai	Vs.	M/s. Sonata Software Ltd., 208, T.V. Indl Estate, S.K. Ahire Marg, Worli, Mumbai-400 025  PAN-AABCS 8459D
(Appellant)		(Respondent)

Appellant by: Shri Ajeet Kumar  
Shri Pragati Kumar  
Respondent by: Shri Vijay Mehta

Date of Hearing :22.08.2012  
Date of pronouncement:29.8.2012

**ORDER**

**PER N.K. BILLAIYA, AM:**

This appeal by the Revenue is directed against the order of Ld. CIT(A)-15 Mumbai dt.12.2.2010 for assessment year 2005-06.

2. The Revenue has raised following substantive grounds of appeal:

"1. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in holding that the assessee is eligible for deduction u/s. 10A of the I.T. Act when the assessee company has been formed by hiving off the Sonata Software Division a part of the erstwhile company, Indian Organic Chemicals Ltd. from an already*

*existing company and other conditions laid down u/s. 10A were also not satisfied.*

2. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in holding that the assessee is eligible to include service charges received from M/s. Sonata Information & Technology Ltd. at Rs. 8,65,99,355/- while computing deduction u/s. 10A.*
3. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in allowing the claim of unbilled software income of Rs. 2,92,82,531/-.*
4. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in holding that the assessee is eligible for disallowance of Rs. 8,02,72,632/- on account of transfer pricing adjustment in respect of International transaction entered into with Associated Enterprise Offshore Digital Service Inc. (ODSI)“*

3. At the very outset, the Ld. Counsel for the assessee submitted that issues involved in ground No. 1,2 & 3 of the present appeal have already been decided in favour of the assessee by the Tribunal in earlier years.

4. For ground No. 1, the Ld. Counsel for the assessee pointed out that a similar issue had arising since assessment year 1998-99 to 2004-05. Referring to the judgement of the Tribunal in assessee's own case in ITA Nos. 495 & 496/M/02 for assessment years 1998-99 and 1999-2000 in which the Tribunal has categorically held that the assessee is eligible for deduction u/s. 10A of the Act. Same view has been consistently followed by the Tribunal during assessment year 2004-05.

5. We have carefully considered the orders referred by the Counsel and find that the Tribunal in earlier years have held that assessee is eligible for deduction u/s. 10A of the Act. The Ld. Departmental Representative had not brought anything contrary on records. Respectfully following the finding of the Tribunal in earlier years, we confirm the order of the Ld. CIT(A) on this ground. Ground No. 1 is accordingly dismissed.

6. Ground No. 2 relates to inclusion of service charges received by the assessee from M/s. Sonata Information & Technology Ltd. which the assessee has included while computing deduction u/s. 10A of the Act.

7. The Ld. Counsel for the assessee once again pointed out that this issue has been decided by the Tribunal in assessee's own case in earlier years starting from assessment year 1998-99 till 2004-05. We find that the Tribunal in ITA No. 495-496/M/02 in assessee's own case for A.Y. 1998-99 and 1999-2000 has held that service charges received from SITL were eligible for inclusion while computing deduction u/s. 10A. The same view has been followed by the Tribunal for subsequent assessment years till A.Y. 2004-05. We find that the Ld. CIT(A) has allowed assessee's appeal following the finding of the Tribunal. The Ld. DR could not controvert by bringing any material on record. Respectfully following the decision of the Tribunal in assessee's own case, order of the Ld. CIT(A) is confirmed. Ground No. 2 is accordingly dismissed.

8. Ground No. 3 relates to the allowance of the claim of unbilled software income of Rs. 2,92,82,531/-. The Ld. Counsel for the assessee pointed out that similar issue had come up before the Tribunal in assessment year 2002-03 to 2004-05.

9. We have perused the orders of the Tribunal in ITA No. 2289 & 4337/M/06 pertaining to assessment year 2002-03 & 2003-04. We find that the Tribunal has decided the issue in favour of the assessee. We also find that the Ld. CIT(A) has allowed the appeal on this ground following the decision of the Tribunal in earlier years. Respectfully following the decision of the Tribunal and also finding that no contrary material has been brought on record by the Ld. DR, finding of the Ld. CIT(A) are confirmed. Ground No. 3 is accordingly dismissed.

10. Ground No. 4 relates to the TP adjustment in respect of International transaction entered into with Associated Enterprise Offshore Digital Service Inc (ODSI).

11. Briefly stated the facts of the case are that during the course of the assessment proceedings, the Assessing Officer noticed that the assessee has entered into various International transaction in the previous year relevant to the assessment year under consideration. The AO found that all these transactions are detailed in the audit report in Form No. 3CEB filed with return of income. Invoking the provisions of Sec. 92CA(1). The AO referred the matter to the Transfer Pricing Officer (TPO) for determining Arm's Length Price in relation to international transactions. After receiving the report of the TPO, the AO noticed that the TPO has not accepted the ALP of international transaction relating to the transaction of the assessee with ODSI. The TPO has made an adjustment of Rs. 8,02,72,632/-. The AO followed the order of the TPO and made a total adjustment of Rs. 8,02,72,632/- with the income of the assessee on account of Transfer pricing.

12. Before the Ld. CIT(A), the assessee strongly objected to the adjustments made by the TPO. The main contention of the assessee was that the assessee has rightly adopted the cost plus method (CPM) for determining the ALP in respect of the transaction relating to the service by the assessee to ODSI. It was further pointed out before the Ld. CIT(A) that the TPO has grossly erred in adopting transactional Net Margin Method ("TNMM") for determining the ALP. It was also pointed out by the assessee that the comparables adopted for TNMM were not appropriate. It was also contended that even if TNMM is taken as the most appropriate method, the operating profit of the assessee to total cost in respect of services rendered to ODSI was 33.02% which was higher than the ratio of operating profit to total cost of comparables used by the AO at 27.31% for determining the ALP.

13. After considering the facts and submissions of the assessee, the Ld. CIT(A) came to the conclusion that no adjustment is required as the gross margin earned by the assessee in respect of services to OSDI was higher as compared to the amount charged to the unrelated parties and accordingly directed the AO to delete the addition made on account of Transfer Pricing adjustment of Rs. 8,02,72,632/-.

14. Aggrieved by this finding of the Ld. CIT(A), Revenue is in appeal before us. The Ld. Departmental Representatives supporting the findings of the TPO argued that on the facts of the case TNMM Method is the most appropriate method for determining the ALP in respect of the transaction entered by the assessee with its AE ODSI. The Ld. DR further submitted that CPM method adopted by the assessee was not appropriate on the facts of the case. Ld. DR submitted that the TPO has rightly pointed out that this method (CPM) was not found suitable as these averages did not factor in the difference in the skill sets/level of employees engaged in performing work for the AE and non AE. The Ld. DR concluded that the adjustment made by the TPO deserved to be confirmed.

15. The Ld. Counsel for the assessee pointed out that the law does not provide any hierarchy of method to be adopted in the determination of ALP. He further pointed out that on the same set of facts for A.Y. 2004-05 and 2006-07, no adjustments have been made in the case of the assessee. Therefore, the Revenue cannot take a different view for the year under consideration on the same set of facts. For this proposition, the Ld. Counsel relied upon the decision of the Hon'ble Supreme Court in the case of Radha Soami Satsang 193 ITR 321. The Ld. Counsel submitted that internal comparables are more reliable than the external comparables and therefore CUP/CPM method are more appropriate as they are direct and use internal data for comparison. The Ld. Counsel relied upon the decision of the Tribunal in the case of DCIT Vs MSS India (P) Ltd. 32 SOT 132 (Pune), Sapient Corpn.

Pvt. Ltd. VS DCIT in ITA No. 5263/Del/2010, Adobe Systems India (P) Ltd. Vs ACIT 44 SOT 49 (Del). The Ld. Counsel further pointed out that the comparables used by the TPO for the application of TNMM method, the TPO has included 5 such companies where either two case of super profit or super turnover. Specifically pointing out the Ld. Counsel submitted that at item No. 17 & 18 which relates to Satyam Computers and Infosys, the sales are to the tune of Rs. 3464.22 and 6859.66 millions and the operating profit to the total cost of these two companies are 30.31 and 43.49 respectively. The Ld. Counsel submitted that such high turnover companies cannot be taken as comparables. Moreover, the financial statements of Satyam Computers have been held to be not reliable for considering the comparables. For this proposition, the Ld. Counsel relied upon the decision of ITAT Bangalore Bench in ITA No. 398 and 418/Bang/08 wherein the Tribunal has directed that Satyam Computer services should not be taken as a comparable company to arrive at ALP. The Ld. Counsel further pointed out that if these high turnover and high profit company are removed from the comparables, list adopted by the TPO the average would come to the same as shown by the assessee in its international transaction. The Ld. Counsel finally concluded that the ratio of operating profit to the total cost in respect of services rendered to ODSI comes to 33.02% which is higher than the ratio of operating profit to the total cost of comparables used by the AO at 27.31% for determining the ALP. Therefore no TP adjustments are required on the facts of the case.

16. We have considered the rival submissions and carefully perused the orders of the lower authorities and the Paper Book submitted by the assessee. We find that the TPO has not assigned any valid reason for rejecting the method adopted by the assessee for the determination of ALP with its transaction with ODSI. Where an assessee has followed one of standard methods of determining ALP, such a method cannot be discarded in preference over transactional profit methods, unless revenue authorities are able to demonstrate fallacies in application of standard methods. The transaction profit method should be applied only when standard or traditional

methods are incapable of being properly applied in the facts of the case because while traditional methods seeks to compute the prices at which international transactions would normally be entered into by the associated enterprises but for their interdependences and relationships, transactional profit methods seek to compute the profits that the tested party would normally earn on such transactions with unrelated parties. For this proposition, we derive support from the decision of ITAT, Pune Bench in the case of ACIT, Circle 2, Nashik Vs MSS India (P) Ltd. (2009) 32 SOT 132. While there is no particular order or priority of methods which the assessee must follow and no method can invariably be considered to be more reliable than others, TNMM and Profit Split Method (PSM) are treated as methods of last resort which are pressed into service only when the standard methods i.e. CUP Resale Price Method(RPM) and Cost Plus Method (CPM) cannot be reasonably applied. We find substance in the argument of the Counsel that on the facts of the case CUP/CPM adopted by the assessee is the most appropriate method. It would not be out of place to refer to the 19 comparables used by the TPO.

S.No.	Company name	Financial year	Sales	OP to total cost
1.	Bodhtree Consulting Ltd.	200503	3.87	24.85
2.	Akshay Software Technologies Ltd.	200503	5.89	7.72
3.	Lanco Global Systems Ltd.	200503	6.11	13.78
4.	Expenys Software Solutions Ltd.	200503	7.3	70.68
5.	Sankhya Infotech Ltd.	200503	12.99	27.35
6.	Sasken Network Systems ltd.	200503	14.44	16.52
7.	Gebbs Infotech Ltd.	200503	14.74	16.52
8.	VJIL Consulting Ltd.	200503	15.6	6.68
9.	Four Soft Ltd.	200503	15.94	24.7

10.	Thirdware Solution Ltd.	200503	29.11	66.11
11.	Geometric Software Solutions Co. Ltd.	200503	95.44	20.34
12.	Tata Elxsi Ltd. (Seg)	200503	146.46	24.35
13.	Visual Soft Technologies Ltd(Seg)	200503	185.43	23.52
14.	Sasken Communication Technolgies Ltd (Seg)	200503	189.05	14.42
15.	Flextronics (seg)	200503	457.45	32.19
16.	L&T Infotech Ltd.	200503	562.45	11.72
17.	Satyam	200503	3464.22	30.31
18.	Infosys	200503	6859.66	43.49
19.	Compulink Systems Ltd.	200503	12.86	43.62
			Avg.	27.31

17. A clause reading of the above chart shows that at item No. 4 on a turnover of 7.3 Million the OPM is 70.68. Similarly at item No. 10 on a turnover of 29.11 Million, the OPM is 66.11 and at item No. 17 as pointed out earlier in the case of Satyam, the financial results are not reliable and therefore it should be excluded in the list of comparables. Similarly in the case of Infosys cannot be considered with the assessee as it would be a comparison between a Banyan tree and a small plant and it would be like Ferrari car with Maruti 800. The Delhi Bench has taken a similar view in ITA No. 3856/Del/2010 in the case of Agnity India Technologies Pvt. Ltd. wherein on similar facts, the Tribunal has directed to exclude Infosys from the list of comparables. The ITAT Delhi Bench 'A' in the case of Adobe Systems India (P) Ltd. Vs ACIT (supra) has accepted the objections of the assessee to exclude super normal profit companies from the list of comparables. Considering the above decisions of the Tribunal, if we exclude these four companies from the list of comparables and recompute the OPM from the list of comparables adopted by the TPO, the average OPM comes to 18.91 whereas the Net Profit Margin of the assessee is 18.11%. Thus considering the facts of the case from all the possible angles, we do not find any reason



for TP adjustment, nor we find any reason to tinker with the findings of the CIT(A), accordingly order of the Ld. CIT(A) is confirmed.

Order pronounced on this 29<sup>th</sup> day of August, 2012.

***Sd/-***

(D.K. AGRAWAL)  
Judicial Member

***Sd/-***

(N.K. BILLAIYA)  
Accountant Member

Mumbai, Dated 29<sup>th</sup> August, 2012  
Rj

*Copy to :*

- 1. The Appellant*
  - 2. The Respondent*
  - 3. The CIT-concerned*
  - 4. The CIT(A)-concerned*
  - 5. The DR 'J' Bench*
- True Copy*

*By Order*

*Asstt. Registrar, I.T.A.T, Mumbai*