

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH: 'T': NEW DELHI**

**BEFORE SHRI R.S. SYAL, ACCOUNTANT MEMBER  
AND  
SHRI A.T. VARKEY, JUDICIAL MEMBER**

**ITA No. 2423/Del/2010  
Assessment Year: 2003-04**

Mentor Graphics (Noida) P. Ltd.,  
Building-A, Logix Techno Park  
Plot no. 5, Sector 127, Noida  
(PAN:AABCM5494Q)  
(Appellant)

Vs. Dy. Commissioner of Income  
Tax, Circle-6(1), New Delhi  
(Respondent)

And

**ITA No. 2847/Del/2010  
Assessment Year: 2003-04**

Dy. Commissioner of Income  
Tax, Circle-6(1), New Delhi  
(Appellant)

Vs. Mentor Graphics (Noida) P. Ltd.,  
Building-A, Logix Techno Park,  
Plot no. 5, Sector 127, Noida  
(PAN:AABCM5494Q)  
(Respondent)

Assessee by : S/sh. Rohit Tiwari & Ravi Sharma, CAs  
Department by: Sh. Judy James, Standing Counsel for DR

**ORDER**

**PER R.S. SYAL, AM :**

These two cross appeals, one by the assessee and other by the Revenue, arise out of the order passed by the CIT(A) on 22.04.2010 in relation to the assessment year 2003-04.

2. The only issue pressed by the learned AR from the assessee's appeal is against the inclusion of certain companies in the list of comparables.

3. Briefly stated the facts of the case are that the assessee Mentor Graphics (NOIDA) P. Ltd., formerly known as IKOS India Pvt. Ltd., is a wholly owned subsidiary of IKOS Systems Inc. USA, which, in turn, was acquired by Mentor Graphics Corporation, USA during the year relevant to the assessment year under consideration. The assessee reported two international transactions, namely, "Software Development Services Rendered" with value of Rs. 11,17,29,489/- and "Marketing Support Services Rendered" with value of Rs. 1,33,72,483/-. Insofar as the segment of "Software development services" is concerned, the assessee provided software development services only to its AEs and not to the third parties. Such software development services were utilized by its parent company, which is engaged in the development of software products for chip designing. Apart from this, the assessee also rendered "Marketing Support Services" to IKOS, USA by securing clients in India for its foreign entity. The assessee is a contract service provider who was remunerated by its AEs at cost plus 13% in respect of both the above types of services. The Transactional Net Margin Method (TNMM) was used by the assessee as a most appropriate method with the Profit Level Indicator (PLI) of Operating profit to Sales. Four companies were chosen by it as comparables which have been listed on page 3 of the order of the Transfer Pricing Officer (TPO). The arithmetic

mean of the Profit ratio of these four companies was computed at 5.50% against the assessee's PLI of 9.75%. That is how, the assessee demonstrated that its international transactions were at Arm's Length Price (ALP). The TPO changed the PLI to Operating profit/ Total cost (OP/TC) by accepting the TNMM as the most appropriate method. Not satisfied with assessee's selection of comparables and the use of multiple year data, the TPO searched a new set of comparables with current year's data alone. After entertaining objections from the side of the assessee, the TPO shortlisted 16 companies as comparable which have been tabulated on page 9 of his order. The arithmetic mean of their OP/TC at 22.30% was found to be breaching  $\pm 5\%$  margin of the assessee's OP/TC. This resulted into transfer pricing adjustment of Rs. 1,34,64,448/-. The Assessing Officer made this addition. The learned CIT(A) accepted the TPO's version in entirety except treating Genesys International Corporation Ltd. as not comparable. Both the sides are in appeal on their respective stands.

4. We have heard the rival submissions and perused the relevant material on record. It is noticed that the only dispute pressed before us from the assessee's appeal is the inclusion of four companies in the list of comparables by the TPO. No other aspect, such as the application of OP/TC as PLI or the exclusion of some of the companies chosen by the assessee in its Transfer Pricing Study report or consideration of current year's data alone etc. has been challenged

before us. As such, we will confine ourselves only to examining the inclusion of certain companies in the list of comparables which have been agitated before us.

5. Before considering the comparability or otherwise of the companies assailed before us, it is paramount to consider the functional profile of the assessee company. We have noticed above that the assessee rendered not only Software development services but also Marketing support services to its AEs. The TPO has clubbed both the sets of international transactions and proceeded to determine their ALP by treating both of them as Software development services rendered in a combined manner. As the assessee has not challenged this aspect, we will also consider both these services in a combined manner as software development services, albeit we feel that these two ought to have been benchmarked separately.

6. The assessee entered into an Agreement with Mentor Graphics (Ireland) Ltd effective from 08.05.2002 under which it undertook to render `Development services to its AEs. A copy of the Agreement is available at pages 127 onwards of the paper book. `Development Services` in this Agreement have been defined to mean `all development activities concerning any of the Products, including but not limited to (i) development of new Products; and (ii) creation of improvements, updates, adaptations, translations or other modifications to existing Products or Products under development`. The expression `Products` has been defined in this Agreement to mean and include `all software products

which any Party or any Affiliate markets or intends to market and updates, enhancements, new versions and new releases thereof, other than "Specifically Excluded Products", if any, set forth in Exhibit Aö. From the above description of the work to be carried out by the assessee, it clearly emerges that the assessee is providing software development services to its AEs as a captive unit. With the above understanding of the functional profile of the assessee company, let us examine if the four companies under challenge are, in fact, comparable.

**(i) Aftex Infosys Ltd.**

7.1. The TPO included this company in the list of comparables with profit rate of 86.45%. The assessee objected to the inclusion of this company by contending through its letter dated 23.01.2006, a copy of which is available on pages 266 onwards of the paper book, that this company is a software-driven and internet product company that produces Personal Data Assistant (PDA) machine for Para-banking and Smart Card Machines which are used in public transportation. The assessee also contended that this company deals in software products having its own Intellectual Property Rights of the software products developed by it and hence is not comparable. The TPO in a generalized and sweeping manner brushed aside the assessee's objections given for this company and others without separately discussing as to how a particular company was not incomparable as per the assessee's version. The learned CIT(A) upheld the assessment order.

7.2. After considering the rival submissions and perusing the relevant material on record, we find from the Annual Report of Aftek Infosys Ltd., a copy of which is available on record, that this company is, in fact, engaged in the software products by owning Intellectual Property Rights to the software products. Apart from that, it can be seen from its Annual report that it undertook acquisition of 49% of stake in Arexera for its products business.

7.3. The Mumbai Bench of the Tribunal in *Petro-Aroldite (P) Ltd Vs. DCIT, (2013) 154 TTJ (Mum.) 176* has held that a company cannot be considered as comparable because of exceptional financial results due to mergers/demergers etc. Similar view has been taken by the Delhi Benches of the Tribunal in several cases including *Toluna India Pvt. Ltd. Vs. ACIT (ITA No. 564/D/2013)*. It is patent that the mergers/demergers largely influence the profitability of a company during the year of happening of such event, which makes it incomparable. As there have been acquisitions by Aftek Infosys Ltd. in the year in question and the financial results of the erstwhile company stand included in the overall profitability of this company, we hold that the same cannot be considered as a comparable.

7.4. Be that as it may, it is seen that Aftek Infosys Ltd. is not only engaged in providing software development services but is also in the business of software products by holding Intellectual Property Rights in some software products developed by it. No segmental data of the `Software development servicesø of

this company is available. Thus, it cannot be considered as comparable to the assessee on an entity level because the assessee is engaged only in the provision of contract software development services. We, therefore, order for the exclusion of this company from the list of comparables.

**(ii) Blue Star Infotech Ltd.**

8.1. The TPO included this company in the final set of comparables with the profit ratio of 37.27%. The learned AR was fair enough to concede before us about the similarity of the functional profile of this company with the assessee. It was, however, claimed that the Related Party Transactions of this company were quite substantial.

8.2. After considering the rival submissions and perusing the relevant material on record, we find that the predominant view of the Tribunal across the country in several cases is that the transactions of a company having more than 25% of Related Party Transactions (RPTs) are considered as controlled, thereby failing the test of comparability. This view has been taken in several decisions including by the Delhi Bench in *Toluna India Pvt. Ltd. (supra)* and *Actis Advisers Pvt. Ltd. Vs. DCIT, (2012) 20 ITR 138 (Del.)(Trib.)*. and Mumbai Bench in *Stream International Services Pvt. Ltd. Vs. ACIT (IT) (2013) 141 ITD 492 (Mum.)*. The mechanism for calculating the percentage of Related Party Transactions has been broadly laid down in *Nokia India Private Ltd. Vs. DCIT, 2014-TII- 224-ITAT- DEL-TP*. Since the authorities below have not examined

the extent of the RPT percentage of this company, which the learned AR is claiming to be in excess of 25%, we set aside the impugned order and remit the matter to the file of AO/TPO for fresh determination of the percentage of Related Party Transactions of this company in consonance with the broader principles laid down in the case of *Nokia India Private Ltd (supra)*, to the extent these are applicable. If the Related Party Transactions of this company are found to be more than 25%, then this company should be excluded from the set of comparables and in the otherwise situation, it should continue in the list of comparables.

**(iii) Sark Systems India Ltd.**

9.1. The TPO included this company in the list of comparables with profit rate of 23.51%. The assessee challenged the inclusion of this company before the TPO as well as the learned CIT(A), but without any success.

9.2. After considering the rival submissions and perusing the relevant material on record, it is noticed that this company is a Software products company having Intellectual Property Rights of the software products developed by it. This fact emerges from the Annual report of this company, a copy of which is available in the paper book. It can be observed from page 486 of the paper book, being page no. 23 of the Annual report of this company, that it is engaged in the business of production and sale of software products. As the assessee is engaged in rendering contract software development services, it cannot be considered as



comparable with Sark Systems India Ltd. We, therefore, direct to eliminate this company from the list of comparables.

**(iv) Zylog Systems Ltd.**

10.1. The TPO made this company as a part of the list of comparables with the profit margin of 24.93%. The assessee is contesting against the inclusion of this company in the final set of comparables.

10.2. Having heard the rival submissions and perused the relevant material available on record, it is noticed as an admitted position that this company is functionally comparable with the assessee company. The learned AR candidly accepted this position. He, however, urged to exclude this company on the basis of fresh Acquisitions undertaken by it during the financial year relevant to the assessment year under consideration. We find from its Annual report, which is available in the paper book, that the business acquisitions of three firms in USA were undertaken by this company giving a substantial boost to its operations. When we come to the Schedule of fixed assets of this company, which is available on page 523 of the paper book, it can be seen that there is an entry with the narration "Business acquisitions", during the year with the value of Rs. 8,47,18,999/-. These facts abundantly show that this company undertook acquisitions in the relevant year making it incomparable in the light of the reasoning given above while dealing with Aftek Infosys Ltd. We, therefore, order to delete this company from the list of comparables.

11. The first issue taken by the Id. DR from the Revenue's appeal is against the exclusion from the list of comparables by the Id. CIT(A) of Genesys International Corporation Ltd. with a profit margin of 45%. There is not much discussion in the TPO's order about this company. Similarly, we find from page 16 of the impugned order that although there is some reference to the exclusion of companies with higher percentage of Related Party Transactions, but there is no specific discussion about Genesys International Corporation Ltd. or the percentage of its RPTs. As such, we set aside the impugned order and remit the matter to the file of AO/TPO for considering the percentage of Related Party Transactions of this company in consonance with our decision above while considering the case of Blue Star Infotech Ltd. If the percentage of the RPTs of this company turns out to be more than 25%, then this company should be excluded from the list of comparables. In the otherwise situation, the TPO's inclusion of this company should be upheld. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings.

12.1. The only other issue which survives in the appeal of the Revenue is against the deletion of addition of Rs.1,33,96,258/- made by the Assessing Officer by disallowing deduction claimed by the assessee under Section 10A of the Act.

12.2. Briefly stated the facts apropos this ground are that the assessee claimed deduction of Rs. 1.33 crores under Section 10A of the Act. On being called upon to explain about the eligibility of deduction, the assessee stated that it was entitled to deduction in view of fulfillment of all the requisite conditions as prescribed under Section 10A. The Assessing Officer held the assessee to be not qualifying for deduction under this section because the registration was granted by the Software Technology Park of India (STPI) and not the Inter-ministerial Standing Committee (IMSC) . He held that the IMSC was entrusted with the obligation to examine the proposals for STP units and there was no provision under which it could delegate this power to Software Technology Park of India. He further held that STPI society has mechanically approved all the units without examining anything except export commitments. Further, there was no evidence that Press Note 5 and Green Card were issued with the concurrence of the Department of Revenue or the CBDT. The learned CIT(A) overturned the assessment order on this point by relying on the order dated 06.06.2008 passed by the Delhi Bench of Tribunal in the case of ACIT Vs. Sanjay Bhalla.

12.3. We have heard the rival submissions and perused the relevant material available on record. The only objection taken by the Assessing Officer for refusing deduction under Section 10A is that the registration was granted by the STPI Society and not the Inter-ministerial Standing Committee. We find that this issue is no more *res integra* in view of the judgment dated 26.2.2013 of the

Honøble Delhi High Court in *CIT Vs. Technovate E Solution Pvt. Ltd.*, a copy of which has been placed on record by the ld. AR. In this judgment, it has been held that the approvals given by the Directors of Software Technology Parks of India are valid having the authority of the Inter-ministerial Standing Committee. This position was fairly accepted by the ld. DR also. In view of the binding precedent of the Honøble jurisdictional High Court, the facts of which are on all fours with those of the assessee company, we are of the considered opinion that no exception can be taken to the view canvassed by the learned CIT(A) on this score. This ground fails.

13. In the result, both the cross appeals filed by the assessee as well as the Revenue are partly allowed for statistical purposes.

The decision is pronounced in the open court on 18<sup>th</sup> February, 2015.

**Sd/-**  
**(A.T. VARKEY)**  
**JUDICIAL MEMBER**

**Sd/-**  
**(R.S. SYAL)**  
**ACCOUNTANT MEMBER**

Dated: 18<sup>th</sup> February, 2015.

RK/-

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi