IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'I-2' NEW DELHI

BEFORE SHRI PRAMOD KUMAR, ACCOUNTANT MEMBER
&
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

ITA No.-5924/Del/2012
(Assessment Year: 2008-09)

Giesecke & Devrient India Pvt. Ltd. Corporate Office, Plot #57, Sector-44 Gurgaon PAN : AABCG4223D	vs	DCIT Circle-12(1), Central Revenue Building New Delhi
Assessee by		**Sh. Harpreet Ajmani, Adv., Sh. Rohan Khare, Adv.**
Revenue by		**Ms. Vatsala Jha, CIT, DR**

Date of Hearing	**24.05.2018**
Date of Pronouncement	**23.08.2018**

ORDER

PER SUDHANSHU SRIVASTAVA, J.M.

This present appeal by the assessee is preferred against the Final Assessment Order dated 18.09.2012 passed under section 144C read with section 143(3) of the Income Tax Act, 1961 (hereinafter called "the Act").

2.0 Brief facts of the case are that the assessee is a wholly owned subsidiary of Giesecke & Devrient GmBH("G&D GmBH") and is engaged in the business of trading of Currency Verification and Processing Systems ("CVPS") and assembling and distribution of SIM cards to the telecommunication service

providers. Further, the company is also engaged in providing software services to G&D GmBH.

2.1 The return of income for year was filed declaring an income of Rs.1,89,362/-. Subsequently, the return was revised declaring an income of RS. 3,34,31,113/-. Since the Assessee had entered into international transactions, reference was made to the Transfer Pricing Officer ("TPO") to determine the Arm's Length Price (ALP) of the international transactions. Details of the transactions undertaken by the Assessee are as under:-

S. NO.	NATURE OF TRANSACTION	AMOUNT (In INR)
1.	Import of CVPS Machines and spare parts ("Distribution Function")	32,65,84,552
2.	Import of Raw Material for SIM Card ("Assembly Function")	11,97,70,998
3.	Software Development	8,93,34,164
4.	Sale of SIM Cards	4,94,72,539
5.	Import of Capital Equipment	2,22,07,884
6.	Provision of Installation Services	93,23,193
7.	Service Expenses	1,11,21,465
8.	Commission Expenses	48,84,400
9.	Interest on External Commercial Borrowing	73,87,140
10.	Repairs and Maintenance	59,09,162
11.	Other Expenses	34,97,831
12.	Reimbursement of Expenses	51,43,772
13.	Sale of others	1,13,248

2.2 From the international transactions declared by the Assessee, the TPO picked up the transactions regarding the Software Development Segment and the SIM Card Assembly Segment. With regard to the Software Development Segment, the Assessee had selected OP/OC as the Profit Level Indicator ("PLI") whilst applying TNMM as the Most Appropriate Method ("MAM") and declared its margin at 11.04%. The assessee, further, in its Transfer Pricing Study (TP Study) had selected a total of 18 comparables with an average OP/OC of 14.05% and hence claimed the said transaction to be at arm's length. The TPO while accepting the MAM as selected by the assessee, accepted only 7 out of the 18 comparables and further introduced 12 additional comparables with an average OP/OC of 24.95% thereby determining an adjustment of Rs. 1,10,57,340/- for the Software Development Segment.

2.3 In the SIM Card Assembly Segment, the assessee had declared a PLI of (15.22%) and justified the same to be owing to various circumstances such as initial years of operation, high competition in the market etc. The assessee, in its TP study, had selected 5 comparables with an average OP/OC of 6.39%. During the transfer pricing proceedings, the TPO issued a show cause notice to the assessee and vide the assessee's reply dated 05.10.2011, the assessee submitted a detailed reasoning as to why it had incurred

losses and additionally also objected to one of the comparables selected by the assessee itself which was acceded to by the TPO. Thereafter, the final OP/OC of the comparables was worked out at 4.78% as opposed the margin of (15.22%) of the Assessee and an adjustment of Rs. 12,04,39,125/- was determined by the TPO.

2.4 Aggrieved, the assessee preferred to file objections before the Ld. Dispute Resolution Panel ("DRP"), which were disposed off vide directions dated 08.08.2012. The Ld. DRP upheld the action of the TPO vis-à-vis the software development segment. Regarding the SIM Card Assembly Segment, the Ld. DRP rejected the plea of the assessee regarding provision for capacity under-utilization adjustment and working capital adjustment, but granted partial relief whilst directing exclusion of one comparable namely M/s Solectron EMS Limited.

2.5 The said directions culminated into the final assessment order dated 18.09.2012 against which the assessee has approached the ITAT and has raised the following grounds of appeal:-

"Transfer Pricing- Software Development Segment [Rs. 1,10,57,340]

1. *On the facts and in law, the Learned Transfer Pricing Officer – I(2), New Delhi ("Ld. TPO") and Deputy Commissioner of Income Tax, the Learned Assessing Officer ("Ld. AO") erred*

in determining and the Hon'ble Dispute Resolution Panel ("Hon'ble DRP") erred in confirming the addition of Rs.1,10,57,340 in relation to international transactions pertaining to software development segment.

1.1 On facts and in law, the Ld. TPO, Ld. AO and the Hon'ble DRP erred in rejecting the Transfer Pricing ("TP") Documentation maintained by the Appellant u/s 92D of the Income Tax Act, 1961 ("the Act"), read with Rule 10D of the Income Tax Rules, 1962 ("the Rules") and in carrying out a fresh search for comparable companies using inappropriate filters.

1.2 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in using data obtained pursuant to issuance of notice under Section 133(6) of the Act which was not available to the Appellant at the time of maintenance of Transfer Pricing Documentation, thereby contravening the provisions of Rule 10B(4) of the Rules and further, erred in not providing the complete information which was called pursuant to issuance of notice under Section 133(6) of the Act.

1.3 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in selecting certain companies as comparable, with a prejudiced intention of making an addition to the returned income of the Appellant, without appreciating that in cognizance of Rule 10B(2)(b), the

functional, asset and risk profile of these alleged comparable companies are dissimilar with that of the Appellant.

1.4 On the fact and in the circumstances of the case and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in changing the profit margin computation of alleged comparable companies by incorrectly considering certain income / expense as operating / non-operating.

1.5 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in not allowing risk adjustment to the Appellant, thereby contravening the Rule 10B(1)(e)(iii).

Transfer Pricing – SIM Card Assembly Segment [Rs.118,461,592]

2. On the facts and in law, the Ld. TPO and the Ld. AO erred in determining and the Hon'ble DRP erred in confirming the addition of Rs.11,84,61,592 in relation to international transactions pertaining to SIM card assembly segment.

2.1 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in directly applying the Operating Margin ("OP Margin") of comparable companies in the SIM card assembly segment to that of the Appellant without taking into account commercial reasons and factual data to support the losses incurred in the SIM card assembly segment.

2.2 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in making a conjecture that the Appellant

imported chips from its associated enterprise at a considerably higher price without negotiating for reduction in price or subsidy.

2.3 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in disregarding the internal comparability analysis with respect to in-house assembly of SIM Cards vis-à-vis outsourcing the assembly of SIM Cards to a third party.

2.4 On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in considering the erroneous margins of comparable companies accordingly erred in computing the amount of adjustment on account of transfer price.

2.5 On facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP violated the provisions of Rule 10B(1)(e)(iii) and Rule 10B(3) of the Rules by denying the benefit of working capital adjustment based on erroneous reasons.

2.6 On facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP violated the provisions of Rule 10B(1)(e)(iii) and Rule 10B(3) of the Rules by denying the benefit of idle capacity adjustment to eliminate differences on account of capacity utilization of the Appellant vis-à-vis the comparable companies.

2.7 On facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in relying on erroneous calculation for computing 'cash losses' (before depreciation) for the purposes of

eliminating differences arising on account of capacity utilization vis-à-vis comparables and further, failed to produce correct computation in this regard.

2.8 *On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in computing the amount of adjustment by considering total cost and sales, instead of apportioning the same to relevant transactions of the Appellant with associated enterprises and non-associated enterprises.*

3. *On the facts and in law, the Ld. TPO, the Ld. A.O. and the Hon'ble DRP erred in disregarding prior years' data used by the Appellant to benchmark the international transactions in its TP documentation for the year and holding that current year (i.e. Financial Year 2007-08) data for comparable companies should be used despite the fact that the same was not necessarily available to the Appellant at the time of preparing its TP documentation, and grossly misinterpreting the requirement of "contemporaneous" data in the Rule 10B(4) of the Rules to necessarily imply current year data, thereby breaching the principles in natural justice and "impossibility of performance".*

4. *On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in not granting the benefit of the 5% variation as per the proviso to section 92C(2) of the Act to the Appellant, as the law stood at the time of preparation of TP documentation.*

5. On the facts and in the circumstances of the case, the Ld. AO erred in initiating penalty proceedings under section 271(1)(c) of the Act.

6. On the facts and in the circumstances of the case, the Ld. AO erred in levying interest under section 234B of the Act.

7. On the facts and in the circumstances of the case, the Ld. AO has erred in not granting full credit of advance tax of Rs.20,698,500 paid by the appellant and also short credit of tax deducted at source of Rs.15,01,872 on the income of the appellant."

2.6 The assessee, vide application dated 24.09.2014, has also raised the following additional grounds:-

2.9 Without prejudice to our other grounds of appeal, the Ld. TPO ought to have considered that in view of the peculiar facts of the matter Giesecke & Devrient GmBH should have been taken as 'Tested Party' for the purpose of benchmarking international transaction in respect to SIM Card assembly segment.

2.10 Without prejudice to our other grounds of appeal, the Ld. TPO ought to have considered that pursuant to Rule 10B of the Income Ta Rules, 1962 and the OECD Guidelines the 'Tested Party' is one with less complex functional analysis

where profitability can be reliably ascertained with least adjustments."

3.0 At the outset, the Ld. Counsel for the assessee submitted that Ground Nos. 3 to 5 are not being pressed. We dismiss these two grounds as not pressed.

3.1 We now take up the assessee's grounds (Ground Nos. 1 to 1.5) regarding the software development segment. Both the parties have agreed that lower authorities have not disputed the functional profile of the assessee under the Software Development Segment, wherein the assessee was acting as a captive service provider and all the risks were borne by the Associated Enterprise (AE). The assessee did not own any intellectual property. The assessee, vide a detailed chart, has agitated the exclusion of the following 16 comparables and the inclusion of 2 comparables finally selected by the TPO:

(A) <u>COMPARABLES BEING SOUGHT TO BE EXCLUDED</u>:

i. Avani Cincom Technologies
ii. Bodhtree Consulting Limited
iii. Celestial Labs
iv. E-Zest Solutions Limited
v. Igate Global Solutions Ltd.
vi. Infosys Technologies Ltd.
vii. Kals Systems Limited (Segmental)

viii. LGS Global Ltd.
ix. Mindtree Limited (Segmental)
x. Persistent Systems Pvt. Ltd.
xi. Quintegra Solutions Limited
xii. R System International Limited
xiii. Softsol India Limited
xiv. Tata Elxi Limited
xv. Thirdware Solution Limited
xvi. Wipro Limited (Segmental)

(B) COMPARABLES BEING SOUGHT TO BE INCLUDED:

i. SIP Technologies and Exports Limited
ii. PSI Data System Ltd.

3.2.0 Now, we will deal with all these comparables individually. We will first take up the comparables which the assessee is agitating for exclusion from the final set of comparables selected by the TPO and as affirmed by the Ld. DRP.

(i) Avani Cincom Technologies ("Avani Cincom"):

3.2.1 This comparable was rejected by the assessee in the TP study for the reason of there being insufficient data in the public domain but was introduced by the TPO. The assessee objected to the inclusion of Avani Cincom but the objections were rejected by the TPO/ Ld. DRP. Before us, the Ld. Counsel for the assessee, vide a detailed chart and a hand out from of the website, argued that Avani

Cincom was not functionally comparable to the assessee since the assessee was a captive software service provider and on the contrary Avani Cincom was engaged in provision of both software development services and also development of software products. Additionally, it was argued that the segmental details of the company were not available and that the Annual Report available in the public domain was also incomplete. The Ld. Counsel placed heavy reliance on the order of the co-ordinate Bench of ITAT Bangalore in the case of Sun Gard Solutions India Pvt. Vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.) and other decisions of coordinate Benches referred in his chart, which are for the same Assessment Year i.e. 2008-09, where the co-ordinate benches had take a view that Avani Cincom was not functionally comparable to a captive software service provider.

3.2.2 The Learned Departmental Representative (CIT DR), on the other hand, supported the orders of the authorities below. It was vehemently argued before us that since this company passes all the filters, thus, it is a fit comparable.

3.2.3 We have heard the rival submissions and carefully considered the material on record. This company was selected by the TPO as a comparable, in spite of the objections of the assessee that this company is not functionally comparable to the assessee as it is

into software products whereas the assessee offers software development services to its Associated Enterprise ('AE'). The TPO rejected the assessee's objections on the ground that thiscompany had categorised itself as a pure software developer, just like the assessee. In selecting this company as a comparable, the TPO had relied on information submitted by this company collected under Section 133(6) of the Act. We notice that the co-ordinate Bench of Tribunal in the case of Sun Gard Solutions India Pvt. vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.), while considering this comparable for the same financial year, has observed as follows :

> *"6.4.1 We have heard the rival contentions and have perused and carefully considered the material on record; including the judicial decisions cited and placed reliance upon. We find that the co-ordinate bench in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 has held that this company is functionally dis-similar and different from the assessee who is a provider of software development services to its AEs and directed that this company be omitted from the list of comparables. At paras 7.6.1 and 7.6.2 of its order, the co-ordinate bench held as under:—*
>
> > *"7.6.1 We have heard both parties and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the final set of comparables only on the basis of information obtained under section 133(6) of the Act. In these*

circumstances, it was the duty of the TPO to have necessarily furnished the information so gathered to the assessee and taken its submissions thereon into consideration before deciding to include this company in its final list of comparables. Non-furnishing the information obtained under section 133(6) of the Act to the assessee has vitiated the selection of this company as a comparable.

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

6.4.2 Following the aforesaid decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra), we direct the Assessing Officer/TPO to exclude this company from the list of comparables."

3.2.4 We are of the view that the factual matrix is similar with the decision of co-ordinate bench in Sun Gard Solutions India Pvt. vs. ACIT, [2015] 63 taxmann.com 323 (Bangalore - Trib.). Respectfully following the view taken by co-ordinate Benches of the Tribunal, we direct the AO / TPO to exclude this company from the list of comparables. We also note that since complete details of this comparable is not available in public domain and there is contradiction in the information collected under section 133(6) of the Act and the annual report then such a company cannot be selected as a fit comparable.

(ii) Bodhtree Consulting Limited ("Bodhtree"):

3.2.5 The next comparable being agitated by the Assessee is Bodhtree Consulting Limited. The said comparable was rejected by the Assessee in its Transfer Pricing study for not being functionally comparable and being engaged in niche IT services. Before us, the Ld. Counsel for the Assessee strongly argued for exclusion of the said comparable on the ground that Bodhtree is an end to end web solutions provider and was earning income from sale of its software products. Additionally, it was pointed out whilst referring to the

Annual report that there was insufficient segmental data vis-à-vis the incomes from services and products. The Ld. Counsel placed strong reliance on the co-ordinate bench decision in the case of Sun Gard Solutions India Pvt. vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.) and order of the Delhi Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd v ACIT in ITA No. 333/Del/2013, wherein the said comparable was excluded primarily for being a software product company. Reliance was also placed on the decision of Delhi Bench of the Tribunal in Saxo India Private Limited vs. ACIT (ITA No. 6148/Del/2015) [subsequently affirmed by Hon'ble Delhi High Court in ITA 682/2016] wherein the comparable was excluded as being engaged in the business of Software Development and Software Product and no segmental details being available. It was fairly pointed out that though there is no finding of the Ld. DRP on this comparable but it was submitted that since all the material facts are available on record and there is no dispute on application of filters, the issue may be adjudicated.

3.2.6 The Learned Departmental Representative, on the other hand, supported the orders of the authorities below. It was fairly conceded before us that there is no difficulty in adjudication of this comparable basis the facts on record. It was vehemently argued

before us that since this company passes all filters, thus, it is a fit comparable.

3.2.7 We have heard the rival submissions and perused the material on record along with the various decisions of the co-ordinate benches. We are of the opinion that in view of all relevant facts being available on record, there is no impediment in adjudicating the issue. Our view is fortified by the judgment of the Hon'ble Delhi High Court in the case of Pr. CIT vs. Pitney Bowes Software India Pvt. Ltd in ITA 681/2015, vide order dated 28.09.2015, wherein the High Court had categorically held that the Tribunal was justified in adjudicating a comparable which was not agitated by the assessee either before the TPO or the Ld. DRP.

3.2.8 We note that the coordinate Bench of the ITAT in Nokia Siemens Networks India Pvt. Ltd vs. ACIT in ITA No. 333/Del/2013 has excluded this comparable by observing as follows:

> *"43. From Page No 12 of the Paper book containing Annexure II to the Directors' report, a part of the annual report of the company, we find that this company is engaged in only one segment which comprises of income from software development, open and end to end web solutions, software consultancy designs and software products; whereas the Assessee is engaged in rendering software development services. Under Note 5 "Segmental Information", it is stated that the company has only one identifiable reporting segment that is software development service, showing that no*

separate segmental finances relating to the software development open and end-to-end web solutions, software consultancy designs and software products are available.

44. It is argued on behalf of the assessee that this company is following a different pricing model, as is evident from the annual report to be found at paper book page No. 24 that the revenues from software development is recognized based on software developed and billed to the client whereas the assessee is a captive software developer for its AE's.

45. Ld. AR placed reliance on a decision of this Tribunal in ITA No. 6402/DEL/2012 (AY 2008-09) in the case of Aircom International (India) Pvt Ltd v DCIT, (2017) 50 CCH 0280 (hereinafter "Aircom") in support of his plea that Bodhtree is engaged in providing open and end-to-end web solutions, software consultancy, design and development of solutions, using the latest technologies and not comparable with the company which is into the business of softwaredevelopment and providing related services to its AE. The coordinate Bench in the judgment of Aircom (supra) has excluded this comparable company by making following observations:

> *"15.2. We find from the Annual report of this company that it: "has only one segment, namely, software development. Being a software solutions company, which is engaged in providing open and end-to-end web solutions, software consultancy, design and development of solutions, using the latest technologies." Thus, it can be seen that this company is providing end-to-end solutions and also consultancy which is not the case with the assesse company. Another relevant factor to be noticed is Page 1254 of the paper book, which divulges the significant accounting policies of this company. Under the head 'Revenue recognition', it has been mentioned that: "revenue from software development is recognized based on software developed and billed to clients." As*

against this, the Schedule forming part of the accounts of the assessee company provides for revenue recognition in the terms: "revenue from software developed is recognized over the contracted period of development on cost plus basis." It can be seen that there is a lot of difference in the revenue recognition models of the assessee as well as Bodhtree Consulting Ltd. This factor, in addition to the functional dissimilarity as discussed above, makes this company non comparable with the assesse company. We, therefore, order to exclude it from the list of comparables."

46. There is no dispute that the Aircom is also into the business of software development and providing related services to its AE. We are, therefore, of the considered opinion that being a software solutions company which is engaged in providing open and end-to-end web solutions, software consultancy, design and development of solutions, using the latest technologies, Bodhtree company cannot be compared to the assessee which is a captive software developer for its AE's."

3.2.9 We are of the view that the factual matrix in the present matter is similar with the decision of coordinate bench in Nokia Siemens Networks India Pvt. Ltd vs. ACIT in ITA No. 333/Del/2013 and respectfully following the view taken by co-ordinate Bench of Tribunal, we direct the AO / TPO to exclude this company from the list of comparables. Our view is further fortified by the judgment of the Hon'ble Delhi High Court in the case of Saxo India (supra) wherein their Lordships have clarified that a company engaged in providing Software Development Service cannot be regarded as a fit

comparable to a company engaged in providing both Software Development and Software Product services and sufficient segmental details are not available.

(iii) Celestial Labs ("Celestial"):

3.2.10 The next comparable being challenged by the assessee is Celestial Labs. The said comparable was introduced by the TPO as being functionally comparable to the assessee and also on the ground that the said comparable was considered as a comparable in the preceding assessment year. Before us, the Ld. Counsel for the Assessee firstly contended that merely because the comparable was taken as a comparable in the preceding assessment year would not by itself be a ground for its acceptance in the subsequent assessment year. The Ld. Counsel placed reliance on the judgments of the Hon'ble Delhi High Court in Rampgreen Solutions Pvt. Ltd. vs. CIT reported in [2015] 377 ITR 533 (Delhi), Chryscapital Investment Advisors Pvt. Ltd. vs. DCIT reported in [2015] 376 ITR 183 (Delhi) and Avenue Asia Advisors Private Limited vs. DCIT (ITA No. 350/2016) and submitted that the functionality of an entity is the key determinative factor for its inclusion or exclusion in the list of comparables and there is no such thing as *estoppel* on the ground that the assessee had accepted the entity as being functionally comparable in a previous assessment

year. It was fairly accepted that though there is no finding of the Ld. DRP on this comparable but since all material facts are available on record and there is no dispute on application of filters, adjudication on this comparable could be made.

3.2.11 On merits, the Ld. Counsel submitted that Celestial could not be held as a comparable since its functionality was very different from that of the Assessee. It was further submitted that Celestial was into bio-informatics software products and owing to insufficiency of segmental data in the Annual Report, the same could not be accepted as a comparable. The Ld. Counsel took us through the annual report to show that during the impugned year Celestial had issued an IPO and also owned intangibles.

3.2.12 On the contrary, the Ld. CIT DR appearing on behalf of the Department contended that the said comparable had already been accepted by the assessee as being functionally comparable in the preceding year and hence the assessee was barred from taking a contrary stand in the impugned year. On merits she placed strong reliance on the orders of the TPO/ Ld. DRP and contended that the findings of the TPO were well substantiated.

3.2.13 Having heard the parties, we are in agreement with the contentions of the Ld. Counsel for assessee that unless the Function, Assets and Risk profile of a comparable is demonstrated to be

similar/dissimilar from record, a comparable cannot *per se* be excluded / included only on account of its selection in the previous assessment year. Rule 10B(1)(e) read with Rule 10B(2)/(3) of the Income Tax Rules, 1962 lays down broad parameters regarding comparability of a controlled transaction with an uncontrolled transaction. It is well settled that there can be no *estoppel* against law. Selection of comparable being a factual exercise needs to be undertaken by looking at the functions, assets and risk profile of a comparable for that relevant assessment period. Our view is further fortified by the judgments of the Hon'ble Delhi High Court in Rampgreen Solutions Pvt. Ltd. vs. CIT, [2015] 377 ITR 533 (Delhi), Chryscapital Investment Advisors Pvt. Ltd. vs. DCIT [2015] 376 ITR 183 (Delhi) and Avenue Asia Advisors Private Limited vs. DCIT (ITA No. 350/2016).

3.2.14 On merits, we are of the view that the factual position in the present matter is similar with the decision of the Bangalore Bench of the Tribunal in Sun Gard Solutions India Pvt. vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.), wherein this comparable was excluded by the coordinate bench whilst observing as follows :

> *"7.4.1 We have heard the rival submissions and perused and carefully considered the material on record, including the judicial*

decisions cited. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 had held that this company, being into bio-informatics and software products and services, is to be omitted from the list of comparables as it was functionally dis-similar and different from a captive software service provider. At paras 9.4.1 and 9.4.2 of the above order, the co-ordinate bench held as under:—

> *"9.4.1 We have heard both the parties and perused and carefully considered the material on record. While it is true that the decisions cited and relied on by the assessee were with respect to the immediately previous assessment year, and there cannot be an assumption that it would continue to be applicable for this year as well, the same parity of reasoning is applicable to the TPO as well who seems to have selected this company as a comparable based on the reasoning given in the TPO's order for the earlier year. It is evidently clear from this that the TPO has not carried out any independent FAR analysis for this company for this year viz. Assessment Year 2008-09. To that extent, in our considered view, the selection process adopted by the TPO for inclusion of this company in the list of comparables is defective and suffers from serious infirmity.*
>
> *9.4.2 Apart from relying on the afore cited judicial decisions in the matter (supra), the assessee has brought on record substantial factual evidence to establish that this company is functionally dis-similar and different from the assessee in the case on hand and is therefore not comparable and also that the findings rendered in the cited decisions for the earlier years i.e. Assessment Year 2007-08 is applicable for this year also. We agree with the submissions of the assessee that this company is functionally different from the assessee. It has also been so held by co-ordinate benches of this Tribunal in the assessee's own case for Assessment*

Year 2007-08 (supra) as well as in the case of Triology E-Business Software India Pvt. Ltd. (supra). In view of the fact that the functional profile of and other parameters of this company have not changed in this year under consideration, which fact has also been demonstrated by the assessee, following the decision of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 and Triology E-Business Software India Pvt. Ltd. in ITA No. 1054/Bang/2011, we hold that this company ought to be omitted from the list of comparables. The A.O. /TPO are accordingly directed."

7.4.2 Following the aforesaid decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09, we direct the Assessing Officer/TPO to omit this company from the list of comparables."

3.2.15 Respectfully following the decision of coordinate bench in Sun Gard Solutions India Pvt. vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.), we direct the Assessing Officer/TPO to exclude this company from the final list of comparables.

(iv) E-Zest Solutions Limited("E-Zest"):

3.2.16 The Ld. Counsel for the assessee has argued for exclusion of E-Zest from the final list of comparables on the ground that the said company is functionally dissimilar to assessee, as it is engaged in providing e-Business Consulting services including product

development services and technical services which they themselves characterise as Knowledge Process Outsourcing ('KPO') services. He submitted that even as per the information gathered by the TPO under section 133(6) of the Act, this comparable is also engaged in software products. Whilst placing heavy reliance on the company's website handout along with the Annual Report, he submitted that the assessee being a captive software development company cannot be compared with a KPO. Additionally, he took us through the annual report to evidence that no segmental data vis-à-vis the services and products was available.

3.2.17 Per contra, the Ld. CIT DR supported the orders of the TPO in including this company as a comparable.

3.2.18 We have considered the arguments of both the parties and also the material available on record. We are of the view that the factual position in the present matter is similar with decision of coordinate bench in Sun Gard Solutions India Pvt. Ltd. vs. ACIT in ITA No. 1487/Bang/2012, wherein it is held as follows:

> *"8.4.1 We have heard the rival contentions and perused and carefully considered the material on record; including the judicial decision cited. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 has omitted this company from the list of comparables on the ground that the KPO services rendered by it*

are not comparable to those rendered by a captive provider of software development services. At para 14.4 of its order, the co-ordinate bench has held as under:—

> *"14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of Capital I-Q Information Systems (India) (P.) Ltd. (supra) that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company, i.e. e-Zest Solutions Ltd. be omitted from the set of comparables for the period under consideration in the case on hand. The A.O./ TPO is accordingly directed."*

8.4.2 Following the above decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09, we direct the Assessing Officer to exclude this company i.e. e-Zest Solutions Ltd., from the list of comparables."

3.2.19 Respectfully following the decision of coordinate bench in Sun Gard Solutions India Pvt. vs. ACIT reported in [2015] 63 taxmann.com 323 (Bangalore - Trib.), we direct the Assessing Officer/TPO to exclude this company from the final list of comparables.

(v) Igate Global Solutions Ltd. ("Igate"):

3.2.20 The next comparable being contested for exclusion is Igate Global Solutions Limited. The assessee rejected Igate in its TP Study holding the same to be functionally different. The TPO, however, included the same in the final list of comparables. Before us, the Ld. Counsel of the assessee submitted that Igate deserved to be excluded from the final list of comparables since Igate was engaged in rendering both software development as well as ITES Services. While referring to the notes to accounts of the annual report, he argued that that no proper segmental data were maintained by the said company. He also drew our attention to the fact that there was a merger during the relevant year. Hence, it was submitted that the said comparable deserves to be excluded. It was fairly accepted that though there is no finding of the Ld. DRP on this comparable but since all the material facts were available on record and as there was no dispute on application of filters,the issue could be adjudicated. He relied on the

co-ordinate bench's decision in the case of Nokia Siemens Networks India Pvt. Ltd vs. ACIT in ITA No. 333/Del/2013 in which the co-ordinate bench, whilst appreciating the fact that Igate was providing various services and owing to the fact that there was no segmental data, directed its exclusion.

3.2.21 The Ld. CIT DR, on the other hand, whilst taking support from the orders of the lower authorities vehemently supported Igate's inclusion. She fairly conceded that since the assessee is not arguing regarding application of filters and reliance is placed only on the financials to demonstrate difference in functionality, she has no objection if the issue of exclusion of this comparable is adjudicated by the Bench.

3.2.22 We have heard the rival submissions and perused the material on record. In view of the necessary facts being available on record, we do not see any impediment in adjudicating this comparable. On merits, we do not agree with the submissions of Ld. Counsel for the assessee that this Company ought to be removed from the list of comparables only on account of disclosure of 'Amalgamation' in the Annual Report being undertaken during this relevant period. The Ld. Counsel has not shown the effect of this exceptional event (Amalgamation) on the financials for the relevant period. However, we agree with the submissions of the Ld. Counsel for

Assessee that this company is engaged in providing array of services under the head Software Development and ITES and there are insufficient segmental details *vis-a-vis* services rendered under these heads. We note that for similar reasons this company was excluded by coordinate Bench in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013. Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

(vi) Infosys Technologies Ltd. ("Infosys"):

3.2.23 The next comparable which is being agitated for exclusion by the assessee is Infosys Technologies Ltd. The said comparable was included by the TPO whilst holding that Infosys passes all filters and was, hence, comparable to the Assessee. Before us, the Ld. Counsel of the Assessee submitted that not only is Infosys an industry giant but it also spends heavily on its Research & Development (R&D) activities and owns significant intangibles. He took us through the Annual Report of Infosys to substantiate that there is significant difference in the scale of operations. Additionally, from the various pages of the Annual report, he showcased as to how Infosys was providing a wide array of services including software products, but insufficient segmental details were mentioned in the financials.

3.2.24 Per contra the Ld. CIT Departmental Representative placed heavy reliance on the order passed by the lower authorities.

3.2.25 We have heard the rival submissions and perused the relevant material on record. We notice that on similar set of facts coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, has excluded this comparable by observing as follows:

"78. This company is undoubtedly a corporate giant with its large scale of operations vis-à-vis the Assessee company; that it had a brand impact to determine the premium pricing; that it has a different model of revenue recognition. It is submitted on behalf of the assessee that this comparable has been rejected in Assessee's own case in immediately preceding year, i.e. AY 2007-08 by the Tribunal on account of different risk profile, scale, nature of services, revenue ownership of branded/ proprietary products, onsite and offshore services etc. This fact is not contradicted by the revenue.

79. Further, the Assessee has placed reliance on Aircom (supra), in order to exclude this comparable company on the basis of its magnitude. The coordinate bench has rejected this comparable by making following observations:-

> *"17.2. We have considered the rival submissions and perused the relevant material on record. It can be seen that the TPO has included this company in the list of comparables by rejecting the assessee's contentions. The assessee is providing and assigning software services to its AE alone without acquiring any intellectual property rights in the work done by it in the development of software. The Hon'ble Delhi*

High Court in CIT vs. Agnity India Technologies (P) Ltd. (2013) 219 Taxmann 26 (Del) considered the giantness of Infosys Ltd., in terms of risk profile, nature of services, number of employees, ownership of branded products and brand related profits, etc. in comparison with such factors prevailing in the case of Agnity India Technologies Pvt. Ltd., being, a captive unit providing software development services without having any IP rights in the work done by it. After making comparison of various factors as enumerated above, the Hon'ble Delhi High Court held Infosys Ltd. to be non-comparable with Agnity India TechnologiesPvt. Ltd. The facts of the instant case are similar to the extent that the extant assessee is also not owning any branded products and having no expenditure on R&D etc. When we consider all the above factors in a holistic manner, there remains absolutely no doubt that Infosys Technologies Ltd. is not comparable with the assesse company. Respectfully following the judgment of the Hon'ble jurisdictional High Court in Agnity India (supra), we hold that Infosys Technologies Ltd., cannot be treated as comparable with the assessee company. This company is, therefore, directed to be excluded from the list of comparables."

80. The diversified activities of business, its deployment of capital, resources and the brand name make this company not comparable with the assessee and, therefore, this company has to be excluded from the final set of comparable companies for benchmarking international transaction related to software segment."

3.2.26 Respectfully following the view taken by the coordinate Bench, whilst, following the judgment of the Hon'ble Delhi High Court, as afore mentioned, we direct the AO/ TPO to exclude Infosys from the final list of comparables.

(vii) Kals Systems Limited (Segmental) ["Kals"]:

3.2.27 The next comparable being agitated before us is Kals Systems Limited. In its TP study, the assessee has rejected the said comparable as not being functionally comparable. The TPO, however, introduced Kals as a comparable that it passes all filters. Before us, the Ld. Counsel of the assessee strongly opposed the inclusion of Kals and referring to the Annual Report of Kals submitted that this comparable dealt in software products as well as services. By relying on the screenshot of website of Kals, he argued that this company is engaged in providing varied array of activities including software products. He argued that even though the TPO had taken segmental details of Kals namely "Software Development & Training" segment for comparison with assessee, but, as per the financials, there is lack of segmental data/bifurcation *vis-à-vis* the income and expenses in relation to the products developed and sold by Kals.

3.2.28 The Ld. CIT Departmental Representative relied on the orders of the lower authorities and strongly argued for its inclusion.

3.2.29 We have heard the rival contentions of the parties and also perused the relevant material on record. We note that on similar set of facts, the coordinate Bench of the Tribunal in the case of Nokia

Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013 has excluded this comparable by observing as follows:

"81. At the outset it is brought to our notice that this company was considered by a coordinate bench of this tribunal in the immediately preceding year that is assessment year 2007-08 in assessee's own case and this Tribunal rejected this company to be included as a comparable to the assessee.

82. On a perusal of the order dated 18.5.2016 in ITA No. 5837/Delhi/2011 in assessee's own case, we find that this company was considered by this Tribunal vide paragraph numbers 37 to 39 and found that the software segment of this company also includes revenues from software and training, whereas the assessee company is not engaged in imparting any training or selling its software products to attract revenue. On this premise, this Tribunal held that the finances of this company are not comparable with the assessee company and on that ground this company is not a valid comparable.

83. Further, the Assessee has placed reliance on Aircom (supra), in order to exclude this comparable company on the ground that this company consisting of STP unit is engaged in software products and development of software and is also undertaking training activity of software professionals on online projects and not a good comparable. The coordinate bench has rejected this comparable by making following observations:-

> *"18.3. After considering the rival submissions and perusing the relevant material on record, we find that the entire premise of the TPO's inclusion of this company in the list of comparables is that the software products and training constitute only 4.24% of its revenue. This inference has been*

drawn on the basis of the information supplied by this company stating: "the use of readymade object laboratories is only to the tune of about (3.4 to 6.96) % in the year 2007-08 to 2008-09 . We fail to comprehend as to how the above line conveys that the software products' revenue stands at 4.24%. What has been written is that the company's use of the readymade object laboratories is only to the tune of maximum 4.24%. By no imagination this can be construed as revenues from software products. When we peruse the Annual report of this company, which is available in the paper book, it can be seen that there is no such mention of software products revenue limited to 4.24%. On the contrary, it has been mentioned in the Notes to the financial statement that: "the company is engaged in development of software and software products since its inception." The company consisting of STPI unit is engaged in software products and development of software and is also undertaking training activity of software professionals on online projects. Not only the revenues of the segment considered by the TPO also include the revenue from software products, but also from training imparted on commercial basis. It is clear that the assessee is not providing any training under this segment, which has been rather included by the assessee in the second category of the assessee's business, namely, 'Software Deployment, Training, Consultancy and Equipment Rental.' Since the assessee's activity under this segment does not include any revenue from training, but the revenue of Kals Information Systems Ltd., for the purpose of comparison includes income from training, this company ceases to be comparable with the assessee's segment of `Software development services'. Similar view has been taken by the Tribunal in the assessee's own case for the immediately preceding assessment years 2006-07 and 2007-08. Respectfully following the precedents, we hold that Kals Information Systems Ltd. (Seg.) should be expunged from the set of comparables."

84. No change of circumstances is brought to our notice either by the assesse or the revenue, as such we do not find any reason to take a different view from the view taken by this Tribunal for the earlier year. We, therefore, consequently hold that this company is not a valid comparable to that of the assessee and has to be excluded from the final set of comparable companies for benchmarking international transaction related to software segment."

3.2.30 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude Kals from the list of comparables.

(viii) LGS Global Ltd. ("LGS"):

3.2.31 The next comparable being contested before us is LGS Global Ltd. At the outset, it was fairly accepted by the Ld. Counsel of the assessee that the said comparable was submitted by the assessee itself in its Transfer Pricing Study. He, however, submitted that this is not a fit comparable and there is difference in the FAR profile of this company *vis-a-vis* that of the assessee and, thus, is not a suitable comparable in terms of Rule 10B (1)(e) read with Rule 10B(2)/(3) of the Income Tax Rules, 1962. By relying on the decision of the Special Bench in the case of DCIT v Quark Systems Pvt. Ltd. reported in [2010] 38 SOT 307 (CHD)(SB) [which now stands confirmed by the

Hon'ble High Court of Punjab and Haryana in [2011] 244 CTR 542] he argued that there is no *estoppel* against law and the assessee can agitate its own comparables. He submitted that recently the Hon'ble High Court of Bombay in the case of CIT vs. Tata Power Solar Systems Ltd. reported in [2017] 298 CTR 197 (Bombay) has taken similar view. He submitted that although the said comparable was submitted by the assessee itself in the Transfer Pricing study, but it was objected to during the TP proceedings itself as is evident from Pg. 68 of the TPO's order.

3.2.32 On merits, the Ld. Counsel submitted that LGS could not be considered as a comparable owing to functional differences in the profile of LGS in comparison to that of the assessee. He took us through various pages of the Annual Report to demonstrate that LGS was an end-to-end service provider and was providing product evaluation, design and development of products. Additionally, it was also pointed out that this comparable was providing BPO Services in the field of Human Resources, life sciences, legal services, supply chain management, sales, customer support etc. He drew our attention to the notes to accounts to substantiate that segmental data for the variety of services was not available. It was further submitted that the said comparable failed the TPO's own foreign exchange earning filter.

3.2.33 The Ld. CIT Departmental Representative, on the other hand, strongly opposed the assessee agitating the said comparable since the same was submitted and accepted by the assessee in its Transfer Pricing study. Additionally, the Ld. CIT DR relied on the orders of the TPO and the Ld. DRP.

3.2.34 We have heard the parties at length and also perused the material on record. We agree with the arguments advanced by the Ld. Counsel for the assessee that there can be no *estoppel* against law in terms of selection of a comparable and the comparability has to be adjudicated in terms of parameters laid down under Rule 10B of the Rules. Our view is further fortified by the judgment of the Hon'ble Bombay High Court in CIT vs. Tata Power Solar Systems Ltd. reported in [2017] 298 CTR 197 (Bombay), wherein it has been observed as follows :

> *"We find that the impugned order of the Tribunal holding that a party is not barred in law from withdrawing from its list of comparables, a company, if the same is found to have been included on account of mistake as on facts, it is not comparable. The Transfer Pricing Mechanism requires comparability analysis to be done between like companies and controlled and un-controlled transactions. This comparison has to be done between like companies and requires carrying out of FAR analysis to find the same. Moreover, the Assessee's submission in arriving*

at the ALP is not final. It is for the TPO to examine and find out the companies listed as comparables which are, in fact comparable."

3.2.35 On merits, we note that on similar set of facts, the coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, has excluded this comparable by observing as follows:

"85. Initially the assessee offered this company as a comparable, but the assessee claims to have found that this company is not a comparable and wrongly included in the final list of comparable companies. Inasmuch as the key determinative factor as far as the inclusion/exclusion of any company from the list of comparables is the functionality of an entity, we are of the considered opinion that this company has to be considered on the parameters of functionality and assessee cannot be prevented from challenging the same.

86. Page No. 26 of the 9th annual report 2007-08 of this company can be found at page No. 935 of the paper book clearly establishes that this company is engaged in a multifarious activities including an end to end service provider and offers variety of services. It is involved in product evaluation, design & development etc. of the products. Further, it also renders BPO services in the field of Human Resources, Life Sciences, Legal Services, Supply Chain Management, Sales, and Customer Support etc. Further, the financial statements lacks in providing the segmental results as well.

87. Further reading of the notes forming part of the accounts vide schedule 14 incorporated at page No. 971 of the paper book coupled with entries in scheduled 5 at page No. 966 thereof show that there is an exceptional circumstances during the year, i.e. the company has written off Goodwill, which arose on account of merger of Lanco Global Systems Inc.

88. In view of the vast functional diversity of this company as is evident from the "offerings of the LGS service and solution" to be found at page No. 935 of its annual report coupled with the fact of the exceptional circumstance occurred during the year, we are of the considered opinion that this company is not a good comparable with the assessee and on that score it has to be excluded from the final set of comparable companies for the present year under consideration."

3.2.36 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

(ix) Mindtree Limited (Segmental) [“Mindtree”]:

3.2.37 The assessee’s next contention is regarding the exclusion of Mindtree as a comparable. As in the case of LGS, the Ld. Counsel of the Assessee fairly accepted that the said comparable was proposed as a comparable by the assessee itself in its TP Study and placed

reliance on his arguments advanced for the earlier comparable i.e. LGS Global Ltd.

3.2.38 On merits, the Ld. Counsel submitted that Mindtree is structured into two business units that focus on software development Research and Development Services and IT Services. It was further submitted that in addition to these services, Mindtree also offers IT strategic consulting services, application development, data warehousing and business intelligence, application maintenance, package implementation, product architecture, design and engineering embedded software, technical support, testing and infrastructure management service. Additionally, it was submitted that even though the software development segment has been taken by the TPO, the services provided under the umbrella of software development are in a wide array and can by no stretch of imagination be compared to a software developer like the assessee. He further invited our attention to various pages of the Annual report and submitted that the income declared during the year includes revenue of WOS [TES PV and Projects Solutions Pvt. Ltd.] which was acquired on 17.12.2007. Additionally, it was also submitted that the said company earned substantially from onsite projects and hence, had a different business model altogether. It was also fairly accepted that though there is no finding of the Ld. DRP on this comparable but

since all material facts are available on record and as there is no dispute on application of filters, the issue can be adjudicated.

3.2.39 Per contra, the Ld. CIT DR strongly opposed the submissions of the assessee and vehemently argued towards Mindtree's inclusion. Like earlier comparables, she fairly conceded that since the assessee is not arguing regarding application of filters, she has no objection if the issue of exclusion of this comparable is adjudicated by the Bench.

3.2.40 We have heard the rival submissions and considered the relevant material on record. In view of all material facts being available on record, we proceed to adjudicate this issue. On merits, we are of the view that the factual position in the present case is similar to the decision of coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, wherein this comparable was excluded by observing as follows:

> *"91. Assessee sought the exclusion of this company on the ground of functional dissimilarity. However Ld. TPO included it on the ground that this company is deriving revenue from both software as well as ITES and sufficient segmental information is not available in the financial statements. Under the head "the business performance", at page No. 1010 of the paper book it is revealed that this company is structured into two business units*

that focus on software development R&D services, and IT services. It also offers IT Strategic Consulting, Application Development, Data Warehousing and Business Intelligence, Application Maintenance, Package Implementation, Product Architecture, Design and Engineering, Embedded Software, Technical Support, Testing and Infrastructure Management Service.

92. Further at page No. 27 of the annual report incorporated at page No. 1027 of the paper book it is mentioned that on 17/12/2007 the company acquired hundred percent of the outstanding equity shares of TES PV and Projects Solutions Private Limited which was subsequently renamed as Mindtree Technologies Private Limited at a total consideration of Rs. 259.7 million equivalent to USD 6.55 million. It is further stated that as a consequence of this, the revenues of this company as on 31st March 2008 of Rs. 64.80 millions has been included in the above revenues for that year.

93. Needless to say the vast functional dissimilarity coupled with the extraordinary event of acquisition of equity shares stated above suggests that this company is not a good comparable with the assessee and consequently is liable to be excluded from the list of comparables."

3.2.41 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

(x) Persistent Systems Pvt. Ltd. ("Persistent"):

3.2.42 The next comparable being agitated by the assessee before us is Persistent Systems Pvt. Limited. The Ld. Counsel fairly accepted that Persistent was the Assessee's own comparable and placed reliance on his arguments advanced in respect of LGS and Mindtree.

3.2.43 On merits, the Ld. Counsel submitted that Persistent could not be considered as a comparable since they primarily dealt in product development and analytical services. To establish the difference in functionality, he referred to the handouts of the screenshot of website of Persistent and various pages of the Annual Report. He further submitted that proper segmental details of this comparable are not available in public domain and, thus, this company cannot be considered to be a comparable to the assessee. He further took us through the Annual Report and argued that the company had undertaken acquisitions during the year, which had bearing on the financials. It was also submitted that though there is no finding of the DRP on this comparable but since all material facts are available on record and as there is no dispute on application of filters, the issue could be adjudicated.

3.2.44 Per contra, the Ld. CIT Departmental Representative placed heavy reliance on the orders of the lower authorities and prayed that since this company passes all filters, it is a suitable comparable. In

terms of the submission made by the Ld. Counsel for assessee that he is not disputing the application of filters, the Ld. CIT Departmental Representative conceded to the adjudication of this comparable by this Bench.

3.2.45 We have heard the rival submissions and perused the relevant material on record. We are of the opinion that since all the relevant facts are available on record and since the assessee is not disputing the application of filters, there is no reason to remit the matter back to the lower authorities. We note that on similar set of facts, the coordinate Bench of Tribunal in the case of Trianz Holdings Pvt. Ltd. vs. DCIT in ITA No. 1568/Bang/2012, has excluded this comparable by observing as follows:

> *"17.1.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing and analytic services, it is functionally different and further that segmental results are not available. The TPO rejected the assessee's objections on the ground that as per the Annual Report for the company for Financial Year 2007-08, it is mainly a software development company and as per the details furnished in reply to the notice under section 133(6) of the Act, software development constitutes 96% of its revenues. In this view of the matter, the Assessing Officer included this company i.e.*

Persistent Systems Ltd., in the list of comparables as it qualified the functionality criterion.

17.1.2 Before us, the assessee objected to the inclusion of this company as a comparable submitting that this company is functionally different and also that there are several other factors on which this company cannot be taken as a comparable. In this regard, the learned Authorised Representative submitted that:

(i) This company is engaged in software designing services and analytic services and therefore it is not purely a software development service provider as is the assessee in the case on hand.

(ii) Page 60 of the Annual Report of the company for F.Y. 2007-08 indicates that this company, is predominantly engaged in 'Outsourced Software Product Development Services' for independent software vendors and enterprises.

(iii) Website extracts indicate that this company is in the business of product design services.

(iv) The ITAT, Mumbai Bench in the case of Telecordia Technologies India Pvt. Ltd. (supra) while discussing the comparability of another company, namely Lucid Software Ltd. had rendered a finding that in the absence of segmental information, a company be taken into account for comparability analysis. This principle is squarely applicable to the company presently under consideration, which is into product development and product design services and for which the segmental data is not available.

The learned Authorised Representative prays that in view of the above, this company i.e. Persistent Systems Ltd. be omitted from the list of comparables.

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

17.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the

details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (supra) that in the absence of segmental details/information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems Ltd. ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly."

3.2.46 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

(xi) Quintegra Solutions Limited ("Quintegra"):

3.2.47 Quintegra was rejected by the assessee in its TP Study as not being functionally comparable to the assessee. The TPO however included the same holding it to be comparable to the assessee. The Ld. Counsel for the assessee submitted before us that Quintegra could not be taken as a comparable since the same was functionally different from the assessee. It was submitted that Quintegra was

mainly a KPO and was engaged in product engineering services, having proprietary software products and was hence not a pure software developer like the assessee. Additionally, it was submitted that owing to the lack of segmental data between the products and services, the same could not be held to be comparable to the assessee. He also took us through the Annual Report to demonstrate that Quintegra was making substantial investments in its Research & Development activities and, as a result, was owning substantial intangibles. He further argued that there was an acquisition during the year and, hence, Quintegra on this count as well could not be accepted as a comparable. It was also fairly accepted that though there is no finding of the Ld. DRP on this comparable but since all the material facts are available on record and as there is no dispute on application of filters, the issue could be adjudicated.

3.2.48 In response, the Ld. CIT Departmental Representative vehemently opposed the submissions of the assessee's counsel and prayed that since this company passes all filters, it is a suitable comparable. In terms of the submission made by the Ld. Counsel for assessee that he is not disputing the application of filters, the Ld. CIT Departmental Representative, in all fairness, accepted that the Bench could take a view on the comparability.

3.2.49 We have considered the arguments of both the parties and also the material available on record. We are of the opinion that since all the necessary facts for adjudication of this comparable are available on record, there is no reason to remit this issue back to the file of the lower authorities. We are of the view that the factual position in the present matter is similar with decision of the coordinate bench in Sun Gard Solutions India Pvt. Ltd. vs. ACIT in ITA No. 1487/Bang/2012, wherein it is held as follows:

> *"12.1 This company was selected as a comparable by the TPO inspite of the assessee's objections that this company is functionally different and also since there were peculiar economic circumstances in the form of acquisitions made during the year. The TPO rejected the assessee's objections, holding that this company qualifies all the filters applied. On the issue of acquisitions, the TPO rejected the assessee's objections observing that the assessee had not adduced any evidence to show that this event had any influence on the pricing or the margin earned.*
>
> *12.2 Before us, the assessee objected to the inclusion of this company in the list of comparables on the ground that it was functionally different and also that there were other factors for which this company cannot be considered as a comparable to the assessee in the case on hand who was a captive software service provider to its AEs. It is submitted that this company i.e. Quintegra Solutions Ltd. is engaged in product engineering services and its Annual Report states that it is engaged in proprietary software products and in research and development*

activities which has resulted in creation of its own IPRs. In support of its plea for exclusion of this company from the list of comparables, the learned Authorised Representative placed reliance on the decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 where this company was excluded from the list of comparables on the ground of functional differences from a captive software service provider.

12.3 Per contra, the learned Departmental Representative supported the order of the TPO in including this company as a comparable to the assessee.

12.4.1 We have heard the rival contentions and perused and carefully considered the material on record; including the judicial decision cited and placed reliance on by the assessee. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 has omitted this company i.e. Quintegra Solutions Ltd. from the list of comparables since it is into product engineering services; is engaged in proprietary software products, has substantial R&D activity which has resulted in creation of IPRs and its own intangible assets thereby making it functionally different from the assessee in the case on hand is a captive software service provider; as is the assessee in the case on hand. At paras18.3.1 to 18.3.3 of its order, the co-ordinate bench has held as under:—

> *"18.3.1 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details brought on record that this company i.e. Quintegra Solutions Ltd. is engaged in product engineering services and is not purely a software development service*

provider as is the assessee in the case on hand. It is also seen that this company is also engaged in proprietary software products and has substantial R&D activity which has resulted in creation of its IPRs. Having applied for trade mark registration of its products, it evidences the fact that this company owns intangible assets. The co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010 dt.9.11.2012) has held that if a company possesses or owns intangibles or IPRs, then it cannot be considered as a comparable company to one that does not own intangibles and requires to be omitted from the list of comparables, as in the case on hand.

18.3.2 We also find from the Annual Report of Quintegra Solutions Ltd. that there have been acquisitions made by it in the period under consideration. It is settled principle that where extraordinary events have taken place, which has an effect on the performance of the company, then that company shall be removed from the list of comparables.

18.3.3 Respectfully following the decision of the co-ordinate bench of the Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (supra), we direct that this company i.e. Quintegra Solutions Ltd. be excluded from the list of comparables in the case on hand since it is engaged in proprietary software products and owns its own intangibles unlike the assessee in the case on hand who is a software service provider."

12.4.2 Following the above decision of the co-ordinate bench of this Tribunal (supra), we direct the Assessing Officer/TPO to omit this company from the list of comparables."

3.2.50 Respectfully following the view taken by the coordinate Bench, we direct the AO / TPO to exclude this comparable from the list of comparables.

(xii) R System International Limited ("R System"):

3.2.51 R System International Limited was a comparable chosen by the assessee itself in its TP Study. The Ld. Counsel for the Assessee relied on the case of laws as referred in the case of LGS and other comparables, to contend its exclusion even though this comparable was chosen by the assessee itself in the Transfer Pricing documentation.

3.2.52 On merits, the Ld. Counsel for the Assessee, whilst taking us through the various pages of the Annual Report, submitted that R System was mainly into the business of outsourced product development and customer support services and from the Notes to Accounts it was argued that sufficient segmental details are not available. Additionally, it was also submitted that R Systems was providing BPO services to its customers, which is not akin to software development and hence could not be functionally comparable to the profile of the assessee. Further, he took us through pages 18, 23, 32 and 104 of the Annual Report to show how the company had issued an IPO and also made strategic acquisitions during the impugned year. From the financials he submitted how R Systems was spending extensively on their R&D activities and resultantly owned intangibles

as well. It was also fairly accepted that though there is no finding of the Ld. DRP on this comparable, the same could be adjudicated.

3.2.53 The Ld. CIT Departmental Representative relied on the orders of the lower authorities and prayed that since this company passes all filters, it is a suitable comparable. In terms of the submission made by the Ld. Counsel for Assessee that he is not disputing the application of filters, the Ld. CIT Departmental Representative had no objection to the adjudication of this comparable by this Bench.

3.2.54 We have heard the rival submissions and perused the material available on record. We note that all the relevant facts necessary for adjudication of this comparable are available on record and, therefore, we do not see any reason to remit the matter back to the file of the lower authorities. We are of the view that the factual position in the present case is similar to the decision of coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, wherein this comparable was excluded by observing as follows:

> *"103. Assessee objected the inclusion of this company in the set of comparables on the ground that this company was functionally different from the assessee. However, this company was selected as a comparable by the TPO and the assessee has argued for its exclusion on the ground that it functionally dissimilar to that of*

the Assessee as this company is engaged in the Outsourced Product Development and Customer Support Services. Further, it also offers low end BPO Services. Page No. 9 of the annual report of this company establishes this fact.

104. Having regard to the information furnished in the annual report of this company vide page numbers 1356, 1362, 1366, 1371, 1378 and 1380 of the paper book, we are convinced that that this company is not a pure software service provider but is engaged in development and sale of products and on the ground excludable from the final set of comparable companies for benchmarking international transaction related to software segment."

3.2.55 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

(xiii) Softsol India Limited ("Softsol"):

3.2.56 The next comparable being agitated before us is Softsol India Ltd. The said comparable was rejected by the assessee in its Transfer Pricing Study on the ground that it failed the RPT filter. The TPO however rejected the filter applied by the Assessee and applied the filter of RPT< 25% as opposed to RPT<15% as applied by the assessee. Hence, the TPO held Softsol of being a fit comparable and added the same to the final list. Before us, the Ld. Counsel for the

assessee submitted that Softsol was not functionally comparable to the FAR profile of the assessee since the same is in the business of providing end to end services. Referring the screenshot of website (handout) of Softsol, he argued that the company was in the business of manufacturing wide range of software products, software development and training services. He also took us through the Annual Report of the company wherein it was mentioned that they deal in software products and from the notes to accounts it was shown that the company does not maintain proper segmentals. Thereafter, the Ld. Counsel took us though the financials and it was submitted that the company develops intangibles and also that their revenue recognition model was different from that of the assessee. Additionally, without prejudice to the above arguments, the Ld. Counsel submitted that the filter as adopted by the TPO of RPT<25% was not a valid filter and for the same the assessee placed reliance on the Bengaluru Bench's decision in the case of LSI Technologies India Pvt. Ltd. vs. ITO in ITA No. 1380/Bang/2010, order dated 13.05.2016. As in the case of some of the earlier comparables being contested, it was fairly pointed out that though there is no finding by the Ld. DRP on this comparable, the Bench could adjudicate the issue all the same. Further, the Ld. Counsel for the Assessee also submitted

that the arguments regarding application of filters may be treated as not pressed and prayed for adjudication of this comparable.

3.2.57 The Ld. CIT Departmental Representative vehemently argued for the comparable's inclusion and took support from the TPO's order. In terms of the submission made by the Ld. Counsel for assessee that he is not disputing the application of filters, the Ld. CIT Departmental Representative had no objection to the adjudication of this comparable by the Bench.

3.2.58 We have heard the rival submissions and also perused the relevant material on record. We are of the opinion that since all the relevant facts necessary for adjudication of this comparable are available on record we can proceed to adjudicate this comparable. We are of the view that the factual position in the present case is similar to the decision of the coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, wherein this comparable was retained by observing as follows:

> *105. The Assessee objected this company from the list of comparable while preparing its TP study on the ground of related party transactions and also basing on the statement in the annual report to the effect that this company is a provider of e-commerce, network technology, Internet infrastructure and other special*

technology areas and has diverse client base ranging from large customers to small high-tech start-up companies.

106. Ld. TPO observed that the company at present is in various areas of software development industry and what is stated above in the annual report is a futuristic statement. Ld. TPO referred to para 2.1 to be found on page No. 1533 of the paper book to the effect that no inventory is held, since the company is engaged in developing software and providing IT solutions. This fact evidences that this company is confined only to software development and not yet into net work or internet infrastructure. Even the Profit and Loss Account to be found at page No. 1536 also shows that other than the other income, the company is deriving income only from software exports. Even the Note 15 of the Notes on Account reads that there are no separate reportable segments. We do not find any material from the record that this company has actually been engaged in the activities like a) business of Software Products b) Software Development c) Training Services; and d) manufacture of vide range of products or that it provides end to end business solutions.

107. We therefore find it difficult that this company is functionally different from the assessee or that it is not a good comparable for want of any segmental information or related party information. We, therefore, find that this company has to be retained as a good comparable in the final list of comparables."

3.2.59 Respectfully following the view taken by the coordinate Bench, we reject the arguments of the assessee and direct the AO/TPO to include this company in the final list of comparables.

(xiv) Tata Elxsi Limited ("Tata Elxsi"):

3.2.60 The next comparable being agitated before us is Tata Elxsi Limited. The said comparable was chosen by the assessee itself in its TP Study. The Ld. Counsel for the assessee relied on the case laws as relied upon while arguing for exclusion of LGS and some other comparables, to contend exclusion of Tata Elxsi even though the comparable was chosen by the assessee itself in its TP Study.

3.2.61 On merits, the Ld. Counsel submitted that the said company could not be considered as a comparable since the company, along with providing software development, also dealt in product design services, innovation design engineering, visual computing and systems integration and support. The Ld. Counsel drew our attention to the 'Notes to accounts' of the Annual Report to argue that the company, although, dealt with wide array of services, it did not maintain proper segmentals, and, hence, the same could not be retained as a comparable. Like some of the earlier comparables, it was also fairly accepted that though there is no finding of the Ld. DRP on this comparable but in view of all the material facts being available on record and as there being no dispute on application of filters, adjudication on this comparable be done.

3.2.62 The Ld. CIT Departmental Representative placed reliance on the orders of the Ld. DRP and TPO. The Ld. CIT DR had no objection to the adjudication of this comparable by the Bench.

3.2.63 We have heard the rival submissions of the parties and also perused the relevant material on record. We are of the opinion that since all the necessary facts for adjudication of this comparable are available on record, we can adjudicate this issue. We are of the view that the factual position in the present matter is similar with decision of the coordinate bench in Sun Gard Solutions India Pvt. Ltd. v ACIT in ITA No. 1487/Bang/2012, wherein it is held as follows:

> *"13.1 This company was selected as a comparable by the TPO overruling the objections of the assessee to the inclusion of this company on several counts like functional dis-similarity, having significant R&D activity, brand value, size, etc.*
>
> *13.2 Before us, the learned Authorised Representative contended that this company i.e. Tata Elxsi Ltd., is not functionally comparable to the assessee as it performs a variety of functions under software development services segment, namely product design, innovation design engineering, visual computing labs etc. as per the details reflected in its Annual Report; whereas the assessee in the case on hand is a captive software service provider. In support of its plea for excluding this company from the limit of comparables, the learned Authorised Representative placed reliance on the decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for*

Assessment Year 2008-09, wherein this company was omitted from the list of comparables on grounds of being functionally different and dis-similar to a captive software service provider.

13.3 Per contra, the learned Departmental Representative supported the orders of the TPO in including this company as a comparable to the assessee.

13.4.1 We have heard the rival contentions and perused and carefully considered the material on record; including the judicial decision cited by the assessee. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 has held that this company is to be omitted from the set of comparables as it is functionally different and dis-similar from a captive software service provider, as is the assessee in the case on hand. At paras 13.4.1 and 13.4.2 of its order, the co-ordinate bench has held as under:—

> *'13.4.1 We have heard both parties and carefully perused and considered the material on record. From the details on record, we find that this company is predominantly engaged in product designing services and not purely software development services. The details in the Annual Report show that the segment "software development services" relates to design services and are not similar to software development services performed by the assessee.*
>
> *13.4.2 The Hon'ble Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. v. ACIT (ITA No.7821/Mum/2011) has held that Tata Elxsi Ltd. is not a software development service provider and therefore it is not functionally comparable. In this context the relevant portion of this order is extracted and reproduced below:-*
>
> > *"... Tata Elxsi is engaged in development of niche product and development services which is entirely*

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

As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.'

13.4.2 Following the above decision of the co-ordinate bench of this Tribunal (supra), we direct the Assessing Officer/TPO to exclude this company from the list of comparables to the assessee."

3.2.64 Respectfully following the view taken by the coordinate Bench, we direct the AO / TPO to exclude this company from the list of comparables.

(xv) Thirdware Solution Limited ("Thirdware"):

3.2.65 The next comparable agitated before us is Thirdware Solution Limited. The Ld. Counsel for the assessee has objected to the

inclusion of this company as a comparable on the ground that apart from software development services, it is in the business of product development; trading in software and giving licenses for the use of software. He also pointed out from the Annual Report that this company has not provided any separate segmental profit and loss account for software development services and product development services. He further argued that the TPO has wrongly computed the margin of this comparable and has taken entity level sales figure whilst calculating the operating margin and not the sales of the software segment. He argued that no details are given in the financials in respect of nature of transaction with subsidiaries. It was also fairly accepted that though there is no finding of the Ld. DRP on this comparable but in view of all the material facts being available on record and there being no dispute on application of filters, request was made to adjudicate this comparable.

3.2.66 The Learned CIT Departmental Representative, on the other hand, supported the orders of the authorities below. She also had no objection to the adjudication of this comparable by the Bench.

3.2.67 We have heard the rival submissions of the parties and also perused the relevant material on record. We are of the opinion that all necessary facts for adjudication of this comparable being available on record, we can adjudicate this issue. We are of the view that the

factual position in the present matter is similar with decision of coordinate bench in Sun Gard Solutions India Pvt. Ltd. v ACIT inITA No. 1487/Bang/2012, wherein it is held as follows:

"14.1 This company was selected as a comparable by the TPO inspite of the assessee's objections to its inclusion on the ground that its turnover was in excess of Rs.500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable on the ground that apart from software development services, it is in the business of product development; trading in software and giving licenses for the use of software. The learned Authorised Representative also pointed out from the Annual Report that this company has not provided any separate segmental profit and loss account for software development services and product development services. In support of its plea for exclusion of this company from the list of comparables, the learned Authorised Representative placed reliance on the decision of the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09, wherein it was held to be not comparable to a purely software development service provider.

14.2 Per contra, the learned Departmental Representative supported the order of the TPO in including this company in the list of comparables to the assessee.

14.3.1 We have heard both parties and perused and carefully considered the material on record; including the judicial decision relied on by the assessee. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra)

for Assessment Year 2008-09 has directed exclusion of this company from the list of comparables to a pure software service provider, like the assessee in the case on hand, as it is functionally different; being engaged in product development and earns revenue from sale of licenses and subscription, etc. holding as under at para 15.3 of its order:—

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

14.3.2 Following the above decision of the co-ordinate bench (supra), we direct the Assessing Officer/TPO to exclude this company from the list of comparables."

3.2.68 Respectfully following the view taken by the coordinate Bench, we direct the AO / TPO to exclude this company from the list of comparables.

(xvi) Wipro Limited (Segmental) ["Wipro"]:

3.2.69 The last comparable being agitated for exclusion before us is Wipro Limited. The said comparable was introduced by the TPO by holding that it satisfies all filters. Before us the Ld. Counsel for the Assessee submitted that the said company cannot be held to be comparable to the Assesse since the same is functionally different. It was submitted that although the TPO has taken the software segment, Wipro is engaged in several operations within the said segment itself and additionally deals in software products too. The Ld. Counsel took us through various pages of the Annual Report to substantiate the above argument and whilst referring to the 'Notes to Accounts' of the financials it was submitted that the said company did not maintain proper segmentals bifurcating the revenues/expenses between the services and products within the software segment. Additionally, by referring to the financials, it was submitted that the said company owned intangibles and whilst taking us through various pages it was also submitted that the said company had undertaken various acquisitions during the relevant assessment year.

3.2.70 The Learned CIT Departmental Representative, on the other hand, supported the orders of the authorities below.

3.2.71 We have heard the rival submissions of the parties and also perused the relevant material on record. We are of the view that the factual position in the present matter is similar with decision of the coordinate bench in Sun Gard Solutions India Pvt. Ltd. vs. ACIT in ITA No. 1487/Bang/2012, wherein it is held as follows:

> *15.1 This company was selected as a comparable by the TPO inspite of the objections by the assessee to its inclusion in the list of comparables on several grounds like functional dis- similarity, brand value, size, turnover etc.*
>
> *15.2 Before us, the learned Authorised Representative of the assessee contended that this company namely, Wipro Ltd., is not functionally comparable to the assessee as it owns significant intangibles in the nature of customer related intangibles and technology related intangibles; has huge brand value, is a market leader in size and turnover which render it not functionally comparable to a captive provider of software development services. In support of its plea for exclusion of this company from the list of comparables, the learned Authorised Representative of the assessee placed reliance on the decision of the co-ordinate bench in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09, wherein this company was held to be functionally different and dis-similar and not comparable to a captive provider of software development services.*

15.3 Per contra, the learned Departmental Representative supported the order of the TPO in including this company in the list of comparables to the assessee.

15.4.1 We have heard both parties and perused and carefully considered the material on record. We find that the co-ordinate bench of this Tribunal in the case of 3DPLM Software Solutions Ltd. (supra) for Assessment Year 2008-09 has held that this company is to be excluded from the list of comparables as it is functionally different and dis-similar from a captive software development service provider, as is in the case on hand. At para 12.4.1 and 12.4.2 of its order the co-ordinate bench in its order (supra) has held as under:—

> *"12.4.1 We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison.*
>
> *12.4.2 We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held*

that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration."

15.4.2 Following the above decision of the co-ordinate bench (supra), we direct the Assessing Officer/TPO to omit this company from the list of comparables."

3.2.72 Respectfully following the view taken by the coordinate Bench, we direct the AO/TPO to exclude this company from the list of comparables.

3.3.0 Now, we will deal with comparables which the assessee is agitating for inclusion in the final set of comparables selected by the TPO / DRP.

<u>SIP Technologies and Exports Limited ("SIP Technologies")</u>

3.3.1 The first inclusion being prayed by the Assessee is of SIP Technologies. The said comparable was rejected by the TPO whilst holding that the said company has declining revenue. Before us, the

Ld. Counsel for the Assessee submitted that diminishing revenue has to be seen for three consecutive years and since this company does not have losses for three consecutive years, the said comparable ought to be included. It was further submitted that the TPO himself has not disputed the fact that SIP Technologies is functionally comparable to the Assessee and the TPO has only rejected the said comparable on the ground that the said company has diminishing revenue. It was further submitted that turnover cannot be a criteria for inclusion or exclusion of a comparable.

3.3.2 On specific query by the Bench, the Ld. CIT Departmental Representative fairly accepted that in principle the criteria of checking the financials of three year consecutive years has consistently been followed by both the Department as well as the assessees over the years. On merits she relied on the orders of the lower authorities.

3.3.3 We have heard the rival submissions of the parties and also perused the relevant material on record. We are of the view that the factual position in the present case is similar to the decision of coordinate Bench of Tribunal in the case of Nokia Siemens Networks India Pvt. Ltd. vs. ACIT in ITA No. 333/Del/2013, wherein this comparable was included by observing as follows:

> *"116. This company selected by the assessee was rejected by the TPO on the ground of diminishing revenues. Ld. DRP also held*

that the companies having diminishing revenues/persistent losses for the previous 3 years were exceptions and refused to interfere with the findings of the Ld. TPO.

117. It is submitted by the Ld. AR that this company was accepted as functionally comparable to the assessee by the Department as well as by a Coordinate Bench of this Tribunal in assessee's own case for the previous assessment year of 2007 – 08. It is argued by the Ld. AR that the diminishing revenue filter is invalid for the simple reason that revenue is not a true indicator of the performance of company as during its business life cycle owing to changing economic conditions, a company could have variation in its revenue pattern over a period of time. For example a company with increasing revenues over a period of time does not necessarily reflect that it is performing better as the corresponding increase in expenses could be higher than revenues and the company might still incur losses. Similarly, a company with diminishing revenues over a period of time need not imply that the performance of the company is deteriorating as it might still have good profit margin on account of cost efficiency i.e. minimizing/ reducing its expenses. Therefore, the net operating margin of the company with increasing revenues over a period of time is a better indicator of the performance of the company. Thus it is submitted that excluding companies having persistent losses is a more appropriate filter and on this basis, assessee himself has excluded companies which have shown persistent losses. It is further submitted by the Ld. AR that the Ld. DRP as well as TPO has taken a stand that such diminishing revenue goes against the industry trend, that there can be nothing farther from the truth as variance in profitability is the very essence of business and which

more than demonstrates the arm's length character prevalent in a free market economy, and it would defy commercial logic and rationale, and economic business cycle if every company were to only make profits and increase profits year after year. Low profits in some years and losses in some years is a business reality. If one were to go with the logic assumed by the learned TPO, every company should have increasing revenues and the company which has lower profits or returns losses should discontinue business operations because it would not represent an arm's length nature of business.

118. Ld. AR submits that this position has now been accepted by the Delhi High Court and various benches of this Tribunal. In a recent order passed by the coordinate bench in case of Aithent Technologies (P.) Ltd. vs. DCIT [2016] 74 taxmann.com 214 (Delhi-Trib.) on the adoption of diminishing revenue filter it has been held as under:-

> *"14.3 A careful perusal of the pattern of profit/loss earned by the assesse as per its audited accounts divulges that as against the current year's profit of Rs. 62.39 lac, the earlier years' profit was Rs. 92.74 lac. This manifests that the profit for this year has diminished from the earlier year. When we consider the figures of losses for the financial years 2005-06 and earlier years, it comes to light that there were losses right from financial year 2002-03 up to 2005-06. On an overview of the above extracted Table, it can be seen that the assessee's profit is not steady, but, has diminished during the instant year from the preceding year. In such a situation, if we exclude the companies having diminishing profits, it would mean that the companies whose profit pattern is also similar to that of the assesse would face the axe. Doing so would mean excluding the comparable companies from the final tally, which is not appropriate.*

However, the companies having persistent losses, obviously, cannot be compared with the assessee because it has earned positive income not only in this year, but, in the preceding year as well. We, therefore, hold that the companies having diminishing revenue should not be excluded, but, only the companies having persistent losses should be expelled from the final tally of comparables."

119. While following the decision of the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) (P.) Ltd. this view has further been affirmed by another co-ordinate bench of this ITAT in case of Vestergaard Asia (P.) Ltd. vs. DCIT [2017] 88 taxmann.com 313 (Delhi-Trib.) wherein the court has observed that:-

"28. This comparable sought to be included by the assessee was rejected by the TPO on the ground that its revenue is continuously diminishing over the years.

……

30. The Ld. DR on the other hand argued that the revenue of the company has been reducing over a number of years. This fact indicates that the company is undergoing abnormal/exceptional circumstances and therefore its margins cannot be taken as reflecting those of the industry. He vehemently argued that this company should be excluded from the comparability analysis.

……

33. As regards the argument of diminishing revenue, we note that the reduction of revenue from FY 2009-10 (3.99 crore) to FY 2010-11 (3.98 crore) is approximately Rs. 1 lac. In our view, such a minor difference in revenue cannot be taken to mean that the company is undergoing abnormal circumstances and should be rejected. Even otherwise, if the functional similarity of the company with the assessee is accepted, the same should not be rejected simply because of difference in revenue. Our view is supported by the decision of the Hon'ble Delhi High Court in the case of Chryscapital

Investment Advisors (India) (P.) Ltd. (supra), in which it was observed:

> *"'33. Such being the case, it is clear that exclusion of some companies whose functions are broadly similar and whose profile - in respect of the activity in question can be viewed independently from other activities cannot be subject to a per se standard of loss making company or an "abnormal" profit making concern or huge or "mega" turnover company.*
>
> *As explained earlier, Rule 1OB (2) guides the six methods outlined in clauses (a) to (f) of Rule 10B (1), - while judging comparability. Rule 10B (3) on the other hand indicates the approach to be adopted where differences and dissimilarities are apparent. Therefore, the mere circumstance of a company - otherwise conforming to the stipulations in Rule 10B (2) in all details, presenting a peculiar feature - such as a huge profit or a huge turnover, ipso facto does not lead to its exclusion. The TPO, first, has to be satisfied that such differences do not "materially affect the price...or cost"; secondly, an attempt to make reasonable adjustment to eliminate the material effect of such differences has to be made."*
>
> *In light of the above, we direct the TPO to include this company in the list of comparables."*

120. With regards to Revenue's stand that SIP technologies need to be rejected on the ground that it suffered losses, it is submitted on behalf of the assessee that for the filter of persistent losses to come into play it should be shown that the comparable under dispute has incurred losses for three preceding years including the assessment year in question. Reliance in this regard is placed on the Pune ITAT order in case of Bobst India (P.) Ltd. vs. DCIT [2015] 63 taxmann.com (Pune-Trib.) wherein the bench observed that a company can be rejected as persistent loss maker only if it has incurred losses for more than 3 years. In the present case in the immediate preceding year the comparable company has showed operating profit of 13.90%, thus, as the company has not

suffered losses and its functionality has not been challenged by the TPO, it becomes clear that there is no valid ground to exclude this company as comparable.

121. On a careful consideration of the factual and legal position, we find that this company is a valid comparable to the assessee and, therefore, has to be included in the final set of comparables."

3.3.4 Respectfully following the view taken by the coordinate Bench, we direct the AO / TPO to include this company in the list of comparables.

(ii) PSI Data System Ltd. ("PSI Data"):

3.3.5 The next comparable being agitated for inclusion by the Assessee is PSI Data which the Ld. Counsel mentioned was submitted as a comparable in its TP Study and been accepted by the TPO as well, as evidenced from page 44 of the TPO's order, however the same has not been inadvertently been added in the final list of comparables.

3.3.6 The Ld. CIT Departmental Representative fairly accepted that if this company passes all filters and has been accepted by the TPO itself, then this comparable may be included.

3.3.7 We have heard the rival submissions of the parties and also perused the relevant material on record. In view of the acceptance

given by the Ld. CIT Departmental Representative, we direct the AO/ TPO to include this company in the list of comparables.

3.4.0 As regards ground Nos. 1.4 and 1.5, the Ld. Counsel for the assessee submitted that while computing the profit margin of the comparables, the TPO has incorrectly considered certain income/ expenses as operating/non-operating and prayed that necessary directions may be passed to re-compute the margin/s of comparable/s. Further, he prayed that risk adjustment may be allowed in terms of Rule 10B (1)(e) read with Rule 10B(2)/(3) of the Rules.

3.4.1 On the issue of claim for risk adjustment, the Ld. Counsel submitted that the claim had been made both before the TPO as well as the Ld. DRP. However, both have denied the assessee's claim. The Ld. Counsel further submitted that while estimating the return for uncontrolled company, there is a need to give an appropriate adjustment pertaining to market/systematic risk faced. Uncontrolled comparable companies operate under uncontrolled conditions bearing certain risks during the course of its operations. Therefore, such comparable uncontrolled companies earn a risk premium which is not earned by a captive software development provider similar to the assessee which is a risk averse and, therefore,

the profits of the captive unit would be less than risk taking companies and hence, an adjustment in this regard is required. He placed reliance on the decision of the coordinate Bench in Motorola Solutions India (P.) Ltd's case, Intellinet Technologies India (P.) Ltd. vs. ITO reported in [2012] 22 taxmann.com 28/53 SOT 92 (Bang.) (URO) and Bearing Point Business Consulting (P.) Ltd. vs. Dy. CIT reported in [2013] 33 taxmann.com 92/57 SOT 244 (Bang. - Trib.) in support of assessee's claim for risk adjustment.

3.4.2 The Learned CIT Departmental Representative, on the other hand, supported the orders of the authorities below and vehemently argued that since contemporaneous data was not produced by the assessee to substantiate its claim of risk adjustment the claim has been correctly rejected.

3.4.3 We have considered the submissions of the parties and also perused the relevant material on record. On overall factual matrix of the issues and as last and final opportunity and in the interest of justice, it is our considered opinion that the issues raised in Ground Nos. 1.4 and 1.5 require reconsideration and re-examination and are thus restored to the file of AO/TPO for passing appropriate orders in accordance with law after giving proper opportunity to the assessee. It is ordered accordingly.

3.5.0 Now we will deal with grounds relating to SIM Card Assembly Segment (Ground Nos. 2 to 2.8 and additional ground/s No. 2.9 and 2.10).

3.5.1 Before us the Ld. Counsel for the assessee has submitted that his pleadings can be summarized on the following legal points:

a. Transfer Pricing adjustment should be restricted to the value of international transaction (i.e. excluding domestic transaction with unrelated parties)

b. Capacity Adjustment may be granted

c. Working Capital Adjustment may be granted

d. As an alternative argument, it is submitted that since the Assessee has also undertaken domestic transactions in SIM Card Assembly Segment and an internal comparable in that regard is available, necessary directions may be passed to use internal comparable to determine the arm's length price.

e. Lastly, as an alternative argument, it is submitted that if reliable data is not available to determine arm's length price of an international transaction by taking the Indian entity as the tested party, then the foreign Associated Enterprise ('AE') may be taken as the tested party.

3.5.2 The additional grounds (Ground Nos. 2.9 and 2.10) filed in the present appeal deal with taking foreign AE as the tested party. Further, contemporaneous data and transfer pricing analysis by taking foreign AE as the tested party have been produced before us vide a separate application to file additional evidence.

3.5.3 It is submitted before us that if the legal submissions regarding the first three arguments are accepted then there would be no necessity to adjudicate the alternative arguments.

3.5.4 The first issue raised by the Ld. Counsel for the assessee is regarding restricting the transfer pricing adjustment to the value of the international transaction. Our attention was drawn to Pages 32, 46, 57 and 288 of the Paper book to show that during the relevant period the total operating expenses of Rs. 63,79,13,808/- were incurred on the SIM Card Segment. Out of the total operating expenses, a sum of Rs. 41,04,24,653/- related to raw materials, stores and spares consumes and out of this a sum of Rs. 7,07,33,702/- pertained to indigenous purchase (domestic transaction). It was argued before us that the TPO, while determining the arm's length price of this transaction, has erroneously taken the total operating expenses at the entity level, which is not permissible. Reliance was placed on the judgment of the Hon'ble Bombay High Court in the case of CIT vs. Alstom Projects India Ltd. reported in

[2017] 394 ITR 141 (Bombay) and of the Hon'ble Delhi High Court in the case of CIT v. Keihin Panalfa Ltd. (ITA No.11 of 2015), judgment dated 09.09.2015. He further pointed out that the Ld. Dispute Resolution Panel has decided this issue in favour of Assessee in Assessment Year 2014-15 whilst directing the TPO to allow proportionate adjustment and restricting the transfer pricing adjustment to related party international transactions.

3.5.5 The Ld. CIT Departmental Representative placed heavy reliance on the order of the TPO / DRP.

3.5.6 We have heard the rival submissions of the parties and perused the relevant material on record. We notice that the TPO, while benchmarking this transaction (SIM Card Assembly Segment), has taken the value of transaction at entity level rather than restricting the exercise of benchmarking to the value of international transaction between the Associated Enterprises and also included the value of indigenous purchases from the local parties. We are of the considered opinion that the mandate of Chapter X of the Act is very clear and only the international transactions between related parties are to be considered for the purposes of benchmarking. Our view is further fortified by the decision of Hon'ble Bombay High Court in CIT vs. Alstom Projects India Ltd reported in [2017] 394 ITR 141 (Bombay), wherein it is held as follows :

"2. Mr. P.C. Chhotaray, learned Counsel for the Appellant urges the following question of law for our consideration:—

> *"Whether, on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the TPO has applied the transfer pricing adjustment to all transactions, i.e. entity level in the absence of actual segmental accounts being maintained on regular basis by the assessee ?"*

3. The impugned order of the Tribunal upheld the Respondent-assessee's contention that the transfer pricing adjustment has to be made only in respect of transaction entered into by the Respondent-assessee with its Associated Enterprises.

4. The grievance of the Revenue is that in the absence of segmental accounts being maintained by the Respondent-assessee, transfer pricing adjustment had to be done at entity level. We specifically asked Mr. Chhotaray, learned Counsel for the appellant whether any such submission was advanced by the Revenue before the Tribunal. At this, he fairly states that no such submission was made on behalf of the Revenue. Thus we fail to understand how the present question arises from the impugned order of the Tribunal.

5. Be that as it may, Mr. Chhotaray, learned Counsel for the Revenue submits that identical question as raised herein had been admitted by this Court and in particular invited our attention to the following orders passed at the stage of admission:—

> *(a) CIT vs. Super Diamonds, Income Tax Appeal No. 298 of 2013; (Order dated 16 February 2015); and*
>
> *(b) CIT v. Global Jewellery (P.) Ltd. Income Tax Appeal No.1395 of 2013. (Order dated 16 April 2015)*

6. In both the above appeals we find that the question admitted was with regard to transfer pricing adjustment being done at the entity level and not restricted only to the transactions with Associated Enterprises. However, both the appeals were admitted without the Court having had benefit of submissions on behalf of the Respondent-assessee.

7. Thereafter this Court consequent to the above two orders had occasion to consider the issue of transfer pricing adjustments being done in respect of all transactions (entity level) or only in respect of transaction entered into with Associated Enterprises in the following cases:—

(i) CIT v. Hindustan Unilever Ltd. [2017] 394 ITR 73/[2016] 72 taxmann.com 325 (Bom.);

(ii) CIT v. Tara Jewels Exports (P.) Ltd. [2016] 381 ITR 404/80 taxmann.com 117 (Bom.);

(iii) CIT v. Petro Araldite (P.) Ltd. Income Tax Appeal No.1804 of 2013 rendered on 24th November 2015;

(iv) CIT v. Thyssen Krupp Industries (P.) Ltd. [2016] 381 ITR 413/70 taxmann.com 329 (Bom.);

(v) CIT v. Summit Diamond (India) Pvt. Ltd. Income Tax Appeal No.1647 of 2013 rendered on 11th July 2016.

In all above appeals, this Court after hearing both sides upheld the view of the Tribunal that the transfer pricing adjustment has to be done only in respect of International Transactions with Associated Enterprises and not at an entity level. It may be pointed out that during the course of all the above appeals, the fact that two appeals had been admitted on the above issue were not pointed out.

8. Nevertheless, the distinction sought to be made by the Revenue is that the issue of non keeping of segmental accounts by the Assessee was not for consideration in the above cases which were dismissed, as in this case.

9. This very issue/question as raised herein was raised by the Revenue in Petro Araldite (P.) Ltd. (supra). The question raised therein was as under:—

> *"Whether on the facts and law the Tribunal was justified in directing AO/TPO to bench mark as AE transactions without appreciating (a) the Assessee itself in its transfer pricing study & report (TPSR) has chosen entity level PLI to benchmark the AE transactions; (b) the Assessee had itself failed to furnish audited segmental accounts and therefore, the TPO had rightly applied revised PLI at the entity level to determine the ALP?"*

At the above hearing, the Revenue accepted that even in the absence of segmental accounts, the adjustment has to be done only in respect of the international transactions with Associated Enterprises. This is so recorded in the order dated 24 November 2015. Therefore, on the above ground itself, the question as proposed does not give rise to any substantial question of law.

10. We may once more note that the Income Tax Department within the jurisdiction of this Court must adopt a consistent view on issues of law. In this case, we find that the Revenue urges the absence of segmental accounts would warrant entity wise adjustment, when the Revenue had itself in Petro Araldite (P.) Ltd. (supra) did not canvas the point, as even according to it

the issue stood covered by the earlier orders of this Court in favour of the Assessee. The Revenue must apply the law equally to all and cannot take inconsistent position in law (de hors the facts) to apply different standards to different assessee. The administration of the tax laws should not degenerate into an arbitrary and inconsistent application of law dependent upon the Assessee concerned.

11. We also note that the Delhi High Court in CIT v. Keihin Panalfa Ltd. (ITA No.11 of 2015) decided on 9th September, 2015 has while dealing with transfer pricing adjustment in the absence of segmental accounts held that adjustments have to be restricted only to transactions with Associated Enterprises. It further held that where separate accounts are not available, then proportionate adjustments to be made only in respect of the international transactions with Associated Enterprises.

12. We are in respectful agreement with the view of the Delhi High Court in Keihin Panalfa Ltd. (supra). One must not lose sight of the fact that the transfer pricing adjustment is done under Chapter X of the Act. The mandate therein is only to redetermine the consideration received or given to arrive at income arising from for International Transactions with Associated Enterprises. This is particularly so as in respect of transaction with non Associated Enterprises, Chapter X of the Act is not triggered to make adjustment to considerations received or paid unless they are Specified Domestic Transactions. The transaction with non-Associated Enterprises are presumed to be at arms length as there is no relationship which is likely to influence the price. If the contention of the Revenue is accepted, it would lead to artificial

increase in the profits of transactions entered into with non Associated Enterprises by applying the margin at entity level which is not the object of Chapter X of the Act. Absence of segmental accounting is not an insurmountable issue, as proportionate basis could be adopted as done by the Delhi High Court in Keihin Panalfa Ltd. (supra).

13. In the above view, no substantial question of law arises. Therefore, we do not entertain the present appeal."

3.5.7 After considering the above and respectfully following the judgments of the Hon'ble Bombay High Court and the Hon'ble Delhi High Court, we hold that the proportionate adjustment is to be allowed to the assessee and the exercise of benchmarking is to be restricted to the value of international transaction. On the overall factual matrix, we restore this issue to the file of AO/TPO to re-compute and benchmark this transaction, after giving sufficient opportunity of hearing to the assessee.

3.6.0 The second issue argued by the Ld. Counsel for the assessee is regarding allowability of capacity adjustment. During the course of assessment, TPO has dealt with the issue of allowability of capacity adjustment whilst observing as follows:

"The assesse has provided some of the capacity utilization figures of the comparables. However out of the 4 comparables, data is not available in respect of Circuit Systems India Ltd. In respect of

Fine-line Circuit Ltd, the data is not available in respect of High technology multilayer broad segment. Under these circumstances, this data cannot be used to come to a conclusion in this regard. Nevertheless, an analysis was made as to what is the percentage of total expenditure that depreciation accounts for in respect of the assesse vis-à-vis the comparables. In respect of the assesse it was found that depreciation was 4.27% of the total expenditure of this segment. In respect of the comparables it was seen as below.

S.No.	*Name*	*Depn./TC (%)*
1.	*BCC Fuba India Ltd.*	*10.06*
2.	*Circuit Systems India Ltd.*	*3.95*
3.	*Fine-line Circuits India Ltd.*	*5.32*
4.	*Solectron EMS India Ltd.*	*1.80*
Average		*5.28*

As it can be seen, the difference is not so large as to have a telling effect on the profitability of the assesse. Another exercise was undertaken, of calculating the OP/Sale margin of the assesse and comparables after excluding depreciation. The result in the case of the assesse was (-) 15.22%. In the case of the comparables it was as follows:

S.No.	*Name*	*OP/Sales (%)*
1.	*BCC Fuba India Ltd.*	*1.18*
2.	*Circuit Systems India Ltd.*	*12.76*
3.	*Fine-line Circuits India Ltd.*	*(-)1.45*
4.	*Solectron EMS India Ltd.*	*6.64*
Average		*4.78*

As can be seen, the difference between the assessee's margin and that of the comparables with or without depreciation remains

more or less constant. Hence, there is no case for a comparability adjustment on account of unutilized capacity in this case.
Besides this, admittedly the capacity utilization risk in this segment is also borne by the assesse. Hence, as argued earlier, there can be no case for comparability adjustment once the risk is borne by the assesse."

3.6.1 While dealing with the objections filed by the assessee regarding allowability of capacity adjustment, the Ld. DRP has observed as follows:

"The issue of capacity adjustment has been considered in detail by the TPO. Since the data of the comparables was not available with the TPO, he tried to make a study using depreciation figure in order to find out if there was any marked differences in asset utilization levels. It was not an implied position of the TPO to ascertain cash loss of the assesse. However, since the capacity utilization figures duly certified by auditors are not available, the capacity utilization was not considered. We do not find any infirmity in this."

3.6.2 Before us, the Ld. Counsel for the assessee has vehemently argued that, undisputedly, assessee was bearing the risk of idle capacity and this being one of the initial years of operation of its business, capacity adjustment ought to have been granted in terms of Rule 10B (1)(e)(iii) read with Rule 10B(2)/(3) of the Income Tax Rules,

1962 ('Rules'). On the issue of allowability and the manner of computing the capacity adjustment, he placed heavy reliance on the following judicial precedents:

i. CIT vs Petro Araldite Pvt. Ltd. [2018] 93 taxmann.com 438 (Bombay)/[2018] 256 Taxman 16 (Bombay)
ii. M/s. Royal Star Jewellery Pvt. Ltd. vs ACIT & Other, ITA 2463/2013, order dated 30.01.2017 (Bombay High Court)
iii. Transwitch India (P.) Ltd. v. Dy. CIT [2012] 21 taxmann.com 257/53 SOT 151 (Delhi - Trib.)
iv. Dy. CIT v. Class India (P.) Ltd. [2015] 62 taxmann.com 173 (Delhi);
v. Saxo India (P.) Ltd. v Asstt. CIT [2016] 67 taxmann.com 155 (Delhi - Trib.)
vi. Molex India Tooling (P.) Ltd. vs DCIT [2016] 75 taxmann.com 303 (Bangalore - Trib.)
vii. HCL Technologies BPO Services Ltd. v. Asstt. CIT [2015] 60 taxmann.com 186/69 SOT 571 (Delhi)
viii. Global Turbine Services Inc. v. ADIT (International Taxation) [2013] 38 taxmann.com 220 (Delhi)
ix. Dy. CIT v. Innodata Isogen India (P.) Ltd. [IT Appeal No. 5390 (Delhi) of 2010]
x. Google India (P.) Ltd. [IT Appeal No. 1170 (Bang.) of 2011]
xi. Calsonic Kansel Motherson Products Ltd. vs DCIT [2016] 72 taxmann.com 109 (Delhi - Trib.)
xii. Fiat India (P.) Ltd. [IT Appeal No. 1848 (Mum.) of 2009]
xiii. Global Vantedge (P.) Ltd. v. Dy. CIT [2010] 37 SOT 1 (Delhi).

xiv. Tasty Bite Eatables Ltd. vs ACIT [2015] 59 taxmann.com 437 (Pune - Trib.)

3.6.3 Further, the Ld. Counsel fairly accepted out that the issue of allowability of capacity adjustment was decided against the assessee in earlier assessment year by the co-ordinate Bench of this Tribunal vide order dated 15.03.2013. He submitted that though an appeal was filed challenging the said order dated 15.03.2013 passed by the Tribunal, the Hon'ble Delhi High Court, vide order dated 27.08.2014, dismissed the appeal of the Assessee as being barred by limitation, but with a liberty to agitate this issue before the Tribunal in subsequent years and to suitably represent the relevant facts and legal position before the Tribunal in accordance with law. He further tried to distinguish the earlier decision of the coordinate Bench whilst arguing that the Tribunal in its earlier decision had *per se* not considered the issue of allowability of capacity adjustment and had refused to interfere with the findings of lower authorities on this issue as the relevant data was not available on record. He submitted that the relevant data is now available on record. To buttress his arguments, he placed heavy reliance on a recent decision of the Hon'ble Supreme Court in Canara Bank vs. N.G. Subbaraya Setty & Anr. Reported in 2018 SCC OnLine SC 427, wherein *exceptions* to the

principle of *res judicata* have been explained. He argued that since now issue of allowability and computation of capacity adjustment has been settled by a higher forum, i.e., the Bombay High, whilst interpreting the provisions of Rule 10B (1)(e) read with Rule 10B(2)/(3) of the Rules, a legally sustainable claim of Assessee cannot be rejected.

3.6.4 The Learned CIT Departmental Representative, on the other hand, supported the orders of the authorities below and argued that the decision of this Tribunal rejecting the claim of capacity adjustment be followed.

3.6.5 We have heard the rival submissions of the parties and also perused the relevant material on record. We find force in the submissions of the Ld. Counsel for the assessee that in terms of the liberty granted by the Hon'ble High Court in assessee's own case and in view of the recent decision of Hon'ble Bombay High Court in CIT vs. Petro Araldite Pvt. Ltd. reported in [2018] 93 taxmann.com 438 (Bombay)/[2018] 256 Taxman 16 (Bombay), wherein it is held that capacity adjustment is allowable in terms of Rule 10B (1)(e)(iii) read with Rule 10B(2)/(3) of the Rules, the earlier decision of coordinate Bench in Assessee's own case would no act as a impediment to allow capacity adjustment for the relevant period. We notice that Ld. Counsel for the assessee has placed on record revised working with

respect to computation of capacity adjustment in terms of the recent decision of coordinate Benches of the Tribunal and the Hon'ble High Court and, therefore, the earlier decision of Tribunal is distinguishable on this count itself. We are of the opinion that if correct and reliable data is available, then capacity adjustment deserves to be allowed in terms of Rule 10B of the Rules. Our view is further fortified by the decision of Hon'ble Supreme Court in Canara Bank vs. N.G. Subbaraya Setty & Anr. Reported in 2018 SCC OnLine SC 427, wherein exceptions to the principle of *res judicata* have been explained, by observing as follows:

> *"34. Given the conspectus of authorities that have been referred to by us hereinabove, the law on the subject may be stated as follows:*
>
> *(1) The general rule is that all issues that arise directly and substantially in a former suit or proceeding between the same parties are res judicata in a subsequent suit or proceeding between the same parties. These would include issues of fact, mixed questions of fact and law, and issues of law.*
>
> *(2) To this general proposition of law, there are certain exceptions when it comes to issues of law:*
>
> *(i) Where an issue of law decided between the same parties in a former suit or proceeding relates to the jurisdiction of the Court, an erroneous decision in the former suit or proceeding*

is not res judicata in a subsequent suit or proceeding between the same parties, even where the issue raised in the second suit or proceeding is directly and substantially the same as that raised in the former suit or proceeding. This follows from a reading of Section 11 of the Code of Civil Procedure itself, for the Court which decides the suit has to be a Court competent to try such suit. When read with Explanation (I) to Section 11, it is obvious that both the former as well as the subsequent suit need to be decided in Courts competent to try such suits, for the "former suit" can be a suit instituted after the first suit, but which has been decided prior to the suit which was instituted earlier. An erroneous decision as to the jurisdiction of a Court cannot clothe that Court with jurisdiction where it has none. Obviously, a Civil Court cannot send a person to jail for an offence committed under the Indian Penal Code. If it does so, such a judgment would not bind a Magistrate and/or Sessions Court in a subsequent proceeding between the same parties, where the Magistrate sentences the same person for the same offence under the Penal Code. Equally, a Civil Court cannot decide a suit between a landlord and a tenant arising out of the rights claimed under a Rent Act, where the Rent Act clothes a special Court with jurisdiction to decide such suits. As an example, under Section 28 of the Bombay Rent Act, 1947, the Small Causes Court has exclusive jurisdiction to hear and decide proceedings between a landlord and a tenant in respect of rights which arise out of the Bombay Rent Act, and no other Court has jurisdiction to embark upon the same. In this case, even

though the Civil Court, in the absence of the statutory bar created by the Rent Act, would have jurisdiction to decide such suits, it is the statutory bar created by the Rent Act that must be given effect to as a matter of public policy. (See, Natraj Studios (P) Ltd. v. Navrang Studios, (1981) 1 SCC 523 : (1981) 2 SCR 466 at 482). An erroneous decision clothing the Civil Court with jurisdiction to embark upon a suit filed by a landlord against a tenant, in respect of rights claimed under the Bombay Rent Act, would, therefore, not operate as res judicata in a subsequent suit filed before the Small Causes Court between the same parties in respect of the same matter directly and substantially in issue in the former suit.

(ii) An issue of law which arises between the same parties in a subsequent suit or proceeding is not res judicata if, by an erroneous decision given on a statutory prohibition in the former suit or proceeding, the statutory prohibition is not given effect to. This is despite the fact that the matter in issue between the parties may be the same as that directly and substantially in issue in the previous suit or proceeding. This is for the reason that in such cases, the rights of the parties are not the only matter for consideration (as is the case of an erroneous interpretation of a statute inter parties), as the public policy contained in the statutory prohibition cannot be set at naught. This is for the same reason as that contained in matters which pertain to issues of law that raise jurisdictional questions. We have seen how, in Natraj Studios (supra), it is the public policy of the statutory

prohibition contained in Section 28 of the Bombay Rent Act that has to be given effect to. Likewise, the public policy contained in other statutory prohibitions, which need not necessarily go to jurisdiction of a Court, must equally be given effect to, as otherwise special principles of law are fastened upon parties when special considerations relating to public policy mandate that this cannot be done.

(iii) Another exception to this general rule follows from the matter in issue being an issue of law different from that in the previous suit or proceeding. This can happen when the issue of law in the second suit or proceeding is based on different facts from the matter directly and substantially in issue in the first suit or proceeding. Equally, where the law is altered by a competent authority since the earlier decision, the matter in issue in the subsequent suit or proceeding is not the same as in the previous suit or proceeding, because the law to be interpreted is different."

3.6.6 On the issue of allowability of capacity adjustment, we are of the considered view that higher capacity utilization would lead to higher profitability as fixed costs would be spread over in a larger number of units manufactured. The difference in capacity utilization would materially affect the profit margin. Thus, if there is a difference in the level of capacity utilization of the assessee and the level of capacity utilization of the comparable, then adjustment would be required to be made to the profit margin of the comparable on

account of difference in capacity utilization in terms of Rule 10B (1)(e)(iii) read with Rule 10B(2)/(3) of the Rules. Our view is fortified by the recent decision of Hon'ble Bombay High Court in the case of CIT vs. Petro Araldite Pvt. Ltd. reported in [2018] 93 taxmann.com 438 (Bombay)/[2018] 256 Taxman 16 (Bombay). After considering plethora of case laws on the issue of allowability of capacity adjustment, the coordinate Bench of the Delhi Tribunal in HCL Technologies BPO Services Ltd. vs. ACIT reported in [2015] 172 TTJ 1 (Delhi - Trib.), observed as follows :

> *"29. Reliance in this regard is also placed on the recent decision of Chennai Bench of the Tribunal in the case of Mando India Steering Systems (P.) Ltd. v. Asstt. CIT [2014] 49 ITD 284/45 taxmann.com 160 wherein, the Hon'ble Bench has remitted the issue back to the file of the assessing officer with a direction to consider the claim of the assessee with respect to idle capacity adjustment during the relevant period while determining the ALP cost. The relevant extract of the decision reads as under:*
>
> > *"We are of the considered view that under-utilization of production capacity in the initial years is a vital factor which has been ignored by the authorities below while determining the ALP cost. The TPO should have made allowance for the higher overhead expenditure during the initial period of production. In view of the above, we deem it appropriate to remit this issue back to the Assessing Officer with a direction to consider the claim of the assessee with respect to idle capacity adjustment during the relevant period while determining the ALP cost. The assessee is also directed to produce relevant documents in comparable units for the*

necessary analysis. The appeal of the assessee is allowed for statistical purposes in the aforesaid terms."

30. Reliance in this regard is placed on the decision of Pune Bench of the Tribunal in the case of Amdocs Business Services (P.) Ltd. v. Dy. CIT [2012] 54 SOT 46 (URO)/26 taxmann.com 120 wherein, the Tribunal allowed economic adjustment on account of under capacity utilization holding that the appellant was in start up phase during the assessment year consideration. The relevant extract of the decision is reproduced as under:

"9. The next major point made out by the appellant is that this being the first full year of operation, the assessee had incurred certain expenditure which are start-up costs and cannot be fully recovered in the instant year itself, and such an expenditure has abnormally affected the profit margin. It is also canvassed that due to the start-up year the capacity utilization was not satisfactory, whereas its profitability has been bench marked against comparables which are established entities -and have been set up over the years. The plea set- up by the assessee for economic adjustments on account of under capacity utilization and being in start up phase, is not something which is unreasonable and neither it is otiose to the mechanism of transfer pricing assessments. In fact, in principle, the plea of the assessee is in line with the decisions of the Tribunal in the case of Global Venttedge (P.) Ltd. v. DCIT in ITA Nos. 1763-2764/ Del/09 (Del); Brintons Carpets' Asia (P) Ltd. v. DCIT 139 TTJ -177; and, Skoda, Auto India (P.) Ltd. v. ACIT 122 TT J 699. In our view, the matter requiring factual appreciation, the same is remanded back to the file of the Assessing Officer, who shall consider the propositions put forth by the assessee and allow appropriate economic adjustments on a reasonable basis."

31. On the same lines, Delhi Bench of the Tribunal in the case of Global Turbine Services Inc. v. ADIT (International

Taxation) [2013] 38 taxmann.com 220 allowed economic adjustment on-account of under capacity utilization considering the fact that the year under consideration was the first full year of operation of the appellant. Relevant extract of the decision reads as under:

> *"10. We have heard the rival contentions and perused the material available on record. The suitable adjustment for non-utilisation of capacity is to be taken in to account after considering the ALP while working out TP adjustment, this proposition has been held by co-ordinate Bench in the case of the Amdocs Business Services (P.) Ltd. (supra) and various other cases as cited here in above.*
>
> *11. In the given facts and circumstances it was required on the part of the lower authorities to have given due effect to under capacity utilization of the assessee which has not been done TPO for adjustment for ALP determination. In view of the facts and circumstances we are inclined to set aside the matter and restore the issue of under capacity utilization back to the file of the Assessing Officer/TPO to decide the same afresh after giving assessee adequate opportunity of being heard and to file the necessary evidence on this behalf. Needless to say that a proper and speaking order will be passed deciding the issue in accordance with law."*

32. Reliance in this regard is placed on the following observation of the Hon'ble Mumbai Bench of the Tribunal in the case of ACIT v. Fiat India (P.) Ltd. [IT Appeal no 1848 (Mum) of 2009):

> *"As rightly held by the ld. CIT(A), the said submission made by the appellant is sufficient to demonstrate that there was a material difference in the facts of the appellant's case and that of the comparable cases in terms of capacity utilization as well as in other terms. Appropriate adjustments thus were required to be made to eliminate such differences"*

33. Further, the Hon'ble Pune Bench of the Tribunal in the case of Brintons Carpets Asia (P.) Ltd. v. Dy. CIT [2011] 46 SOT 289 (URO)/ 12 taxmann.com 148 while allowing adjustment for idle capacity caused due to labour unrest/ strike and relying upon the above observation of the Mumbai Tribunal held as follows:

> *"15. From the above, it is clear the AO has authority vide clause (iii) above to make the adjustments. Such adjustments are necessary only to remove or minimize the differences in the comparable or anomaly in the said comparable.*
>
> *- Such adjustments are authenticated by the OECD guidelines too. In this regard, we have perused the important findings of the Tribunal in the case of the Fiat India (P.) Ltd (supra) placed at page 191 of the paper book. For the sake completeness, the same is reproduced as under.*
>
> > *. . . . . as regards the adjustments made by the appellant to work out its operating margin for comparing the same with the profit margin of comparable cases, it was held that there was a material difference in the facts of the appellant's case and that of the comparable cases in terms of capacity utilization as well as in other terms. Appropriate adjustments thus were required to be made to eliminate such differences. Further, the TPO himself has allowed similar adjustments made by the appellant in the immediate preceding years i.e. AY 2002- 03, 2003-04 as well as in the immediate succeeding years i.e. 2005-06 and 2006-07 wherein the facts involved were similar to that of the year under consideration i.e. AY 2004-05;*
>
> *accordingly, no infirmity is found in the impugned order of the CIT (A) as the adjustments made by the appellant in TNMM analysis were reasonable and accurate and as reflected in the said analysis, international transactions made by the appellant company with its associated*

concerns during the year under consideration were at arm's length requiring no adjustment/addition on this issue.

16. From the above, it is evident that the appellant is entitled to economic adjustments in the circumstances of under capacity utilization of the company. Of course, such adjustments must be restricted to fixed cost/overheads only. In the instant case, the AO/TPO did not have the occasion to go into the period or the extent of the labour unrest, break-up of the claimed adjustments amounting Rs. 7.32 crores (rounded off), fixed cost versus the variable cost etc. as they summarily rejected the external comparables in view of their preference to the operating profits of the domestic segment of the carpets. Therefore and consequently, this key issue also has to be set aside to the files of the TPO/AO for fresh examination of the issue.

Prima facie we see the need for such economic adjustments to the total cost of the carpet of the export segment. We refuse to comment on the facts relating to the figures as none of the authorities has gone into the details of such economic adjustments and they summarily rejected the claims. As such, the requisite adjustments are borne out of the relevant rules/provisions and therefore, the claim is bona fide and has support of the law. For this, the appellant prefers to go to the files of the AO for want of a speaking order on this issue. In our opinion, the request of the appellant deserves to be considered favourable."

34. Also, in the case of E.I. Dupont India (P.) Ltd. v. Dy. CIT [2012] 49 SOT 123/[2011] 16 taxmann.com 352 (Delhi), the Hon'ble Delhi Bench of the Tribunal, while allowing the adjustment for capacity utilization held that:

> *'"It is a matter of fact that fixed costs remain the same even when there is under utilization of capacity. Therefore, the case of the appellant and the comparable cases have to be examined in respect of capacity utilization so as to make the controlled and uncontrolled transactions comparable."*

Also, the Hon'ble Delhi Bench of the Tribunal in the case of ITO v. CRM Services India Pvt. Ltd. upheld the claim of the appellant towards adjustment of idle capacity:

> *"8.1 This brings us to the alternative argument that the appellant is entitled to get adjustment in respect of capacity under-utilization. No objection has been raised by the ld. CIT, DR in this matter. As a matter of fact, he has fairly accepted the proposition that adjustment in this regard is required to be made.*
>
> *At the same time, it is also held that suitable adjustment has to be made to such PLI in respect of idle capacity."'*

35. Further, the Hon'ble Bangalore bench of the Tribunal in the case of Genisys Integrating Systems (India) (P.) Ltd. v. Dy. CIT [2012] 53 SOT 159/20 taxmann.com 715 the Hon'ble Tribunal held as under:

> *"The appellant should also be given adjustment for under utilization of its infrastructure. The AO shall consider this fact also while determining the ALP find make the TP adjustments. With these directions, the appeal of the appellant is disposed of. "*

36. Further, the Hon'ble Delhi' Bench of the Tribunal in the case of Transwitch India (P.) Ltd. v. Dy. CIT [2012] 53 SOT 151/21 taxmann.com 257 held as under:

> *"4.11 Another TPO's contention is that claim of the appellant that the sealing drive reduced its revenue is*

unsubstantiated. In this regard, appellant has submitted that the appellant had placed on record its quarterly 'capacity' utilization statement demonstrating the fall in its capacity utilization during the quarter January to March, 2006. The capacity utilization, of the appellant during the quarter January to March, 2006 fell to 72% as' against the normal capacity utilization of 87% to 94% during the financial year ending December, 31, 2005. Further, the fact that the appellant had to shift its office premises at a very short notice, sufficiently substantiates the low capacity utilization of the appellant during the last quarter of financial year 2005-06. We find out ourselves in agreement with the appellant's submission in this regard."

37. Hon'ble Delhi High Court, in the appeal preferred by the revenue in the case of Transwitch India (P.) Ltd. (supra), vide order dated 17.07.2013, upheld the adjustment claimed by the assessee on account of capacity utilization. Reliance in this regard is also placed on the recent decision of Delhi Bench of the Tribunal in the case of Dy. CIT v. Panasonic AVC Networks India Co. Ltd. [2014] 63 SOT 121 (URO)/42 taxmann.com 420, wherein the Hon'ble Bench has held that capacity underutilization is an important factor affecting net profit margin as lower capacity utilization results in higher per unit costs which in turn results in lower profits. The relevant finding of the decision reads as under:

"5. Having heard the rival contentions and having perused the material on record, we see no reasons to interfere in very well reasoned findings and directions of the learned CIT (A). Rule 10B (1)(e)(ii) of the Income Tax Rules 1962 does indeed provide that the net profit margin realized in a comparable uncontrolled transaction is adjusted, inter alia, for differences in enterprise entering

into such transactions, which could materially affect the net profit margin in open market. Capacity underutilization by enterprises is certainly an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits. Of course, the fundamental issue, so far as acceptability of such adjustments is concerted, is reasonable accuracy embedded in the mechanism for such adjustments, 'end as long as such an adjustment mechanism can be found, no objection can be taken to the adjustment. In our considered view, the learned CIT (A)'s approach is reasonable in this regard and the adjustments are on a conceptually sound basis. In any case, as pointed out by the learned counsel, the adjustments so directed by the learned CIT(A) have duly been made by the Assessing Officer, and there have been no issues regarding implementing these adjustments. We approve the conclusions arrived by the CIT (A) on this issue and decline to interfere in the matter."

38. In view of the aforesaid, it is respectfully submitted that appropriate adjustment for idle capacity is required to be made while computing the operating margin of the appellant.

39. We have heard rival submissions and perused the material placed on record. We find that there is force in the argument of Ld. Counsel for the assessee that while calculating operating cost, the abnormal cost incurred on account of start-up should be excluded. Following the same parity of reasoning in the cases cited by him and keeping in view that the judgement of ITAT co-ordinate Bench in the case of Transwitch India (P.) Ltd. (supra) affirmed by Hon'ble Delhi High Court. Therefore, respectfully following the decision of Hon'ble High Court, we direct TPO/A.O. to adjust operating cost by excluding abnormal cost incurred on account of

start-up company like salary, rent and depreciation. This matter is restored to the file of TPO/A.O. to re-determine the operating cost on the above lines to arrive at operating profit."

3.6.7 Respectfully following the judgment of the Hon'ble Bombay High Court and the decision/s of the coordinate benches of Tribunal as aforementioned, we are of the considered opinion that the Assessee is entitled to the benefit of capacity adjustment whilst benchmarking the international transaction of SIM Card Assembly.

3.6.8 Another linked issue is regarding computation of capacity adjustment. In our opinion, the methodology adopted by TPO/DRP in computing 'capacity adjustment' whilst only considering the depreciation, is erroneous. Recently, the issue of computation of capacity adjustment has been considered by the coordinate Bench of the Delhi Tribunal in DCIT vs. Claas India (P) Ltd reported in [2015] 62 taxmann.com 173 (Delhi - Trib.) by observing as follows:

"8. We have heard the rival submissions and perused the relevant material on record. Before embarking upon the question of allowability and extent of capacity adjustment under the TNMM, we want to make it clear that the assessee reduced its operating costs by considering its capacity utilization vis-à-vis that of comparables and resultantly claimed that its increased profit as a result of such reduced operating costs be compared with that of the comparables. The TPO has also agreed in principle with the

otherwise availability of the capacity adjustment. The issue of allowing capacity adjustment before us can be divided into two sub-issues for consideration, viz., first, whether the adjustment should be allowed in the hands of the assessee as has been done by the authorities below or comparables and second, how to compute capacity utilization adjustment under the TNMM. We will deal with these aspects one by one.

i. Capacity adjustment should be allowed in whose hands?

9.1 It has been noticed above that the assessee claimed idle capacity adjustment by reducing its own operating costs. It is further observed that the authorities below have reduced the amount of adjustment by excluding certain costs from the ambit of the costs qualifying for adjustment. However, the adjustment has been ultimately allowed from the operating costs incurred by the assessee. In such circumstances, the question arises as to whether the action of the authorities in allowing the reduction of the operating costs incurred by the assessee, is in accordance with law? In order to find answer to this question, we need to refer to the manner of computation of the arm's length price under TNMM, which has been set out in Rule 10B (1)(e) as under:—

> *"(e) transactional net margin method, by which,—*
>
> *(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base ;*
>
> *(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;*

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market ;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction."

9.2 Sub-clause (i) in the process of determination of the ALP under the TNMM talks of the computation of net operating profit margin realized by the assessee from an international transaction. Sub-clause (ii) is the computation of net operating profit margin realized by an unrelated enterprise from a comparable uncontrolled transaction. This refers to determining the operating profit margin of comparables with the same base as that of the assessee. Sub-clause (iii) provides that the net profit margin realized by a comparable company, determined as per sub-clause (ii) above, 'is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.' It is this adjusted net profit margin of the unrelated transactions or of the comparable companies, as determined under sub-clause (iii), which is used for the purposes of making comparison with the net profit margin realized by the assessee from its international transaction as per sub-clause (i).

9.3 Sub-rule (2) of Rule 10B provides that the comparability of an international transaction with an uncontrolled transaction shall be

judged with reference to certain factors which have been enumerated therein. Rule 10B(3) states that an uncontrolled transaction shall be comparable to an international transaction, if either there are no differences between the two or a 'reasonably accurate adjustment can be made to eliminate the material effects of such differences.' When we read sub-clauses (ii) & (iii) of Rule 10B(1)(e) in juxtaposition to sub-rules (2) & (3) of rule 10B, the position which emerges is that the net operating profit margin of comparable companies calls for adjustment in such a manner so as to bring both the international transaction and comparable cases at the same pedestal. In other words, if there are no differences in these two, then the average of the net operating profit margin of the comparable companies becomes a benchmark. However, in case there are some differences between the comparables and the assessee, then the effect of such differences should be ironed out by making suitable adjustment to the operating profit margin of comparables. That is the way for bringing both the transactions, namely, the international transaction and the comparable uncontrolled transactions, on the same platform for making a meaningful and effective comparison. The above analysis overtly transpires that the law provides for adjusting the profit margin of comparables on account of the material differences between the international transaction of the assessee and comparable uncontrolled transactions. It is not the other way around to adjust the profit margin of the assessee. In other words, the net operating profit margin realized by the assessee from its international transaction is to be computed as such, without adjusting it on account of differences with the comparable uncontrolled transactions. The adjustment, if any, is required to be made only in the profit margins of the comparables.

9.4 Reverting to the facts of the instant case, we find that the authorities below have adjusted the operating costs of the assessee in allowing the capacity adjustment. As against that, the correct course of action provided under the law is to adjust the operating costs of the comparable and their resultant operating profit. There is hardly need to accentuate that there can be no estoppel against the law. Once the law enjoins for doing a

particular thing in a particular manner alone, it is not open to anyone to adopt a contrary or different approach. As the authorities below have adopted a course of action in allowing adjustment, which is not in consonance with law, we cannot approve the same. The impugned order is set aside and the matter is restored to the file of the TPO/AO for giving effect to the amount of idle capacity adjustment in the operating profit of the comparables and not the assessee.

ii. How to compute capacity utilization adjustment under TNMM:

10.1 Under the TNMM, the ALP of an international transaction is determined by computing and comparing the percentage of operating profit margin realized by the assessee with that of the comparables. We have noticed above that the difference in the capacity utilizations is an important factor, which needs to be adjusted. No mechanism has been given under the Act or the rules for computing the amount of capacity utilization adjustment.

10.2 On an overall understanding, we feel that under the TNMM, the first step in granting capacity utilization adjustment is to ascertain the percentage of capacity utilization by the assessee and comparables. There can be no difficulty in working out these percentages. The second step is to give effect (positive or negative) to the difference in the percentage of capacity utilizations of the assessee vis-à-vis comparables, one by one, in the operating profit of comparables by adjusting their respective operating costs. Operating costs can be either fixed or variable or semi-variable. One needs to split semi-variable costs into the fixed part and variable part. In so far as the variable costs and the variable part of the semi-variable costs are concerned, these remain unaffected due to any under or over utilization of capacity. Accordingly, such variable operating costs remain unchanged. The adjustment is called for only in respect of the fixed operating costs and fixed part of semi-variable costs. Such costs are scaled up or down by considering the percentage of capacity utilization by the assessee and such comparable. It can be illustrated with the help of a simple example. Suppose the fixed costs incurred by a comparable (say, A) are Rs. 100 and it has capacity utilization of 50% as

against the capacity utilization of 25% by the assessee. The above percentages show that the assessee has incurred full fixed costs with 25% of the utilization of its capacity, as against A incurring full fixed costs with 50% of its capacity utilization. This divulges that the assessee has incurred relatively more fixed costs and A has incurred lower costs. In order to make an effective comparison, there arises a need to obliterate the effect of this difference in capacity utilizations. It can be done by proportionately scaling up the fixed costs incurred by A so as to make it fully comparable with the assessee. This we can do by increasing the fixed costs of A to Rs. 200 (Rs. 100 into 50/25) as against the actually incurred fixed costs by it at Rs. 100. When we compute operating profit of A by substituting the fixed costs at Rs. 200 with the actually incurred at Rs. 100, it would mean that the fixed costs incurred by the assessee and A are at the same capacity utilization. There can be converse situation as well. Suppose the fixed costs incurred by a comparable (say, B) are Rs. 100 and it has capacity utilization of 25% as against the capacity utilization of 50% by the assessee. The above percentages show that the assessee has incurred full fixed costs at 50% of the utilization of its capacity, as against B incurring full fixed costs at 25% of the capacity utilization. This deciphers that the assessee has incurred relatively lower fixed costs and B has incurred higher costs. This difference in capacityutilizations can be eliminated by proportionately scaling down the fixed costs incurred by B so as to make it fully comparable. This we can do by reducing the fixed costs of B to Rs. 50 (Rs.100 into 25/50) as against the actually incurred fixed cost by it at Rs.100. When we compute operating profit of B by substituting the fixed costs at Rs. 50 with the actually incurred at Rs. 100, it would mean that the fixed costs incurred by the assessee and B are at the same capacity utilization level.

10.3 Turning to the facts of the instant case, we find that both the TPO as well as the ld. CIT(A) have proceeded on a wrong premise not only by allowing capacity utilization adjustment in the assessee's profit, which is contrary to the legal position as discussed above, but also by considering all the comparables as

one unit with the average percentage of their respective capacity utilizations. It is further observed that in the calculation of such capacity utilization adjustment, the ld. CIT (A) has considered four companies as comparable, which view has been modified by us supra inasmuch as we have held that M/s Eicher Motors and M/s. Force Motors are incomparable. Naturally, they would also go out of reckoning in the computation of idle capacity utilization adjustment. In the absence of the availability of financials of all the comparable companies, it is not possible at our end to work out the amount of capacity adjustment in the manner discussed above. Ergo, we set aside the impugned order and direct the TPO/AO to work out the amount of capacity utilization adjustment afresh in terms of our above observations. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings."

3.6.9 Respectfully following the decision of the coordinate bench of the Tribunal in DCIT vs. Claas India (P) Ltd. reported in [2015] 62 taxmann.com 173 (Delhi - Trib.), we are of the opinion that the issue of computation of capacity adjustment requires reconsideration and is thus, restored to file of AO/TPO for re-computation in light of our observations in the preceding paragraph, after granting sufficient opportunity of hearing to the assessee.

3.7.0 The next issue is regarding allowability of working capacity adjustment. Before us, the Ld. Counsel for the assessee has vehemently argued that the TPO/Ld. DRP has erred in not allowing working capital adjustment in terms of Rule 10B (1)(e)(iii) read with

Rule 10B(2)/ (3) of the Rules. He pointed out that during the relevant period, working capital adjustment has been granted for Software Development Segment, however, the same has not been granted for the SIM Card Assembly Segment. Placing reliance on the recent decision of the coordinate Bench of the Delhi Tribunal in Agilent Technologies (International) (P) Ltd. vs. ITO reported in [2018] 91 taxmann.com 59 (Delhi - Trib.), he submitted that the claim of working capital adjustment is to be allowed for service industry also. He argued that such an adjustment is restricted to inventory, trade receivables and trade payables. It was submitted that if a company carries high trade receivables, it would mean that it is allowing its customers relatively longer period to pay their dues, which will result into higher interest cost and the resultant low net profit. Similarly, by carrying high trade payables, a company benefits from a relatively longer period available to it for paying back the dues to its suppliers, which reduces the interest cost and increases profits. In order to neutralize the differences on account of carrying high or low inventory, trade payables and trade receivables, as the case may be, it becomes eminent to allow working capital adjustment so as to bring the case of the assessee at par with the other functionally comparable entities.

3.7.1 On the other hand, the Ld. CIT Departmental Representative placed heavy reliance on the order of lower authorities.

3.7.2 We have heard the rival submissions of the parties and perused the relevant material on record. We are of the opinion that once the TPO/Ld. DRP has principally allowed the claim of working capital adjustment with respect to Software Development Segment than there is no occasion to disallow similar claim for SIM Card Assembly Segment. Now there are various guidelines and factors that have been laid down to work out the working capital adjustment and accordingly, we direct the assessee to provide the detailed working of the working capital adjustment to the TPO and he is directed to verify the correctness of the amount and the working capital adjustment as given by the assessee and allow the same in accordance with settled principles. Thus, with this direction, this issue is treated as allowed for statistical purposes.

3.8.0 Having considered the main arguments of the assessee regarding allowability of proportionate adjustment, capacity adjustment and working capital adjustment and allowing the same for statistical purpose, while restoring them to the file of AO/TPO for computation, we are not inclined to adjudicate on the other alternative legal issues regarding admissibility of internal comparable and taking foreign AE as the tested party. The assessee is, however,

at liberty to raise such issues before the lower authorities, should the need arise.

3.9.0 Ground No. 6 of the appeal dealing with levy of interest under section 234B of the Act, is disposed off as being mandatory and consequential.

3.10.0 Ground No. 7 of the appeal deals with corporate tax issue regarding not granting full credit of advance tax of Rs.20,698,500/- paid by the Assessee and also short credit of tax deducted at source of Rs.15,01,872/- on the income of the appellant. The Ld. Counsel for the assessee has prayed that this issue may be restored to the file of the AO for verification. Per contra, the Ld. CIT Departmental Representative has fairly conceded that she has no objection with verification of such claim. In terms of the above, we direct the AO to verify and allow the claim of the Assessee regarding granting full credit of advance tax of Rs.20,698,500/- paid by the Assessee and also short credit of tax deducted at source of Rs.15,01,872/-.

4.0 In the final result, the appeal of assessee is partly allowed for statistical purposes in terms of our above observations.

Order pronounced in the open court on 23.08.2018

Sd/-	**Sd/-**
(PRAMOD KUMAR)	**(SUDHANSHU SRIVASTAVA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Dated: 23rd August, 2018

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

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ASSISTANT REGISTRAR
ITAT NEW DELHI