

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE
BEFORE SHRI. B. R. BASKARAN, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

IT(TP)A No.2533/Bang/2017
Assessment Year : 2013 – 14

iPass India Pvt. Ltd., Level 5, Prestige Solitaire, No.6, Brunton Road, Bengaluru-560 025.	Vs.	The Income Tax Officer, Ward-3(1)(1), Bengaluru.
PAN – AABCG 3659 G		
APPELLANT		RESPONDENT

Appellant by	:	Shri Chavalli Narayanan, C.A
Respondent by	:	Shri Muzaffar Hussain, CIT (DR)

Date of Hearing	:	12-03-2020
Date of Pronouncement	:	24-04-2020

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal has been filed by assessee against final assessment order dated 27/09/2020 passed by Ld. ITO Ward-3 (1) (1), Bangalore under section 143 (3) read with section 144C of the Act, for assessment year 2013-14 on following grounds of appeal:

Based on the facts and circumstances of the case and in law, iPass India Private Limited (hereinafter referred to as 'Appellant'), respectfully craves leave to prefer an appeal against the order passed by the learned Assessing Officer (hereinafter referred to as the 'learned AO') in pursuance to the directions issued by the Hon'ble Dispute Resolution Panel ('DRP') under section 143(3) read with section 144C of the Income Tax Act, 1961 ('the Act') on the following grounds:

That on the facts and circumstances of the case and in law:

- 1. The learned AO/Transfer Pricing Officer ('TPO'), based on the directions of the DRP, erred in law and in facts, by making an addition of Rs.221,11,804 on account of adjustment to the arm's length price in respect of the international transaction relating to provision of software development services by the Appellant to its Associated Enterprise ('AE');*
- 2. The learned AO/TPO and the learned DRP have erred, in law and in facts, by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act, read with the Income Tax Rules, 1962 ('Rules'), conducting a fresh economic analysis for the determination of the Arm's Length Price ('ALP') in connection with the impugned international transaction of software development services, and holding that the Appellant's international transaction is not arm's length;*
- 3. The learned AO/TPO has erred, in law and facts, by exercising his powers under section 133(6) of the Act to obtain information which was not available in public domain and relying on the same for comparability purposes to determine the ALP for the impugned international transaction of software development services;*
- 4. The learned AO/TPO and the learned DRP have erred, in law and in facts, by rejecting certain comparables considered by the Appellant in the comparability analysis by applying the following quantitative and qualitative filters :*
 - a) The learned AO/TPO and the learned DRP have erred, in law and in facts, by rejecting companies having turnover less than Rs.1 crore as a comparability criterion;*
 - b) The learned AO/TPO and the learned DRP have erred, in law and in facts, by determining the arm's length margin/ price using only FY 2012-13 data which was not available to the Appellant at the time of complying with the transfer pricing documentation requirements;*
 - c) The learned AO/TPO and the learned DRP have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant for having different accounting year (i.e. companies having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months);*
 - d) The learned AO/TPO and the learned DRP have erred, in law and in facts, by not accepting the Appellant's plea that companies should not be rejected using employee cost greater than 25% of the total revenues as a comparability criterion;*
 - e) The learned AO/TPO and the learned DRP have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant where consolidated results have been used for analysis. The Appellant had considered the consolidated results in only those cases where the income of the Indian company constituted more than 75% of the consolidated companywide / segmental revenues;*

- f) The learned AO/TPO and the learned DRP have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant using export earnings greater than 75% of the sales as a comparability criterion;*
- 5. The learned AO/TPO and learned DRP have erred, in law and in facts, by accepting I rejecting companies based on unreasonable comparability criteria;*
 - 6. The learned AO/TPO and the learned DRP have erred, in law and in facts, by providing adverse working capital adjustment without appreciating the fact that the Appellant is a captive service provider of the AE;*
 - 7. The learned AO/TPO and learned DRP have erred, in law and in facts, by not making suitable adjustments on account of differences in the risk profile of the Appellant vis-à-vis the comparables, while conducting comparability analysis;*
 - 8. The learned AO/TPO and the learned DRP have erred, in law and in facts, by computing the arm's length price without giving benefit of +/-3 percent under the proviso to section 920(2) of the Act;*
 - 9. The learned AO has erred, in law and in facts, in imposing the interest under Section 234A and Section 234B of the Act;*
 - 10. The learned AO has erred, in law and in facts, by initiating penalty proceedings u/s 271(1)(c) of the Act.*

The Appellant submits that each of the above grounds is independent and without prejudice to one another.

The Appellant craves leave to add, alter, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide on the appeal in accordance with the law.

Brief facts of the case are as under:

2. Assessee is a company and filed its return of income on 16/12/2013 for year under consideration declaring total income of Rs.3,81,65,121/-. Return was processed under section 143(1). Subsequently, notice under section 143(2) and 142(1) were issued and served on assessee. In response to statutory notices, representative of assessee appeared before Ld.AO and filed requisite details as called for.

3. Ld.AO observed that assessee had entered into international transaction exceeding Rs.15 crores with its associated

enterprises. Accordingly reference was made to the transfer pricing officer under section 92CA of the Act.

4. Upon receipt of reference, Ld.TPO called upon assessee to file economic details of international transaction in Form 3 CEB. From details filed by assessee, it was observed that assessee during the year had following international transaction with its associated enterprises:

Particulars	Amount
Software development services	Rs.21,90,21,815/-

5. Ld.TPO observed that assessee used TNMM as most appropriate method and OP/OC as PLI to compute arms length margin of international transaction at 15.33%. Ld.TPO observed that assessee used following 26 comparables in TP study:

S. No	Name of the Company	Weighted Average (%)
1	Akshay Software Technologies Limited	6.74%
2	Blue Star Infotech Limited (Consolidated)	7.18%
3	Caliber Point Business Solutions Limited (Segmental)	3.19%
4	Cat Technologies Limited	-1.75%
5	CG-VAK Software & Exports Limited (Segmental)	1.44%
6	Cigniti Technologies Ltd.	8.63%
7	Evoke Technologies Private Limited	10.44%
8	Goldstone Technologies Limited	8.52%
9	Helios& Matheson Information Technology Limited	16.13%

10	Larsen & Toubro Infotech Limited	22.92%
11	Lucid Software Limited	27.68%
12	Maveric Systems Limited	-9.68%
13	Mindtree Limited (Segmental)	15.98%
14	Persistent Systems and Solutions Limited	16.00%
15	Persistent Systems Limited	26.66%
16	Priya Softweb Solutions Private Limited	14.03%
17	R S Software (India) Limited	16.58%
18	R.Systems International Ltd (Segmental)	7.95%
19	Sasken Communication Technologies Ltd	14.14%
20	Satyam Computer Services Ltd	14.71%
21	Saven Technologies Limited (Segmental)	17.30%
22	Silverline Technologies Ltd	14.25%
23	Thinksoft Global Services Limited	13.73%
24	Thirdware Solutions Limited	18.12%
25	Ybrant Digital Limited (Ermerly known as LGS Global Ltd)	13.60%
26	Zylog Systems Limited	29.04%
	Arithmetical Mean	12.83%

As average margin of these comparables were 12.83% is, assessee held its transaction to be at arms length.

6. Ld.TPO applied following filters to comparables selected by assessee and accepted comparables viz., Larsen and Toubro Infotech Ltd, mind tree Ltd, persistent systems Ltd, RS software (India) Ltd and CG-VAK Software and Exports Ltd.

S.No.	Filters
1	Companies whose data for FY 2012-13 is not available - excluded
2	Companies whose Software development service income < Rs.1 Crore - excluded

3	Companies whose software development services revenue is < 75% of the total operating revenues - excluded
4	Companies which have more than 25% related party transactions of the sales - excluded
5	Companies which have less than 75% of the sales as export service income - excluded
6	Companies having different financial year ending - excluded
7	Companies with employee cost less than 25% of turnover - excluded

7. Ld.TPO rejected balance 21 comparables. Margin computed by Ld.TPO in respect of comparables finally selected are as under:

S. No	Name of the Company	(OP/OC)
1	CG-VAK Software & Exports Limited	20.54%
2	Larsen & Toubro Infotech Limited	26.06%
3	Mindtree Limited	18.19%
4	Persistent Systems Limited	28.27%
5	R S Software (India) Limited	17.41%
6	ICRA Techno Analytics Ltd	17.10%
7	Tech Mahindra Limited	18.72%
AVERAGE MARGIN (unadjusted)		20.90%
Less: Working capital adjustment		-5.36%
AVERAGE MARGIN (adjusted)		26.26%

It has been submitted that Ld.TPO provided with adverse working capital adjustment of -5.36%

8. Ld.TPO thus proposed adjustment under section 92CA being shortfall amounting to Rs.2,15,34,608/-. DRP also upheld the working capital adjustment computed by Ld.TPO.

Aggrieved by proposed adjustment, assessee raised objections before DRP.

9. DRP in their order, after considering submissions advanced by assessee, excluded 1 comparable viz., Tech Mahindra Ltd and upheld the remaining 6 comparables selected by Ld.TPO.

Ld.AR submitted that **Ground No.1-4** are general in nature is and therefore do not require adjudication.

10. In **Ground No.5** assessee seeks exclusion of persistent systems Ltd., and inclusion of Akshay software technologies Ltd.

14. Assessee has raised **Additional ground no.11**, under rule 11, which reads as under:

Ground 11: The Learned AO/TPO and Hon'ble DRP erred in retaining Larsen and Toubro Infotech Ltd., as comparable company though it is functionally dissimilar to the appellant company.

10.1. Ld.AR submitted that failure to raise this ground at an earlier stage was not wilful. It has been submitted that by way of abundant caution assessee raises exclusion of this comparable. It has been submitted that, though this comparable was a part of assessee's own list in TP study, assessee now seeks to challenge this comparable for exclusion due to various differences in risk profile.

10.2. Ld.CIT.DR submitted that, in the event this comparable is admitted to be considered, it may be sent back to Ld.AO/TPO as objections raised by assessee in respect of these comparables have not been analysed/verified.

10.3. Considering the submissions advanced by both sides, we note that comparable arises out of assessment records and no new facts needs to be referred to for adjudicating the same. We also refer to the decision of *Special Bench* in case of *DCIT vs*

Quark Systems, reported in (2010) 38 SOT 307, wherein it was held that;

“.....even if assessee had taken ‘D’ as a comparable in its transfer pricing audit, still it was entitled to point out to Tribunal that said enterprise had wrongly been taken as a comparable.”

10.4. In lieu of the above, respectfully following the ratio is laid down by *Hon’ble Supreme Court* in case of *Jute Corporation India vs CIT* reported in 187 ITR 688 and *National Thermal Power Corporation vs CIT* reported in 229 ITR 383, and *DCIT vs Quark Systems* (supra), we admit additional ground raised by assessee.

Accordingly Additional ground no.11 raised by assessee stands admitted.

11. Before we undertake the comparability analysis, it is *sine qua non* to understand functions performed, assets owned and risks assumed by assessee under this segment.

11.1. Functions:

In TP study at page 217, assessee has been set to work on a constant eye trade to model known as Scrum, which is one of the implementation approaches under Agile methodology of software development. It has been submitted in TP study that assessee undertakes Limited functional specifications and requirement analysis. However under coding and documentation, assessee generates and maintains documentation for coding undertaken by it. It is also been stated that assessee along with AE undertake project management jointly. Assessee interacts play regularly with associated enterprise and project tracking happens through emails and conference calls. It has been submitted that the U.S. associated enterprise undertake system testing to evaluate

compliances with the specified requirement and the final release of software to customer is also undertaken by the U.S. associated enterprise.

11.2. Assets employed

It has been submitted that apart from routine tangible assets like computer equipment, office equipment, furniture fixtures assessee do not own any intangibles.

11.3. Risks assumed

It has been stated that assessee assumes Ltd market risk in the process of rendering services to associated enterprises.

11.4. Characterisation:

From the basis of above FAR analysis, assessee has been characterised as routine software development service provider carrying out routine functions and bearing minimal risk typically born by Contract service provider operating in these industry.

Based on above characterisation, we shall consider the comparability of comparables alleged by assessee for exclusion/inclusion.

12. Ground No. 5-6:

Ld.AR submitted that assessee seeks exclusion of persistent systems Ltd.

12.1. He submitted that this comparable is functionally not similar with assessee as it is engaged in software product services and technology innovations. He also submitted that there is no segmental information available in respect of various segments undertaken by this company. Ld.AR also submitted that this company is engaged in extensive in-house research and development activities. Placing reliance on assessee's own case

for assessment year 2012-13 Ld.AR submitted that this tribunal has directed exclusion of this comparable.

12.2. On the contrary Ld.CIT DR placed reliance upon orders passed by authorities below.

12.3. We have perused submissions advanced by both sides in light of records placed before us.

12.3.1. Annual report of this comparable has been placed at page 510-713 of paper book. Profit and loss account at page 610 reveals that assessee earns revenue from operations amounting to Rs. 12, 945.12 crores. Scheduled 22 shows that the entire revenue has been earned from sale of software services. At page 616 of paper book in notes forming part of consolidated financial statements suggest that revenue recognition also involves revenue from royalty. It is also clear at page 603 that this company is exposed to risks unlike assessee that is a captive service provider. Under such circumstances we do not find it appropriate to consider this comparable in the finalist. It is noted that in preceding assessment year this *Tribunal* has excluded this comparable on these dissimilarities. Assessee has been found to be a captive service provider even during the year under consideration and a high risk bearing company cannot be considered to be a comparable with assessee which is a risk mitigated company.

Accordingly we direct Ld. AO/TPO to exclude this company from final list.

13. In additional ground assessee seeks exclusion of Larsen and Toubro Infotech Ltd. We note that authorities below have not considered this comparable having regard to objections raised by

assessee. Ld.AR has submitted that this comparable was also excluded by this tribunal in the preceding assessment year.

13.1. We are of opinion that this comparable should be set-aside to Ld.AO/TPO to verify comparability, based on objections raised by assessee. Needless to say that, proper opportunity of being heard may be granted to assessee in accordance with law.

Accordingly, this comparable raised by assessee stands set aside to Ld.AO/TPO.

14. Assessee seeks inclusion of Akshay Software Technologies Ltd.

14.1. It has been submitted by Ld.AR that this company is functionally similar with that of assessee. Referring to the reply filed by this comparable under section 133(6) forming part of assessment proceedings before Ld.TPO, Ld.AR submitted that this comparable should be considered in finalist. Ld.AR submitted that observations of DRP that this comparable is engaged in providing professional services, procurement, installation, implementation, support and maintenance, ERP products and services in India and overseas. The Ld.AR submitted that, as these were not in the nature of software development, the DRP directed its exclusion. He submitted that revenue earned by this comparable is software services for which segmental information is available. Note 29 at page 1 to 10 reveals that this company earns foreign currency from export of software services.

14.2. On the contrary Ld. CIT DR submitted that submitted that it is an accepted position that this company is providing ERP products and services. Further it is also an admitted position

that this company is operating in variance segments including software product however the segmental information available is only as income from software services. Ld.CIT DR submitted that going by parameters applied by assessee to exclude Persistent Systems Infotech Ltd., this comparable also deserves to be included as there is sale of products for which segmental information is are not available. He also refer to the decision of this *Tribunal* in case of *M/s metric stream Infotech (India) private limited vs DCIT in ITA (TP) A No. 1418 and 2735/B/2017 for assessment year 2013-14* wherein this comparable has been upheld for exclusion.

14.2. We have perused submissions advanced by both sides in light of records placed before us. We also perused decision relied upon by Ld.CIT DR in case of *M/s Metricstream Infotech (India) Pvt.Ltd (supra)*.

14.2.1. It is noted that this tribunal excluded this comparable for the reason that the nature of services are doubtful. Before us Ld. A.R. has not been able to establish the correct nature of business carried out by this company or provide with segmental information is in respect of various services provided by this company to its clientele. Under such circumstances we are unable to appreciate the argument advanced by Ld. ar for inclusion of this comparable.

14.2.2. Respectfully following the view taken by this tribunal in case of *M/s Metricstream Infotech (India) Pvt.Ltd (supra)*, we uphold exclusion of this comparable.

Accordingly this comparable deserves to be excluded from finalist.

Accordingly Grounds 5-6 raised by assessee stands partly allowed.

15. Ground No. 6 has been raised by assessee for providing negative working capital adjustment.

15.1. It has been submitted that Ld.TPO determined arm's length price by making a negative working capital adjustment which has been upheld by DRP. Admittedly assessee do not bear any working capital risk as compared to the comparables. If at all any working capital adjustment is to be made in such a situation, it would be a positive working capital adjustment to bring the comparables on par with assessee.

15.2. We therefore direct Ld.AO/TPO to recompute working capital adjustment in actuals to the selected comparables to make them comparable with assessee.

Accordingly, this ground raised by assessee stands allowed for statistical purposes.

16. Ground No.8 is academic in nature at this stage.

17 Ground No.9 is premature and **Ground No.10** is consequential and therefore do not require adjudication.

In the result appeal filed by assessee stands partly allowed as indicated hereinabove.

Order pronounced in the open court on 24th April, 2020.

Sd/-
(B. R. BASKARAN)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 24th April, 2020.
/Vms/*

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,
Income-Tax Appellate Tribunal.
Bangalore.