

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

M/s. Extentia Information Technology Pvt. Ltd., Extentia Tower, Survey No.209-1,2,3, Sub Plot No.34, Road No.12A, Kalyani Nagar, Pune – 411 006 PAN : AAACE7933M	Vs.	DCIT, Circle-1(2), Pune
Appellant		Respondent

Date of hearing	02-03-2020
Date of pronouncement	04-03-2020

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 28-08-2017 passed by the Assessing Officer (AO) u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2013-14.

2. Modified grounds have been filed and also certain additional grounds have been raised by the assessee. Since the additional

grounds involve pure question of law and do not require any fresh examination of facts, we admit them in the hue of the judgment of Hon'ble Supreme Court in *National Thermal Power Company Ltd. Vs. CIT (1998) 229 ITR 383 (SC)*.

3. The first issue raised by the assessee through modified ground no.1 and additional ground no.7 is that the reference made by the AO to the Transfer Pricing Officer (TPO) for determining the ALP of a 'specified domestic transaction' and, in turn, determination of Arm's Length Price (ALP) by the TPO of the 'international transaction' is invalid and violative of the provisions of section 92CA of the Act.

4. Briefly stated, the facts of the case, as are material for this issue, are that the assessee filed its return declaring total income at Rs.1,99,54,082/-. Certain international transactions were reported in Form No.3CEB. The AO made a reference to the TPO for determining the ALP of the reported 'Specified Domestic Transaction' (SDT) amounting to Rs.7,07,45,549/- after obtaining due approval from the Pr. CIT. The TPO recommended transfer pricing adjustment of Rs.1,11,28,742/- to the value of the

‘International transaction’. A draft order was passed accordingly. The Dispute Resolution Panel (DRP) gave certain directions which had the effect of reducing the amount of transfer pricing adjustment from Rs.1.11 crore and odd to Rs.79,81,424/- in the final assessment order. Aggrieved thereby, the assessee is in appeal before the Tribunal.

5. The first legal issue raised by the assessee through the above referred additional and modified grounds is that the TPO erred in determining the ALP of the ‘international transaction’ when the reference made by the AO was only for the ‘specified domestic transaction’. The ld. AR invited our attention towards the letter dated 08-09-2015 written by the AO to the Pr. CIT seeking permission for making a reference to the TPO for determining the ALP of the ‘specified domestic transaction’ amounting to Rs.7,07,45,549/- and the ‘international transaction’ of Rs. Nil. A copy of this letter has been placed at page 186 of the paper book. The Pr. CIT accorded such permission vide his letter dated 21-09-2015. Thereafter, the AO made a reference to the TPO for determining the ALP of the ‘specified domestic transaction’ of Rs.7.07 crore and the ‘international transaction’ of Rs. Nil through

his letter dated 13-10-2015, a copy of which is available at page 188 of the paper book. The TPO determined the ALP of the 'international transaction' with book value of Rs.7.07 crore by proposing transfer pricing adjustment of Rs.1.11 crore. The case of the assessee is that the TPO was incompetent to determine the ALP of the 'international transaction' when the reference made to him by the AO was only for the 'specified domestic transaction' of equal value. The Id. DR strenuously opposed the contention.

6. Having heard the rival submissions and gone through the relevant material on record, it is observed from the Form No.3CEB, a copy of which has been placed at page 25 onwards of the paper book, that on the front page under Part A of the Form, the assessee reported value of Rs.2,60,04,296/- against column No. 8: "Aggregate value of *international transactions* as per book of accounts". Against the Column No. 9: "Aggregate value of *Specified Domestic Transactions* as per books of accounts", the assessee reported value of Rs.7,07,45,549/-. As per the relevant Instructions at the material time, the AO was admittedly bound to make a reference to the TPO in case the value of the reported international transactions/specified domestic transactions

exceeding Rs.15/5 crore. Acting upon the report of the assessee in Form No.3CEB wherein the aggregate value of the 'specified domestic transactions' was shown at Rs.7.07 crore, the AO sought approval from the Pr. CIT and made a reference to the TPO for determining the ALP of the 'specified domestic transactions' of Rs.7.07 crore. The TPO during the course of proceedings before him observed that the value of Rs.7.07 crore was in relation to 'international transactions' and not the 'specified domestic transactions'. He accordingly determined the ALP of the international transaction of Rs.7.07 crore.

7. The case of assessee before the Tribunal is that section 92CA does not permit the TPO to determine the ALP of a transaction not referred to him by the AO. The ld. AR argued that since it was the 'specified domestic transaction' which was referred to him by the AO, he ought not to have proceeded with the determination of the ALP of the 'international transaction'.

8. We do not find any substance in the view bolstered on behalf of the assessee in the facts and circumstances of the present case. Sub-section (1) of section 92CA provides that where an assessee has entered into an international transaction or specified domestic

transaction and the AO considers it necessary, he may with the previous approval of the Pr. CIT refer the computation of the ALP in relation to the said international transaction or SDT to the TPO. Sub-section (2) provides that where a reference is made under sub-section (1), the TPO shall serve a notice on the assessee to produce relevant evidence for its computation of the ALP in relation to the international transaction or the SDT. Sub-section (2A) of section 92CA provides that where “any other international transaction”, other than an international transaction referred to in sub-section (1) comes to the notice of the TPO during the course of proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1). The point to be noted here is that whereas sub-sections (1) and (2) of section 92CA talk of both the ‘international transactions’ as well as the ‘SDTs’, sub-section (2A) refers only to the ‘other international transaction’ and not the “other SDT”. Similar is the prescription of sub-section (2B) of section 92CA which provides that where the assessee has not reported an “international transaction” in Form no. 3CEB, and such international transaction comes to the notice of the TPO, the

provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1). On going through the language of sub-sections (2A) and (2B) in juxtaposition to sub-sections (1) and (2) of section 92CA, it becomes explicitly manifest that when the AO makes a reference to the TPO for determining the ALP of an international transaction or SDT, the TPO is supposed to determine the ALP of such transactions. If, however, during the course of proceedings, another international transaction, whether reported or unreported, comes to the notice of the TPO, then he is competent to directly proceed with the determination of its ALP without going through the process of the AO first seeking approval from the Pr. CIT or making a reference to him. The caveat is that the power of the TPO under sub-sections (2A) and (2B) extends only to the 'international transactions' and not the 'SDT'. In other words, if a SDT comes to the notice of the TPO during the course of proceedings before him, for which either no reference was made by the AO or was not reported, then he is not entitled to determine the ALP of such a SDT directly.

9. The core of controversy in the extant case is that the AO made a reference for determination of the ALP of 'specified domestic transaction', whereas the TPO determined ALP of the 'international transaction.' The contention advanced on behalf of the assessee is that such a determination by the TPO is invalid. There is no doubt that the reference by the AO to the TPO was made for the SDT amounting to Rs.7.07 crore on the basis of the report by the assessee in Form No.3CEB which states the value of SDT as per books of accounts at Rs.7.07 crore. Since the stated value of the SDT was more than Rs.5.00 crore, it was obligatory on the part of AO to make a reference to the TPO for determining its ALP. It was on the basis of the report furnished by the assessee itself that the AO first sought approval from the Pr. CIT and then made a reference to the TPO for determining the ALP of the reported SDT with value of Rs.7.07 crore. The Id. AR fairly confessed that it was, in fact, a mistake on the part of the assessee in reporting wrong values in Column Nos. 8 and 9 of Form No. 3CEB in as much as the correct value of the international transaction was Rs.7.07 crore and that of SDT was Rs.2.60 crore. Once the assessee misreported the figures of SDT and international

transaction, it cannot be allowed to turn around later and seek benefit of its own mistake by contending that the proceedings be set aside as violative of the provisions of section 92CA. The objection would have merited consideration if the assessee had correctly reported but the AO would have made a wrong reference. The initiation of the entire exercise by the AO in making a reference to the Pr. CIT for seeking approval and then to the TPO for determining the ALP is wholly founded on the reporting by the assessee itself. Now, the assessee cannot be allowed to raise a claim before the Tribunal that even though it committed a mistake in reporting the figures of the international transactions and the SDTs correctly, still the authorities should have acted on the basis of correct figures.

10. The ld. AR tried to build up his case by pointing out that the assessee intimated this mistake to the AO as well as the TPO vide its letter dated 22-03-2016 served on the TPO on 27-03-2016. It was submitted that when the mistake was brought to the notice of the authorities, it became necessary for them to discard the earlier reference and make a fresh reference for determination of ALP of the international transaction instead of the SDT.

11. We have seen the letter dated 22-03-2016 through which the assessee allegedly rectified its mistake and intimated the correct figures to the AO/TPO. On going through the letter, a copy of which has been placed at page 166 of the paper book, it can be seen that the assessee simply stated that “the amount of SDT is below the prescribed limit” and “the amount of international transaction is Rs.7,07,45,549/-”. Fully aware of the earlier wrong reporting, the assessee still did not open the cards by correctly stating that there was a mistake in the earlier report in Form No. 3CEB, which it was seeking to rectify. With the correct figures of the value of international transactions and the SDTs below the prescribed limit for making a reference to the TPO, the time available with the AO for completing the assessment had squeezed to 31-3-2016, giving him a period of less than a week to take up and complete the entire assessment. We cannot accord our imprimatur to such type of practices.

12. Be that as it may, it is found that the correct value of the reported transaction is Rs.7.07 crore, for which a reference was made by the AO to the TPO for determining the ALP. The TPO eventually determined ALP of the transaction with a value of

Rs.7.07 crore. In other words, the TPO correctly determined the ALP of the reported transaction of Rs.7.07 crore for which a reference was made to him, albeit with the nomenclature of 'specified domestic transaction' instead of 'international transaction'. The substance of the matter is that the TPO determined the ALP of transaction of Rs.7.07 crore, which was referred to him by the AO after seeking due permission from the Pr. CIT.

13. Reliance of the Id. AR on the *ratio decidendi* in *Times Global Broadcasting Company Ltd. Vs. UOI (2019) 103 taxmann.com 388 (Bom)* is misconceived as the facts of that case are alien to the facts of the instant case. That case is an authority for the proposition that the TPO cannot assume jurisdiction to determine ALP of a SDT not referred to him. *Au Contraire*, the position which subsists before us is that the TPO determined the ALP of the transaction of Rs.7.07 crore, being the same transaction which was referred to him though as a 'SDT' instead of 'international transaction', and that too on the wrong reporting made by the assessee only. In the context of jurisdiction of the TPO to determine the ALP, we find that there is no distinction between referred international

transactions *por una parte* and specified domestic transactions *por otra parte* u/s 92CA(1) of the Act. Once a reference is made to the TPO for determining the ALP of a transaction (international or SDT), he is bound to do so. Such a distinction between the two becomes significant only when the TPO assumes jurisdiction in terms of sub-sections (2A) and (2B) of section 92CA in the sense that he can proceed only with an international transaction and not with a SDT under the later two sub-sections.

14. The Id. AR fired another salvo by submitting that though the assessee inadvertently reported wrong figures in column nos. 8 & 9, but the further details in other columns of Form No. 3CEB indicated the correct position and the AO accordingly ought to have acted with diligence by examining the report in entirety before making a reference. He accentuated on the language of sub-section (1) of section 92CA which is couched with the words: 'and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval....'. He emphasized that the AO was supposed to act conscientiously before seeking approval from the Pr. CIT for making a reference to the TPO in terms of this provision.

15. Column nos. 8 & 9 of Form No. 3CEB refer to “Aggregate value of *international transactions* as per book of accounts” and “Aggregate value of *Specified Domestic Transactions* as per books of accounts”. Subsequent columns contain break-up of the Column nos. 8 & 9 as to the nature of transactions. At this stage, it is pertinent to note that the AO has an option to either *suo motu* determine the ALP u/s 92C or make a reference to the TPO for doing it u/s 92CA. We have uncontrovertedly noted above, that the AO is bound to make a reference to the TPO in case the aggregate value of the reported international transactions exceed Rs.15 crore and/or that of the reported specified domestic transactions exceed Rs.5 crore. The requirement on the part of the AO to consider it ‘necessary or expedient’ is to be seen only in the context of the cases where the aggregate value of the reported international transactions does not exceed Rs.15 crore and still the AO feels it necessary or expedient to get the ALP determined from the TPO. However, once the aggregate figures as given in Column nos. 8 & 9 exceeds Rs.15/5 crore respectively, it immediately becomes incumbent upon the AO to make a reference to the TPO after taking approval from the Pr. CIT. There is no choice. There

is no question of considering it necessary or expedient. Reference has to be invariably made in such situation. Reverting to the facts and circumstances of the extant case, we find that the AO on finding the figure in column no. 9 reported at Rs.7.07 crore, being the aggregate value of specified domestic transactions as per books of accounts at more than Rs.5.00 crore, had no option but to make a reference to the TPO without going into any further details. The position would have been different if the reported value of the international transaction had been less than the Rs.15 crore and the AO had been contemplating to make a reference to the TPO. In that case, the requirement of considering 'necessary or expedient' would have triggered. This contention of the assessee is also ergo jettisoned.

16. At this juncture, it is necessary to note that sections 92 to 92F were introduced by the Finance Act, 2001 w.e.f. 1.4.2002 requiring determination of the ALP only of the international transactions. The Finance Act, 2012, w.e.f. 1.4.2013 extended the application of such provisions to the specified domestic transactions. The term SDT has been defined in section 92BA to mean any of the transactions of the nature as enumerated therein, not being an

international transaction, 'where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.' Thus as per the definition, transaction(s) otherwise fitting into the nature of transactions stipulated under section 92BA, become 'specified domestic transaction' only when their aggregate exceeds Rs.5 crore. In other words, such transactions are not characterized as SDT unless their aggregate value exceeds Rs.5 crore. If the transactions of the nature given in the section are entered into by the assessee, but their aggregate falls short of Rs.5 crore, there is no need for their benchmarking. Neither there is any obligation on the part of the assessee to report it, nor is it required by the AO to determine its ALP, either himself or through TPO.

17. The case of the assessee is founded on the premise that the correct value of the SDT to be reported in Column no. 9 of Form No. 3CEB was Rs.2,60,04,296/-, which was wrongly reported in Column no. 8 and *vice versa*. We do not understand any *raison d'etre* for the assessee in reporting, at all, the correct value of the transactions of the nature prescribed in section 92BA in the first instance, when it did not cross the threshold of Rs.5.00 crore, so as

to become SDT. The fact that such transactions did not become SDT and required no reporting in Form No. 3CEB coupled with the fact that the assessee still reported it and that too, in a wrong column, gives some strength to the view point canvassed by the Id. DR that the assessee wanted to mislead the Revenue by resorting to the tactic with the ulterior motive.

18. In the ultimate analysis, we hold that no infirmity can be found in the TPO's action in determining the ALP of the 'international transaction' of Rs.7.07 crore.

19. Now we proceed to discuss the issue on merits by which the assessee has challenged the transfer pricing addition of Rs.79,81,424/- made by the AO in the final assessment order.

20. Succinctly, the factual matrix is that the assessee is an Indian company which was incorporated in the year 1988. It is engaged in providing support services related to software design and development of custom and packaged application, testing and communication thereof. The assessee has been providing software development and support services in the areas of embedded multimedia and multimedia applications and communication

systems. The assessee reported two international transactions of “Provision of software development and support services” with transacted value of Rs.69,37,222/- and Rs.6,38,08,327/- with its two Associated Enterprises (AEs) respectively. The assessee applied Transactional Net Marginal Method (TNMM) as the most appropriate method for demonstrating these transactions to be at ALP. For this purpose, it made geographical segments with different profit margins. The TPO aggregated the same and computed the assessee’s PLI at 4.20%. As against certain comparables noted by the assessee, the TPO shortlisted ten companies as comparable with their mean margin of OP/OC at 19.00%. On the basis of such margin, the TPO computed transfer pricing adjustment of Rs. 1,11,28,742/-. The DRP ordered the exclusion of two companies, namely, e-Zest Solutions Ltd. and Priya Softweb Solutions Pvt. Ltd. from the list of comparables, which had the effect of reducing the amount of transfer pricing addition to Rs.79.81 lakh. At this stage, it is relevant to mention that the Id. AR did not raise any objection to the aggregation done by the TPO discarding the assessee’s geographical segments. The assessee is aggrieved by the treatment of foreign exchange

fluctuation as non-operating both for the assessee as well as the Revenue; inclusion of three companies in the list of comparables; and treatment of provision of bad and doubtful debts in respect of certain comparables as an item of non-operating expenses.

21. First of all, we take up the assessee's objection regarding treatment of foreign exchange (forex) gain/loss given by the authorities as an item of non-operating nature in the computation of the ALP of the assessee as well as comparables. The ld. AR contended that the forex gain of the assessee ought to have been considered as operating revenue. We find merit in the contention about the inclusion of foreign exchange gain/loss in the operating revenue/costs of the assessee as well as that of the comparables, but only in respect of transactions in the revenue field and not the capital field. The Special Bench of the Tribunal in *ACIT Vs Prakash I. Shah (2008) 115 ITD 167 (Mum)(SB)* has held that the gain due to fluctuations in the foreign exchange rate emanating from exports is its integral part and cannot be differentiated from the export proceeds simply on the ground that the foreign currency rate has increased subsequent to sale but prior to realization. It went on to add that when goods are exported and invoice is raised

in currency of the country where such goods are sold and subsequently when the amount is realized in that foreign currency and then converted into Indian rupees, the entire amount is relatable to the exports. In fact, it is only the translation of invoice value from the foreign currency to the Indian rupees. The Special bench held that the exchange rate gain or loss cannot have a different character from the transaction to which it pertains. The Bench found fallacy in the submission made on behalf of the Revenue that the exchange rate difference should be detached from the exports and be considered as an independent transaction. Eventually, the Special Bench held that such exchange rate fluctuation gain/loss arising from exports cannot be viewed differently from sale proceeds. What is true for exports is also true for other items of expenses/income of revenue nature.

22. In the context of transfer pricing, the Bangalore Bench of the Tribunal in *SAP Labs India Pvt. Ltd. Vs ACIT (2011) 44 SOT 156 (Bangalore)* has held that foreign exchange fluctuation gain is part of operating profit of the company and should be included in the operating revenue. Similar view has been taken in several

decisions including *Trilogy E Business Software India (P) Ltd. Vs DCIT (2011) 47 SOT 45 (URO) (Bangalore)*.

23. The reliance of the ld. DR on Safe Harbour rules to contend that foreign exchange gain or loss be taken as non-operating, is not sustainable. There is no doubt that in such rules, forex gain/loss has been treated as non-operating. However it is relevant to note that such rules are not applicable to the assessment year under consideration. The Hon'ble Delhi High Court in *Pr. CIT VS. Cashedge India Pvt. Ltd.*, vide its judgment dated 4.5.2016 in ITA 279/2016, has held that : 'So far as the question of fluctuation of foreign exchange was concerned, the ITAT ruled that the relevant provision, i.e. 'Safe Harbour Rules' had not been notified for the concerned assessment year and were, therefore, inapplicable'. Thus the Hon'ble High Court did not disturb the operating nature of forex gain/loss as held by the tribunal.

24. We note from the Notes forming part of the Accounts of the assessee for the year under consideration that one of the transactions involving fluctuation in foreign currency is in the capital field, which is, 'Purchase of capital goods worth Rs.13,85,590/-.' Forex gain/loss in respect of such a transaction

cannot be considered as a part of operating expense/income. The ld. AR candidly admitted that the TPO considered forex gain/loss as non-operating not only for the assessee but also for the comparables. In view of the foregoing discussion, we are of the considered opinion that the amount of foreign exchange gain/loss arising out of revenue transactions is required to be considered as an item of operating revenue/cost, both for the assessee as well as the comparables. We hold accordingly.

25. Now we take up the comparability of three companies challenged by the assessee. In order to appreciate the comparability or otherwise of the companies under challenge, it is *sine qua non* to first understand the functional profile of the assessee. The TPO has briefly referred to the functions carried out by the assessee as that of providing Software Development and Support services in the areas of embedded multimedia, multimedia applications and communication systems as per the requirements of its AEs. There is some further elaboration in the show cause notice dated 19-08-2016 issued by TPO capturing the nature of assessee's services as implementing end-to-end business processes on force.com platform to help companies run effectively. The nature of services

has been noted as existing business process review; implementation of solutions using sales force best practices on the salesforce1 platform; existing application and data migration/import services; integration with third party systems; user interaction customization and work flows; implantation of sales force communities for external users of the origination; development of custom reports and dashboards; analytics and business intelligence and development of App Exchange solutions etc. For having more clarity on the nature of services rendered by the assessee, we have also gone through the Agreements entered into by the assessee with its two AEs. These Agreements also provide that the assessee “agrees to provide Software Development services to the CLIENT (i.e. the A.E.) as described in Work Orders issued by CLIENT from time to time during the period of the Agreement. The term “Work Products” has been defined to consist of work including but not limited to reports, specifications, data, databases, software and documentation that has been developed and delivered by the assessee pursuant to the Work Orders. To sum up, the nature of services provided by the assessee to its AEs is that of software development in the field of multimedia. With the above

understanding of the functional profile of the assessee, we now proceed to examine as to whether the companies under challenge are comparable or not.

1. Thirdware Solutions :

26. The TPO included this company in the list of comparables by rejecting the assessee's contention of the same being functionally different and its turnover being five times more. No relief was allowed by the DRP, which has brought the assessee before the Tribunal.

27. We have heard both the sides and gone through the relevant material on record. A copy of the Annual report of the company has been placed at 212 onwards of the paper book. Page 304 of the paper book is a copy of this company's Profit and loss account which records Revenue from sale of services at Rs.142.25 crore. The authorities have canvassed a view that this company is engaged only in rendering of software services by rejecting the assessee's plea that it was into software products. Page 72 of the Annual report of this company has note on Revenue Recognition under the head "Income from Services". It has been reported that

the: `Revenue from software development and implementation on time and material contracts is recognized and are billable to clients as per the terms of specific contracts. Revenue from sale of user licenses for software applications is recognized on e-delivery of Software License Key to end user'. Though under the head "Revenue from sale of products", this company has shown NIL figure but when we correlate it with other figures from the Profit and loss account, it transpires that this company is also into sale of software products. Under the head "Expenses" at page 304 of the Paper book, this company has recorded a figure of Rs.24.82 crore as "Purchase of stock in trade". Obviously, there can be no purchase of stock in trade if only services are to be rendered. Under the main head of "Disclosure of principal product or services", this company has reported against the sub-head of "Description of product or services" as "Acquisition/purchase of IT Hardware and Software including software as a service (SAAS)". The above discussion amply proves that this company is not exclusively engaged in rendering software services as is the assessee. We, therefore, order to exclude this company from the list of comparables.

2. Infobeans System India Ltd. :

28. The TPO proposed the inclusion of this company which was objected to by the assessee contending that the business model of the company was different. Not convinced, the TPO included it in the list of comparables which was countenanced by the DRP.

29. Having heard both the sides and gone through the relevant material on record, we find that the findings recorded by the lower authorities on this issue are correct. Annual report of this company is available at page 336 of the paper book. Page 348 is a copy of its Profit and loss account with the figure of 'Revenue from operations' standing at Rs.21.30 crore. Break-up of the Revenue is given in Note No.17 with the remarks "Sale of software". The Id. AR contended that it was clear from the Note No.17 that this company had only sale of software and not that of sale of software development services. We do not approve such a contention for the reason that the company used a generalized term of "Sale of software" to represent the amount realized from sale rendering of software development services. This fact is divulged from the Auditor's report on page 344 of the paper book. Under the head: 'In respect of its Inventories', the Auditor has reported that "The

company is Service Company, primarily engaged in Software Development. Accordingly, it does not hold any physical inventory.’ Note No.26 forming part of financial statements categorically records that the figure of Revenue of Rs.21.65 crore is from “Services rendered”. The DRP has correctly recorded that this company apart from involved in software development services is also engaged in providing software product development services and no distinction can be drawn between the activities of software development and software product development services. In our considered opinion, there is a difference in rendering software development services as a Contractor and rendering software development services to and for self. When a contract/job is received for developing a particular software product for and on behalf of a customer, the company developing such software product does not become a software product company, but remains only as a software development service provider. On the other hand, when a company develops its own software product, which is then commercially exploited by giving licenses to the users, then a company is said to be a software product company to that extent. Expenses incurred on development

of such software products are capitalized at the time of incurring and then written off over a period, whereas in case of software development service provider all the expenses are claimed as deduction simultaneous with the revenue received from the rendering of such software development services. It is only when a company develops its software product for self which is licensed to customers that we can say that the company is engaged into software products and not software development services. If on the other hand, a company renders software product development services on contract basis, the company is said to be involved in providing software development services only. Apart from the auditor clearly mentioning InfoBans Systems India Private Limited to be earning all the revenues only from rendering of software services, we find that, unlike a software product company, there is no capitalization of any expenditure on development of software for self in its balance sheet. This shows that this company, like the assessee, is engaged only in providing software development services to its customers.

30. Reliance of the ld. AR on a decision of Mumbai Bench of the Tribunal in *M/s. Emerson Electric Company (India) Pvt. Ltd. Vs. ACIT, decision dated 14-06-2019* for treating this company as comparable is not of any assistance as the relevant discussion has been made while dealing with the assessment year 2014-15 and not the A.Y. 2013-14 as is the year under consideration. The ld. AR also admitted this fact, which is substantiated from the Mumbai Tribunal order noticing the margin of this company at 48.97%, whereas such a margin has been noticed in the case of the assessee at 33.73%. Further there is difference in the figures of revenue. As against Rs.32.96 crore considered by the Mumbai Tribunal, the figure of revenue as considered in the case of the assessee is Rs.21.30 crore. This shows that the Mumbai Tribunal, while holding such company to be not comparable, was dealing with it for the A.Y. 2014-15 and not the A.Y. 2013-14 under consideration. Nature of work and business model of a company can undergo change from one year to another. It goes without saying that one needs to examine the comparability position on year to year basis independently. For one year, a company may be comparable and for the next year, it may cease to be so for a

variety of reasons. We, therefore, hold that the authorities below were justified in including this company in the list of comparables.

3. R.S. Software (India) Ltd. :

31. The TPO included this company in the list of comparables without making much discussion in his order. The assessee approached the DRP which discussed, at para 8 of its direction, the deployment by the TPO of turnover filter of more than Rs.1.00 crore and less than Rs.5.00 crore. After discussing certain decisions, the DRP held that upper turnover filter should be fixed at ten times and lower turnover filter at 1/10th of the turnover of the tested party (the assessee). It, therefore, fixed the upper turnover filter of Rs.250 crore and lower turnover filter of Rs.2.50 crore against the assessee's turnover at Rs.25.17 crore. The AO, while finalizing the assessment and giving effect to the direction of the DRP included R.S. Software (India) Ltd. in the list of comparables. The contention of the assessee is that this company does not pass the turnover filter as stipulated by the DRP.

32. Having heard both the sides and gone through the relevant material on record, we find from the Annual report of this company, copy placed at page 469 of the paper book, that its

“Revenue from operations” stands at Rs.293.22 crore. This shows that the turnover of this company standing at Rs.293.22 crore does not pass the upper turnover filter approved by the DRP at ten times the assessee’s turnover. This has been specifically spelt out by the DRP that: “Therefore, the upper turnover filter is fixed at Rs.250 crores and lower turnover filter is fixed at Rs.2.50 crore”. It is thus evident that the upper turnover filter, as applied by the DRP, does not permit the inclusion of R.S. Software (India) Ltd. in the list of comparables, whose turnover exceeds Rs.250 crore. As the turnover of this company stood at Rs.293.22 crore, it is obviously more than that approved by the DRP.

33. The ld. DR vehemently argued that the turnover filter approved by the DRP is not enshrined in the statute and hence, the same was rightly tinkered with by the AO/TPO at the time of giving effect to its directions. We fully agree with the first part of the contention of the ld. DR that the statute has not provided any upper or lower turnover filter, but the fact of the matter is that in so far as this case is concerned, once the DRP directed to apply a particular filter that became sacrosanct for the TPO. Sub-section (13) of section 144C provides that : `Upon receipt of the directions

issued under sub-section (5), *the Assessing Officer shall, in conformity with the directions, complete the assessment* without providing any further opportunity of being heard to the assessee ...'. It means what is required to be done by the AO at the stage of completing the assessment under sub-section (13) is to first pick up the income determination under the draft order; then ascertain the directions given by the DRP; and thereafter religiously give effect to the same by modifying the income computation as per the draft order strictly in accordance with the direction of the DRP. This manifests that once the matter travels to the DRP, the AO/TPO become bound to give effect to the directions of the DRP *vis-à-vis* the income computation under the draft order. Such directions are mandatory and not directory on the AO. The AO has no option to accept or reject the same in as much he is bound to follow the same, whether or not he agrees with the same. As R. S. Software (*supra*) does not pass the turnover filter approved by the DRP, we order to exclude this company from the list of comparables.

34. Having discussed the inclusion or otherwise of the above referred three companies in the list of comparables, now we proceed to determine the correctness of the profit margin of two comparables, namely, CG-VAK Software and Exports Ltd. and Exilant Technologies Ltd.

35. The assessee has not disputed the *per se* inclusion of these two companies in the list of comparables. The only quarrel is on the computation of their OP/OC. To be precise, the question is about the treatment given by the authorities below to the Provision for bad and doubtful debts as non-operating. The TPO while calculating the profit margin of CG VAK Software and Exports Ltd., reduced the amount of Provision for bad debts at Rs.39,97,218/- from total expenses for working out the OP/OC at 18.40%. The view point of the assessee is that the Provision for bad and doubtful debts ought not have been reduced from operating expenses.

36. We have gone through the Annual report of this company whose copy has been provided on behalf of the assessee. It can be seen from the 'Expenditure' under the head "Operating and other expenses" at Rs.1.87 crore that there is an item of "Provision for

doubtful debts” at Rs.39,97,218/- included in it. The provision for doubtful debts has a direct relation with the sales made by a company. In the same way in which the amount of sales is an item of operating revenue, the amount of provision for doubtful debts, having direct link with the sales, is also an item of operating expense. In our considered opinion, Provision for doubtful debts cannot be treated as a non-operating expense. We, therefore, direct to include the amount of Provision for doubtful debts in the expense side of this company for calculating the profit margin. Similar is the position regarding Exilant Technologies. Provision for bad and doubtful debts of this company stands at Rs.81,91,798/- which can be found in the detail of Other expenses. The TPO while calculating the profit margin of this company reduced such an amount. Following the reasoning given hereinabove, we direct to include Reserve for doubtful debts as an item of operating expenses in calculating the operating profit margin of this company.

37. The only other ground which survives for consideration is the disallowance of Rs.5.00 lakh made by the AO on page 8 of the assessment order. The AO observed that the assessee furnished

details of expenses claimed under the head “Office expenses” at Rs.2,43,38,458/-. These expenses included Administrative expense, Finance and legal charges, Office maintenance, Other expenses and Repairs and maintenance expenses. The assessee furnished only ledger extract of these expenses. The claim was not found to be fully verifiable. An addition of Rs.5.00 lakh was, therefore, made out of such expenses. The assessee did not raise any objection before the DRP on this addition. Accordingly, the AO made the addition in the final assessment order.

38. We have heard both the sides on the point. It is seen that the AO notified the disallowance of Rs.5.00 lakh in the draft order. Having not challenged such disallowance before the DRP, the assessee impliedly accepted such disallowance, which proposition has not been refuted by the Id. AR. His argument was that such a disallowance of Rs.5.00 lakh having been made out of Operating expenses should be excluded while calculating the PLI of the assessee. We agree with this contention for the obvious reason that once a particular expenditure itself is disallowed, there can be no question of including it in the Operating expenses for calculating the profit margin in the process of determination of the ALP.

While upholding the disallowance, we direct to exclude Rs.5.00 lakh from the Operating expenses of the assessee for the purpose of calculation of its ALP.

39. To sum up, we set-aside the impugned order and remit the matter to the file of AO/TPO for a fresh determination of the ALP in terms of the discussion made *supra*. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh determination.

40. In the result, the appeal is partly allowed for statistical purposes.

Order pronounced in the Open Court on 04th March, 2020.

Sd/-
(PARTHA SARATHI CHAUDHURY)
JUDICIAL MEMBER

Sd/-
(R.S.SYAL)
VICE PRESIDENT

पुणे Pune; दिनांक Dated : 04th March, 2020
सतीश

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr. CIT -5, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे
“सी” / DR ‘C’, ITAT, Pune
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	02-03-2020	Sr.PS
2.	Draft placed before author	03-03-2020	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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