

IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE-PRESIDENT
AND SHRI A.K.GARODIA, ACCOUNTANT MEMBER

IT(TP)A No.632 /Bang/2015
Assessment year : 2009-10

M/s Mformation Software Technologies (I) Pvt. Ltd., 4 th Floor, Manteen Towers, A Block, Diamond District, Old Airport Road, Bangalore-560 008 Pan No.AAECM0999F	Vs.	The Income Tax Officer , Ward-12(1) Bangalore
APPELLANTS		RESPONDENT

And

IT(TP)A No.658/Bang/2015
Assessment year : 2009-10

The Income Tax Officer , Ward-4(1)(3), Rastrothana Bhavan, Nrupatunga Road, Bangalore	Vs.	M/s Mformation Software Technologies (I) Pvt. Ltd. Silver Oak Building, E2 Block, A Wing, Manyata Embassy Business Park, Nagwara, Pan No.AAECM0999F
APPELLANTS		RESPONDENT

Appellant by	:	Shri P.C.Khincha, CA
Respondent by	:	Shri Manjeet Singh, Addl.CIT

Date of hearing	:	10-02-2020
Date of Pronouncement	:	12-02-2020

ORDER

Per N.V. Vasudevan, Vice-President

IT(TP)A No.632/Bang/2015 is an appeal by the Assessee while IT (TP)A.No.658/Bang/2015 is an appeal by the Revenue. Both these appeals are directed against the order dated 23.2.2015 of CIT(A)-IV, Bangalore, relating to A.Y.2009-10.

2. The Assessee is a company engaged in the business of rendering Software Development Services (SWD Services). During the financial year 2008-09 relevant to the assessment year 2009-10, the assessee provided contract software development services to its Associated Enterprises. As per the provisions of Sec.92 of the Income Tax Act, 1961 (Act), income from an international transaction has to be determined having regard to the Arm's Length Price (ALP).

3. It is not in dispute between the Assessee and the revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) of determination of ALP and that the Profit Level Indicator (PLI) to be adopted for the purpose of comparison of the profit margin of the Assessee with that of the comparable companies was Operating Profit to Total Cost (OP/TC). The OP/TC as computed by the Assessee and the TPO in respect of the disputed international transaction was as follows:

	As per the TP Study
Operating Income	Rs.25,50,19,230
Operating Expenses	Rs.22,76,95,741
Operating Profit (Op. Income – Op. Expenses)	Rs. 2,73,23,489
Operating/Net margin	12.00%

4. The Assessee had chosen 5 companies as comparable with that of the Assessee. The average arithmetic mean of profit margins of those companies were 12.92%. Since the profit margin of the Assessee as computed by the Assessee was within the (+) (-) 5% range of profits permitted by the second proviso to Sec.92C(2) of the Act, the Assessee claimed that the price charged by it in the International Transaction had to be regarded as at Arm's Length.

5. The TPO to whom the question of determination of ALP was referred by the AO accepted some of the comparable companies chosen by the Assessee. The TPO on his own search selected some more companies as comparable companies at arrived at arithmetic mean of profit margin of 11 companies and determined ALP and consequent addition to be made to the total income as follows:

Comparables selected by the TPO and their arithmetic mean:

Sl. No.	Comparables Selected by TPO	NCP Margins as per TPO Order (%) (WC- Unadj)	NCP Margins as per TPO Order (%) (WC Adj)
1	KALS Information Systems Ltd.	13.89	12.45
2	Akshay Software Technologies Ltd	8.11	8.62
3	Bodhtree Consulting Ltd.	62.27	60.76
4	RS Software (I) Ltd.	9.97	10.99
5	Tata Elxsi Ltd. (seg)	20.28	19.47
6	Sasken Communication Technologies	27.91	27.73
7	Persistent Systems Ltd.	41.40	40.05
8	Zylog Systems Ltd.	7.81	5.15
9	Mindtree Ltd. (seg)	5.52	3.87
10	L&T Infotech Ltd.	24.72	24.77
11	Infosys Technologies Ltd.	45.61	42.77
Arithmetical Mean		24.32	23.33

6. Computation of the arm's length price by the TPO and the adjustment made:

Arm's Length Mean Margin	24.32%
Less: Working Capital Adjustment (Annex. C)	0.70%
Adjusted mean margin of the comparables	23.62%
Operating Cost	Rs.22,76,95,741
Arm's Length Price (ALP)@ 123.62% of Operating Cost	Rs.28,14,77,475
Price Received	Rs.25,50,19,230
Short fall being adjustment u/S. 92CA	Rs.2,64,58,245

7. The Assessee did not file objections before the Dispute Resolution Panel against the determination of ALP by the TPO as above which was incorporated by the AO in his draft assessment order. The AO therefore incorporated the addition in the final assessment order against which the Assessee preferred appeal before CIT(A) who excluded 7 out of the 11 comparable companies chosen by the TPO by applying the turnover filter. The 7 companies so excluded were (i) M/S.Tata Elsi Ltd., (Turnover Rs.378,43,03,000) (ii) Sasken Communication Technologies Ltd. (Turnover Rs.405,31,20,000) (iii) Persistent Systems Ltd. (Turnover Rs.519,69,10,000) (iv) Zylog Systems Ltd. (Turnover Rs.734,93,51.475) (v) Mindtree Ltd.(Turnover Rs.793,22,79,326) (vi) Larsen and Toubro Infotech Ltd. (Turnover Rs.1950,83,81,374 and (vii) Infosys Ltd. (turnover Rs.20264,00,00,000).

8. Aggrieved by the order of the CIT(A) excluding 7 comparable companies from the list of comparable companies, the revenue has preferred appeal before the Tribunal and the relevant grounds raised by the revenue are Gr.No.2 & 3 which reads as follows:

''2. On the facts and circumstances of the case, the Id.CIT(A) erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable and accordingly, erred in excluding the comparables.

3. The Id.CIT(A) erred in excluding uncontrolled comparables having turnover more than Rs.200 Crores in the absence of turnover criterion prescribed in Rule 10B of Income Tax Rules and also there being no correlation between turnover and profit margin”.

9. The Assessee in its appeal has raised several grounds challenging the order of CIT(A) in so far as it relates to determination of ALP in the SWD services segment. However at the time of hearing the learned counsel for the Assessee prayed for exclusion of only one comparable retained by the CIT(A) as a comparable company viz., M/S.Bodhtree Consulting Ltd.

10. As far as exclusion of 7 companies listed above which are part of the final comparable companies chosen by the TPO are concerned, we find that the turnover of these companies is 10 times greater than the turnover of the assessee which is only a sum of Rs.25,50,19,320. The turnover of (i) M/S.Tata Elsi Ltd., (Turnover Rs.378,43,03,000) (ii) Sasken Communication Technologies Ltd. (Turnover Rs.405,31,20,000) (iii) Persistent Systems Ltd. (Turnover Rs.519,69,10,000) (iv) Zylog Systems Ltd. (Turnover Rs.734,93,51.475) (v) Mindtree Ltd.(Turnover Rs.793,22,79,326) (vi) Larsen and Toubro Infotech Ltd. (Turnover Rs.1950,83,81,374 and (vii) Infosys Ltd. (turnover Rs.20264,00,00,000). It has been held by the Hon'ble Karnataka High Court in the case of *Acusis Software (I) P. Ltd. v. ITO in ITA No.223/2017, judgment dated 14.8.2018* that if the turnover of the comparable company is less or more than 10 times the turnover of assessee, then it cannot be considered as a comparable company. In the light of the aforesaid decision of the Hon'ble High Court, we are of the view that the aforesaid 7 companies were rightly excluded from the list of comparable companies by the CIT(A). Thus Gr.No.2 & 3 raised by the revenue are dismissed.

11. As far as Assessee's appeal is concerned, the only issue to be decided is with regard to the correctness of inclusion of M/S.Bodhtree Consulting Ltd., as a comparable company. As far as this company is concerned, it is the plea of the

Assessee that Bodhtree Consulting Ltd. ('Bodhtree' for short) follows a revenue recognition method, which is not comparable to the fixed price project model followed by the Assessee. Consequently, Bodhtree's profit margin fluctuates significantly on a year-on-year basis, with the result that it cannot be considered as comparable to the Assessee. Apart from the above, it the plea of the Assessee that Bodhtree is also engaged in the provision of software solutions developed in-house, like MIDAS, ShareTree, TeleTree, SecureTree, AppsScale. It is the plea of the Assessee that the Assessee is only a captive software development service provider that does not design/develop/sell software products and does not own IPs. Based on the above submissions, the learned counsel submits that Bodhtree is functionally dissimilar to the Assessee. The learned counsel for the Assessee has also placed reliance on the decisions of this Hon'ble Tribunal in *Autodesk India P Ltd v. DCIT* [Order dated 13.05.2016 in IT(TP)A No.1369/Bang/2014] (paras 5.1 — 5.3 at pages 8-11) and *Infinera India P Ltd v. ITO* [(2016) 72 taxmann.com 68 (para 14(2) at page 6)] wherein, in the cases of assesseees similar to the Assessee herein, this Hon'ble Tribunal directed exclusion of the said company for the very same assessment year. Respectfully following the precedent on the issue rendered in relation to same AY 2009-10, we direct exclusion of this company from the list of comparable companies.

12. The TPO is directed to compute ALP as per the directions given in this order and in accordance with law after affording opportunity of being heard to the Assessee.

13. Ground No.4 raised by the Revenue is with regard to computation of deduction u/s 10A of the Act. The Revenue in the grounds of appeal No.4 has projected its grievance regarding the action of the learned CIT(A) in excluding, while computing deduction u/s.10A of the Act, Communication expenses and expenses incurred in foreign currency from the export turnover on the ground that these expenses are attributable to delivery of software outside India from the export turnover but directed that the said sum should also be excluded from the

total turnover while computing deduction u/s.10A of the Act. The Assessee was entitled to claim deduction u/s.10A of the Act on the profits derived from its SWD services unit. Sec.10A(4) provides the methodology of computation of deduction u/s.10A of the Act and it lays down that the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking. Export turnover has been defined under Explanation 2 (iv) to Sec.10A as:-

"export turnover" means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India."

While computing the deduction u/s.10A of the Act, the AO noticed that during the relevant assessment year, the Assessee had incurred telecommunication charges and expenses in foreign currency which was not reduced from the export turnover while computing deduction of Rs.8,00,47,585 under section 10A of the Income Tax Act, 1961. The AO therefore excluded the aforesaid sum from the export turnover without excluding them from the total turnover. As a result, the deduction claimed u/s.10A of the Act by the Assessee was allowed at a lesser sum than what was claimed by the Assessee.

14. It was the plea of the Assessee that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee also made an alternate prayer that expenses that are reduced from the export turnover should also be reduced from the total

turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*. The CIT(A) accepted the alternate plea of the Assessee. The revenue is in appeal against the order of CIT(A).

15. We have heard the Id. counsel for the assessee and the Id. DR on the issues raised in this regard. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that there is no merit in Gr.No.4 raised by the Revenue. it would be just and appropriate to direct the Assessing Officer to exclude the charges referred to in Gr.No.10 referred to above both from export turnover and total turnover, as has been prayed for by the assessee in the alternative. In view of the acceptance of the alternative prayer, we are of the view that no adjudication is required on the ground whether the aforesaid sums are required to be excluded from the export turnover. Moreover, the order of the Hon'ble Karnataka High Court has been upheld by the Hon'ble Supreme Court in the case of *CIT v. HCL Technologies Ltd. in Civil Appeal No.8489-98490 of 2013 & Ors. dated 24.04.2018*. Consequently ground No.4 is dismissed.

16. In the result appeal by the revenue is dismissed while the appeal by the Assessee is partly allowed.

Pronounced in the open court on this 12th day of Feb.2020.

Sd/-
(A.K.GARODIA)
Accountant Member

Sd/-
(N.V. VASUDEVAN)
Vice-President

Bangalore,
Dated, the 12th Feb.2020.

/ am/

Copy to:

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

By order

Asst. Registrar
ITAT, Bangalore