IN THE HIGH COURT OF KARNATAKA, BENGALURU

DATED THIS THE 10th DAY OF JULY 2018

PRESENT

THE HON'BLE Dr.JUSTICE VINEET KOTHARI

AND

THE HON'BLE Mrs. JUSTICE S.SUJATHA

I.T.A.No.49/2009

Between:

1. The Commissioner of Income- Tax,
C.R. Building, Queens Road,
Bangalore.

2. The Assistant Commissioner of Income-Tax,
Circle – 12(1),
C.R. Building, Queens Road,
Bangalore.

…Appellants

(**By Mr. K.V.Aravind, Advocate**)

And:

Philips Software Centre Pvt. Ltd.,
(Since merged with Philips Electronics
India Ltd.,)
Philips Innovation Campus,
No.1, Murphy Road,
Ulsoor,
Bangalore-560 008.

…Respondent

(**By Mr. Farrokh Irani for**
Mr. T. Suryanarayana, Advocate)

This I.T.A. is filed under Section 260-A of Income Tax Act 1961, praying to (a) Formulate the substantial questions of law stated therein, (b) allow the appeal and set aside the Order passed by the ITAT Bangalore in ITA No. 218/BNG/2008, dated 26-09-2008 Annexure A, confirm the orders of the Appellate Commissioner and Assistant Commissioner of Income Tax, Circle -12(1), Bangalore.

This I.T.A. coming on for Admission, this day ***Dr. Vineet Kothari J***. delivered the following:-

J U D G M E N T

Mr. K.V. Aravind. Adv. for Appellants - Revenue
Mr.Farrokh Irani for
Mr.T.Suryanarayana . Adv. for Respondent-Assessee

1. The Appellants - Revenue have filed this appeal raising purported substantial questions of law arising from the Order of the **learned Income Tax Appellate Tribunal Bangalore Bench "B", Annexure A** dated **26/09/2008** in **ITA.No.218(BNG)/2008** for **AY 2003-04 (Philips Software Centre Private Ltd., Vs. Asst. Commissioner of Income Tax).**

2. The appellants - Revenue have suggested nine substantial questions of law which are quoted below for ready reference: -

"(1) Whether the Tribunal was correct in holding that the transfer pricing provisions cannot be invoked and applied in the case where the provisions of Section 10A of the Act, is availed of by the assessee, particularly when the language of the statue is plain and unambiguous?

(2) Whether the Tribunal was correct in holding that the Transfer Pricing Officer/ Assessing Officer needs to satisfy and communicate to the tax payer the Clause under section 92C(3) of the Act before proceeding further in the matter?

(3) Whether the Tribunal was correct in holding that the tax payer was justified in using earlier year data in comparability analysis though it is mandatory as per Rule 10B(4) to use the current year's data, and also that the data available in the public databases latest by the specified data should be alone be used and the TOP cannot use data becoming available subsequent to the specified date?

(4) Whether the Tribunal was correct in holding that the proviso to Section 92C(2) of

the Act provides for a standard deduction of 5% in all the TP cases?

(5) Whether the Tribunal was correct in allowing a flat comparability adjustment of 11.72% (6.46% working capital adjustment + 5.25% risk adjustment) ignoring all important issues like the quality of adjustment data, purpose and reliability of the adjustment performed to be considered before making adjustment on account of capital and risk, which was contrary to Rule 10B(3) (ii) which provides for only reasonably accurate adjustment?

(6) Whether the Tribunal was correct in holding that the companies with even a single rupee worth related party transactions should not be selected as a comparables and still proceeded to accept the tax payer's comparables which had significant related party transactions?

(7) Whether the Tribunal was correct in upholding the arms length price determined by the tax payer which suffered from various defects and rejecting the arms length price determined by the TPO which was based on

cogent evidence and correct analysis of the data?

(8) Whether the Tribunal's order suffers from perversity because it neither lays down the parameters for selection of comparables nor specifies the comparables finally accepted and their margins nor does it specify the method finally adopted by the Tribunal and also because of inherent contradictions?

(9) Whether the Tribunal's order is perverse in the sense that no reasonable person properly instructed in law could have reached such a conclusion in the facts and circumstances of the case?"

3. The appeal was admitted by the Co-ordinate Bench of this Court on **16/02/2009** with the following substantial questions of law for consideration of this Court:-

"34. *Whether the Tribunal was correct in holding that the transfer pricing provisions cannot be invoked and applied in the case where the provisions of Section 10A of the*

Act, is availed of by the assessee, particularly when the language of the statue is plain and unambiguous?

35. Whether the Tribunal was correct in holding that the tax payer was justified in using earlier year data in comparability analysis though it is mandatory as per Rule 10B(4) to use the current year's data and also that the data available in the public databases latest by the specified data should alone be used and the TOP cannot use data becoming available subsequent to the specified date?

36. Whether the Tribunal was correct in holding that the proviso to section 92C(2) of the Act provides for a standard deduction of 5% in all the TP cases?

37. Whether the Tribunal was correct in allowing a flat comparability adjustment of 11.72% (6.46% working capital adjustment + 5.25% risk adjustment) ignoring all important issues like the quality of adjustment data, purpose and reliability of the adjustment

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performed to be considered before making adjustment on account of capital and risk, which was contrary to Rule 10B(3) (ii) which provides for only reasonably accurate adjustment?

38. Whether the Tribunal was correct in holding that the companies with even a single rupee worth related party transactions should not be selected as a comparables and still proceeded to accept the tax payer's comparables which had significant related party transactions?

39 Whether the Tribunal was correct in upholding the arms length price determined by the tax payer which suffered from various defects and rejecting the arms length price determined by the TPO which was based on cogent evidence and correct analysis of the data?"

4. The summary of the findings/observations of the learned Income Tax Appellate Tribunal in its Order

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dated **26/09/2008** as given in **para 5.71** is quoted below for ready reference:-

> *" 5.71. We, therefore, summarise our conclusion as follows:-*
>
> *i) Since the basic intention behind introducing the transfer pricing provisions in the Act is to prevent shifting of profits outside India, and the assessee claiming benefit* ***under section 10A of the Act, the transfer pricing provisions ought not to be applied to the assessee.***
>
> *ii) Circular No.14/2001 issued by the CBDT is binding upon the TPO.*
>
> *iii) There was no infirmity in the TP Study conducted by the assessee, and the TPO erred in disregarding the same for the purpose of computing framing the assessment and making the transfer pricing adjustment.*
>
> *iv) The TPO or the A.O. needs to satisfy and communicate to the taxpayer the relevant clause under section 92C(3) which has been triggered by the assessee, which has necessitated the application of provisions of*

the transfer pricing provisions. In the instance case, since this was not demonstrated to the assessee, the transfer pricing order is void.

v) The TPO erred in conducting a fresh study for the purpose of passing his order. The study conducted by the TPO is not in conformity with the provisions of Rule 10B(4) and 10D(4).

vi) The TPO erred in disregarding the most appropriate method adopted by the assessee in the TP Study, and also in using the Prowess data base. The TPO did not provide any reason for deviating from the TP Study in respect of these matters.

vii) The TP Study cannot be ignored by the TPO, in the absence of any deficiency or insufficiency. Further, the order passed with the intention of making a higher transfer pricing adjustment.

viii) For the purpose of comparability, companies with even a single rupee of transactions with associated enterprises cannot be considered as comparables.

ix) Adjustment needs to be made to the margins of the comparables to eliminate differences on account of different functions, assets and risks. More specifically, adjustment needs to be made for:

a) Differences in risk profile.
b) Difference in working capital position.
c) Differences in accounting policies.

x) The TPO has grossly erred in 'normalising' the profits of super profit companies. Such companies should have been excluded from the list of comparables.

xi) The proviso to section 92C(2) of the Act provides a standard deduction of 5% to the taxpayers. The only condition for availing this benefit is that is subject to the option of the taxpayer.

xii) The decision of the Tribunal in the case of Mentor Graphics (supra) and E-gain Communication (supra) are squarely applicable to the assessee's case. Some of the relevant common facts relating to the *assessee before us and the assessees in both the decisions mentioned above have been summarized below:*

Sl.No.	***Mentor Graphics***	***Philips Software (Assessee)***
1.	*Engaged in rendering captive Contract software development Services to its associated enterprises. (Para 2.1 on page 116 ITD)*	*Engaged in rendering captive Contract software development Services to its associated enterprises.*
2.	*The Software developed By Mentor Graphics India was used in house by the associated enterprises. (Para 2.1 on page 116 ITD)*	*The software developed by Philips Software is used in House by the associated enterprises.*
3.	*The Software developed by Mentor Graphics was integrated By the associated enterprises In the software components and Hardware manufactured outside India, (Para 2.1 on page 116 ITD)*	*The software developed by Philips Software is integrated By the associated enterprises In the software components and hardware manufactured Outside.*
4.	*The complete package of the Hardware and software manufactured was sold in open Market by the associated Enterprises. (Para 2.1 on page 116 ITD)*	*The complete package of the Hardware and software manufactured is sold in the Open market by the Associated enterprises.*
5.	*Mentor Graphics was insulated From all business and operation Al risks. (Para 33 and 46.1 on*	*Philips Software bears nominal business and Operational risks.*

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	Page 133 and 143, respectively ITD)	
6.	*Mentor Graphics used to Develop software as instructed By its parent company. (Para 2.1 On page 116 ITD)*	*Philips Software is Continuously provided Services to its associated Enterprises.*
7.	*Net profit margin of Mentor Graphics was 6.99% (Para 6 on Page 118 ITD)*	*Net profit margin of Philips Software is 5.91%*

Sl.No.	***E-gain Communication***	***Philips Software (Assessee)***
1.	*E-gain Communication is a captive Company rendering software Development services to its Associated enterprises. (Para 31 On page 23 of the order)*	*Engaged in rendering captive Contract software development Services to its associated Enterprises.*
2.	*E-gain was insulated from all Business and operational risks (Para18 on page 10 of the order)*	*Philips Software bears Nominal business and Operational risk.*
3.	*Net profit margin of E-gain Communication was 5.16% (Para 4 on page 2 of the order)*	*Net profit margin of Philips Software is 5.91%.*

xiii) Based on the issues raised and discussed, it should be concluded that the transactions of the assessee with its associated enterprises satisfy the arm's length test, and that the order of the TPO is bad in law and on facts.

xiv) Without prejudice to the submission of the assessee that the comparables selected *by the TPO should not be considered for the purpose of comparability analysis, the assessee has prepared a working carrying out an accept/reject test on the comparables of the TP Study as well as the companies selected by the TPO as comparables. Even on the basis of this statement, the transactions of the assessee with its associated enterprises satisfy the arm's length test.*

In the result, the appeal is allowed."

5. We are of the opinion that the issue involved in this appeal is no longer *res integra* as we have already held in **I.T.A.No.536/2015 c/w. I.T.A.No.537/2015 (Pr. Commissioner of Income Tax, Bangalore and Another Vs. M/s. Softbrands India P.Ltd.,) rendered on 25-06-2018,** that in these type of cases, such findings are findings of facts and unless an *ex-facie* perversity in the findings of the learned Income Tax Appellate Tribunal is established by the appellant, the appeal at the instance of an assessee or the Revenue under **Section 260-A** of the Act is not maintainable, as

no substantial question of law requiring our consideration would arise in this appeal under **Section 260-A** of the Act.

The relevant portion of the said judgment dated **25/06/2018** is quoted below for ready reference:-

> ***"Conclusion:***
>
> *55. A substantial quantum of international trade and transactions depends upon the fair and quick judicial dispensation in such cases. Had it been a case of substantial question of interpretation of provisions of Double Taxation Avoidance Treaties (DTAA), interpretation of provisions of the Income Tax Act or Overriding Effect of the Treaties over the Domestic Legislations or the questions like Treaty Shopping, Base Erosion and Profit Shifting (BEPS), Transfer of Shares in Tax Havens (like in the case of Vodafone etc.), if based on relevant facts, such substantial questions of law could be raised before the High Court under* ***Section***

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260-A *of the Act, the Courts could have embarked upon such exercise of framing and answering such substantial question of law. On the other hand, the appeals of the present tenor as to whether the comparables have been rightly picked up or not, Filters for arriving at the correct list of comparables have been rightly applied or not, do not in our considered opinion, give rise to any substantial question of law.*

56. We are therefore of the considered opinion that the present appeals filed by the Revenue do not give rise to any substantial question of law and the suggested substantial questions of law do not meet the requirements of ***Section 260-A*** *of the Act and thus the appeals filed by the Revenue are found to be devoid of merit and the same are liable to be dismissed.*

57. We make it clear that the same yardsticks and parameters will have to be applied, even if such appeals are filed by the Assessees, because, there may be cases where the Tribunal giving its own reasons

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*and findings has found certain comparables to be good comparables to arrive at an **'Arm's Length Price'** in the case of the assessees with which the assessees may not be satisfied and have filed such appeals before this Court. Therefore we clarify that mere dissatisfaction with the findings of facts arrived at by the learned Tribunal is not at all a sufficient reason to invoke **Section 260-A** of the Act before this Court.*

58. The appeals filed by the Revenue are therefore dismissed with no order as to costs."

6. The point pressed by the learned counsel for the Revenue, Mr. Aravind K.V. before us today is that the learned Tribunal in the afore-quoted **para.5.71(i)** has made an observation that where the assessee claiming the benefit under **Section 10-A** of the Act, being a newly established Undertaking in Free Trade Zone is claiming deduction under that provision then,

the provisions of **Chapter X** regarding Transfer Pricing ought not to have been applied to the Assessee. He submits that these observations are contrary to the **second Proviso to Section 92C(4)** of the Act. The **Sub-section (4)** and its **First Proviso** are quoted below for ready reference:-

> "**92C(4):** *Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:*
>
> ***Provided*** *that* ***no deduction under section 10A [or section 10AA] or section 10B or under Chapter VI-A shall be allowed*** *in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section."*

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7. The learned counsel for the Respondent -- Assessee, Mr. Farrokh Irani drew our attention to the Assessment Order passed by the Assessing Authority in the present case vide **Annexure C** on **31/03/2006** in which the **Transfer Pricing Adjustments** under **Chapter X** of the Act to the extent of **₹22,10,80,792/-** were made by the Assessing Authority, but no deduction under **Section 10-A** is given to the Assessee with respect to the said **Transfer Pricing Adjustment** made by the Assessing Authority in the present case.

8. The submission made by the learned counsel for the Revenue is, therefore, misplaced and bereft of factual foundation in the assessment of the present assessee. The afore-quoted **para 5.71(i)** of the Tribunal cannot be even described as a finding of fact, but it is merely an *obiter*. Though such an *obiter* or observation appears to be made by the learned Tribunal in ignorance of the aforesaid **Proviso to Sub-section (4) of**

Section 92C of the Income Tax Act, but we do not find any binding character of such findings or observations because as far as the computation of income of the assessee is concerned, the Assessing Authority has not given any benefit of **Section 10-A** of the Act to the assessee with respect to Transfer Pricing Adjustments made in the Assessment Order.

9. There is no reversal of such findings of the Assessing Authority by the Tribunal in the present case. Therefore, this observation cannot be said to be causing any prejudice to the Revenue in the present case. Therefore, no substantial question of law arises on the said submission of the learned counsel for the Revenue.

10. As far as the other questions are concerned, we have already observed above that none of the questions actually gives rise to any substantial questions of law in the present appeal in view of our

aforesaid judgment extracted above and therefore there is no merit in the present appeal of the Revenue.

11. The appeal of the Revenue is liable to be dismissed and is accordingly dismissed.

No costs.

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JUDGE

Sd/-
JUDGE

BMV*

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