IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "A" NEW DELHI
BEFORE SHRI R.P. TOLANI, JUDICIAL MEMBER
AND
SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER
I.T.A. No. 5043/Del/2010

A.Y. : 2006-07

M/s Adobe Systems India Private Limited, Plot No. 1-1-A, City Centre, Sector-25-A, Noida (UP) - 201301 (PAN/GIR NO. : AACCA2982J) **(Appellant)**	vs.	Additional Commissioner of Income Tax, Noida Range, Noida **(Respondent)**

Asseessee by	:	Sh. Arijit Chakravarty, A.R.
Department by	:	Mr. Ashok Pandey, C.I.T.(D.R.)

ORDER

PER SHAMIM YAHYA: AM

This appeal by the Assessee is directed against the order of the Ld. Commissioner of Income Tax (Appeals) dated 05.10.2010 and pertains to assessment year 2006-07.

2. The effective issue raised is that Ld. Commissioner of Income Tax (Appeals) erred in passing the assessment order u/s 143(3) read with section 144C of the IT Act. It has been urged that Assessing Officer /DRP has erred in making the addition of ₹ 10,40,75,727/- to the income of the assessee on account of adjustment in the Arms Length Price of international transaction entered by the assessee with associated enterprise. It has been urged that TPO/Assessing Officer has erred by accepting companies earning super normal profits.

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3. The brief facts of the case are that the assessee Adobe Systems India Private Limited (hereinafter called Adobe India or the Assessee) is a wholly and subsidiary of Adobe Systems Inc., USA. It is engaged in providing software development services and marketing support services to its associated enterprises. The TPO in this case noted that the assessee company is showing OP/Cost Margin of 14.96% which he considered to be quite low, as compared to other companies which are engaged in similar IT fields. The TPO in this case passed a Transfer Pricing order making a upward adjustment of ₹ 10,40,75,727/- on the arms length price of the international transactions. The TPO had worked out the average of arithmetic mean of ALP (OP/OC) of 42 comparables at the average of 24.91 percent. The Arm's Length Price of international transaction was determined as under:-

"Operating Revenue	₹ 110,31,15,603 (A)
Total cost	₹ 96,64,48,907/- (B)
Operating Profit	₹ 13,66,66,696 (C)
Arm's Length Price of Operating Profit 2 24.91%	₹ 24,07,42,423 (D)
Adjustment (D-C)	₹ 10,40,75,727/-

Accordingly, the Arm's length price of the International Transaction has been adjusted upwardly by ₹ 10,40,75,727/-."

4. The TPO did so by rejecting some of the comparables used by the assessee and added some more comparables which the assessee had objected. Ld. counsel of the assessee submitted that he shall be

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restricting his arguments against the inclusion of the following in the transfer pricing analysis.

S.No.	Company Name	OP/OC margin for F.Y. 2005-06
1.	Cranes Software International Ltd.	90.91%
2.	GDA Technologies Limited	158.06%
3.	Jayamuruthi Software Systems Limited	103.94%

4.1 Assessee's submission in this regard is that these are super normal profit making companies and should be excluded from comparables set. As there is tendency skew the results and cannot be considered as representative of the industry. Against the above contention of the assessee TPO only dealt with Jayamaruthi Software Systems Limited and GDA Technologies Limited and did not deal with Cranes Software International Limited. The assessee's submission as regards the GDA Technologies was as under:-

> "This company did not appear in the search conducted by the assessee in its transfer pricing documentation.
>
> As per the products details available in Prowess database, for F.Y 2005-06, the company has earned its entire income from "Computer hardware and software".
>
> On review of this Annual Report (attached as Annexure 4) for FY 2006-07 (as annual report for FY 2005-06 is not available) it is observed as follows:-

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- Page 64 of the Annual Report, "….,your company has carried out IC design, systems design, software development and PCB layout for several global customers."
- Page 64 of the Annual Report, "The company has also started offshore Design Centres during the year for customers based out of US. The company has developed office in a Box, several Field Programmable Gage Array boards, Gigabit Passive Optical Network) during the year."

Based on the above, it is evident that the company is primarily engaged in developing and licensing of products which are not similar to the services provided by the assessee. Further, no segmental information is available. Hence, we wish to submit that the same cannot be considered as a comparable and should be rejected as "functionally different".

Additionally, the assessee would like to bring to your attention that supernormal profit making companies should be excluded from the comparable set as they have a tendency to skew the results and cannot be considered as representative of the industry.

The judgement pronounced by the Hon'ble Delhi Income Tax Appellate Tribunal (ITAT) in the case of Mentor Graphics (Noida) Pvt. Ltd. mentions the following on pages 39-40 of the above mentioned ITAT Ruling:

"…..The wide difference in the ratio of operating margins…in the final selection of comparable ….is a clear pointer to the fact that the selection made was faulty…The OECD guideline on this point is as under-

1.47 Where the application of one or more methods produces a range of figures, a substantial deviation among points in that range may indicate that the data used in establishing the some of the points may not be as reliable as the data used to establish the other points in the range or that the deviation may result from features of the comparable data that require adjustments"

Inferring from the above ruling, we requests your goodself to not consider companies displaying abnormal profits since they deviate from the normal trend displayed by the data set."

4.2 The assessee's submission as regards the Jayamaruthi Software Systems Limited was as under:-

"This company was rejected by the assessee in its transfer pricing documentation, on the ground that this company is "functionally not comparable".

- The company has negligible employee cost, i.e. 0.01 cores on turnover of 5.69 crores which is extraordinarily low for a service company. Moreover, the company's annual report is not available to validate its cost structure. Given the abnormal cost structure it is not prudent to rely on the financial statements of the company. Hence, the company should be rejected on this basis.

Additionally, the assessee would like to bring to your attention that supernormal profit making companies should be excluded from the comparable set as they have a tendency to skew the results and cannot be considered as representative of the industry.

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The judgement pronounced by the Delhi ITAT in the case of Mentor Graphics (Noida) Pvt. Ltd. (supra) has also mentioned the reservation against using supernormal profit making companies in the comparable set.

Based on above facts, the company should not be considered as a comparable company."

4.3 The assessee's submission as regards the Cranes Software International Limited was as under:-

"This company was rejected by the assessee in its transfer pricing documentation, on the ground that the company was "functionally not comparable".

The Annual Report (Attached as Annexure 2) and website of the company states as under:-

"Over the last few years, the Company has established itself as a key player in the software products market catering to the needs of the global scientific and engineering community."

"Cranes Software International Limited is a company that provides Enterprise Statistical Analytics and Engineering Simulation Software Products and Solutions across the globe. The Company's business interest span Products, Productized Solutions, Services and R&D in future technologies."

"Cranes Software offers a range of proprietary products – SYSTAT, SigmaPlot, SigmaStat, SigmaScan, TableCurve 2D, TableCurve 3D, PeakFit, NISA, XID, XIP, Survey ASYST, iCaptella, InventX and World-renowned products from reputed principals

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such as Engineering Technology Associates, The Mathworks, Texas Instruments and IBM”.

Accordingly, Cranes is a product based company and owns proprietary products and cannot be compared with the assessee who undertakes only routine functions in developing modules of software and does not own any intangibles in this regard.

Further, as per the depreciation schedule of the company for FY 2005-06, out of the total net assets value of ₹ 148.54 cr., the value of intangible (computer software) is ₹ 136.70 cr.

The presence of intangibles in the balance sheet of Cranes clearly shows that, it is performing significant research and development activities to develop intangibles. Accordingly, it cannot be considered as being comparable to the assessee which is a risk mitigated contract services provider and does not own any intellectual property rights (IPRs). Due to the presence of intangibles the functions performed and risks assumed by Cranes will be different from that of the assessee and cannot be used to benchmark the international transaction of the assessee.

Accordingly, Cranes should not be considered as comparable to Adobe India.”

4.4 The TPO’s observations with regard to these companies were as under:-

“With respect to M/s Jayamaruthi Software System Ltd. (Sr. No. 24), the submission of the assessee has been rejected and is however, required to be included in the list of departmental comparable as it is a listed company and the results are

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audited. The ground that a company is making a supernormal profit, is not accepted on the ground that this comparable is showing consistent growth at about same level in the preceding years also. Hence, there is no abnormality in its performance.

In respect of M/s GDA Technologies Ltd. (Sr. No. 15), the assessee has submitted the accounts of M/s GDA Technology Inc., USA (the parent Company of M/s GDA Technologies Ltd.) to show that the said Indian company i.e. M/s GDA Technologies Ltd, has sufficient Relates party transactions. However, the annual report of the Indian company as well as the information available with 'Capital line' database and 'Prowess' data base do not show such details of related party transactions. Hence, the submission of the assessee is not accepted and accordingly M/s GDA Technologies Ltd. is included in the departmental list of comparables."

4.5 Apart from rejecting some of the comparables and adding some more comparables, the Assessing Officer also used updated data for financial year 2005-06 instead of mean (weighted ALP of earlier years) as computed by the assessee. Ld. counsel of the assessee in this regard submitted no adjustment has been made to the assessee's transfer pricing in earlier years and assessment was done u/s 143(3) of the IT Act. He submitted before us that even if the data considered by Assessing Officer is used excluding companies with super normal profits the arithmetic mean of OP/OC will be 17.15% which will fall within the + - 5% range as permitted by section 92(C)(2).

5. We have carefully considered the submissions. We find that TPO has rejected the assessee's contention with regard to inclusion of

these three supernormal profit companies without any cogent reason. He has not given any comment regarding objection of the assessee regarding inclusion of Crane Software International Limited in the comparables. Regarding Jayamaruthi Software Systems Ltd. he brushed assessee's objection by simply stating that it is a listed company and results are audited. Regarding assessee's objection for inclusion of M/s GDA Technologies Ltd. that the said company has sufficient related party transaction, but the TPO has brushed the contention by ignoring the documents submitted by the assessee and holding that data available with him does not show details of related party transaction. It is undisputed that these three companies have shown supernormal comparable profits as compared to the other comparable. There exclusion from the list of comparable is quite correct. By excluding these three companies from the comparables and showing the computation on the basis of TPO data the arithmetic mean of OP/OC to 17.15% which falls within the +-5% range as permitted by section 92(C)(2). Hence, we find considerable cogency in the arguments of the ld. counsel of the assessee in this regard.

5.1 We further find that assessee has made voluminous submissions including paper books before the DRP who has passed a very cursory

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and laconic order without going into the details of the submissions. We find that this is quite contrary to the mandate of section 144C of the IT Act.

5.2 In our considered opinion, circumstances do not warrant any change in the mark up. Accordingly, we set aside the order of the Assessing Officer and decide the issue in favour of the assessee.

6. In the result, the appeal filed by the assessee is allowed.

Order pronounced in the open court on 21/01/2011 as above.

Sd/-	Sd/-
[R.P. TOLANI] JUDICIAL MEMBER	[SHAMIM YAHYA] ACCOUNTANT MEMBER

Date 21/01/2011

SRB

__Copy forwarded to: -__

1. Appellant 2. Respondent 3. CIT 4. CIT (A)
5. DR, ITAT

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By Order,

Deputy Registrar,
ITAT, Delhi Benches

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