IN THE INCOME TAX APPELLATE TRIBUNAL
Bangalore 'C' Bench, Bangalore

Before Smt. P. Madhavi Devi, Judicial Member
and Shri Abraham P. George, Accountant Member

IT(TP)A No.270/Bang/2014
(Assessment year:2009-10)
A N D
S.P. No.129/Bang/2014
(Arising out of IT(TP)A No.270/Bang/2014)

Cisco Systems Services B.E. India Branch, Divyashree Chambers B Wing, No.11, O Shaughnessey Road, Off Langford Road, Bangalore 560025 PAN: AACCC 4836 D	Vs.	Assistant Director of Income Tax (International Taxation, Circle1(1) Bangalore
(Appellant)		**(Respondent)**

Assessee by: Shri Rajan Vora, CA
Department by: Ms. Priscilla Singsit, (DR)

Date of Hearing: 08/10/2014
Date of Pronouncement: 17/10/2014

O R D E R

Per Abraham P. George, AM

This appeal filed by the assessee is against the order passed by the Assessing Officer u/s 143(3) of the Income Tax Act, 1961, pursuant to the directions of the DRP. It has raised altogether 18 grounds. Of these grounds, 1 and 2 are oncorporate tax matters, Ground Nos. 3 to 16 are on transfer pricing matters, Ground Nos. 17 is on TDS credit not being given and Ground No.18 is on levy of interest u/s 234B of the Act.

1. Grounds relating to the Corporate tax matters are taken first.

2. Through Ground No.1 the assessee assails the treatment given to foreign currency expenditure, which were deducted by the Assessing Officer from the export turnover for the purpose of computing the deduction u/s 10A of the Act. Learned Counsel for the assessee submitted that the DRP had allowed its alternate claim for deducting these amounts from the total turnover also. We find that the deduction given by the DRP is justified in view of the decision of the Hon'ble jurisdictional High Court in the case of CIT vs. Tata Elxsi Ltd (349 ITR 98). Accordingly Ground No.1 is dismissed.

3. Vide its Ground No.2, assessee is aggrieved that the foreign currency expenditure in relation to recharge of international assignee cost were considered as technical service fee and disallowed u/s 40a(ia) of the Act, for want of deduction of tax at source.

4. The learned Counsel for the assessee submitted that it had incurred an expenditure of Rs.5,00,58,000/- as reimbursement of international assignee salaries and Rs.3,12,72,000/- towards recharge of other costs, during the relevant previous year. As per the AR, these were reimbursements made to its affiliates abroad for the employees deputed by them to the assessee's premises. According to the AR, the assessee was engaged in the business of software development and required expertise of personnel of Cisco affiliates abroad. Therefore, the assessee had entered into cross border secondment arrangements with such overseas group affiliates. As per the assessee their salaries, for the period in which they were doing the work of the assessee in India, as

well as their expenditure had to be met by the assessee. The letter of assignment of one of the four persons who was such a seconded personnel, was referred to by the learned AR. According to the learned AR, the said letter dated 27.08.2007 issued by M/s Cisco Systrems Hong Kong Ltd to Shri Tali Badrinath clearly abroad that the said person though an employee of M/s Cisco Systems Hong Kong was working for the assessee in India. The learned AR submitted that there were two elements for the reimbursements; 75% to the salary cost was paid to the concerned seconded personnel directly by the assessee and 25% of their salaries were paid by their employer abroad and such amount was in turn reimbursed by the assessee to such employer. Expenditure incurred by the affiliates aborad in relation to such seconded personnel were also reimbursed by the assessee. As per the learned AR, there were 4 individuals who were rendering their services to the assessee in India. Their employers abroad was not giving any technical service to the assessee. The assessee had not received any technical services from such affiliate companies.

5. Continuing his arguments the learned AR submitted that tax was deducted by the assessee for the whole of the salary, including the 25% reimbursed by the assessee to the affiliate. Thus the payments were subject to tax deduction at source in India. According to the learned AR, the amounts reimbursed to these persons through their employers abroad if considered as technical services, rendered by the employers, it would result in double taxation since amount was already subject to tax deduction at source. Relying on the decision of a Coordinate Bench in the case of IDS Software Solutions (India) (P) Ltd vs.

Income Tax Officer (2009) 21 DTR 240, learned AR submitted that reimbursement of salary paid under the secondment agreement did not constitute fee for technical services. Learned AR pointed out that in said case also the payments were effected by a subsidiary of an US Company in India. As per the learned AR same view was also taken in the case of Income Tax Officer vs. Ariba Technologies (India) Pvt. Ltd (2012) CCH 260 and in the case of Abbey Business Services (India) Private Limited vs. DCIT in ITA No.1141/Bang/2010 dated 18.07.2012.

6. Per contra, the learned DR submitted that the payments to the affiliates abroad was not limited to salary, but even out of pocket expenditure and other miscellaneous expenditures were reimbursed. Miscellaneous expenditure reimbursed were not for business travel alone. Relying on the decision of Authority for Advance Ruling in M/s A.T.&S. India P. Ltd. (287 ITR 421) the learned DR submitted that simply terming the agreements as secondment agreement would not be determinative of the nature of the payment. According to him, the concerned affiliates abroad were providing technical services to the assessee. Through the services of their employees, assessee was actually receiving technical services from its affiliates. Therefore, as per the learned DR the assessee was bound to deduct tax at source as set out u/s 195 of the I.T. Act. Having not done so, as per the DR, the Assessing Officer was justified in making a disallowance u/s 40(a)(ia).

7. We have perused the orders and heard the rival contentions. The persons seconded by the assessee and work rendered by them is mentioned by the assessee in its letter dated

28.09.2012 addressed to the DDIT (IT) which has been placed at Paper Book Page Nos. 352 to 363. Relevant portion is given below:

"10.1 Details of seconded personnel

S.No	Name of seconded personnel	Designation	Duration of stay in India (during the relevant FY)	Services rendered/ furnished
1	Thali K Badrinath	Director	365 days	Management of projects relating to network design, planning and implementation
2	Srinivas Ketavarapu	Director	247 days	projects relating to network design, planning and implementation
3	Abhinay Padhye	Director	322 days	projects relating to network design, planning and implementation
4	Vishan Gupta	Vice President	304 days	projects relating to network design, planning and implementation"

That the payment effected were in relation to the above persons has not been disputed by the Revenue. However, the Assessing Officer took a view that these payments were nothing but fees for technical services falling within section 9(1)(vii) of the Act. According to the learned Assessing Officer the conditions of the assignments were laid down by the affiliates and the salaries, incentive payments were to be administered and paid by such affiliates. In other words, according to the learned Assessing Officer these persons remained the employees of the concerned affiliates and assessee was not able to show the projects on which they had worked with it. Another contention of the Revenue is that deduction of tax at source on the remuneration paid to such seconded employees by the assessee was immaterial. Effectively what Revenue say is that the seconded personnel were always the employees of the affiliates abroad.

8. At this juncture, it is necessary to have a look at the documents relied on by the assessee in support of its contention that Shri Tali Badrinath, Shri Srinivasa Ketavarapu, Shri Abhinay Padhye and Shri Vishan Gupta were under a secondment agreement working for the assessee at its location in Bangalore. The case of Shri Tali Badrinath is taken as representative of the character of the transactions. There is a letter dated 27.08.2007 from Cisco Systems Hong Kong Ltd addressed to Shri Tali Badrinath (Page Book 357-358) which reads as under:

"CISCO
Letter of Agreement
Long Term Assignment – Restricted Currency
August 27, 2007
Thali Badrinath
1601 Toulon Court
San Jose, CA 95138
United States.

Dear Thali,

I am pleased to confirm to you in writing our offer for the position of AS Project Manager V, at Grade 12 reporting to Darren May. It is intended that your assignment will be effective on or about August 27, 2007 and is expected to end on August 12, 2010. You will be based in Bangalore, India as a Cisco Systems International assignee on a 3 years assignment, with repatriation to San Jose, California, United States, your point of origin or reassignment to another location based upon business needs of the Company.

The terms and the conditions of your assignment are summarized in the Long Term International Assignment Policy and the following attachments.

* *Summary of International Assignment Provisions*
* *International Assignee Compensation Worksheet*

This letter, together with its attachments, states our entire understanding of your assignment. However, this letter does not modify, amend or supersede written Cisco agreements and policies that are consistent with enforceable provisions of this letter such as Cisco's "Proprietary Information and Invention Agreement" and Cisco's Arbitration Agreement. You should not sign this letter unless you understand it. While it is not the intention of the company to do so, some listed provisions may be changed from time to time as legal requirements may dictate, new practices may require, or for other reasons at the discretion of the company. In the event this should happen, notification will be provided. If questiona should arise concerning any provision listed or any subsequent revisions to policies applicable to employees on International assignment, you are urged to consult with your Cartus International Assignment Consultant, Chel C Lim or yours Cartus RMC, Macy Lau.

You will be an employee of the home country company, paid on the home country payroll. Salary actions including timing and amounts of increases will be consistent with the salary program in effect in your home country. While on assignment, incentive payments will be administered and paid according to the programe in the payroll country.

While you are on International Assignment, the method of your pay delivery will be split between home and host locations unless you are in a country with strict exchange rate currency regulations.

Life Insurance, retirement plans, disability and healthcare coverage will be provided from your payroll country while on assignment. If you are on the US payroll and your work location is outside of the US, the coverage level for medical expenses incurred outside of the US is typically 80% and you are responsible for 20%. For additional information, please refer to the Benefits web site on the Worldwide Plans. Please refer to the International Assignment Policy for more detailed information regarding Compensation and Benefits.

Your assignment is conditional upon the issue and maintenance of valid residency, work and/or any other permits necessary to legally reside and work in India.

Cisco Systems will not guarantee the length of any international assignment. Your assignment will continue as long as mutually acceptable. A long-term assignment is expected to be for a period of less than three years. The actual time will vary and may be impacted by personal emergencies, Company busienss circumstances or performance.

The company will provide for relocation to your point or origin ro to some other mutually agreed upon location upon termination of the international assignment. While the company cannot provide a guarantee of any specific assignment upon return to the US, the Company will attempt to assign you to a position in keeping with both experience and performance.

Please acknowledge receipt of this letter and agreement with its terms by signing the two originals and returning one to the person listed below.
Sincerely yours,
Sd/-
Darren May – Hiring Manager
Date: 8/27/07"

A reading of the above letter brings out certain inconsistencies vis-à-vis the claim of the assessee. The learned Counsel for the assessee had submitted that Shri Tali Badrinath was the Director of M/s Cisco Systems Hongkong Ltd. If that be so, we do not understand how he has been offered a position as a Project Manager reporting to one Mr.Darren May who is only a hiring Manager. The tenor of the letter by itself does not appear to be one that is generally written to a Director.

9. The second document relied on by the assessee is a letter dated 27.08.2007 signed by Shri Tali Badrinath appearing in Page Book Page No.359 which read as under:

"CISCO
August 27,2007
Thalli Badrinath
160 Toulon Court
San Jose, CA 95138 US
RELOCATION ACKNOWLEDGEMENT CLAUSE
I understand and agree that all relocation/allowance payments made to me or my behalf by Cisco Systems Inc, prior to completing one year of employment in the new assignment are in the nature of an advance, that is, I have not earned those payments until I have completed one year of employment in the new assignment.

In the event you resign, Cisco will not assume the cost for return transportation to the home country or return shipment of furniture, household goods, or personal effects except where mandated by law. Should you choose to remain in the host location, your tax equalization calculation will assume that you left the country within thirty days of separation. Should you resign within the first twelve months you will be required to repay a prorated portion of the relocation/assignment costs.

In the event of involuntary termination due to performance issues and/or job restructuring, no reimbursement is required.

If my employment with Cisco terminates prior to one year of service in the new assignment, I authorize at the time of termination of my employment Cisco Systems, Inc. to withold from my final paycheck any assignment related monies due to Cisco Systems Inc. in accordance with the formula stated above. In the event the amount I owe Cisco Systems Inc. is greater than the amount of my final paycheck, I agree to pay the balance in full to Cisco Systems, Inc. within thirty (30) days of my termination date.
Sd/-

Thalli Badrinath"

The second para of the above letter imply that the letter is being written not by Thali Badrinath, but by his employer.

10. The third document relied on by the assessee is an international assignments tax policy equalization agreement on which no date whatsoever is seen. The said agreement as it appears at Page Book No.360 is reproduced hereunder:

> *"CISCO SYSTEMS, INC*
> *INTERNATIONAL ASSIGNMENT TAX EQUALIZATION POLICY AGREEMENT.*
>
> *I acknowledge having read the Tax Equalization Policy of Cisco Systems, Inc (Cisco) located at http://www.cisco.com/FinAdmTax/StockOptions/stock.fad.ashtml and understand the personal impact of the policy. Any questions concerning this policy with Cisco have been fully explained to my satisfaction. I accept that all interpretations under this agreement shall be controlled by the Policy of Cisco, which is included as part of this agreement. Cisco shall have the right and privilege at any time it deems necessary and proper to amend, add, or delete provisions to and from this Policy without prior notice.*
>
> *I understand and agree that all tax positions affecting income, deductions and credits outside the scope of the Policy (i.e. amounts not covered by the Policy) are the responsibility of the employee. Cisco is not liable for any taxes, penalties or interest resulting from a successful challenge by any tax authority of any item not covered by the Policy.*
>
> *In addition, I understand the employee is fully responsible for all penalties and interest charges assessed by any tax authority due to the employee's failure to (1) provide information to Ernst & Young on a timely basis (2) notify Ernst & Young of any significant personal income or*

investment transactions, or (3) cooperate with Cisco with respect to the tax equalization process.

I understand and agree that Cisco will reduce my compensation by an estimated hypothetical tax. The estimated hypothetical tax is an amount which approximates my periodic estimated tax deductions calculated with reference to compensation, benefits, deductions and credits otherwise available to me had I remained in my home country, except as otherwise provided in this Policy. In return, Cisco will advance wages that I have not yet earned to assist with the payment of my actual home and host country tax liabilities within the limits prescribed by the Policy.

I understand that these wagwe advances provided by Cisco for payment of taxes constitutes an obligation by me to Cisco, which will be reconciled with the final liabilities that are Cisco's responsibility through the annual tax equalization settlement calculation. After completion of the tax equalization settlement statement for each taxable year, I agree to repay any obligation for each taxable year within thirty (30) days. If I fail to repay any obligation to Cisco within thirty (30) days after completion of the tax equalization settlement statement, then, unless Cisco and I have agreed otherwise in writing, Cisco shall have the right to:

a) reduce any foreign assignment allowances or reimbursements due to me and/or

b) reduce future amounts paid to me whether as wages, salary or other compensation for services performed in light of my havign received wage advances that I have not yet earned.

The total obligation will become immediately due and payable if my employment with Cisco or any of its affiliate corporations is terminated, whether voluntarily or involuntarily.

If I fail to furnish tax records in response to a request by Cisco pursuant to the Policy, or cease

employment with Cisco or any of its subsidiaries for any reason before the tax records needs to complete the year-end tax equalization settlement statement under the policy are available, then Cisco shall have the right to calculate such amounts by making reasonable assumptions of probable taxes. If an amount is owned to Cisco, Cisco shall also have the right to require immediate payment of such amount, including the right to reduce future amounts paid to me whether as wages, salary or other compensation for services performed in light of my having received wage advances that I have not yet earned, unless Cisco and I have agreed otherwise in writing.

By signing, I accept all terms and conditions of this Tax Equalization Policy Agreement.
Acknowledgement and acceptance. 072252
Thali Badrinath Emp.ID No".

The only other document filed by the assessee in support of the secondment is a summary of international assignment provisions appearing at page Nos. 361 to 363 of the Paper Book, which has not been signed by anybody.

11. It is clear from the above that all the documents were executed by or between Shri Thali badrinath and his employer M/s Cisco Systems Hongknog Ltd abroad. There is nothing in such documents which would bind the assessee to any of the terms stated therein. Though the assessee is claiming that all persons have been sent to India based on secondment agreements, the fact of the matter is that no such secondment agreement is available on record. What we find is that apart from Shri Thali Badrinath, Shri Srinivasa Ketavarapu and Shri Abhinav were also Directors, whereas Shri Vishan Gupta was the

Vice President. It is interesting to have a look at what the learned Assessing Officer has to state in this regard:

> *"3.3 It is manifest from the above that Mr. Badrinath remains an employee of CSI during his assignment to the Branch. The ARs were asked to explain the reasons for which Mr. Thalli K Badrinath was requried to come to India. However, the same has not been submitted despite giving several opportunities. It has been merely submitted that CSI seconded Mr. Thalli K Badrinath to the Branch but it has not been clarified whether the Branch requested CSI to send Mr. Badrinath. In fact even the projects on which he has worked in the Branch have not been stated and it is merely stated that he had rendered services in relation to management of proejcts relating to network design, planning and implementation. Further, the "Long Term Assignment Policy" of Cisco which has been referred to in the "Letter of Agreement" has not been furnished"*

No doubt even if we come to a conclusion that there indeed were no secondment agreements and the persons sent were all along the employees of the affiliates abroad, it would not necessarily means that such affiliates were rendering technical services to the assessee. In our opinion, three cases relied on by the learned DR namely IDS Software Solutions India (P) Ltd, Ariba Technologies India (P) Ltd and M/s Abbey Business India (P) Ltd (Supra) all had different factual scenarios. In the case of IDS Software Solutions, there was an agreement between the U.S. Co which had sent the persons to India, with its Indian subsidiary. It was from such agreement that the Tribunal came to a conclusion that the concerned employees were employees of the assessee during the relevant time. There was also a minutes of the Board of Directors of the U.S Co which substantiated the contentions of the assessee that the deputed persons were working in India as employees of the assessee in India. Similarly

in the case of Ariba Technologies India (P) Ltd also, there were agreements between M/s Ariba USA and its Indian subsidiary through which Ariba US had provided services of one of its employees to its Indian subsidiary. In the case of M/s Abbey Business India Services also, there was an outsourcing agreement between Abbey U.K. entered with its subsidiary in India. The Tribunal had verified the clauses of this agreement and came to a conclusin that there was a secondment of staff to the assessee. As against this, here, as mentioned by us above, there was no such agreement of secondment, produced by the assessee before us or before any of the lower authorities. We are, therefore, of the opinion that the issue requires a revisit by the Assessing Officer. Whether the employees of the affiliates abroad were rendering services to the assessee company, as a part of any technical services agreed to be rendered by such affiliates to the assessee, has to be seen based on the verification of actual services rendered by them. Assessee should also be given an opportunity to show that the employees came to India only on a secondment and had not rendered any technical services on behalf of the affiliates abroad. We, therefore, set aside the order of the Assessing Officer in this regard and remit the issue back to the file of the Assessing Officer for consideration afresh. Ground No.2 of the assessee is allowed for statistical purposes.

12. Now we take up the grounds relating to the transfer pricing issues. Through Ground Nos. 3 to 16, the assessee assails the application of certain filters by the Assessing Officer for excluding certain companies considered by it as proper comparables and further assails the treatment given to foreign

exchange fluctuation income, which was not considered as operating revenue.

13. Assessee is a branch of M/s Cisco Systems Services B.V. having its registered office in Amsterdam. The Branch was started after obtaining necessary approval from the Reserve Bank of India. The assessee was giving software support services to various affiliates of Cisco Group. Such services, inter alia, included development of software tools, application and processes etc. The assessee had an agreement with M/s CSS-BV entered on 09.07.2009 by which it was to provide software support services to the parent company abroad, for which it was to be paid cost plus 10%. On account of such srvices, assessee had during the relevant previous year paid an amount of Rs.224,86,73,636. To justify the price so received, assessee had furnished transfer pricing documentation alongwith the audit report in form No.3CEB. The assessee had considered 17 comparables for its T.P. study. TNNM method was adopted and profit level indicator taken was the margin on operating cost. Assessee's profit as the margin on its operating cost came to 14.82%. As per the TP study of the assessee, such margin in the case of the comparable averaged to 13.18% only and therefore, did not call for any adjustment in the Arms' Length Price.

14. Out of the comparable selected by the assessee, the TPO while he was working out the ALP, pursuant to a reference made by the Assessing Officer, rejected 12 and after making his own analysis included 6 fresh comparables. Though the assessee had requested the TPO to consider an additional set of 7 comparables

also, this was rejected by the TPO. The final set of 11 comparables considered by the TPO were as under:

S.No	Company Name	Margins of the comparables as per TP orders excluding forex earning.	Margins of the comparable as per TP order excluding force earnings, after working capital adj.
1	Akshay Software Technologies Ltd	8.11%	11.56%
2	Bodhtree Consulting Ltd	62.27%	62.78%
3	Infosys Ltd	45.61%	45.08%
4	Kals Information Systems Ltd	13.89%	15.30%
5	Larsen & Toubro Infotech Ltd	20.39%	23.11%
6	Mindtree Ltd (Segmental)	5.52%	7.45%
7	Persistent Systems Ltd	41.40%	42.42%
8	R S Software (India) Ltd	9.97%	13.86%
9	Sasken Communication Technologies Ltd (Segmental)	27.91%	30.35%
10	Tata Elxsi Ltd	20.28%	22.11%
11	Zylog Systems Ltd	7.81%	8.13#

While working out the PLI, TPO excluded the forex gains. The adjusted margin of the comparables as per the TPO came to 26.05%. Since the assessee was having a margin of 14.82% only, the TPO recommended an adjustment of Rs.21,98,76,959/- as under:

Arm's Length Mean Margin on cost	24.32%
Less: Working capital adjustment (Annex.C)	-1.73%
Adjusted Margin	26.05%
Operating Cost	1,958,390,000
Arms Length Price (ALP) 126.05% of operating cost	2,468,550,595
Price Received	2,248,673,636`
Shortfall being adjustment u/s 92CA	219,876,959

The objections taken by the assessee before the DRP in this regard were overruled.

15. Now before us the learned AR submitted that foreign exchange gain of Rs.44,19,30,032/- were entirely operational in nature, coming out of debtors realization, creditors payments, inter company cross charges etc. According to him the gain on foreign exchange fluctuation was arrived after adjusting the exchange loss on purchase of fixed assets coming to Rs.1,47,634/-. As per the learned AR, there was no dispute that foreign exchange fluctuation gain was on account of operational transactions. Relying on the decision dated 14.08.2014 of the Coordinate Bench in the case of one of the affiliates of the assessee, namely Cisco Systems India (P) Ltd vs. DCIT in IT(TP)A No.271/Bang/2014, the learned DR submitted that foreign exchange fluctuation gain had to be treated as a part of operating income. The learned AR submitted that the observations of the DRP in the case of the assessee were very similar to those made in the case of Cisco Systems India (P) Ltd (Supra) and even the assessment year was the same. As per the learned AR the Tribunal had come down heavily on DRP's refusal to follow the decision in the case of Saplap India (P) Ltd vs. DCIT (2010) 6 ITR (Trib.) 81.

16. Per contra, the learned DR submitted that the assessee could not demonstrate how the foreign exchange fluctuation gain could be considered as operational in nature.

17. We have perused the orders and heard the rival contentions. The TPO had considered foreign exchange fluctuation gains to be non-operational in nature. This view was confirmed by the DRP stating that the foreign exchange

fluctuations had nothing to do with the business operations of a tax payer. The DRP had refused to follow the decision of M/s. Saplap India (P) Ltd (Supra). None of the authorities have given any finding that foreign exchange fluctuation gains were relatable to any capital receipts or outgoes. Assessee had given a break up of foreign exchange gain in which it had specifically excluded the exchange loss on purchase of fixed assets. We are of the opinion that the foreign exchange fluctuation gain arising to the assessee on realization of trade debtor's, payment to creditors etc., were nothing but operational income. In the case of M/s Cisco Systems India (P) Ltd (Supra) which is not only an affiliate of the company, within the same group, but also engaged in a similar line of business like that of the assessee, it was held by this Tribunal as under:

> *"23. We have considered the rival submissions. In the course of hearing before us, the ld. counsel for the assessee also filed a segment wise break up of foreign exchange fluctuation gain, the same is given as* ***Annexure-I to this order****. It can be seen from the aforesaid chart given by the assessee that the total foreign exchange gain on account of realization of proceeds from debtors, taken to creditors, inter-company statements etc. was a sum of Rs.179,01,08,756. Out of the above, the assessee on his own has excluded foreign exchange fluctuation on account of advances towards share capital charged to P&L account and foreign exchange fluctuation in the matter of purchase of fixed assets charged to P&L account. It is thus clear from the chart that a sum of Rs.37,89,23,185 which was sought to be added as part of the operating income on rendering software development services is only on account of transactions of rendering software development services by the assessee to its AE and the foreign exchange fluctuation at the time of realization of the payment for rendering software development services. It is therefore clear that the foreign exchange fluctuation in question has to be treated as part of the operating income of software development services segment of the assessee and the operating profit to operating cost has to be determined accordingly. The DRP has refused to follow the decision of ITAT Bangalore Bench*

in the case of SAP Labs India Pvt. Ltd. (supra). In our view, the decision rendered by the Tribunal is binding on the DRP and the DRP cannot be heard to say that the decision rendered by the Tribunal is incorrect and refuse to follow the same. In the given facts and circumstances, we hold that the foreign exchange gain from software development services has to be considered as part of the income from software development services while computing the margin of the assessee and accordingly the margin of 12.67% computed by the assessee is directed to be adopted.

18. Once operating margin of the assessee is recomputed considering forex as operating in nature, its profit level indicator would arise to 37.38% as under:

Cisco Systems Services B.V.India-Branch A.Y 2009-10

Margin computation

Particulars	As per TPO	Considering forex as operating in nature
Income Income from software development services	2,24,86,73,636	2,24,86,73,636
Other Income (OR)	-	44,17,82,000
	2,24,86,73,636	2,69,04,55,636
Expenditure Personnel cost	92,14,29,000	92,14,29,0000
Operating and Administrative expenses	99,95,30,000	99,95,30,000
Depreciation	3,74,31,000	3,74,31,000
Operating Expenses (OC)	1,95,83,90,000	1,95,83,90,000
Operating Profit (OP)	29,02,83,636	73,20,65,636
OP/OC	14.82%	37,.38%

We, therefore, direct that margin of 37.38% computed by the assessee be verified and accepted if found correct. Such margin is to be compared with the PLI of the selected comparables, in line with the directions given by this Tribunal in the case of Cisco Systems India (P) Ltd (Supra).

19. On the second aspect, viz. selection of comparables, the learned AR submitted that 4 of the comparables namely, Bodhtree Consulting Ltd, Infosys Ltd, Kals Information Systems Ltd and Tata Elxsi Ltd have to be excluded, considering the decision of the Tribunal in Cisco Systems India (P) Ltd (Supra). According to him, if these companies are excluded and forex is considered as operating income, then assessee's profit margin will be much higher than that of the comparables and it will not be necessary to consider the additional comparables submitted by the assessee before the TPO. Per contra, the learned DR supported the authorities.

20. We have perused the orders and heard the contentions. There is no dispute that the M/s. Cisco Systems India (P) Ltd (Supra)is an affiliate of the assessee company and engaged in similar business like that of the assessee namely rendering software services development etc. Though the said company was having other business also, with regard to its software development segment, this Tribunal held Bodhtree Consulting Ltd, Infosys Ltd, Kals Information Systems Ltd and Tata Elxsi Ltd to be not proper comparables. Relevant paras of the order dated 14.08.2014 is reproduced hereunder:

> *26.1 Bodhtree Consulting Ltd.:- As far as this company is concerned, it is not in dispute that in the list of comparables chosen by the assessee, this company was also included by the assessee. The assessee, however, submits before us that later on it came to the assessee's notice that this company is not being considered as a comparable company in the case of companies rendering software development services. In this regard, the ld. counsel for the assessee has brought to our notice the decision of the Mumbai Bench of the Tribunal in the case of Nethawk Networks Pvt. Ltd. v. ITO, ITA No.7633/Mum/2012, order dated 6.11.2013. In this case, the Tribunal followed the*

decision rendered by the Mumbai Bench of the Tribunal in the case of Wills Processing Services (I) P. Ltd., ITA No.4547/Mum/2012. *In the aforesaid decisions, the Tribunal has taken the view that Bodhtree Consulting Ltd. is in the business of software products and was engaged in providing open & end to end web solutions software consultancy and design & development of software using latest technology. The decision rendered by the Mumbai Bench of the Tribunal in the case of* Nethawk Networks Pvt. Ltd. *(supra) is in relation to A.Y. 2008-09. It was affirmed by the learned counsel for the Assessee that the facts and circumstances in the present year also remains identical to the facts and circumstances as it prevailed in AY 08-09 as far as this comparable company is concerned. Following the aforesaid decision of the Mumbai Bench of the Tribunal, we hold that Bodhtree Consulting Ltd. cannot be regarded as a comparable. In this regards, the fact that the assessee had itself proposed this company as comparable, in our opinion, should not be the basis on which the said company should be retained as a comparable, when factually it is shown that the said company is a software product company and not a software development services company.*

26.2 Infosys Ltd.:- As far as this company is concerned, it is not in dispute before us that this company has been considered to be functionally different from a company providing simple software development services, as this company owns significant intangibles and has huge revenues from software products. In this regard, we find that the Bangalore Bench of the Tribunal in the case of M/s. TDPLM Software Solutions Ltd. v. DCIT, ITA No.1303/Bang/2012, by order dated 28.11.2013 with regard to this comparable has held as follows:-

> *"11.0 Infosys Technologies Ltd.*
>
> *11.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected these objections raised by the assessee on the grounds that turnover and brand aspects were not materially relevant in the software development segment.*
>
> *11.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee in the case on hand. The learned Authorised Representative drew our attention to various parts of the Annual Report of this company to submit that this company commands substantial brand value, owns intellectual property rights and is a market leader in software development activities, whereas the assessee is merely a software service provider operating its business in India and does not possess either any brand value*

or own any intangible or intellectual property rights (IPRs). It was also submitted by the learned Authorised Representative that :-

(i) the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010 has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any intangible and hence does not have an additional advantage in the market. It is submitted that this decision is applicable to the assessee's case, as the assessee does not own any intangibles and hence Infosys Technologies Ltd. cannot be comparable to the assessee ;

(ii) the observation of the ITAT, Delhi Bench in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856 (Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and market leader assuming all risks leading to higher profits cannot be considered as comparable to captive service providers assuming limited risk ;

(iii) the company has generated several inventions and filed for many patents in India and USA ;

(iv) the company has substantial revenues from software products and the break up of such revenues is not available ;

(v) the company has incurred huge expenditure for research and development;

(vi) the company has made arrangements towards acquisition of IPRs in 'AUTOLAY', a commercial application product used in designing high performance structural systems.

In view of the above reasons, the learned Authorised Representative pleaded that, this company i.e. Infosys Technologies Ltd., be excluded form the list of comparable companies.

11.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that comparability cannot be decided merely on the basis of scale of operations and the brand attributable profit margins of this company have not been extraordinary. In view of this, the learned Departmental Representative supported the decision of the TPO to include this company in the list of comparable companies.

11.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) for Assessment Year 2007-08 is applicable to this

year also. We are inclined to concur with the argument put forth by the assessee that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly."

The decision rendered as aforesaid pertains to A.Y. 2008-09. It was affirmed by the learned counsel for the Assessee that the facts and circumstances in the present year also remains identical to the facts and circumstances as it prevailed in AY 08-09 as far as this comparable company is concerned. Respectfully following the decision of the Tribunal referred to above, we hold that Infosys Ltd. be excluded from the list of comparable companies.

26.3 KALS Information Systems Ltd.:- As far as this company is concerned, it is not in dispute before us that this company has been considered as not comparable to a pure software development services company by the Bangalore Bench of the Tribunal in the case of M/s. Trilogy e-business Software India Pvt. Ltd. (supra). The following were the relevant observations of the Tribunal:-

"(d) KALS Information Systems Ltd.

46. As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual repot, the salary cost debited under the software development expenditure was Rs. 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of Bindview India Private Limited Vs. DCI, ITA No. ITA No 1386/PN/1O wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

"16. Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said

company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of I T enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds."

Based on all the above, it was submitted on behalf of the assessee that KALS Information Systems Limited should be rejected as a comparable.

47. We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly software development service provider. We therefore accept the plea of the Assessee that this company is not comparable."

Following the aforesaid decision of the Tribunal, we hold that KALS Information Systems Ltd. should not be regarded as a comparable.

26.4 Tata Elxsi Ltd.:- As far as this company is concerned, it is not in dispute before us that in assessee's own case for the A.Y. 2007-08, this company was not regarded as a comparable in its software development services segment in ITA No.1076/Bang/2011, order dated 29.3.2013. Following were the relevant observations of the Tribunal:-

II. UNREASONABLE COMPARABILITY CRITERIA :

19. The learned Chartered Accountant pleaded that out of the six comparables shortlisted above as comparables based on the turnover filter, the following two companies, namely (i) Tata Elxsi

Ltd; and (ii) M/s. Flextronics Software Systems Ltd., deserve to be eliminated for the following reasons :

(i) Tata Elxsi Ltd., : The company operates in the segments of software development services which comprises of embedded product design services, industrial design and engineering services and visual computing labs and system integration services segment. There is no sub-services break up/information provided in the annual report or the databases based on which the margin from software services activity only could be computed. The company has also in its response to the notice u/s.133(6) stated that it cannot be considered as comparable to any other software services company because of its complex nature. Hence, Tata Elxsi Ltd., is to be excluded from the list of comparables.

(ii) Flextronics Software Systems Ltd. : The learned TPO has considered this company as a comparable based on 133(6) reply wherein this company reflected its software development services revenues to be more than 75% of the "software products and services" segment revenues. Flextronics has a hybrid revenue model and hence should be rejected as functionally different. Based on the information provided under "Revenue recognition" in its annual report, it can be inferred that the software services revenues are earned on a hybrid revenue model, and the same is not similar to the regular models adopted by other software service providers. The learned representative pleaded that a regular software services provider could not be compared to a company having such a unique revenue model, wherein the revenues of the company from software/product development services depends on the success of the products sold by its clients in the marketplace. Hence, it would be inappropriate to compare the business operations of the assessee with that of a company following hybrid business model comprising of royalty income as well as regular software services income, for which revenue break-up is not available. He finally submitted that this was a good reason to exclude this company also from the list of comparables.

20. On the other hand, the learned DR supported the order of the lower authorities regarding the inclusion of Tata Elxsi and Flextronics Software Systems Ltd., in the list of comparables. He reiterated the contents of para 14.2.25 of the TPO's order. He also read out the following portion from the TPO's order :

> *"Thus as stated above by the company, the following facts emerge :*

1. The company's software development and services segment constitutes three sub-segments i) product design services; ii) engineering design services and iii) visual computing labs.

2. The product design services sub-segment is into embedded software development. Thus this segment is into software development services.

3. The contribution of the embedded services segment is to the tune of Rs.230 crores in the total segment revenue of Rs.263 crores. Even if we consider the other two sub-segments pertain to IT enabled services, the 87.45% (›75%) of the segment's revenues is from software development services.

4. This segment qualifies all the filters applied by the TPO."

Regarding Flextronics Software Systems, the following extract from page 143 of TPO's order was read out by him as his submissions :

"It is very pertinent to mention here that the company was considered by the taxpayer as a comparable for the preceding assessment year i.e., AY 2006-07. When the same was accepted by the TPO as a comparable, the same was not objected to it by the taxpayer. As the facts mentioned by the taxpayer are the same and these were there in the earlier FY 2005-06, there is no reason why the taxpayer is objecting to it. How the company is functionally similar in the earlier FY 2005-06 but the same is not functionally similar for the subsequent FY 2006-07 even when no facts have been changed from the preceding year. Thus the taxpayer is arguing against this comparable as the company was not considered as a comparable by the taxpayer for the present FY 2006-07."

21. We have heard the rival submissions and considered the facts and materials on record. After considering the submissions, we find that Tata Elxsi and Flextronics are functionally different from that of the assessee and hence they deserve to be deleted from the list of six comparables and hence there remains only four companies as comparables, as listed below:"

26.5. Following the aforesaid decision of the Tribunal, we hold that M/S.Tata Elxsi Ltd. should not be regarded as a comparable".

21. Assessee here is also engaged in the software development business and therefore, for the same reasons as mentioned by the Tribunal in the case of M/s. Cisco Systems India (P) Ltd (Supra), we direct the Assessing Officer to exclude these companies from the set of selected comparables.

22. Accordingly, we direct the TPO to rework the PLI of the comparables after including the operating foreign exchange gains also. In so far as the comparables rejected by the TPO are concerned, the learned AR having submitted that these would be irrelevant once foreign exchange fluctuation gain is considered as operating income, we do not find it necessary to adjudicate. In the result Ground Nos.3 to 16 of the assessee are partly allowed for statistical purposes.

23. Vide its Ground No.17 the assessee states that the credit for tax deducted at source given was only Rs.1,46,966/- whereas it was eligible for Rs.2,13,96,098/-. We direct the Assessing Officer to verify this claim of the assessee and give credit for tax, as per evidence produced. Ground No.17 is allowed for statistical purposes.

24 Ground No.18 which is on interest under Section 234B of the Act is consequential in nature and does not need any adjudication.

25. In the result appeal of the assessee is treated as partly allowed for statistical purposes.

S.P. No.129/Bang/2014:

26. Since the appeal of the assessee has been decided, stay petition is dismissed as infructuous.

Order pronounced in the Open Court on 17th October, 2014.

Sd/-	Sd/-
(P.Madhavi Devi)	**(Abraham P. George)**
Judicial Member	**Accountant Member**

Bangalore dated 17th October, 2014.

Vnodan/sps

Copy to:

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

By Order

ASSISTANT REGISTRAR
Income Tax Appellate Tribunal,
Bangalore Benches, Bangalore