IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-1 : NEW DELHI

BEFORE SHRI R.S. SYAL, AM & SHRI KULDIP SINGH, JM

ITA No.6200/Del/2012
Assessment Year : 2008-09

Headstrong Services India Pvt. Ltd., 103, Ashoka Estate, Barakhamba Road, New Delhi. PAN: AABCT7650D	Vs.	DCIT, Circle-12(1), New Delhi.
(Appellant)		(Respondent)

Assessee By	:	Shri Nageswar Rao & Shri Shailesh Kumar, Advocates
Department By	:	Shri Amrendra Kumar, CIT,DR Shri Deepak Tiwari, Sr. DR

Date of Hearing	:	10.02.2016
Date of Pronouncement	:	11.02.2016

ORDER

PER R.S. SYAL, AM:

This appeal by the assessee is directed against the final assessment order passed on 17.10.2012 by the Assessing Officer (AO) u/s 143(3) read with section 144C of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2008-09.

2. First issue raised in this appeal is against the making of addition towards transfer pricing adjustment amounting to Rs.15,41,06,180/-.

3. Briefly stated, the facts of the case are that the assessee is a 100% subsidiary of Headstrong Services LLC. The assessee is a 100% export oriented unit (EOU) for manufacture and export of computer software. It is engaged in the provision of Software development services and IT enabled services (ITES) to its AEs. The assessee reported two international transactions, namely, Provision of software services and Provision of IT enabled services. The AO made reference to the Transfer Pricing Officer (TPO) for determination of the ALP of these international transactions. The TPO made transfer pricing adjustment amounting to Rs.60,39,585/- for the international transaction of ITES. He also took up the international transaction of 'Software services' with transacted value of Rs.128,96,15,682/-. It was noticed that the assessee selected itself as a Tested party by choosing the Transactional Net

Margin Method (TNMM) as the most appropriate method. The assessee used Operating Profit/Total Cost (OP/TC) as its Profit Level Indicator (PLI) which was shown at 16.53%, calculated by taking weighted average margin of four years, being the actual figures for the financial year 2007-08 plus projected figures for the coming three years. The assessee chose 23 companies as comparable, with their average PLI at 14.43%. Thus it was demonstrated that this international transaction was at arm's length price (ALP). The TPO accepted the assessee as a tested party and also the TNMM as the most appropriate method. However, the assessee's PLI, computed on the basis of profit of four years including projected profit of three years, was rejected. The TPO considered the operating profit margin of the assessee for the current year alone, calculated on the basis of actual figures. He made certain amendments in the list of comparables in the sense that some of the comparables chosen by the assessee were removed while a few new were introduced. Average PLI of comparables, being OP/OC computed at 23.82%, was applied as a benchmark for working out the transfer pricing adjustment amounting to Rs.20,18,08,602/- for this international transaction. The assessee challenged the draft order before the Dispute Resolution Panel (DRP). The TPO in his order giving effect to directions given by the DRP, did not make any adjustment in relation to the international transaction of ITES. As regards the other international transaction of `Software development services', he recomputed the profit margin of comparables at 19.73%. By applying the same to the total operating cost incurred by the assessee, the TPO downscaled transfer pricing adjustment to Rs.15,41,06,180/-. It is this amount which was added by the AO in the final assessment order, which is subject matter of the instant appeal.

4. We have heard the rival submissions and perused the relevant material on record. The ld. AR challenged the addition on account of transfer pricing adjustment from the international transaction of `Software development services' broadly on three counts, namely, Calculation of the assessee's PLI; Selection of comparables; and that when the assessee is entitled to deduction u/s 10A, then no transfer pricing adjustment can be made. We will deal with these in seriatim.

A. CALCULATION OF ASSESSEE'S PLI

5. The ld. AR challenged the calculation of the assessee's PLI by the TPO on different scores, which we will deal with hereinafter separately.

a. Whether projected profit rate of subsequent years can also be considered ?

6.1. The assessee adopted PLI of OP/OC and computed its weighted average profit rate of 16.53%, by taking profit margins for a period of four years, being actual figure for the current year at 6.52% and projected figures for coming three years at 17.23%, 19.05% and 19.05%. The TPO rejected this approach and held that only profit for the current year could be considered as the assessee's PLI.

6.2. The ld. AR vehemently opposed the action of the authorities below in rejecting the assessee's PLI computed by considering, *inter alia*, the projected figures for coming three years. It was submitted that the assessee took contracts from its AEs in earlier years, which were running beyond a particular year and, hence, the profitability for one year cannot be decisive to calculate the real profits. On being called upon to point out Agreements entered into with its AEs, the ld. AR took us through pages 213 onwards of the paper book, which is copy of an Agreement between the assessee and its AE for providing software development services. This Agreement has been entered into on 25.2.2008 w.e.f. 1.4.2007. The ld. AR candidly admitted that all other Agreements which generated revenue for the assessee during the year were effective from 1st April, 2007. As the previous year relevant to the assessment year under consideration also begins from 1.4.2007, we cannot accept the assessee's contention that the Agreements were entered in earlier years and would spill over in the subsequent years as well. On going through the assessee's Annual accounts, it emerges that under the heading 'Other current assets' as appearing in the Balance sheet, there is an item of 'Unbilled revenue amounting to Rs.3,24,77,983/-.' On further inquiry, it transpired that this amount represents work-in-progress of the assessee accounting for expenses incurred during the year for which the work is still incomplete and no revenue is received. The ld. AR accepted that all the expenses booked in the Profit & Loss Account match with the corresponding revenue actually realized and this provision of work-in-progress is a standard accounting procedure adopted for excluding expenses incurred on work done for which revenue is yet to be accounted for. This divulges that the assessee debits expenses to its Profit & Loss account only to the extent for which corresponding revenue is recognized in accounts and as such, there is no possibility of shifting revenue or expenses from one year to another, so as to distort the figure of profit for each year independently. We are, ergo, unable to approve this argument raised on behalf of the assessee.

6.3. Further, section 92(1) provides that: 'Any *income arising from an international transaction* shall be computed having regard to the arm's length price.' Section 92C dealing with the computation of arm's length price provides through sub-section (1) that the arm's length price in relation to an international transaction shall be determined by any of the methods given in this provision. When we consider the language of section 92(1) in juxtaposition to that of section 92C(1), it emerges that it is the income arising from an international transaction which is to be computed having regard to its ALP. Sub-section (3) (a) of section 92C provides that where the AO, during the course of any proceedings for assessment is of the opinion that *"the price charged or paid in an international transaction*" has not been determined as per ALP, then, he may proceed to determine the ALP in relation to the said international transaction. This provision, again, brings out that it is *'the price charged or paid in international transaction*' which is taken up for consideration by the AO for examining whether or not the same is at ALP. The above provisions plentifully show that it is the actual income from an international transaction earned during the year, which is taxed at its ALP. The base for comparison, being the actual income of the assessee from an international transaction, cannot be substituted with any hypothetical figure by considering, *inter alia,* projected profits for the subsequent years. Essence of the entire transfer pricing provisions is to compare the actual price/profit realized/earned by the assessee from an international transaction with the price/profit realized/earned from comparable uncontrolled transactions. It is totally impermissible to substitute *actual profit earned by the assessee from an international* *transaction* with any other profit base, either by considering the actual profits for the earlier years as well or by taking into account the projected profits of the subsequent years, for the purposes of determining the ALP of an international transaction. Moreover, the figures taken for subsequent three years are mere projections. The correctness of these projections is mystery for us. We, therefore, jettison the view point of the assessee in calculating its PLI by considering figures for the current year and also projected figures for subsequent three years. The impugned order is, therefore, upheld on this score.

(b) Foreign Exchange Fluctuation

7.1. The ld. AR contended that the adjustment on account of difference in foreign exchange rates for the year under consideration *vis-à-vis* the earlier year was claimed by the assessee by means of adjustment to its operating profit, which was wrongly refused by the TPO. He submitted that the value of Indian Rupees appreciated in comparison with all the major foreign currencies, especially the US dollars. It was argued that the average exchange rate for USD in the Financial year 2006-07 was Rs.45.25 in comparison with Rs.40.29 for the Financial year 2007-08, relevant to the assessment year under consideration. The effect of such fluctuation in the foreign exchange rate, as explained by the ld. AR was, that decline of 10.96% was registered in the assessee's revenue, which was required to be adjusted against its profit margin for the current year. He submitted that the authorities below erred in not allowing such adjustment to the assessee's PLI. The ld. DR opposed granting of any adjustment in the PLI of the assessee in principle and also on merits. He submitted that adjustment, if any, can be allowed only in the profit rate of comparables and not that of the assessee. As such, we need to first determine, if any adjustment to the actual profit margin of the assessee is at all possible for the purposes of determining the ALP of an international transaction?

7.2. Chapter-X of the Act contains special provisions relating to avoidance of tax. Section 92, which is the first section of this Chapter, provides for computation of income from an international transaction having regard to arm's length price. Sub-section (1) of the section provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Section 92C of the Act enshrines provisions relating to computation of arm's length price. Sub-section (1) of the section states that the arm's length price in relation to an international transaction shall be determined by any of the methods listed herein which include, *inter alia,* the transactional net margin method. Sub-section (2) of section 92C provides that the most appropriate method referred in sub-section (1) shall be applied for determination of the ALP in the manner as may be prescribed. Calculation of ALP under the TNMM, which method has been accepted by the assessee as the most appropriate method in the instant case, has been prescribed under Rule 10B(1)(e) of the Income-tax Rules, 1962, which states that for the purposes of section 92C(2), the ALP in relation to the international transaction shall be determined as under : -

> `**(e) transactional net margin method,** by which,—
>
> (i) the net profit margin *realised* by the enterprise from an international transaction entered into with an associated

enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base ;

(ii) the net profit margin *realised* by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market ;

(iv) the net profit margin *realised* by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.'

7.3. A bare perusal of sub-clause (i) of Rule 10B(1)(e) brings out that the net profit margin *realized* by the enterprise from an international transaction is to be computed in relation to a particular base. Sub-clause (ii) provides that the net profit margin *realized* by the enterprise from the comparable uncontrolled transaction is computed having regard to the same base. Sub-clause (iii) provides that the net profit margin *realized* by *a comparable company, determined as per sub-clause (ii)* above, *'is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, ... which could materially affect the amount of net profit margin* in the open market.' It is this adjusted net profit margin of the unrelated transactions or of the comparable companies, as determined under sub-clause (iii), which is used as benchmark for the purposes of making comparison with the net profit margin realized by the assessee from its international transaction as per sub-clause (i). Sub-clause (iv) states that the net profit margin *realized* by the enterprise, as referred in sub clause (i), is established to be the same as a net profit margin referred in sub-clause (iii) of the comparables. Sub-clause (v) states that the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to international transaction. On going through the above sub-clauses of Rule 10B(1)(e), it becomes patent that as per the first step, the net profit margin '*realized'* by the enterprise from an international transaction is to be computed. Use of the word *'realized*' in the provision richly indicates that it is the calculation of actual operating profit margin of the assessee earned from international transaction, which is not any adjusted figure. Similar position can be traced from the language of sub-clause (iv), where again reference has been made to profit margin `realized' by the assessee from the international transaction. When we consider sub-clauses (ii) and (iii), it turns out that, firstly, the net operating margin actually realized from the comparable uncontrolled transaction is computed, which is determined in the same way as that of the assessee as per clause (i), that is, actual figures without making any adjustment. Then sub-clause (iii) talks of adjusting the actually realized margin of comparables to bring the same at par with the international transaction undertaken by the assessee, so as to iron out the effects of differences between the international transaction and comparable uncontrolled transactions. On going through all the sub-clauses of Rule 10B(1)(e), the position which follows is that the net profit margin *realized* by the assessee from its international transaction is taken as such and the adjustments, if any, due to differences between the international transaction and comparable uncontrolled transactions, are given effect to in the profit margin of comparables. The viewpoint canvassed by the learned Authorized Representative that the adjustment should be carried out in the profit margin of the assessee is, ergo, devoid of merit and contrary to the legal provisions, which is hereby repelled. Our view is supported by several orders passed by the Delhi benches of the tribunal on this issue including *DCIT vs. Claas India Pvt. Ltd.* (ITA No.1783/Del/2011) dt. 12.08.2015 and *Saxo India Pvt. Ltd. VS. ACIT* (ITA No. 6148/Del/2015) dt. February, 2016. Resultantly, it is held that foreign exchange fluctuation adjustment, or for that matter any other adjustment, can be legally made only in the profit margin of the comparables, if it is otherwise factually warranted and not in the profit margin of the assessee.

7.4. On going through all the Agreements entered into by the assessee with its AEs, to which our attention was drawn by the ld. AR, it is manifest that these have been made effective from 1.4.2007, being the current year alone. Under such circumstances, there can be no ground for arguing that the Agreements were entered in the preceding year and the remuneration as realized in the current year on the basis of the foreign exchange rates as applicable, adversely affected its profit margin for the current year, thereby requiring an upward revision in PLI of the assessee. Once the Agreements have been entered into with effect from the first day of the previous year, there can be no scope for comparing the rate of foreign exchange during the year with that of the preceding year or any other earlier year, so as to claim any adjustment.

7.5. The next leg of the argument of the ld. AR about the foreign exchange fluctuation having adversely affected its profits for the current year on standalone basis, is also unsustainable. It is so for the reason that this is a factor, whose impact is common both to the assessee and comparables. Any northwards or southwards sojourn in the foreign currency rate leaves its impact on the operating profit of the assessee in the same manner as on that of the comparables. If the assessee's profit margin got shrinked due to adverse fluctuation in the foreign exchange rate, the same rate when applied to the comparables, would have affected their profit margins as well. Since adjustment is permissible in the profit margin of comparables only due to differences between the international transaction and the comparable uncontrolled transaction, and not due to a factor affecting profit of both the assessee and comparables in the same manner, we refuse to allow any adjustment in the profit rate of comparables because of fluctuation in the foreign currency rate.

7.6. It is, therefore, held that neither the assessee can claim any adjustment on account of foreign exchange fluctuation rate in its profit nor such an adjustment, on the facts and circumstances of the instant case, is warranted in the profit margin of comparables.

(c) Revenue sharing formula

8.1. The ld. AR submitted that the assessee's AE shared 80% of total revenue from its clients with the assessee and for similar services obtained from unrelated parties, the AE shared 78.5% of the revenue with such third parties. In the light of this arrangement with the assessee for sharing higher profit percentage by its AE with it *vis-à-vis* the third parties, the ld. AR contended that its international transaction should be considered at ALP within the meaning of Comparable uncontrolled price (CUP) method. The ld. AR stated that such submission was made before the DRP also which has been rejected without any plausible reason. This was countered by the ld. DR, who stated that such a revenue sharing formula has no significance in so far as the assessee's operating profit margin is concerned.

8.2. We have heard the rival submissions and perused the relevant material on record. It is observed that the assessee adopted TNMM as the most appropriate method in its TP study report. The TPO accepted the same. It was only for the first time that the assessee raised this alternative submission before the DRP for applying the alleged internal CUP method, which came to be turned down by the DRP.

8.3. It is noticed that the assessee has treated itself as a tested party in its transfer pricing study report, which has been accepted by the TPO. Under the CUP method as prescribed under Rule 10B(1)(a), price charged for services rendered in a comparable uncontrolled transaction is identified which is then adjusted to account for differences, if any, between the international transaction undertaken by the assessee and comparable uncontrolled transactions. Such adjusted price is taken as ALP in respect of the services provided by the assessee in the international transaction. From the machinery provision contained in Rule 10B(1)(a) in this regard, it is clear that the internal CUP provides for comparing the assessee's international transaction with another comparable uncontrolled transaction undertaken by it. We fail to appreciate the logic behind the ld. AR's submission in comparing the Revenue sharing formula between the assessee and its AE on the one hand and its AE and third parties on the other. As the assessee is a tested party, under the CUP method, it is only the price charged by it which can be compared with the price charged by some comparable(s) in uncontrolled transactions. The argument put forth on behalf of the assessee can be successfully applied only in determining the ALP of the international transactions undertaken by its AE so as to make a valid comparison between remuneration paid by such AE to the assessee with that paid to unrelated parties, provided other terms and conditions of the provision of services are similar. Presently, we are dealing with the determination of ALP of the international transaction undertaken by the assessee and not its foreign AE. The assessee can resort to the CUP method only by showing that the price charged by it from its AE was favourably comparable to the price charged by some other comparable company(ies) in uncontrolled transaction(s). The ld. AR has brought no material on record to show the price charged in a comparable uncontrolled situation. We, therefore, hold that the view canvassed before the DRP for the first time in resorting to the CUP method is devoid of merits and as such, the most appropriate method in the facts and circumstances of the instant case is TNMM, which was originally adopted by the assessee and also approved by the TPO.

9. To sum up the above discussion, we hold that the assessee was not right in working out its PLI by also considering projected profits for the three subsequent years; no deduction on account of foreign exchange fluctuations can be allowed in the facts and circumstances of the instant case; and the revenue sharing formula as put forth by the assessee as relevant under the CUP method for determining the ALP, is not correct.

Consequently, it is held that the calculation of PLI of the assessee done by the TPO under TNMM is correct, which does not warrant any interference. We, therefore, countenance the same. The assessee fails on this issue.

B. SELECTION OF COMPARABLES.

10. The assessee agitated inclusion of certain companies by the TPO in the final list of comparables and also exclusion of certain companies which, in its opinion, ought to have been included in such list.

11. Before going into the question of comparability of the companies assailed before us, it is relevant to understand the nature of business carried out by the assessee. We have briefly noticed above that the assessee is engaged in providing software development services to its AEs. The assessee is providing end-to-end systems integration and consulting services in focused vertical market segments including Securities and Investment Banking, Airlines & Transport and Technology. The assessee's TP study report discloses that it is providing customized software application development for its AE

within which it focuses on the services of Application development, Re-engineering and legacy applications, Maintenance of existing applications, Enterprise application integration and specialized quality assurance and testing services. The assessee is providing services in two kinds of projects, namely, Integrated projects (in which work is done both by the assessee and its US based AE to be finally delivered to the client) and Non-integrated projects (in which work is done by the assessee alone and this work is end product in itself). The above narration of facts indicates that the assessee is a captive unit engaged in providing software development services to its AEs only under this international transaction and is not selling software products under its own ownership. With the above background in mind, we will examine the comparability or otherwise of the companies assailed in the instant appeal.

12. Firstly, we will deal with the companies which have been included by the TPO in the final set of comparables and the assessee claims them to be incomparable. A submission common to some of such companies

was made by the ld. AR that certain Benches of the Tribunal in other cases have held them to be not comparable. In that view of the matter, it was urged that those companies, being *ex facie* incomparable, be automatically excluded from the list of comparables drawn by the TPO.

13. We express our reservations in accepting such a broad proposition. It is axiomatic that if company 'A' is functionally different from company 'B', then, such company cannot be considered as comparable. Two companies can be considered as comparable when both are discharging the overall similar functions, though there may be some minor differences in such functions, not marring the otherwise comparability. Notwithstanding the functional similarity, many a times a company ceases to be comparable because of other reasons as well. To cite an example, if company 'A', though functionally similar to company 'B', but has related party transactions (RPTs) breaching a particular level, then, such company cannot be considered as comparable to company 'A' in the year in which the RPTs breach such a level. If, however, in the subsequent year, the related party transactions fall below

that limit, then such company would again become comparable. To put it simply, if company 'A' has been held to be incomparable *vis-a-vis* company 'B', then it is not essential that company 'A' would be incomparable to company 'C' also. What is relevant to consider is, firstly, the functional profile of company 'A' *vis-a-vis* company 'C'. If both are functionally similar, then notwithstanding the fact that company 'A' was held to be incomparable to company 'B', it may still be comparable to company 'C'. Despite the fact that company 'A' is functionally similar to company 'B', it may still have been declared as incomparable to company 'B' because of other relevant reasons. If company 'A' passes the same reasons *vis-a-vis* company 'C', then company 'A' will find its place in the list of comparables of company 'C', notwithstanding the fact that it was held to be incomparable to company 'B'. The crux of the matter is that the mere fact that company 'A' has been held to be not comparable in a judicial order passed in the case of company 'B', does not *per se* make it incomparable in all the subsequent cases to follow. Not only company 'A' held to be incomparable to company 'B' can be comparable to company 'C', but company 'X' held to be comparable to company 'Y' can also be incomparable to company 'Z', depending upon the functional profile and the applicability or otherwise of the related factors. There can be no hard and fast rule that if a particular company has been held to be not comparable in the case of another company, then such former company would cease to be comparable to the assessee company also. Comparability of each company needs to be ascertained only after matching the functional profile and the relevant factors of the other company. Ergo, this contention raised on behalf of the assessee cannot be accepted. With the above parameters and the factual matrix, we will distinctly examine the companies chosen by the TPO to ascertain if they are really comparable.

(i) Avani Cimcon Ltd.

14.1. This company was not chosen by the assessee as a comparable for the international transaction of Software development services. The TPO included it by observing that it was also engaged into software development consulting company with client base in Australia, US, UK, Africa and the European Union with major focus on the travel and insurance industry. The DRP also rejected the assessee's contention against the inclusion of this company.

14.2. We have perused the Annual accounts of this company available in the assessee's paper book. Apart from its Balance sheet, Profit & loss account and some Schedules, the Director's Report and Auditor's Report, etc. of this company are not available. The ld. AR contended that the information of this company available in the public domain for the year under consideration has been downloaded and placed before us and except for these documents, no other reports etc., constituting part of Annual report for the year ending 31.3.2008, are available. However, our attention was drawn towards certain Tribunal orders which have considered the functional profile of this company on the basis of information available on its website. First is Tribunal order in *Agnity India Technologies Pvt. Ltd. Vs. DCIT (ITA No.6485/Del/2012).* Vide its order dated 20.9.2013, the tribunal considered the functional profile of this company by noticing it to be a Product company owning software products like Dxchange, Travel Solutions, Insurance Solutions, Customer Appreciation, etc. Similar view has been taken by the Mumbai Bench of the Tribunal in the case of NetHawk Networks India Pvt. Ltd. Vs. ITO (ITA No.7633/N/2012). Vide its order dated 6.11.2013, the Tribunal for the assessment year 2008-09 has noticed Avani Cimcon Ltd. to be a Product company. No contrary material has been placed before us by the ld. DR to show the functional profile of this company matching with the assessee. When contrasted with the assessee company, which is engaged in providing software development services to its group concerns, we fail to see as to how a software product company like Avani Cimcon Ltd., having intellectual property rights over some of the products developed by it, can be compared with the assessee on an entity level. We, therefore, order for the elimination of this company from the list of comparables.

(ii) Bodhtree Consulting, Persistent Systems Ltd., Quintegra Solutions Ltd., Tata Elxsi, Thirdware Solutions Ltd.

15.1. The assessee accepted these companies as comparable before the TPO which is apparent from his order. No issue was raised before the DRP contesting the comparability of these companies. It is only for the first time that the assessee has challenged before us that these companies are not comparable. It was, therefore, prayed that these companies be excluded from the list of comparables. This was opposed by the ld. DR, who argued that once the assessee has accepted a particular company as comparable before the TPO and/or DRP, it cannot be allowed to resile from its stand in contesting before the Tribunal that the same is not comparable.

15.2. The Special Bench of the Tribunal in *DCIT vs. Quark Systems Pvt. Ltd., (2010) 132 TTJ (Chd) (SB) 1,* has held that a company which was included by the assessee and also by the TPO in the list of comparables at the time of computing the ALP, can be excluded by the Tribunal if the assessee proves that the same was wrongly included. The ld. DR argued that this Special Bench decision should not be applied because much water has flown since then and the transfer pricing provisions have come out from its nascent stage. We are unable to accept this contention raised on behalf of the Revenue for the obvious reason that the hands of the assessee cannot be tied to challenge the comparability of a company before the Tribunal for the first time if it is really incomparable. A mere challenge to the comparability of a company before the Tribunal does not itself lead to the acceptance of comparability. Rather, the facts are required to be probed and examined for ascertaining whether such a company is, in fact, comparable or not. There can be no estoppel against the exclusion of certain comparables from the list of comparables which are, in fact, not comparable. Several orders have been passed by the Delhi benches of the tribunal even in the recent past following the *ratio* of the Special bench decision referred to hereinabove. In view of the fact that the comparability or otherwise of these companies was not examined by the TPO, in our considered opinion, the ends of justice would meet adequately if the impugned order on this issue is set aside and the matter is restored to the file of AO/TPO for examining the assessee's contention afresh as regards the comparability of these companies. We order accordingly.

(iii) <u>e-Zest Solutions</u>

16.1. The TPO included this company in the list of comparables after collecting information u/s 133(6) which disclosed that it was engaged in rendering software development services only. The assessee's objections about the unreliable information and non-availability of information in public domain, were rejected by the TPO.

16.2. We have heard the rival submissions and perused the Annual report of this company, which is available on page 1 onwards of the paper book. Page 6 of the Annual report, being an annexure to the Auditor's report, clearly indicates under (ii) that: 'there is no inventory with the company since it is engaged in software development.' From the balance sheet of this company, it is noticeable that there is no closing stock of any software products. Since the assessee is also engaged in rendering software development services and this company is also doing the same business, we are of the considered opinion that this company was rightly included in the list of comparables.

16.3. The ld. AR's contention this company, being in KPO business as against the assessee's BPO business, is unsubstantiated. Neither it has been shown that the assessee is rendering BPO services nor that e-Zest is providing KPO services. We, therefore, approve the view taken by the authorities below on this issue.

(iv) Infosys Technologies Ltd.

17.1. The TPO noticed that this company was finding place in the accept/reject matrix but was rejected in the TP documentation by claiming that it failed functional comparability. The TPO found this company to be into software development services qualifying all the filters applied by him. The assessee raised certain objections against the inclusion of this company, but without any success. The TPO included the same in the final list of comparables. The assessee is aggrieved against its inclusion in the ultimate set of comparables.

17.2. We have considered the rival submissions and perused the relevant material on record. It can be seen that the TPO has included this company in the list of comparables by rejecting the assessee's contention about the brand of this company helping in earning huge profits and also the brand-related products swelling the ultimate profit rate of this company. We find that the assessee is a captive unit rendering services to its AE alone without acquiring any intellectual property rights in the work done by it in the development of software. The Hon'ble Delhi High Court in *CIT vs. Agnity India Technologies (P) Ltd. (2013) 219 Taxmann 26 (Del)* considered the giantness of Infosys Ltd., in terms of risk profile, nature of services, number of employees, ownership of branded products and brand related profits, etc. in comparison with such factors prevailing in the case of Agnity India Technologies Pvt. Ltd., being, a captive unit providing software development services without having any IP rights in the work done by it. After making comparison of various factors as enumerated above, the Hon'ble Delhi High Court held Infosys Ltd. to be incomparable to Agnity India Technologies Pvt. Ltd. The facts of the instant case are more or less similar inasmuch as the extant assessee is also a captive service provider with a limited number of employees at its disposal and also not owning any branded products with no expenditure on R&D etc.

When we consider all the above factors in a holistic manner, there remains absolutely no doubt that Infosys Technologies Ltd. is incomparable to the assessee company. Respectfully following the judgment of the Hon'ble jurisdictional High Court in *Agnity India (supra)*, we hold that Infosys Technologies Ltd. cannot be treated as comparable to the assessee company. This company is, therefore, directed to be excluded from the list of comparables.

(v) KALS Information Systems Ltd. (Seg.)

18.1. This company was not chosen by the assessee as a comparable. However, the TPO included it in the final list. The sum and substance of the reasoning adopted by the TPO for considering this company as comparable is that it is also a software development and consulting company, meeting the filters adopted by him.

18.2. We have gone through the Annual accounts of this company, a copy of which is available in the paper book. Schedule no. 16 comprising Notes to the Financial Statements gives background of this company to be 'engaged in development of software and software products since its inception.' This company consists of STPI unit engaged in development of software and software products. Segmental information of this company is available in the paper book which has been divided into two parts, namely, `Application software segment' and `Training segment'. It is the `Application software segment' of this company, which has been adopted by the TPO. The development of software and all software products have been clubbed under the 'Application software' segment. Since the figures of this company taken by the TPO for making comparison with the assessee include the effect of software products as well, apart from software development services, the same cannot be considered as comparable. It is obvious that a product company cannot be compared with a company engaged in providing software development services because of difference in the inherent characteristics of both. We, therefore, order for the removal of this company from the set of comparables.

(vi) Wipro Ltd. (Seg.)

19.1. The TPO included this company in the list of comparables by overruling the assessee's objections about the super normal profits earned by this company; very high turnover; owning significant IPRS in the form of patents; and engaged in R& D activity. The assessee failed to persuade the DRP to fall in line with its reasoning for the exclusion of this company from the final set of comparables. That is how, the assessee is before us.

19.2. We have heard the rival submissions and perused the relevant material on record. It is noticed that the TPO has taken 'Software development' segment of this company on standalone basis. We agree with the TPO that super normal profits or very high turnover cannot be criterion for treating an otherwise functionally comparable company as incomparable. However, the fact remains that this company own significant IPRS in the form of patents which are obviously used in the rendering software development services. Apart from that, this company is engaged in R&D activity. Per contra, the assessee in question is only a captive software development service provider not owning any IPRS. Owning or not owning IPRS in the form of patents in software developed by a company, has an important bearing on the profits earned by it from the 'Software development services' segment. A company which does not own any IPRS and carries on the activity of rendering software development services at its own, cannot be compared with a company which provides software development services by using its own IPRS in the form of patents of software. Under such circumstances, we hold that this company cannot be considered as comparable at segmental level. The same is *ex consequenti* directed to expelled from the set of comparables.

(vii) Softsol India Ltd.

20.1. This company was included by the TPO in the list of comparables. Though the ld. AR initially challenged its inclusion, however, later on, the comparability of this company was accepted. We, therefore, approve the impugned order in including this company in the list of comparables.

21. Now, we will take up certain comparables which have been excluded by the TPO and the assessee intends their inclusion.

(i) Aditya Birla Minacs IT Services Ltd. (formerly known as PSI Data Systems); and Aditya Birla Minacs Tech. Ltd. (Birla Technologies Ltd.)

22.1. These two companies were initially proposed as comparable by the TPO. However, subsequently, it was realized that the same were not comparable. The TPO noticed that the ratio of related party transactions (RPT) to sales of these companies was 33.65% and 94.09%, respectively, which made them controlled transactions and hence incomparable. The assessee is aggrieved against the non-inclusion of these companies in the final list of comparables.

22.2. We have heard the rival submissions and perused the relevant material on record. It is found that the predominant view of the Tribunal in several cases is that the transactions of a company having more than 25% of Related Party Transactions (RPTs) are considered as controlled, thereby failing the test of comparability. This view has been taken in several decisions including the Delhi Bench in *Toluna India Pvt. Ltd.*

(supra) and *Actis Advisers Pvt. Ltd. Vs. DCIT, (2012) 20 ITR 138 (Del.)(Trib.).* and Mumbai Bench in *Stream International Services Pvt. Ltd. Vs. ACIT (IT) (2013) 141 ITD 492 (Mum.).*

22.3. Adverting to the facts of the instant case, it is noticed that the TPO recorded RPT as a percentage of sales at a level higher than 25% for both the companies so as to exclude them. The ld. AR contended that while computing the related party transactions, the TPO also considered 'Reimbursement of expenses (Net)', which ought not to have been included.

22.4. We do not find any substance in this argument for the reason that the reimbursement of expenses debited by the assessee to its Profit & Loss Account are, in fact, part of the total costs incurred by the assessee. The mere fact that such costs were initially incurred by the AE and then reimbursed, would not alter the position. Further, no material has been placed on record to show that these re-imbursements were without any mark-up. The Hon'ble jurisdictional High Court in *CIT VS. Cushman And Wakefield (India) Pvt. Ltd. (2014) 367 ITR 730 (Del)* has held that reimbursement of expenses even without any mark-up are also required to be processed under TP provisions by benchmarking under one of the methods.

22.5. Be that as it may, we find that both these companies are also into sale of software products. It is apparent from their Annual accounts, copies of which have been placed on record. While analyzing the exclusion of certain companies challenged by the assessee above, we have held that a company with software product cannot be compared with the assessee company, which is engaged in providing software development services. Applying the same analogy, we hold that these two companies were also rightly excluded by the TPO as these are also functionally different, engaged in sale of software products as well. We, therefore, approve the view taken by the TPO on this issue.

(ii) Indium Software (I) Ltd.

23.1. We have perused the relevant part of the Annual accounts of this company, which has been reproduced on page 41 of the TPO's order. It can be seen that this company, apart from rendering software services, is also engaged in 'Sale of software.' In addition to that, this company has also income from `Training services'. Even though the amount of revenue from training services is less, still one cannot anticipate the impact of revenue from `Training' in the overall profitability of this company. We, therefore, hold this company to be incomparable and approve the view taken by the authorities in its exclusion.

(iii) <u>SIP Technologies and Exports Ltd</u>.

24.1. This company was originally the assessee's comparable which was excluded by the TPO. The assessee wants inclusion of this company in the final tally of comparables.

24.2. We have gone through the Annual accounts of this company, a copy of which has been placed on record. The TPO excluded this company from the list of comparables by holding that it made an investment of Rs.5 crore in SIP Solutions Ltd., which was more than twice of the total revenue, thereby affecting the working capital and causing abnormal margin/loss. When we go through the Schedule of

Investments of this company, which is available at page 608 of the paper book, it transpires that Investment of Rs.5 crore in Siptech Solutions Ltd., was made in some earlier year inasmuch as the same figure is appearing in the balance sheet of the preceding year as well. Thus, it is clear that there is no abnormal activity of this company. Since this company is also exclusively engaged in providing software development services, we hold it to be comparable.

(iv) VMF Soft Tech Ltd.

25.1. This was originally the assessee's comparable, which was excluded by the TPO by observing that it was outsourcing a major part of its work.

25.2. We have perused the Annual accounts of this company, which are available in the paper book. It can be seen that out of total 'Software expenses' amounting to Rs.55.11 lac, this company outsourced this activity by means of sub-contract by incurring expenses of Rs.53.95 lac. Thus, it is palpable that this company has outsourced its major activity and, hence, cannot be compared with a company like the assessee rendering in-house services. We, therefore, hold that this company was rightly excluded from the list of comparables.

C. DEDUCTION U/S 10A- WHETHER ANY TP ADDITION IS PERMISSIBLE?

26.1. The ld. AR vehemently argued that its profit is deductible u/s 10A of the Act. He submitted that once the profit from rendering of software development services is deductible u/s 10A, then, no motive can be attributed for artificially reducing the profit by manipulating the price with its AE. It was elaborated that the profit of an assessee, eligible for deduction under section 10A, becomes tax neutral irrespective of its quantum. He, therefore, urged that either the international transaction should not be processed in terms of Chapter-X of the Act or higher amount of deduction should be allowed corresponding to the amount of addition on account of transfer pricing adjustment. This was forcefully contested by the ld. DR.

26.2. Having heard the rival submissions and perused the relevant material, we find ourselves unable to accept both the submissions advanced by the ld. AR on this aspect of the matter. In so far as the first submission for not carrying out any transfer pricing adjustment in view of the benefit enjoyed by it u/s 10A of the Act is concerned, we find that no exception has carved out by the statute for non-determination of the ALP of an international transaction of an assessee who is eligible for the benefit of deduction section 10A/10B or any other section of Chapter-VIA of the Act. Section 92(1) clearly provides that any income arising from an international transaction is required to be computed having regard to its arm's length price. There is no provision exempting the computation of total income arising from an international transaction having regard to its ALP, in the case of an assessee entitled to deduction u/s 10A or 10B or any other relevant provision. Section 92C dealing with computation of ALP clearly provides that the ALP in relation to an international transaction shall be determined by one of the methods given in this provision. This section also does not immune an international transaction from the computation of its ALP when income is otherwise eligible for deduction. On the contrary, we find that sub-section (4) of section 92C plainly stipulates that where an ALP is determined, the AO may compute the total income of the assessee having regard to the ALP so determined. This shows that the total income of an assessee entering into an international transaction, is required to be necessarily computed having regard to its ALP without any exception. Thus, the ld. AR's argument that since its income is subject to deduction u/s 10A, the provisions of the Chapter-X of the Act should not be applied, in our considered opinion, has no force in view of the clear statutory mandate contained in proviso to section 92C(4), which reads as under:-

> `*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:'.*

26.3. A circumspect perusal of this proviso read along with sub-section (4) of section 92C divulges that when the total income of an assessee from an international transaction is computed having regard to its ALP, then, no deduction u/s 10A or any other section including those covered under Chapter VIA of the Act shall be allowed in respect of the amount of income by which the total income of the assessee has been enhanced after computation of income determined on the basis of the ALP of an international transaction. The legislature has unconditionally provided for not allowing the benefit of deduction under any section in respect of the addition made on account of transfer pricing adjustment. Not allowing of any benefit u/s 10A in respect of an addition on account of transfer pricing adjustment pre-supposes the existence of transfer pricing addition in the first instance to an assessee who is otherwise eligible to the benefit of deduction under this section. If one was to presume that no addition towards transfer pricing adjustment is comprehensible in the case of an assessee enjoying the benefit of deduction u/s 10A, then there was no need to enshrine an express provision forbidding the grant of deduction under this section in respect of enhancement of income due to transfer pricing adjustment. Once the legislature has engrafted an unambiguous provision explicitly spelling out the non-granting of deduction u/s 10A on the enhanced income due to transfer pricing addition, we are afraid to accept the assessee's contention, which runs diagonally opposite to the unequivocal language of proviso to section 92C(4). This contention, if taken to a logical conclusion, would amount to obliterating the provisio itself, which is patently incorrect.

26.4. Our view is fortified by the Special Bench order in the case of *Aztech Software and Technology Services Ltd. vs. ACIT (2007) 107 ITD 141 (SB) (Bangalore)* in which similar issue has been decided by the Special Bench by holding that availability of exemption u/s 10A to the assessee is no bar to applicability of sections 92C and 92CA. Similar view has been taken by Pune Bench of the Tribunal in the case of *ACIT vs. MSS India (P) Ltd. (2009) 123 TTJ 657 (Pune)* and several other orders referred to on page 5 of the TPO's order. The reliance of the ld. AR on the order of the Mumbai Bench of the Tribunal in the case of *DCIT vs. Tata Consultants Services Ltd.* (ITA No. 7513/M/2010) dated 4.11.2015, in our considered opinion is misconceived, because, in that case, the Tribunal primarily found that the AO erred in not himself examining the issue of TP and failed to apply his mind to the TP report filed by the assessee. The last sentence in para 54 of the order upholding the assessee's contention that no TP adjustment can be made where the assessee enjoys benefit of deduction u/s 10A or 80HHE, etc., is only *obiter dicta* inasmuch as the addition was found to be not sustainable on the other main grounds as discussed in the body of the order. On the contrary, we find that the decision of the Special bench in *Aztech Software (supra)* permitting the applicability of sections 92C and 92CA to an assessee availing the benefit of section 10A of the Act is its *ratio decidendi.* On a specific query, the ld. AR could not point out any judgment of some Hon'ble High Court deciding this point either way. In view of the fact that there is already a Special Bench decision in the case of *Aztech Software (supra)* which supports the making of transfer pricing adjustment notwithstanding the eligibility of deduction u/s 10A to the assessee, apart from clear statutory mandate contained in proviso to section 92C(4), we are more inclined to go with the view of the Special Bench.

26.5. It is, therefore, held that the eligibility of the assessee to deduction u/s 10A of the Act does not operate as a bar for determining the ALP of international transaction undertaken by it and further the enhancement of income due to such transfer pricing addition cannot be considered for allowing the benefit of deduction under this section.

27. In view of the foregoing discussion, we set aside the impugned order and remit the matter to the file of AO/TPO for a fresh determination of the ALP of the international transaction of `Software development services' in consonance with our decision on various aspects given above. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings.

28.1. Ground no. 8 of the appeal is against allowing short deduction u/s 10A to the extent of Rs.1,22,342/- in respect of Noida unit, which is eligible for tax holiday u/s 10A of the Act.

28.2. The facts apropos this ground are that the assessee computed its eligible profit u/s 10A at Rs.13.61 crore. The assessee credited its Profit and loss account with 'Liability no longer required - written back' amounting to Rs.1,48,180/- and 'Miscellaneous income' amounting to Rs.1,93,018/-. Deduction u/s 10A was also claimed in respect of these two items. It was argued that these expenses were claimed in earlier years, which led to reduction of eligible income of such years. But, in this year, these were reversed to the above extent as there was excess deduction in earlier years and accordingly, the assessee was entitled to benefit of section 10A on these amounts. The AO bifurcated sum of these two amounts in three parts and apportioned a sum of Rs.1,22,342/- in respect of eligible unit and reduced this amount from the eligible profit of unit D-4 (Noida). The assessee is aggrieved against this decision of the AO.

28.3. After considering the rival submissions and perusing the relevant material on record, we find that a sum of Rs. 1,22,342/- has been apportioned by the AO himself as relatable to the eligible unit D-4, Noida. This apportionment has been done of sum of two items, namely, Rs.1,48,180/- which was claimed as deduction by the assessee in earlier years and a sum of Rs.1,93,018/- which is the amount of bank charges refunded during the year. These two items were claimed as deduction in the earlier years from the eligible income and these have turned out to be excessive to this extent, either because of the excess provision created in the earlier year which has been now reversed or the excess bank charges claimed which have been refunded in the instant year. Since these expenses at the time of their incurring in the earlier years went on to reduce the eligible income of the Noida unit, in our considered opinion, when the excess amount is reversed in the current year, the same should also be made eligible for the benefit of deduction u/s 10A of the Act. We, therefore, overturn the assessment order on this point, and direct the inclusion of a sum of Rs. 1,22,342/- in the eligible profit for the purposes of deduction.

29.1. Ground no. 9 is against not allowing deduction u/s 10A on a sum of Rs.1,53,300/-, being the amount of depreciation disallowed. The assessee claimed depreciation during the assessment year 2007-08 on `Provision of computer software' amounting to Rs.3,65,000/-, which was disallowed. Since the closing WDV of last year i.e., 2,55,500/- (Rs.3,65,000 – 1,09,500/-) would be included in the opening written down value of current year, the AO opined that the depreciation claimed in the current year on this amount should also be disallowed. Accordingly, depreciation amount of Rs.1,53,300/- (Rs.2,55,500x60%) was disallowed.

29.2. Having heard both the sides and perused the relevant material on record, we find it as an undisputed position that the `Provision of computer software' amounting to Rs.3,65,000/- disallowed in the preceding year, namely, AY 2007-08, has not been further assailed by the assessee. The ld. AR submitted that such disallowance was accepted and no further appeal was filed on this issue. The ld. DR did not controvert this position. In that view of the matter, it becomes explicit that the opening written down value to the extent of Rs.2,55,500/- was excessive and ought to have been reduced. Once this amount is reduced, the assessee's claim for depreciation on such amount to the tune of Rs.1,53,300/- also becomes disallowable. We, therefore, approve the action of the AO in making addition for a sum of Rs.1,53,300/-.

29.3. However, the disallowance of depreciation to this extent will correspondingly enhance the eligible profits of Noida unit and the resultant amount of deduction u/s 10A to this extent. Thus, the disallowance so made would be set off with the increased claim of deduction u/s 10A resulting into no ultimate addition on this score. As the AO has simply made disallowance on account of depreciation without allowing benefit of section 10A on this disallowance, we hold that the assessee should also be allowed benefit u/s 10A of the Act to this extent. This ground is allowed.

30. Other ground about charging of interest u/s 234B, 234D and 244A is consequential and, accordingly, disposed of.

31. In the result, the appeal is partly allowed.

The order pronounced in the open court on 11.02.2016.

Sd/-	Sd/-
[KULDIP SINGH] JUDICIAL MEMBER	[R.S. SYAL] ACCOUNTANT MEMBER

Dated, 11th February, 2016.

dk

Copy forwarded to:

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

AR, ITAT, NEW DELHI.