

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
and
SHRI JASON P. BOAZ, ACCOUNTANT MEMBER**

**ITA No.1129/Bang/2010
(Assessment year: 2006-07)**

M/s.Yahoo Software Development India P.Ltd.
'Torrey Pines', Embassy Golf Links,
Business Park Off. Indiranagar-Koramangala
Intermediate Ring Road,
Bangalore. ... Appellant
PAN:AAACY1876D

Vs.

Deputy Commissioner of Income-tax,
Circle 12(5),
Bangalore. ... Respondent

Appellant by: Shri Sriram Seshadri, Advocate.
Respondent by: Shri Farhat Hussain Qureshi, CIT(DR)

Date of hearing : 22/12/2014.
Date of pronouncement: 31/12/2014.

O R D E R

Per Smt.P.MADHAVI DEVI, JM:

This is an appeal filed by the assessee against the assessment order passed u/s 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961[hereinafter referred to as 'the Act'] dated 23/07/2010 for the assessment year 2006-07.

2. The assessee has filed as many as 11 grounds of appeal. However, at the time of hearing, learned counsel for the assessee submitted that he wishes to press only grounds No.4.3 and 9. All the other grounds are rejected as not pressed.

2.1 In addition to the above grounds, the assessee has also filed additional grounds of appeal and an application for admission of the said additional ground. It is stated that the additional grounds raised by the assessee are necessary to assess the appropriate Arms' Length Price (ALP) of the international transactions undertaken by the petitioner being the subject matter of appeal and to render substantial justice. It is stated that the adoption of turnover filter as an adequate filter has been upheld by this bench of the Tribunal in the case of *Genisys Integrating Systems (India) P. Ltd. Vs. Dy. CIT (152 TTJ 215)* and therefore the same should be applied in the assessee's case also to reject companies having turnover in excess of INR 200 crores as comparable to the assessee. It is also submitted that the Tribunal has held in various cases that software product companies cannot be compared to software development companies owing to functional dissimilarity and therefore *R Systems international Ltd* and *Persistent Systems Ltd.*, should also be rejected as comparable cases as these companies are product oriented companies and are functionally dissimilar to the assessee. Thus, the assessee sought to raise two additional

grounds of appeal. However, at the time of hearing, learned counsel for the assessee submitted that the assessee does not wish to press the additional ground No.2 relating to exclusion of R Systems international Ltd and Persistent Systems Ltd., from the list of comparable companies. The said additional ground of appeal is accordingly rejected as not pressed.

2.2 The lone additional ground which is pressed by the assessee is for adopting the turnover filter and to exclude the companies which are having turnover of more than Rs.200 crores since the assessee's turnover is only Rs.80 crores. The learned Departmental Representative, however, opposed the additional ground on the ground that the assessee has not adopted such filter at the time of its own TP study and selecting the comparables and has not raised any objection before the Transfer Pricing Officer (TPO) or the Disputes Resolution Panel(DRP). Therefore, according to him, the assessee is precluded from raising such a ground at this stage.

2.3 Having regard to the rival contentions and the material on record, we find that the additional ground raised by the assessee is for the adoption of the turnover filter in selecting the comparables for determination of the ALP of the international transaction. This Tribunal, in the case of *Agile Software Enterprise Pvt. Ltd.* in IT(TP)A No.1172/Bang/2010 dated

26/09/2014 for assessment year 2006-07 has held that this point can be raised at any stage of the proceedings. In view of the same, we admit the said additional ground of appeal for the turnover filter to be applied and the exclusion of the comparable companies from the list of comparable companies. The learned counsel for the assessee has filed a chart before us giving the names of companies and the grounds on which the assessee seeks their exclusion. According to the learned counsel for the assessee, the following companies fail the turnover filter of INR Rs.200 crores:

<i>Sl. No.</i>	<i>Name of the company</i>	<i>Turnover (in crores)</i>
1.	iGate Global Solutions Ltd.	Rs. 527.91
2.	Infosys Technologies Ltd.	Rs.9028.00
3.	Mindtree Ltd.	Rs. 448.79
4.	Sasken Communication Technologies Ltd.	Rs. 240.03
5.	Flextronics Software Systems Ltd.	Rs. 595.12

The learned Departmental Representative, however, opposed the exclusion of the said companies from the list of comparables only on the basis of the turnover filter. He submitted that since the assessee has not raised any objections before the TPO/AO/DRP with regard to the turnover filter, the authorities were prevented from conducting the FAR analysis to examine their comparability to the assessee. Therefore, according to him, the issue should be set aside to the file of the TPO for FAR analysis.

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2.4 Having regard to the rival contentions and the material on record, we find that this Tribunal, in the case of *Genisys Integrating Systems (India) P. Ltd* (cited supra) has held that turnover is an important filter which has to be adopted for determination of the ALP. The Tribunal has been consistently following the said decision. The FAR analysis would not alter the turnover of the company. In view of the same, we do not find it necessary to remand the issue of comparability of these companies to the AO/TPO for re-determination of the ALP. In view of the turnover being higher than Rs.200 crores in the case of the above companies, we direct the AO to exclude these companies from the list of comparables.

3. The assessee has also sought exclusion of the following companies on the ground of functional dissimilarity:

<i>Sl. No.</i>	<i>Name of the company</i>	<i>Functional dissimilarity</i>
1.	KALS Information Systems Ltd.	Product oriented company
2.	Tata Elxsi Ltd.	-do-
3.	Accel Transmatic Ltd.	Product company

The learned counsel for the assessee submitted that the assessee had raised objections with regard to these companies before the DRP. However, the DRP has confirmed the order of the AO without considering the assessee's objections at length with regard to each of the comparable companies. He submitted that these companies have been considered as not comparable

by the Tribunal in the case of *Agile Software Enterprise Pvt. Ltd.*, (cited supra) wherein it was directed that these companies are to be excluded. He has drawn our particular attention to the relevant paragraphs of the said order.

3.1 The learned Departmental Representative, however, supported the orders of the authorities below.

3.2 Having regard to the rival contentions and the material on record, we find that Agile Software Enterprise Pvt. Ltd., is a company which is engaged in software development services and the relevant assessment year before the Tribunal is also assessment year 2006-07. In the case before us also, the assessee is a software development services company and not a software product company. Therefore, facts of the case before us are similar to the facts of the case before the tribunal in the case of *Agile Software Enterprise Pvt.Ltd.*(cited supra) In view of the same, the decision of the Tribunal in the case of *Agile Software Enterprise Pvt.Ltd.*(cited supra) is very much applicable to the case before us and respectfully following the decision of the co-ordinate bench of the Tribunal on similar set of facts, we hold that these companies are also to be excluded from the list of comparables on account of functional dissimilarity. For the sake of convenience, the relevant paragraphs of the Tribunal's order are reproduced hereunder:

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"8.7 KALS Information Systems Ltd: The Id. AR submitted that this company was a software product company and could not be compared with that of the assessee. The assessee was a software services company and not a software product company. Reliance was placed on the decision of Trilogy e-business Software (I) Pvt. Ltd. (supra). As per the Id. AR, same view was taken in EMC Data (supra) also.

8.7.1 Per contra, the Id. DR submitted that KALS Information Systems Ltd. could not be considered as a software product company.

8.7.2 We have perused the orders and heard the rival contentions. We find that KALS Information Systems Ltd. was considered as a software product company in both Trilogy e-business(supra) as well as EMC Data (supra). In these decisions, a host of companies, inter alia, including KALS Information Systems Ltd. were deliberated upon and held as under:-

"12. The following were the relevant observations of the Tribunal on the aforesaid comparable companies in the case of Trilogy E-Business Software India Pvt.Ltd.(supra):

"(d) KALS Information Systems Ltd.

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 report, the salary cost debited under the software development expenditure was Q 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/10 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

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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.

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."

"(e) Accel Transmatic Ltd.

48. With regard to this company, the complaint of the assessee is that this company is not a pure software development service company. It is further submitted that in a Mumbai Tribunal Decision of Capgemini India (F) Ltd v Ad. CIT 12 Taxman.com 51, the DRP accepted the contention of the assessee that Accel Transmatic should be rejected as comparable. The relevant observations of DRP as extracted by the ITAT in its order are as follows:

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"In regard to Accel Transmatics Ltd. the assessee submitted the company profile and its annual report for financial year 2005-06 from which the DRP noted that the business activities of the company were as under.

(i) Transmatic system - design, development and manufacture of multi function kiosks Queue management system, ticket vending system

(ii) Ushus Technologies - offshore development centre for embedded software, net work system, imaging technologies, outsourced product development

(iii) Accel IT Academy (the net stop for engineers) - training services in hardware and networking, enterprise system management, embedded system, VLSI designs, CAD/CAM/BPO

(iv) Accel Animation Studies software services for 2D/3D animation, special effect, erection, game asset development.

4.3 On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different from the assessee company as it was engaged in the services in the form of ACCEL IT and ACCEL animation services for 2D and 3D animation and therefore assessee's claim that this company was functionally different was accepted. DRP therefore directed the Assessing Officer to exclude ACCEL Transmatic Ltd. from the final list of comparables for the purpose of determining TNMM margin."

Besides the above, it was pointed out that this company has related party transactions which is more than the permitted level and therefore should not be taken for comparability purposes. The submission of the Id. counsel for the assessee was that if the above company should not be considered as comparable. The Id. DR, on the other hand, relied on the order of the TPO.

50. We have considered the submissions and are of the view that the plea of the assessee that the aforesaid company should not be treated as comparables was considered by the Tribunal in Capgemini

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India Ltd (supra) where the assessee was software developer. The Tribunal, in the said decision referred to by the Id. counsel for the assessee, has accepted that this company was not comparable in the case of the assessee engaged in software development services business. Accepting the argument of the Id. counsel for the assessee, we hold that the aforesaid company should be excluded as comparables."

13. The facts and circumstances under which the aforesaid companies were considered as comparable is identical in the case of the Assessee as well as in the case of Triology E-Business Software India Pvt.Ltd. (supra). Respectfully following the decision of the Tribunal referred to above in the case of Triology E-Business Software India Pvt.Ltd.(supra), we direct that the following companies (listed as Sl.No.4 & 15 of the list of comparable companies chosen by the TPO and listed in para-4 of this order) be excluded from the list of 20 comparable arrived at by the TPO."

8.7.3 It might be true that a number of software development companies in their TP studies might have considered KALS Infosystems Ltd. as a comparable and not as a software product company. However this, in our opinion, will not dilute the findings in this regard given by the Tribunal. The assessee having relied on the decision of the Tribunal wherein it has been held that KALS is a software product company, unless the decision of a higher authority which is different from the one given by the coordinate Bench is shown by the revenue, it will not be possible to deviate from the view earlier taken by a coordinate Bench. Accordingly, we direct that KALS Information Systems Ltd. be excluded from the comparables.

8.8 Accel Transmatics Ltd.: Ld. AR raised similar contentions for exclusion of this company as was made in the case of KALS Information Systems Ltd. (supra). Ld. DR also raised similar objections. We find that Accel Transmatics Ltd. has also been considered as a software product company by this Tribunal in the decisions cited at para 8.7.2 above. Relevant part of the decision has been reproduced by us therein. Accordingly, we direct that Accel Transmatics Ltd. be excluded from the comparables.

8.9 Tata Elxsi Ltd.: Ld. AR submitted that this company was engaged in research & development which resulted in creation of Intellectual Property Rights and therefore was

a software product company. Reliance was placed on the decision of coordinate Bench of the Tribunal in the case of EMC Data (supra).

8.9.1 Per contra, the Id. DR submitted that Tata Elxsi Ltd. was not a software product company, but was engaged only in development of software.

8.9.2 We have heard the rival contentions. Whether Tata Elxsi Ltd. could be considered as a software development company was one of the issues which came up for consideration before the this Tribunal in the case of EMC Data (supra), wherein it was held as under:-

"17. As far as comparable at Sl.No.9 of the list of comparable chosen by the TPO listed in the chart given at para-4 of this order viz., Tata Elxsi Ltd., is concerned, the comparability of the aforesaid two companies with that of the software service provider was considered by the Mumbai Bench of this Tribunal in the case of Logica Pvt.Ltd. IT (TP) 1129/Bang/2011 AY 07-08) wherein on the aforesaid company, the Tribunal held as follows:-

"14. As far as comparable at Sl.No.6 & 24 are concerned, the comparability of the aforesaid two companies with that of the software service provider was considered by the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India Private Ltd. (supra) wherein on the aforesaid two companies, the Tribunal held as follows:-

"7.6 FlextronicsSoftwareSystemsLtd.:

As per the statement of the learned AR, this company is also involved in the development of the software product and is also involved in BPO services, besides joint software consultancies for the use in telecommunication industries. Thus, being product and service company, it cannot be taken as comparable. However, the learned CIT DR has amply controverted the said contention of the learned AR by submitting before us a copy of profit and loss account of the company for the relevant assessment year, obtained from the public domain.

From the perusal of the profit and loss account of the said company, it is seen that the revenue sales from services constitutes

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almost 90% and the product sales is only 10%. Thus, in this case also not much adjustment is required to be made for taking the profit ratio for comparing it with the assessee in determining the arms length price. In view of the above, we hold that TPO has rightly included the said company as comparable case which can be taken into consideration for comparing the profit ratio.

7.7. TataElxsi Limited.:

From the facts and material on record and submissions made by the learned AR, it is seen that the Tata Elxsi is engaged in development of niche product and development services, which is entirely different from the assessee company. We agree with the contention of the learned AR that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties."

15. In view of the above, the Id. counsel for the assessee fairly admitted that comparable company at Sl.No.6 viz., Flextronics Software Systems Pvt. Ltd. should be taken as a comparable, while comparable at Sl.No.24 viz., Tata Elxsi Ltd. should be rejected as a comparable."

18. In view of the aforesaid decision, we hold that Tata Elxsi has to be excluded from the list of comparable chosen by the TPO."

8.9.3 *The assessee before us is not developing any niche product. As held by the coordinate Bench of the Tribunal (supra), Tata Elxsi Ltd. could not be considered as a software development company simplicitor. That Tata Elxsi Ltd. was functionally different, has been held by the coordinate Bench of the Tribunal in the case of Yodlee Infotech Pvt. Ltd. (ITA No.1397/Bang/2010 dated*

15.2.2013) as well. We therefore direct that Tata Elxsi Ltd. be excluded from the comparables.

8.10 Lucid Software Ltd.: The Id. counsel for the assessee raised similar contentions as in the case of Tata Elxsi Ltd. here also. According to him, Lucid Software Ltd. was functionally dissimilar and was developing products and was not an software development services company.

8.10.1 We find that Lucid Software Ltd. was also one of the comparables which came up for consideration before the coordinate Bench of this Tribunal in the case of EMC Data (supra). EMC Data was also doing software development services in one of its segments and TPO had considered Lucid Software Ltd. also for comparison. The coordinate Bench in the aforesaid decision held as under:-

"14. The learned counsel for the Assessee brought to our notice that the comparable company chosen by the TPO at sl.No.10 of the chart given in para-4 of this order viz., Lucid Software Limited, has to be excluded as functionally not comparable with that of the assessee in view of the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India Private Ltd. in ITA No.7821/MUM/2011, which was followed by the ITAT Bangalore Bench in the case of Logica Private Ltd. ITA No.1129/Bang/2011 for AY 07-08, wherein it was held as under:-

"7.2 Lucid Software Limited

It has been submitted before us that this company, besides doing software development services, is also involved in development of software product. The learned AR has tried to distinguish by pointing out that product development expenditure in this case is around 39% of the capital employed by the said company, and, therefore, such a company cannot be considered as tested party. Even as per the information received in response to notice under Section 133(6), the company has described its business as software development company or pure software development service provider. This information itself is very vague as the segmental details of operating revenue has not been made available to examine how much is the ratio of sale from

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software product and sale of software service and development. Looking to the fact that it has developed a software product named as "Muulam" which is used for civil engineering structures and the product development expenditure itself is substantial vis-a-vis the capital employed by the said company, this criteria for being taken as comparable party, gets vitiated. For the purpose of comparability analysis, it is essential that the characteristics and the functions are by and large similar as that of the assessee company and T.P. analysis/study can be made with fewest and most reliable adjustment. If a company has employed heavy capital in development of a product then profitability in the sale of product would be entirely different from the company, who is involved in service sector. Therefore, this company cannot be treated as having same function and profitability ratio.

In our view, due to non-availability of full information about the segmental details as to how much is the sale of product and how much is from the services, therefore, this entity cannot be taken into account for comparability analysis for determining arms length price in the case of the assessee."

15. The facts and circumstances under which the aforesaid companies were considered as comparable is identical in the case of the Assessee as well as in the case of Logica Private Ltd., (supra). Respectfully following the decision of the Tribunal referred to above in the case of Logica Pvt.Ltd..(supra), we direct that the company listed as Sl.No.10 of the list of comparable companies chosen by the TPO and listed in para-4 of this order to be excluded from the list of 20 comparable arrived at by the TPO."

8.10.2 Respectfully following the said decision, we hold that Lucid Software Ltd. was not functionally similar to the assessee and the same has to be excluded from the comparables. Directed accordingly.

8.11 Megasoft Ltd.

8.12 Aztech Software Ltd.

8.13 Geometric Software Ltd.

Ld. AR submitted that in each of the above companies the RPT filter exceeded 15%. According to him, RPT

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filter has been upheld by this Tribunal in a host of decisions including that of EMC Data (supra). Per contra, the Id. DR supported the orders of authorities below. We have perused the orders and heard the rival contentions. Application of RPT filter while selecting the comparables has been held to be an appropriate criteria by this Tribunal in a number of decisions. In the case of EMC Data (supra), it was held as under:-

16. As far as comparable companies at Sl.No.1 & 2 &19 of the chart of comparable companies chosen by the TPO at page-4 of this order viz., Aztec Software Limited and Geometric Software Ltd. (Seg.) and Megasoft Ltd., is concerned, it is not in dispute before us that the related party transaction in the case of companies exceeds 15% and in view of the decision of the Tribunal in the case of 24 X 7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010, followed by this Tribunal in the case of Logica Private Ltd. (supra) wherein it was held that where the RPT exceeds 15%, such companies should not be taken as comparable companies. Following the said decision, we hold that companies at Sl.Nos. 1 & 2 & 19 referred to above of the list of the comparable companies chosen by the TPO be excluded from the list of comparable companies while working out the ALP."

There is no dispute that RPT filter in the case of Megasoft Ltd. was 17.08%, that of Aztech Software Ltd. was 17.78% and that of Geometric Software Ltd. was 19.34%. Coordinate Benches of the Tribunal are consistently following 15% as cut off mark for applying the RPT filter. Accordingly, we direct exclusion of Megasoft Ltd., Aztech Software Ltd. and Geometric Software Ltd. from the comparables.

9. Based on the above, we direct the AO to recomputed the Profit Level Indicator and work out the arithmetic mean margin of the comparables. Thereafter, the AO has to decide whether the PLI of the assessee is within +/- 5% range of the arithmetic mean of the comparables as set out u/s. 92C(2) of the Act and decide on the adjustment, if any, required on the ALP. Ordered accordingly."

3.3 The assessee also sought to have Mindtree Ltd., excluded as a comparable on account of related party

transactions being more than 15% of the total transactions. Learned counsel for the assessee has placed reliance upon the decision of the Tribunal in the case of *Agile Software Enterprise Pvt. Ltd.*, (cited supra) wherein the Tribunal has held that 15% is the cut-off mark for applying the RPT filter and adopting the same, Mindtree Ltd., was excluded. Respectfully following the said decision, we direct the AO to exclude the said company also from the list of comparable. The assessee does not have any grievance for adoption of other companies as comparables. The AO is, therefore, directed to re-compute the ALP after excluding the companies directed by this Tribunal in this order. The assessee's ground of appeal 4.3 is accordingly allowed.

4. As regards the ground No.9, we find that it is with regard to computation of deduction u/s 10A of the Act and the assessee's prayer is to adjust both export turnover as well as total turnover by reducing 50% of data link charges of Rs.33,96,939/- for computing deduction u/s 10A of the Act. We find that this issue is covered in favour of the assessee by the decision of the jurisdictional High Court in the case of *CIT vs. Tata Elxsi Ltd.* (349 ITR 98). Respectfully following the same, we allow the said ground of appeal of the assessee and direct the AO to exclude data link charges both from the export turnover as well as the total turnover for computing deduction u/s 10A of the Act.

5. In the result, the assessee's appeal is partly allowed.

Pronounced in the open court on 31st of December, 2014.

sd/-
(Jason P Boaz)
ACCOUNTANT MEMBER
eksrinivasulu

sd/-
(Smt. P.Madhavi Devi)
JUDICIAL MEMBER

Copy to:

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

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore.