

IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH : BANGALORE

BEFORE SHRI A.K. GARODIA, ACCOUNTANT MEMBER  
SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

IT(TP)A No.1776/Bang/2013
Assessment year : 2009-10

The Deputy Commissioner of Income Tax, Circle 11(3), Bangalore.	Vs.	M/s. Fair Isaac India Software Pvt. Ltd., 135, Old Airport Road, Kodihally, Bangalore – 560 017. <b>PAN: AABCF 7670G</b>
APPELLANT		RESPONDENT

IT(TP)A No.24/Bang/2014
Assessment year : 2009-10

M/s. Fair Isaac India Software Pvt. Ltd., Bangalore – 560 017. <b>PAN: AABCF 7670G</b>	Vs.	The Deputy Commissioner of Income Tax, Circle 11(3), Bangalore.
APPELLANT		RESPONDENT

Revenue by	:	Shri G.R. Reddy, CIT-I(DR) Dr. P.K. Srihari, Addl. CIT(DR)
Assessee by	:	Shri S. Raghunathan, Advocate

Date of hearing	:	11.07.2016
Date of Pronouncement	:	08.09.2016

## **ORDER**

*Per Asha Vijayaraghavan, Judicial Member*

These are appeals filed both by the revenue and the assessee arising from the assessment order dated 29.1.2013 passed u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [“the Act”].

### **ITA No.1776/Bang/2013**

2. The revenue in its appeal has raised the following grounds:-

- “1. The order of the DRP is opposed to law and the facts and circumstances of the case.
2. The DRP erred in directing the AO to follow the ratio of the Hon'ble Court in the case of Tata Elxsi Limited 349 ITR 98 and exclude Rs. 2,59,83,333 being the telecommunication charges and travel expenses of Rs. 16,08,944 incurred in foreign currency from the total turnover- also while computing the deduction u/s 10A of the LT. Act as the decision of the High Court is binding, without appreciating the fact that there is no provision in section 10A that such expenses should be reduced from the total turnover also, as clause (iv) of the explanation to section 10A provides that such expenses are to be reduced only from the export turnover.
3. The DRP erred in not appreciating the fact that the jurisdictional High Court's decision in the case of Tata Elxsi Limited 349 ITR 98 has not been accepted by the department and an appeal has been filed before the Hon'ble Supreme Court.
4. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the DRP be reversed and that of the Assessing Officer be restored.

5. The appellate craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal.”

3. The issue that arises for consideration in this appeal is as to whether the DRP was justified in directing the AO to exclude telecommunication charges of RS.2,59,83,333 and travel expenses of Rs.16,08,944 incurred in foreign currency from the total turnover also while computing the deduction u/s. 10A of the Act, following the decision of the Hon'ble jurisdictional High Court in the case of *CIT v. Tata Elxsi Ltd.*, 349 ITR 98 (Karn) wherein it was held that whatever is excluded from the export turnover, has also to be excluded from the total turnover.

4. The only grievance of the Revenue is that the decision of Hon'ble High Court of Karnataka in *Tata Elxsi (supra)* has not been accepted by the revenue and an appeal by the revenue has been filed before the Hon'ble Supreme Court. We are of the view that as of today, law declared by the Hon'ble High Court of Karnataka which is the jurisdictional High Court is binding on us. We therefore find no infirmity in the directions of the DRP and uphold the same.

5. In the result, the appeal of the revenue is dismissed.

**ITA No.24/Bang/2016**

6. The assessee company is engaged in the business of development of software and provides sales & marketing support. It filed the return of income for the AY 2009-10 declaring a total income of Rs.34,21,148 after claiming deduction u/s. 10A amounting to Rs.11,24,01,664. In the scrutiny proceedings, the Assessing Officer observed that the assessee had international transaction exceeding Rs.15 crores and the case was referred to the TPO. The TPO in his order u/s. 92CA of the Act determined an adjustment to the arm's length price (ALP) to the extent of Rs.4,51,80,222. The final set of comparables selected by the TPO is as under:-

Sl No.	Name of the comparable	Sales (in Rs.)	Cost (in Rs.)	Margin
1	Kals Information Systems Ltd.	2,14,04,686	1,87,93,813	13.89%
2	Akshay Software Technologies Ltd.	12,23,21,483	11,31,49,350	8.11%
3	Bodhtree Consulting Ltd.	16,05,75,212	9,89,56,821	62.27%
4	R S Software (India) Ltd.	1,49,57,12,634	1,36,01,02,589	9.97%
5	Tata Elxsi Ltd. (segmental)	3,78,43,03,000	3,14,63,15,000	20.28%
6	Sasken Communication Technologies Ltd.	4,05,31,20,000	3,18,69,97,000	27.91%
7	Persistent Systems Ltd.	5,19,69,10,000	3,67,52,70,000	41.40%
8	Zylog Systems Ltd.	7,34,93,51,475	6,81,69,98,160	7.81%
9	Mindtree Ltd. (seg)	7,93,22,79,326	5,74,06,63,058	5.52%
10	Larsen and Toubro Infotech	19,50,83,831,374	15,64,12,76,626	24.72%
11	Infosys Ltd.	2,02,64,0000,000	1,39,17,00,00,000	45.61%
<b>Average mean</b>				<b>24.32%</b>

7. Further the TPO in his order dated 15.3.2013 passed u/s 92CA(5) r.w.s. 154 revised the adjustment to the ALP to an amount of Rs.3,16,01,043. The Assessing Officer passed a draft assessment order u/s. 143(3) r.w.s. 144C of the Act, against which the assessee appealed before the DRP. The DRP issued directions u/s. 144C(5) of the Act. Aggrieved by the order of the DRP, the assessee is in appeal before us.

8. Though several grounds are raised in the appeal by the assessee, the Id. counsel for the assessee pressed for only grounds Nos.3 (a), (d) & ground No.7. Thus, the other grounds are dismissed as not pressed.

9. As far as ground No.7 is concerned regarding deduction u/s. 10A of the Act, this issue has already been considered by us while dealing with the revenue's appeal hereinabove, confirming the order of the DRP. Therefore, ground No.7 raised by the assessee on this issue is also dismissed.

10. Ground Nos. 3(a) & (d) raised by the assessee read as follows:-

“3(a) The AO/TPO erred on facts in benchmarking the transactions of the ‘limited risk’ software services of the Appellant with companies operating as full fledged entrepreneurs, without considering the differences in the functions performed, assets employed and risk undertaken.

3(d) The AO/TPO erred on facts in arbitrarily accepting companies without considering the differences in the turnover and size of the Appellant vis-à-vis the comparables.”

11. The Id. counsel for the assessee has furnished a chart with respect to comparables selected by the TPO.

(1) Kals Information Systems Ltd.

11.1.1 It was submitted that Kals Information Systems Ltd. selected by the TPO has two segments viz., development of software & software products and training services. Hence this company was also engaged in the development of software products. This company's inventory was 52.79% of the total current assets and it incurs business promotion expenses at 4.36% of sales. The turnover of this company was Rs.2.14 crores. It was therefore contended that this company was not functionally comparable with that of assessee. Reliance was placed on the decision of the Tribunal in the case of *M/s. Unisys India Pvt. Ltd. in IT(TP)A No.67/Bang/2015* [para 33 of the order] and in the case of *M/s. CISCO Systems (India) Pvt. Ltd. in ITA No.271/Bang/2014* [para 26.3 of the order] wherein it was held that this company is functionally different as it is a software product company. The relevant observations of the Tribunal are as follows:-

“26.3 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 *Trilogy e-business Software India (P.) 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 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 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. shall not be regarded as a comparable.”

11.1.2 Apart from the functionally dissimilarity, the ld. counsel submitted that the turnover of this company is 10 times more than the assessee company. In this regard, he invited our attention to the decision of the Tribunal in the case of *ACIT v. M/s. McAfee Software (India) Pvt. Ltd.* In IT(TP)A No. 04/Bang/2012, order dated 18.03.2016, wherein it has been held as follows:-

“7. Both Revenue appeal and Assessee’s appeal are interrelated. Revenue is mainly aggrieved on the RPT filter adopted by Ld.CIT(A) at 0% where as the Co-ordinate Benches have been accepting upto 15% and in some orders up to 25%. Depending on the facts of each case in each year, the RPT filter is being used / approved. Learned Counsel fairly admitted that Co-ordinate Bench in the case of ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 ( Sunquest) has followed the other decisions on the issue and held that in various other cases companies having related party transaction upto 15% of total revenues can be considered. Considering the above, it was contended that the Revenue’s Ground No. 2 may have to be allowed and the companies rejected by Ld.CIT(A) has to be reconsidered. At the same time, Learned Counsel also submitted that the companies which are functionally not similar, having RPT of more than 15% and high turnover cases require reconsideration and made various submissions on the issue. Ld.



DR also made submissions on the filters of RPT, turnover etc., and comparability of each of the companies.

8. As a general proposition, various filters are required to be adopted in selecting a company as a comparable. This is part of FAR analysis. However, there cannot be rigid rule or percentage fixed in adopting various filters. Generally, a turnover filter is adopted to avoid selection of high end companies (big companies) with that of 'minnows' in the similar line of business. How to adopt the filter depends on each case. Say for example, in the TP analysis of a company having 20 Crores receipts, a company with 2 Crores to 200 Crores can be stated to be within the range i.e., factor of ten as upper and lower limits. In certain cases, the ITAT also accepted turnover filter of 1 Crore to 200 Crores. But the range cannot be fixed, as the facts may vary from case to case. Simply a comparable can not be excluded on upper turnover limit when infact in number of cases. Assessee do not raise any objection on inclusion of companies with very small turnovers. The 200 Crores upper limit also cannot be considered in a case whose turnover is, say 300 Crores. Therefore, instead of a fixed 1cr – 200 Crore range, what one has to consider is the turnover/receipts of Assessee and range of upper limit at ten times and lower limit also ten times..i.e., one tenth. Thus, for example the range for a 300 Crores company can be from 30 Crores ( $1/10^{\text{th}}$ ) to 3000 Crores (Ten times). Even this has some limitations. For example if range is considered say 2 to 200 Crores, a comparable company cannot be rejected if the turnover is 1.99 Crores or say 201 Crores. There can be margin of variation. These are broad parameters so that no fixed formula can be adopted on uniform basis across all areas of functions. The same principles will also apply to related party transactions. In all the captive service providers, RPT is at 100%. So, some broad parameters, given the fact of the case, can only be considered. Considering these observations, Learned Counsel fairly admitted that they will not context the RPT filter and turnover filter issue and restricted the agreements to only the comparability of the cases on functionality. Accordingly, the issues on RPT, turnover filter and risk adjustment are considered not pressed."

11.1.3 Following the decision of the co-ordinate Bench of the Tribunal in the case of *M/s. CISCO Systems (India) Pvt. Ltd. (supra)*, we direct that Kals Informations Systems Ltd. be excluded from the final list of comparables on the functional comparability.

(2) Bodhtree Consulting Ltd.

11.2.1 The Id. Counsel for the assessee submitted that this company is in the business of software products and engaged in providing open and end to end web solutions, data warehousing, software consultancy and design & development of software using latest technology. It is a product company. It has abnormal growth of 67% over previous year on account of launch of its product, MIDAS. The business promotion expenses was to the extent of Rs.11.16 lakhs. In view of the above, it was submitted that this company is not comparable with that of the assessee. Reliance was placed on the decision of *M/s. CISCO Systems (India) Pvt. Ltd. (supra)* wherein Bodhthree Consulting Ltd. was held not to be regarded as a comparable. The relevant observations of the Tribunal at para 26.1 are as under:-

“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 Id. 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.”

11.2.2 In view of the co-ordinate Bench of the Tribunal in the case of *M/s. CISCO Systems (India) Pvt. Ltd. (supra)*, we direct Bodhtree Consulting Ltd. to be excluded from the list of comparables.

(3) Tata Elxsi Ltd.

11.3.1 The Id. counsel for the assessee submitted that Tata Elxsi Ltd. is not a comparable with the assessee company since this company provides product design service, innovation design engineering services,

visual computing labs, systems integration and support. The R&D expenses of this company was 3.26% of the total turnover and cost of goods sold was 10.64% of the cost base. The turnover criterion of this company was of Rs.378.43 crores. In support of its contentions, reliance was placed on the decision of the co-ordinate Bench of this Tribunal in the case of *M/s. CISCO Systems (India) Pvt. Ltd. (supra)* and other cases.

11.3.2 In the case *M/s. CISCO Systems (India) Pvt. Ltd. (supra)*, this Tribunal at para 26.4 & 26.5 held that Tata Elxsi Ltd. should not be regarded as a comparable. The relevant observations are as follows:-

“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. : .....  
.....

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."

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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.”

11.3.4 In view of the decision of the co-ordinate Bench of this Tribunal in the case of *M/s. CISCO Systems (India) Pvt. Ltd. (supra)*, we direct that Tata Elxsi Ltd. be excluded from the final list of TPO's comparables.

(4) Sasken Communication Technologies Ltd. (Seg)

11.4.1 The Id. counsel for the assessee submitted that this company is not functionally comparable since it has different functional profile i.e., product company and focus on R&D and hardware. It incurred losses on impairment of assets and business restructuring expenses. It owns intangibles, 23 in US and 8 in India. Its turnover criterion is Rs.405.31 crores. Reliance was placed on the decision of this Tribunal in the case of *M/s. Yodlee Infotech Pvt. Ltd. v. ITO, IT(TP)A No.108/Bang/2014 dated 12.12.2014* at para 20 of the order.

(5) Persistent Systems Ltd.

11.5.1 It was submitted that this company is engaged in providing licensing of products and sale of products. It has revenue from export of

services and products. This company is engaged in outsourced product development services for independent software vendors and enterprises. The income includes both software services and product sales and segmental details are not available. It owns intangibles of Rs.11.35 million and incurs marketing expenses. The turnover criterion is of Rs.519 crores. Hence it was submitted that this company is not comparable with that of the assessee.

(6) Larsen & Toubro Infotech Ltd.

11.6.1 It was submitted that this company is providing offshore operations but the comparable has majority of onsite revenue of 52.72% of the total revenue. It develops inhouse intangibles and owns intangibles of Rs.2,253 lakhs for FY 2008-09. The turnover criterion is of Rs.1,950.83 crores. Hence this company was sought to be rejected as a comparable.

(7) Infosys Ltd.

11.7.1 It was submitted that Infosys Ltd. has brand related profits. It has brand earnings of Rs.3,253 crores and owns significant intangibles. The onsite revenue is to the extent of 49.30% of total revenue. It had total turnover of Rs.20,264 crores as against Rs.40.36 crores of the assessee. It incurred sales and marketing expenses of 4.6% of the sales. Therefore, on these grounds, this company was sought to be rejected as a comparable.

12. In support of its contentions for rejection of the comparables viz., Sasken Communication Technologies Ltd., Persistent Systems Ltd., Larsen Toubro Infotech Ltd. and Infosys Ltd., reliance was placed on the decision of this Tribunal in the case of *Yodlee Infotech Ltd. v. ITO*, IT(TP)A No.108/Bang/2014 dated 12.12.2014, *M/s. Unisys India Pvt. Ltd. v. D CIT in IT(TP)A No.67/Bang/2015 dated 30.09.2015* and *M/s. CISCO Systems (India) Pvt. Ltd. (supra)*.

12.1 We find that in the case of *Yodlee Infotech Ltd. (supra)*, this Tribunal at para 20 of its order has held as under:-

“20. We have to hold that assessee can seek exclusion of comparables which were a part of its own list, at a later stage, and therefore, we are constrained to reject the line of argument of the learned DR. Coming to the arguments of the learned AR that M/s Tata Elxsi Ltd., M/s Sasken Communication Ltd., M/s Persistent Systems Ltd., M/s L&T Infotech and M/s Infosys Ltd., had turnover in excess of Rs.200 Crores and were to be excluded, we are of the opinion that turnover filter can be applied for selection of comparables. This has been the view consistently taken by the Co-ordinate Benches of this Tribunal in a number of cases. In the case of *M/s Genisys Pvt Ltd Vs DCIT(2011)64 DTR 225* it was held by this Tribunal as under at paras-8 to 09 of its order;

**8.** According to learned counsel for the assessee size is an important facet of an enterprise level difference. He submitted that comparables should have something similar or equivalent and should possess same or almost the same characteristics. To use a simile, he submitted that a Maruti 800 car cannot be compared to Benz car, even though both are cars only. He submitted that unusual pattern, stray cases, wide disparities have to be eliminated as they do not satisfy the test of comparability. Companies operating on large scale benefit from economies of scale, higher risk taking capabilities, robust delivery and business models as opposed to the smaller or



medium sized companies and therefore, size matters. Two companies of dissimilar size therefore, cannot be assumed to earn comparable margins and this impact of difference in size could be removed by a quantitative adjustment to the margins or price being compared if it is possible to do so reasonably accurately. He submitted that size as one of the selection criteria has also been approved by various Benches of the Tribunal, in the following cases :

1. Dy. CIT vs. Quark Systems (P) Ltd. (2010) 132 TTJ (Chd)(SB) 1 : (2010) 42 DTR (Chd)(SB)(Trib) 414 : (2010) 38 SOT 307 (Chd)(SB), wherein it was held that even the filter of lower turnover of Rs. 1 crore is without any reasonable basis and there is no filter for higher turnover also. The application of turnover filter also leaves much to be desired and has to no rationale basis. In our considered view, it is improper to proceed on the basis that the turnover of Rs. 1 crore to infinite is a reasonable classification as turnover base.
2. E-Gain Communication (P) Ltd. vs. ITO (2008) 118 TTJ (Pune) 354 : (2008) 13 DTR (Pune)(Trib) 65;
3. Sony India (P) Ltd. vs. Dy. CIT (2008) 118 TTJ (Del) 865 : (2008) 14 DTR (Del)(Trib) 228 : (2008) 114 ITD 448 (Del);
4. Dy. CIT vs. Indo American Jewellery Ltd., ITA No. 6194/Mum/2008 [reported at (2010) 131 TTJ (Mumbai) 163 : (2010) 40 DTR (Mumbai)(Trib) 386—Ed.];
5. Philips Software Centre (P) Ltd. vs. Asstt. CIT (2008) 119 TTJ (Bang) 721 : (2008) 15 DTR (Bang)(Trib) 505 : (2008) 26 SOT 226 (Bang);
6. Asstt. CIT vs. NIT (2011) 57 DTR (Del)(Trib) 334

**8.1** He further submitted that size as a criteria for selection of comparables is also recommended by OCED in its TP guidelines. The observation of OCED in para 3.43 of the chapter on guidelines reads as follows :

"Size criteria in terms of sales, assets or number of employees : The size of the transaction in absolute value or in proportion to the activities of the parties might affect the relative competitive positions of the buyer and seller and therefore comparability."

**8.2** The learned counsel for the assessee submitted that similar observations were also made by ICAI in para 15.4 of TP guidance note. He submitted that TPO's range of Rs. 1 crore to infinity has resulted in selection of companies like M/s Infosys which is having a turnover of Rs. 9,028 crores which is 1,1007 times bigger than the assessee company which has a turnover of Rs. 8.15 crores. He further submitted that NASSCOM has also categorized the companies based on the turnover as follows :

1. Greater than USD 1 billion (approx. Rs. 50,000 crores)
2. Between USD 100 million to USD 1 billion (Rs. 500 crores to Rs. 5,000 crores) and
3. Others having less than USD 100 million (Rs. 500 crores).

Thus, the learned counsel for the assessee submitted that an appropriate turnover range should be applied in selecting a comparable of uncontrolled companies and the assessee has accordingly, applied the turnover range of Rs. 1 crore to Rs. 200 crores based on Dun and Bradstreet's analysis. He submitted that in the alternative, the categories recognized by NASSCOM may also be applied in selecting comparables.

**8.3** The learned Departmental Representative rebutted this argument and submitted that the Act or Rules does not provide for the turnover filter. He submitted that as rightly pointed out by the TPO in the case of service sector, the size of the company does not matter because, the infrastructure layout is very less and it will not affect the profit ratio in any way. He drew our attention to the particular portion of TPO's order wherein the TPO has the reasoning given for rejecting the turnover filter.

**9.** Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business.

A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various Benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs. 1 crore to Rs. 200 crores have to be taken as a particular range and the assessee being in that range having turnover of Rs. 8.15 crores, the companies which also have turnover of Rs. 1 to Rs. 200 crores only should be taken into consideration for the purpose of making TP study.

The above view was followed by the Co-ordinate Bench of this Tribunal in the case of M/s Bearing Point Business Consulting Pvt. Ltd.,(supra) At paras-5.1 of its order dated 21-12-2012 it was held as under;

“5.1 We have heard the rival submissions and perused the materials on record. The TPO had, while selecting the above 26 comparables, applied a lower turnover filter of Rs.1 Crore but preferred not to apply any upper turnover limit. The size of the comparable is an important factor in comparability. The ICAI TP guidelines note has observed that the transaction entered into by a Rs.1000 Crores company cannot be compared with the transaction entered into by a Rs.10 Crores company and the two most obvious reasons are the size of the two companies and related economies of scale under which they operate. The TPO's range had resulted in selection of companies as comparable such as Infosys which was 277 times bigger than that of the assessee. The Bangalore Bench of the Tribunal in the case of M/s Genisys Integrating Systems (Ind.) Pvt.Ltd., Vs DCIT ITA No.1231/Bang/2010 relying on Dun and Bradstreet's analysis had held that turnover range of Rs.1 Crore to 200 Crore is appropriate. The said

proposition has followed by the earlier Benches of this Tribunal in the following cases:

(i) M/s Kodiak Networks (I) Pvt. Ltd., Vs ACIT – ITA No.1413/Bang/2010

(ii) M/s Genisys Microchip(I) Pvt. Ltd., Vs DCIT ITA No.1245/Bang/2010

(iii) Electronic for Imaging Indi Pvt.Ltd., -ITA No.1171/Bang/2010 &

(iv) M/s Trilogy E-Business Software India Pvt.Ltd., Vs DCIT – ITA No.1054/Bang/2011 dated 23.11.2012.

5.1.1 In the case of M/s Genisys Integrating Systems (Ind.) Pvt.Ltd., Vs DCIT (supra) relying on Dun and Bradstreet' has observed as under;

“9.....we find that the TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun and Bradstreet is more suitable and reasonable. In view of the same we hold that the turnover filter is very important and the companies having a turnover of Rs.1 Crore to 200 Crores have to be taken as a

particular range and the assessee being in that range having turnover of 8.15 Crores, the companies which also have turnover of 1.00 to 200 Crores only should be taken into consideration for the purpose of making TP study”.

5.12 The above view has been followed in the recent order of the Tribunal in the case of Trilogy E - Business(supra). The relevant findings of the Tribunal are extracted as under;

“20. In this regard we find that the provisions of law pointed out by the learned counsel for the assessee as well as the directions referred to by the learned counsel for the assessee clearly lay down the principle that the turnover filter is an important criteria in choosing the comparables. The assessee’s turnover is Rs.47,46,66,638/-. It would therefore, fall within the category of companies in the range of turnover between 1 Crore and 200 Crores (as laid down in the case of Genesis Integrating Systems (Ind.) Pvt. Ltd., Vs DCIT ITA NO.1231(Bang)/2010) Thus, companies having turnover of more than 200 Crores have to be eliminated from the list of comparables as laid down in several decisions referred to by the learned counsel for the assessee. Applying those tests, the following companies will have to be excluded from the list of 26 comparables drawn by the TPO viz.,

**Turnover Rs.**

1) Flextronics Software Systems Ltd.,	848.66 Crores
2) iGate Global Solutions Ltd.,	747.27 Crores
3) Mindtree Ltd.,	590.39 Crores
4) Persistent Systems Ltd.,	293.74 Crores
5) Sasken Communication Tech.Ltd.,	343.57 Crores
6) Tata Elxsi Ltd.,	262.58 Crores
7) Wipro Ltd.,	961.09 Crores
8) Infosys Tech.Ltd.,	13149 Crores”

Accordingly, we have no qualms in directing the TPO to exclude M/s Tata Elxsi Ltd., M/s Sasken Communication Pvt. Ltd., M/s Persistent System Ltd., M/s L&T Infotech Ltd. and M/s Infosys Tech.Ltd., from the selected comparables. This Tribunal in the case of 3DPLM Software Solutions Ltd Vs DCIT (IT(TP) A.1303/Bang/2012 dated 28-11-2013) had also held that Persistent Software Systems Pvt.Ltd., was in product designing services and into software product development. In the same decision it was also held that M/s Infosys Technologies Ltd, had considerable intangibles like IPR, and was into software product development. It was also held that M/s Tata Elxsi Ltd., was developing niche products and into product designing services. Hence, these companies would in any case have to be excluded from the comparables being functionally different.”

12.2 Further, this Tribunal in the case of *M/s. Unisys India Pvt. Ltd.* (*supra*) with regard to the comparables viz., Infosys Ltd. and Persistent Systems Ltd., on the functional comparability has held at para 32 and 36 as follows:-

“32. 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 from 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.”

“36. As far as Persistent Systems Ltd., a comparable by the Assessee in his TP study but was objected to by the Assessee before TPO as not comparable, this Tribunal in the case of IT(TP) A.No.108(Bang) 2014 order dated 12.12.2014 in the case of Yodlee Infotech Pvt.Ltd. Vs. ITO held as follows:-

“5.12 ..... This Tribunal in the case of 3DPLM Software Solutions Ltd. Vs DCIT [IT(TP)A 1303/Bang/2012 dated 28-11-2013] had also held that Persistent Software Systems Pvt. Ltd., was in product designing services and into software product development. In the same decision it was also held that M/s. Infosys Technologies Ltd, had considerable intangibles like IPR, and was also into software product development. It was also held that M/s. Tata Elxsi Ltd., was developing niche products and into product designing services. Hence, these companies would in any case have to be excluded from the comparables being functionally different.”



37. Following the said decision, we direct that Persistent Systems Ltd., be excluded from the final list of comparable companies chosen by the TPO.”

12.3 Following the decisions of the Tribunal in the case of *Yodlee Infotech Ltd. (supra)* and *Unisys India Pvt. Ltd. (supra)*, we direct that Sasken Communication Technologies Ltd. (seg), Persistent Systems Ltd., Larsen & Toubro Infotech Ltd. and Infosys Ltd. be excluded from the final list of TPO’s comparables.

13. With respect to the other comparables viz., Akshay Software Technologies Ltd., R S Software (India) Ltd., Zylog Systems Ltd. and Mindtree Ltd., the Id. counsel for the assessee has submitted that these comparables chosen by the TPO have been accepted by the assessee.

14. To summarise, the assessee has objected to the inclusion of 7 comparables out of 11 chosen by the TPO as comparable companies on the basis of functional dissimilarity and turnover criterion and these 7 comparables have been directed to be excluded from the final list of TPO’s comparables in the foregoing paragraphs. Accordingly, we direct the AO/TPO to recompute the ALP after exclusion of the 7 comparables.

15. In the result, the assessee’s appeal is allowed for statistical purposes.

16. Thus, the revenue's appeal is dismissed and that of the assessee is allowed for statistical purposes.

Pronounced in the open court on this 8<sup>th</sup> day of September, 2016.

Sd/-

( A.K. GARODIA )  
Accountant Member

Sd/-

(ASHA VIJAYARAGHAVAN )  
Judicial Member

Bangalore,  
Dated, the 8<sup>th</sup> September, 2016.

/D S/

Copy to:

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

By order

Assistant Registrar,  
ITAT, Bangalore.