

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'I-1' NEW DELHI**

**BEFORE SHRI R. K. PANDA, ACCOUNTANT MEMBER
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER**

I.T.A .No. 4375/DEL/2011 (A.Y 2005-06)

DCIT Circle-16(1) New Delhi (APPELLANT)	Vs	Transwitch India Pvt. Ltd. A-27, Mohan Cooperative Incl. Estate, Mathura Road New Delhi AAACT4902H (RESPONDENT)
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Appellant by	Sh. Kumar Pranav, Sr. DR
Respondent by	None

Date of Hearing	10.08.2017
Date of Pronouncement	06.11.2017

ORDER

PER SUCHITRA KAMBLE, JM

This appeal has been filed by the Revenue against the order dated 29/7/2011 passed by CIT(A)-XX, New Delhi.

2. The grounds of appeal are as under:-

- “1. *On the facts and in the circumstances of the case and in law, the Ld.CIT(A) has erred in deleting the addition of Rs.1,17,97,001/- made by the A.O on account of difference in Arm’s Length Price as*

worked out by the TPO in his report u/s 92CA (3) of the Income Tax Act, 1961.”

3. The assessee company is a 100% subsidiary of Transwitch Corporation USA (TXC) and is established primarily as a design centre for TXC to carry out activities, which are in the nature of designing and development of software database, particularly VLSI software and supply of VLSI solutions. Transwitch Corporation, USA (XC) is a leading developer and global supplier of innovative high speed (very large scale) integrations semiconductor solutions to communications network equipment manufacturers who serve three fast-growing end-markets i.e. public network infrastructure, internet infrastructure and wide area networks (WANs). The assessee had filed Transfer Pricing documentation before the TPO. The assessee characterized itself as a software designer and developer. Transactional Net Margin Method (TNMM) was chosen as the most appropriate method. Net Operating Profit Margin which is the ratio of Net Operating Profit to Total expenses (OP/TC) was taken as profit level indicator. The assessee has searched for the comparable cases in the public database treating itself as the tested party. The OP/TC of the assessee is at 13%. The TP report has a final set 21 comparables. Data for the F.Y. 2003, 2004 and 2005 are taken. The weighted average arithmetical mean of these comparables come to 10.48%. Therefore, the TP report concludes that the International Transactions are at Arm's Length Price. During the course of the proceedings, as many of the comparables were not having the data for FY 2004-05, the Transfer Pricing Officer asked for the latest financials of the comparable companies and insisted upon using current year data. While submitting the current year data, the assessee contended that in the case of three companies the data were still not available and rejected two companies out of its own set of 21 comparable companies. The TPO conducted a separate search for comparables and introduced Sankhya Infotech Ltd. and Fore C Software Ltd. He rejected 8 companies selected by the assessee. The TPO

rejected the following comparables by giving the reasons for rejection in the third column of the table which is reproduced below:-

S. No.	Name of Comparable	Reason for rejection
1	Asia H R Technologies Ltd.	Abnormal increase in expense (300%)
2	Cressanda Solution Ltd.	Significant Losses
3	Fore C Software Ltd.	As Helios & Matheson Information Technology Ltd. has been rejected due to related party transaction these companies also have related party transactions.
4	Telesys Software Ltd.	
5	Megasoft Ltd.	
6	Blue Star Infotech Ltd.	
7	Pentasoftware Technologies Ltd.	
8	Geometric Software Solutions Ltd.	

The addition was made by Assessing Officer to the return of income on account of Transfer pricing adjustments emanating out of the order of the Transfer Pricing Officer.

4. Aggrieved by the said additions, the assessee filed appeal before the CIT(A). The CIT(A) partly allowed the appeal of the assessee and held that the international transaction of the assessee company is at Arm's Length Price (ALP).

5. The Ld. DR submitted that the CIT(A) erred in deleting the addition of Rs.1,17,97,001/- made by the Assessing Officer on account of difference in Arm's Length Price as work out by the Transfer Pricing Officer. In his report u/s 92CA(3), the CIT(A) has not at all considered that the Transfer Pricing Officer has asked for updated financial data of the comparable companies and insisted upon using current year data since the data of two companies were not available. The Ld. DR further submitted that the assessee itself rejected two companies out of its own set of 21 comparable companies. The TPO has rightly conducted a separate search for comparable and introduce two new

comparables. Therefore, the CIT(A) should have taken into consideration of all the relevant materials before the TPO.

6. We have heard the Ld. DR and perused the order of the CIT(A). Entire issue of dispute is based on the introduction of two comparables by TPO and rejection of 8 comparables of the assessee. As relates to comparables the CIT(A) has called for the remand report from the TPO and the same was taken into account by the CIT(A). The relevant extract of the CIT(A) order is as follows:

“4.7. The Ld. TPO has not given any other reason other than that these three companies are having significant losses. In the remand report dated 02.12.2009, the TPO has justified the action as follows:

“In this connection, it is submitted that the assessee’s contentions regarding loss making companies do not seem acceptable because assessee’s positive margins are obtained in similar market conditions, the loss if arises due to individual factors, then any comparison with this loss making company’s result would result in an aberration and an anomalous situation. The purpose of third party comparison of prices is to judge the operational comparability of the related party transactions of the assessee with unrelated parties. If these result in losses in assessee, then comparison with loss making unrelated companies would be fair, but when assessee’s related party transactions result in profit for the assessee, then it would be illogical to compare its operating margin with loss making companies or negative profit margins.”

“Further, the assessee has wrongly inferred that the TPO has not commented on the high profit making comparables. In fact, the order of the TPO shows that companies with high profit margins like Asia HR Technologies Ltd., Geometries Software Solution Ltd., Megasoft Ltd.,

Blue Star Infotech Ltd. and Pentasoft Technologies were also rejected for various reasons. In light of this and after perusal of the documents enclosed and public data bases, the loss making comparables are further discussed as under. ”

4.8. As it is seen from the Capitaline Database, these 3 companies are not persistent loss makers. They have positive net-worth. As per the TP report of the assessee which is not questioned by the TPO, these companies are in the similar segment of the software industry (TP report for the AY 2004-05 dated October 2005 page no. 12 and 13 of submission dated 19.11.2009).

Only loss for one year should not be the cause for rejection. Therefore, these 3 companies are restored back in the set of comparable of the assessee.

4.9. Regarding the exclusion of Megasoft Ltd., Blue Star Infotech Ltd., Pentasoft Technologies Ltd. and Geometric Software Solutions Ltd., (appearing at 5, 6, 7 8s 8 in Table-1) assessee has not raised any objection as they are found to be having related party transactions.

4.10. Infotech Enterprises Ltd. and Subex Systems Ltd. : Through the submission dated 19.11.2009, the assessee has stated that these two companies are having related party transactions to the extent of 45.03% and 41.86% respectively. In the case of Subex Systems Ltd., the assessee has raised the objection at the appellate stage by saying the operation of the company comprises of software development, services and sale of telecom products and it has related party transactions in the service segment.

I have considered the submission by the appellant. As these two comparables are having substantially high proportion of related party transaction, Infotech Enterprises Ltd and Subex Systems Ltd. are to be excluded from the set of comparables.

4.11. Assessee has submitted that Four Soft Ltd. and Melstar Ltd. Information Technology Ltd. also having related party transaction to the extent of 19.86% and 3.19% respectively. Since these related party transactions are not significantly high, looking into the circumstances of the case, these companies are to be kept in the list of comparables.

4.12. Zigma Software Ltd.: In the TP report of October, 2005, assessee itself had selected Zigma Software Ltd. as a comparable company. In Appendix F of the TP report, under the heading 'brief business description of the comparable company', Zigma Software Ltd. is mentioned as "The company is engaged in the business of EPIC, Computer Aided Design 8s Engineering (CAD/ CAE), Gerographical Information Systems (GIS) and SMS for the cellular Telecom sector." In the submission dated 19.11.2009 on page no. 7 and 8, the assessee has mentioned as below :-

"2.9 The final set of 21 broadly comparable independent companies obtained by the appellant are as below (name of the 21 companies including Zigma Software Ltd. and Subex Systems Ltd. are mentioned)

2.10 The above mentioned companies were selected after conducting a detailed FAR analysis of the comparable companies. The FAR analysis enabled Appellant to map the economically relevant facts and characteristics of the uncontrolled transaction with that of the controlled transaction and to select appropriate comparable companies in order to ascertain the arm's length nature of the Appellant's international transactions with it AEs. "

4.13. During the course of the TP proceedings, the assessee stated before the TPO that Zigma Software Ltd. is not a comparable company due to its proposed expansion plans in the field of Biotech. The TPO has stated that this is not a valid reason since any expansion plan and investment in capital assets by an enterprise have no bearing on the calculation of

OP/TC margins. The OP/TC margin of this comparable is 42.26%. It will also be used as a comparable.

Assessee has stated in the statement of facts filed along with Form no. 35 on 26.07.2008 has stated that Zigma Software Ltd. should be rejected on the ground that the company is in the business of IT enable services, advance PDF format files password recovery, mapping services, Engineering services and therefore Zigma Software Ltd. cannot be considered as a comparable company.

4.14. I have gone through the records and the submissions made by the assessee. Zigma Software Ltd. is a comparable to the assessee company for the following reasons

- 1. This company was selected by assessee "after conducting a detailed FAR analysis of the comparable companies". Assessee knows its functions, risks and assets better than anyone else. All the material facts regarding Zigma Software Ltd. was known to the assessee at the time of documentation.*
- 2. After carefully going through the records I am finding no substantial difference in the functions of the assessee company and that of Zigma Software Ltd. Both are under software development segment.*
- 3. Comparability analysis under TNMM as the most appropriate method cannot be stretched too far to say that the comparable should do exactly same business as that of the assessee. Software development encompasses a broad area of similar activities.*
- 4. 'Cherry picking' is not a healthy trend on either side of the fence. Summary of the treatments given to comparables by the appellant*
- 5. PLI for the appellant is at 13%. This calculation is not disputed by*

the TPO. The average PLI of the comparables is at 12.11%. Therefore, the international transaction of the appellant is at ALP.”

The CIT(A) in its order has clearly set out the reasons why the action of the TPO is not just and proper. Therefore, there is no need to interfere with the order of the CIT(A). It is a detailed and reasoned order. Therefore, the order of the CIT(A) is sustained.

7. In result, appeal of the Revenue is dismissed.

Order pronounced in the Open Court on 06th November, 2017.

Sd/-

(R. K. PANDA)
ACCOUNTANT MEMBER

Sd/-

(SUCHITRA KAMBLE)
JUDICIAL MEMBER

Dated: 06/11/2017

*R. Naheed **

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR

ITAT NEW DELHI

		Date	
1.	Draft dictated on	11/08/2017	PS

2.	Draft placed before author	14/08/2017	PS
3.	Draft proposed & placed before the second member	.2017	JM/AM
4.	Draft discussed/approved by Second Member.		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	06.11.2017	PS/PS
6.	Kept for pronouncement on		PS
7.	File sent to the Bench Clerk	06.11.2017	PS
8.	Date on which file goes to the AR		
9.	Date on which file goes to the Head Clerk.		
10.	Date of dispatch of Order.		