

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'C'**

**BEFORE SHRI N.V VASUDEVAN, VICE-PRESIDENT
AND
SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**

IT(TP)A No. and Assessment Year	Appellant	Respondent
1081/Bang/2019 2012-13	M/S.CSG Systems International (I) Pvt.Ltd., No.55, 4th Floor, Divyasree Towers, Bannerghatta Road, Gurappana Palya, Bengaluru – 560 029. PAN : AABCI 2954 B	The Joint Commissioner of Income Tax (OSD), Circle – 2(1)(1), Bengaluru.
1007/Bang/2019 2012-13	The Deputy Commissioner of Income Tax, Circle – 2(1)(1), Bengaluru.	M/S.CSG Systems International (I) Pvt.Ltd., Bengaluru – 560 029. PAN : AABCI 2954 B

Assessee by : Mr.K.R.Vasudevan, Advocate

Respondent by : Mr.Pradeep Kumar CIT(DR)

Date of Hearing : 12.01.2021

Date of Pronouncement : 13.01.2021

ORDER

PER SHRI N.V VASUDEVAN, VICE-PRESIDENT :

IT(TP)A.No.1081/Bang/2019 is an appeal by the assessee while ITA No.1007/Bang/2019 is an appeal by the Revenue. Both these appeals are directed against the order dated 28.02.2019 of CIT(A)-2, Bengaluru, relating to assessment year 2012-13.

2. The only issue that arises for consideration in these cross appeals is with regard to determination of Arm's Length Price(ALP) in respect of international transaction of

rendering of Software Development Services by the Assessee to its Associated Enterprise (AE). The Assessee is a company engaged in the business of providing contract Software Development Services (SWD Services). The Assessee rendered SWD services to its AE. The transaction of rendering software development services by the Assessee to its AE was a transaction with an Associated Enterprise (AE) and was therefore an international transaction. As per the provisions of Sec.92 of the Income Tax Act, 1961 (Act), income from international transaction has to be computed having regard to Arm's Length Price (ALP).

3. It is not in dispute between the Assessee and the revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for determination of ALP and that the profit level indicator to be adopted for comparison of the Assessee's profit with that of comparable companies was Operating Profit/Total Cost (OP/TC). The OP/TC of the Assessee was 14.93%%. The Assessee in its TP study selected comparable companies whose arithmetic mean of OP/TC was comparable with the profit margins of the Assessee and was acceptable. It was claimed by the Assessee that the price charged by it in the international transaction was at Arm's Length. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred by the AO u/s.92CA of the Act, selected 10 companies as comparable companies with the Assessee. Thus a final set of 10 comparable companies was chosen by the TPO as comparable companies. The arithmetic mean of profit margin of these companies after and before adjustment towards working capital adjustment selected by TPO was as follows:

Sl. No.	Name of the Company	Mark-up on Total Costs (WC–unadj) (in %)
1	Datamatics Global Services Ltd.	14.57
2	Genesys International Corpn. Ltd.	30.09
3	ICRA Techno Analytics Ltd.	17.24
4	Infosys Ltd.	43.10
5	Larsen & Toubro Infotech Ltd.	25.47
6	Mindtree Ltd.	15.01
7	Persistent Systems Ltd.	27.20
8	RS Software (India) Ltd.	15.34
9	Sasken Communication Technologies Ltd.	12.15
10	Spry Resources India Pvt. Ltd.	26.18
AVERAGE MARK-UP		22.63

4. Based on the above average arithmetic mean of profit margin of the comparable companies, the TPO computed the ALP of the international transaction of rendering of SWD services by the Assessee to its holding company as follows:

Computation of arm's length price by the TPO and adjustment made:

Arm's Length Mean Mark-up	22.63%
Less: Working Capital Adjustment	0.11%
Adjusted mean mark-up of the comparables	22.52%
Operating Cost	Rs.51,79,45,502
Arm's Length Price – 122.52% of Operating Cost	Rs.63,45,86,829
Price Received	Rs.57,06,66,385
Shortfall being adjustment u/s. 92CA	Rs.6,39,20,444

5. The difference between the price charged by the Assessee and the ALP determined by the TPO viz., Rs.6,39,20,444/- was added to the total income by the AO in his

draft assessment order dated 11.3.2016 as addition on account of shortfall being adjustment u/s.92CA of the Act.

6. The Assessee did not file objections to the draft assessment order by the AO before the Disputes Resolution Panel (DRP). The AO passed final order of assessment dated 18.4.2016 u/s.143(3) read with Sec.144C(3) of the Act. The Assessee filed appeal before CIT(A) against the final order of Assessment. The CIT(A) by the impugned order excluded 4 out of the 10 comparable companies chosen by the TPO. Against exclusion of the 4 companies, the Revenue has preferred appeal before the Tribunal raising the following grounds of appeal.

On exclusion of

1. M/s Datamatics Global Services Ltd.:-

Whether the Hon'ble CIT(A) was right in fact and in law in excluding M/s Datamatics Global Services Ltd., on the basis of failing export filter of more than 75 % when in fact said comparable was having export sales of 98%.

2. ICRA Techno Analytics Ltd.:

i) Whether the Hon'ble CIT(A) was right in fact and in law in excluding M/s ICRA Techno Analytics Ltd., on the basis of failing export filter of more than 75 % when in fact said comparable was having export sales of 92%.

3. M/s Mindtree Ltd.:

i) Whether the Hon'ble CIT(A) was right in fact in law in seeking exact comparability, which searching for comparable companies of the assessee under TNMM whereas the requirement of law and international jurisprudence require seeking similar comparables companies.

- ii) *Whether while seeking the exact comparability as mentioned above the Hon'ble CIT(A) was right in fact and in law in imposing condition beyond law whereas the requirement of law is to acknowledge only those differences that are likely to materially affect the margin.*

4. M/s Sasken Communication Technologies Ltd.:

- i) *Whether the Hon'ble CIT(A) was right in fact in law in seeking exact comparability, which searching for comparable companies of the assessee under TNMM whereas the requirement of law and international jurisprudence require seeking similar comparables companies.*
- ii) *Whether while seeking the exact comparability as mentioned above the Hon'ble CIT(A) was right in fact and in law in imposing condition beyond law whereas the requirement of law is to acknowledge only those differences that are likely to materially affect the margin.*

7. Aggrieved by non-exclusion of some of the companies chosen by the TPO and inclusion of some comparable companies proposed by the Assessee and not treating foreign exchange gain as part of the operating profits of the Assessee for the purpose of comparing Assessee's profit margin with that of the comparable companies, the Assessee has filed the present appeal before the Tribunal raising several grounds of appeal. However at the time of hearing the learned counsel for the Assessee pressed for adjudication of only Ground No.11 and 13 of the grounds of appeal. These grounds of appeal read as follows:

11. *The learned AO/learned TPO/Hon'ble CIT(A) erred in not considering foreign exchange gain/loss as operating in nature in computing the operating profit to operating cost of the Appellant and the comparable companies.*
13. *The learned AO/ learned TPO/ Hon'ble CIT(A) has grossly erred in accepting the following companies as comparable to the Appellant:*

- *Genesys International Corporation Ltd.*
- *Infosys Ltd.*
- *Larsen & Toubro Infotech Ltd.*
- *Persistent Systems Ltd.*
- *Spry Resources India Pvt Ltd.*

8. As far as Ground No.13 raised by the Assessee is concerned, the learned counsel for the Assessee submitted that he does not want to press for exclusion of the company Spry Resources India Pvt. Ltd., from the list of comparable companies chosen by the TPO. With regard to exclusion of the remaining 4 companies set out in Ground No.13, the learned counsel for the brought to our notice a decision of the ITAT Bangalore Bench in the case of CGI Information Systems & Management Consultants Private Ltd., Vs. ACIT IT(TP) A.No.183/Bang/2017 for AY 2012-13 order dated 11.4.2018 wherein 4 out of the aforesaid five comparable companies set out in Gr.No.13 viz., (a) Genesys International Corpn.Ltd., (b) Infosys Ltd., (c) Larsen and Toubro Infotech Ltd., and (d) Persistent Systems Ltd. were excluded by the ITAT. The functional profile of the Assessee in this appeal and that of the Assessee in the decision cited by the learned counsel for the Assessee is the same. The following were the relevant observations of the Tribunal.

“28. The learned counsel for the Assessee submitted before us that the comparability of the 3 companies out of the aforesaid 4 companies which the Assessee seeks to exclude from the list of comparable companies chosen by the TPO viz., Infosys Ltd., Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd., were considered by the ITAT Delhi Bench in the case of Agilis Information Technologies India (P) Ltd. Vs. ACIT (2018) 89 taxmann.com 440 (Delhi-Trib.) for the same AY 2012-13. In this regard it was submitted that the functional profile of the Assessee is same as that of the Assessee in the case of Agilis Information Technologies India (P) Ltd., is identical in as much as the said company was also involved in providing SWD services to its AE and the TPO had chosen 16 comparable companies out of which 6 companies chosen by the TPO in the case of the Assessee for the purpose of comparability were the same. His submission was that the decision rendered by the Tribunal in the case of Agilis Information Technologies India (P) Ltd., (supra) would be equally applicable to the Assessee in the present case also. The learned DR submitted that the DRP in its directions has merely accepted

with the reasoning of the TPO and therefore the issue of exclusion of these companies should be directed to be examined afresh by the DRP.

29. *We have considered the rival submissions. In the case of Agilis Information Technologies India (P) Ltd., (supra), this Tribunal considered the comparability of the 3 companies which the Assessee seeks to exclude from the final list of comparable companies chosen by the TPO. The functional profile of the Assessee and that of the Assessee in the case of Agilis Technologies India (P) Ltd., is identical in as much as the said company was also involved in providing SWD services to its AE and the TPO had chosen some comparable companies which were also chosen by the TPO in the case of the Assessee for the purpose of comparability. In the aforesaid decision the Tribunal held on the comparability of the 3 companies which the Assessee seeks to exclude as follows:*

*(a) **Infosys Ltd.**, was excluded from the list of comparable companies by following the decision of the Hon'ble Delhi High Court in the case of CIT Vs. Agnity India Technologies (2013) 36 taxmann.com 289 (Delhi). The discussion is contained in paragraphs 4.5 to 4.7 of the Tribunal's order. The Tribunal accepted that Infosys Ltd. is a giant risk taking company and engaged in development and sale of software products and also owns intangible assets and therefore not comparable with a software development service provider such as the Assessee in that case.*

*(b) **Larsen & Toubro Infotech Ltd.**, was excluded from the list of comparable companies by relying on the decision of the Delhi Bench of ITAT in the case of Saxo India (P) Ltd. Vs. ACIT (2016) 67 taxmann.com 155 (Del-Tri). The discussion is contained in paragraphs 4.8 to 4.10 of the Tribunal's order. The Tribunal held that L & T Infotech Ltd., was a software product company and segmental information on SWD services was not available. The Tribunal also noticed that the appeal filed by the revenue against the tribunal's order was dismissed by the Hon'ble Delhi High Court in ITA No.682/2016.*

*(c) **Persistent Systems Ltd.**, was excluded from the list of comparable companies on the ground that this company was a software product company and segmental information on SWD services was not available. The Tribunal in coming to the above conclusion referred to the decision rendered by ITAT Delhi Bench in the case of Cash Edge India Pvt.Ltd. Vs. ITO ITA No.64/Del/2015 order dated 23.9.2015 and the decision of Hon'ble Delhi High Court in the case of Saxo India Pvt.Ltd. (supra). The findings in this regard are contained in Paragraphs 4.14 to 4.16 of its order.*

30. *Respectfully following the decision of the Tribunal we hold that the aforesaid 3 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins. In this regard we are also of the view that the plea of the learned DR for a remand of the issue to the DRP on the ground that the DRP has not given any reasons in its directions cannot be accepted. The DRP has endorsed the view of the TPO in its directions and therefore the reasons given by the TPO should be regarded as the conclusions of the DRP.*

31. *The learned DR next submitted that **Genesys International Corporation Ltd.**, should be excluded from the list of comparable companies. The comparability of this company with the Assessee has been discussed by the TPO in page-11 of his order. The Assessee objected to inclusion of this company in the list of comparable companies for the reason that this company is functionally different and owns intangible assets which are peculiar only when the Assessee owns software products. The objections of the Assessee are contained in its letter dated 22.12.2015 addressed to the TPO and in annexure-B to the said letter. The relevant portion of the objection is at page 711-713 of the Assessee's paper book. According to the Assessee this company is engaged in providing Geographical Information Services comprising of Photogrammetry, Remote Sensing, Cartography, Data Conversion, state of the art terrestrial and 3D geocontent including location based and other computer based related services. Page-38 of the Annual report 2012 containing the above description was brought to the notice of the TPO. Attention of the TPO was invited to the directors report to the shareholders at page ii of the annual report 2012, wherein the Directors have informed the shareholders that the company continued in its journey to be innovators and leaders in the fields of location based services related geo platforms and advanced survey techniques. There is no segmental reporting because it is stated in the annual report that this company is only in one segment viz., GIS based services and therefore there is no requirement of segmental reporting. It was also submitted that this company owns substantial intangibles equivalent to 10.42% of its total turnover.*

32. *The TPO however has regarded this company as a comparable company by observing that this company develops software for mapping and geospatial services and operates a few development centres in India. The company is predominantly into software development services. The intangibles in the possession of the company are only the GIS database which is only depreciation. It does not add significant value to the company.*

33. *The objections as put forth before the TPO were reiterated before the DRP. The DRP in paragraph 6.2.2 & 6.2.3 of its directions dealt with this issue as follows:*

“6.2.2. The functions of the Assessee company have been examined in detail. A financial product on which the settlement system of bank runs is a real time system. It is very complex. Any bug or problem in it can carash the entire banking system of several nations. The Assessee’s claim of providing only basis software services is rejected.

6.2.3. The Panel holds that the software for financial product is much more complex than a geospatial software. Therefore, the panel holds that the Genesys is a valid comparable.”

34. *The learned counsel for the Assessee submitted that the DRP has completely proceeded on wrong facts which does not either emanate from the order of the TPO or the submissions of the Assessee. He reiterated submissions made before the TPO and DRP. The learned DR relied on the order of the DRP/TPO.*

35. *We have given a careful consideration to the rival submissions. It is clear from the material brought to the notice of the TPO by the Assessee that this company renders mapping and geospatial services. In rendering such services it develops software. But that does not mean that this company is in the business of software development. The business profile of this company as per the annual report does not show that this company is into software development service. The only line of business that this company carries on is rendering GIS based services and this is clear from the annual report which specifies that since the company carries on only one line of business viz., GIS based services there is no need to give any segmental results. In the circumstances, we are of the view that there is no basis for the TPO to conclude that this company is predominantly into software development services. The presence of intangible assets is indicative of the fact that this company is not in software development services business. The TPO has overlooked this aspect and proceeded on the basis that the presence of intangible assets would not be significant. Rule 10B(2) of the Income Tax Rules, 1962 (Rules) specifically provides that for the purposes of sub-rule (1) of Rule 10B, the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—*

(a) *the specific characteristics of the property transferred or services provided in either transaction;*

(b) *the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;*

In the given facts and circumstances, we are of the view that Genesys International Corporation Ltd., cannot be considered as a comparable company and the said company should be excluded from the final list of comparable companies. We hold accordingly.”

9. Respectfully following the decision of the Tribunal we hold that the aforesaid 4 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins.

10. As far as the comparable company ICRA Techno Analytics Ltd., challenged by the Revenue in Gr.No.2 of its appeal is concerned, the exclusion of the said company was sought by the Assessee before CIT(A) on the ground of functional comparability. The CIT(A) has however excluded this company on the basis of export turnover filter. It is also the claim of the Assessee that the related party transaction in the case of the aforesaid company was more than 25%. As far as the request of the Revenue that the export sales to turnover of this company is 92% and therefore passes the test of export turnover filter being at least 75% or more of the total turnover. After hearing the rival submissions, we are of the view that the comparability of this company has not been properly analyzed and hence the comparability of this company is set aside to the TPO/AO to be considered afresh on both the functional filter as well as RPT and export turnover filter. We hold and direct accordingly.

11. As far as exclusion of Mindtree Ltd., from the list of comparable companies is concerned, the revenue has challenged its exclusion in Grd.No.3 of its appeal. The learned counsel for the Assessee has no objection to its inclusion in the list of

comparable companies of the TPO. Hence, this company is directed to be included in the list of comparable companies.

12. As far as exclusion of M/s. Datamatics Global Services Ltd., which is challenged by the Revenue in Gr.No.1 of its appeal, the Assessee sought exclusion of this company before CIT(A) on the ground that this company is functionally different from that of the Assessee. The CIT(A) has however in paragraph 6.6.1 at page-43 of his order excluded this company on the basis that this company's export sales are 58% of the total turnover and therefore the company fails the application of export turnover filter. As far as the request of the Revenue that the export sales to turnover of this company is 98% and therefore passes the test of export turnover filter being at least 75% or more of the total turnover. After hearing the rival submissions, we are of the view that the comparability of this company has not been properly analyzed and hence the comparability of this company is set aside to the TPO/AO to be considered afresh on both the functional filter as well as export turnover filter. We hold and direct accordingly.

13. As far as Gr.No.4 raised by the revenue with regard to exclusion of M/s.Sasken Communication Technologies Ltd., is concerned, we find that the CIT(A) excluded this company after finding that this company was functionally different. The revenue in Gr.No.4 does not challenge the finding of CIT(A) but has raised a vague ground that comparability need not be exact and that the requirement of law is only similar companies. We are of the view that the functional comparability not having been disputed, the plea taken by the revenue deserves to be rejected.

14. As far as Gr.No.11 raised by the Assessee with regard to treatment of foreign exchange gain as part of the operating profit of the Assessee we find that in Assessee's own case for AY 2010-11 & 2011-12 in IT(TP) A/No.2642 &

2643/Bang/2017, this Tribunal by its common order dated 31.7.2019 held that as follows:

“24. Now regarding the remaining the issue in respect of TP analysis i.e. consideration of foreign exchange fluctuation gain / loss as operating in nature for the purpose of computation of margin of the assessee as well as the comparable companies as per ground no. 11, we would like to observe that such foreign exchange fluctuation gain / loss of the tested party or of the comparables can be considered for TP analysis if such gain / loss is in respect of turnover of the present year because in TP analysis, we do not consider the absolute gain / loss only. We work out the profit percentage by dividing the operating profit by the turnover of such company and such profit percentage is compared between the tested party and of the comparable company. Hence if such foreign exchange fluctuation gain / loss of the tested party or of the comparable company is not in respect of the turnover of the present year, then such working of profit percentage will be incorrect because numerator is changed by including foreign exchange gain / loss arising in ITA No. 2026/Bang/2017 & IT(TP)A Nos. 2642 & 2643/Bang/2017 Page 19 of 23 respect of the turnover of some other year but the denominator remains same because the turnover is not related to the present year and therefore, the resultant profit percentage will be incorrect. Hence such gain / loss cannot be considered for TP analysis if such gain / loss is not in respect of turnover of the present year. Since the details in this regard is not available and there is no finding of any of the authorities below in this regard, we feel it proper to restore the matter back to the file of AO / TPO for fresh decision with the direction that if it is found that foreign exchange fluctuation gain / loss of the tested party i.e. of the assessee or of the comparable companies is in respect of the current year’s turnover then the same should be considered for TP analysis but if such gain / loss is not in respect of current year’s turnover, then the same should be ignored in case of both i.e. the tested party and of the comparable companies. In case the data in this regard regarding comparable company is not made available by the assessee, then it should be presumed that such foreign exchange gain / loss for comparable company is not in respect of current year’s turnover because generally, the accounting of foreign exchange gain / loss is considered in the sales only if such gain / loss has been received in the year of sale itself and only when such gain / loss is received and accounted for in a later year then only the same is accounted for separately as exchange fluctuation gain / loss. Accordingly, ground no. 11 is allowed for statistical purposes. The AO/TPO should decide this issue as per above discussion after providing adequate opportunity of being heard to assessee.”

15. We direct the TPO/AO to consider the claim of the Assessee raised in Grd.No.11 afresh in the light of the directions of the Tribunal in AY 2010-11 & 2011-12 referred to above. We hold and direct accordingly.

16. The TPO is directed to compute the ALP of the international transaction as per the directions contained in this order after affording Assessee opportunity of being heard.

17. In the result, the appeals are partly allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER
Bangalore,
Dated : 13/01/2021
/NS/*

Sd/-
(N.V VASUDEVAN)
VICE-PRESIDENT

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.