INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES 'A'

BEFORE SHRI N BARATHVAJA SANKAR, VICE PRESIDENT
AND SHRI GEORGE GEORGE K, J.M

ITA No.1413/Bang/2010
(Asst. Year 2006-07)

M/s Kodiak Networks (India) Private Ltd.,
401, 4th Floor, 'Prestige Sigma',
3, Vittal Mallya Road,
Bangalore-1. - Appellant
PA No.AACCK0978J
Vs
The Asst. Commissioner of Income Tax,
Circle-11(5), Bangalore. - Respondent

Date of hearing : 07/12/2011
Date of pronouncement : 27/01/2012

Appellant by : Shri Padam Chand Khincha, C.A.
Respondent by : Shri Etwa Munda, CIT-III

O R D E R

PER GEORGE GEORGE K :

This appeal instituted by the assessee is directed against the assessment completed u/s 143(3) r.w.s 144C of the I T Act, 1961. The relevant asst. year is 2006-07. The assessee is aggrieved by the order of the Dispute Resolution Panel (DRP) dated 20/9/2010. The DRP had issued directions under sub-section (5) of section 144C read with sub-section (8) of section 144C of the Act. The DRP had approved, but for minor modification, the draft order of assessment making transfer price adjustment as suggested by the Transfer Pricing Officer (TPO) u/s 92CA of the Act.

2. The assessee has raised the following concise grounds:-

The lower authorities (the Ld. AO, Ld. TPO and Hon'ble DRP) have erred in –

i) passing the order disregarding the principles of natural justice;
ii) making a reference to Transfer Pricing Officer for determining arm's length price;
iii) passing the order without demonstrating that appellant had motive of tax evasion;
iv) not appreciating that the members of Dispute Resolution Panel also being jurisdictional Commissioners/Director of Income Tax of the appellant, the constitution of the DRP is bad in law;
v) not appreciating that the charging or computation provision relating to income under the head "profits and gains of business or profession" do not refer to or include the amounts computed under Chapter X and therefore the addition under Chapter X is bad in law;
vi) adopting a flawed process of issuing notices u/s 133(6) and relying on the same without providing complete information to the appellant or an opportunity to cross examine the parties involved;
vii) rejecting comparables and transfer pricing analysis of the appellant on unjustifiable grounds;
viii) doing fresh transfer pricing analysis and adopting inappropriate filters in such analysis;
ix) considering the data which was not available to the appellant at the time of complying with the TP documentation requirements;
x) selecting inappropriate comparables and rejecting appropriate comparables;
xi) inappropriately computing the operating margins of comparables and the appellant;
xii) not making proper adjustment for enterprise level and transactional level differences between the appellant and the comparable companies;
xiii) not appreciating that the law does not compel adopting many (or any minimum) companies as

comparables and that the appellant could justify the price paid/charged on the basis of any one comparable only;

xiv) not allowing the benefit of the +/-5% range as per the proviso to section 92C(2);

xv) not excluding the telecommunication charges from the total turnover while excluding the same from export turnover while computing deduction u/s 10A; &

xvi) levying a sum of Rs.30,51,668/- as interest under section 234B and a sum of Rs.19,2222/- as interest under section 234D.

3. Brief facts of the case are as follows:-

The assessee is an Indian Company, a subsidiary of Kodiak Networks Inc., USA. It is engaged in the business of software development service to Kodiak Networks Inc, USA. The return of income for concerned asst. year was filed on 28/11/2006 declaring an income of Rs.11,97,597/-. The return of income was taken up for scrutiny and the case was referred to TPO u/s 92CA for determination of arm's length price. During the year, the assessee company had the following international transactions with its Associate Enterprise (i) rendering of software development services; (ii) marketing and customer support services; (iii) purchase of capital goods; (iv) sale of capital goods; and (v) reimbursement of expenses. There is no objection by the TPO on the pricing of the international transactions with respect to marketing and customer support services, purchase and sale of capital goods and reimbursement of expenses. The TP adjustment has been made only with respect to rendering of software development services to the tune of Rs.1,73,67,933/-.

4. The Assessing Officer forwarded a draft of the proposed order of assessment to the assessee on 17/12/2009 and served on the assessee on

24/12/2009. After receiving draft assessment orders, the assessee filed its objections before the DRP on 22/01/2010. The DRP has issued notice u/s 144C(11) of the Act dated 22/06/2010 and one opportunity of hearing was given on 11/8/2010 and the DRP vide its order dated 20/09/2010 upheld the TPO/AO's transfer pricing adjustment with minor modification in regard to M/s Megasoft Ltd.

5. Being aggrieved with the direction of the DRP, the appellant company ['the appellant' in short] has come up with the present appeal. During the course of hearing, the Ld. A.R argued, touching various aspects and also filed two written submissions, the substances of the second written submissions are summarized as under:

(1) The appellant rendered software development services wholly to its AE. The total value of software development service was Rs. 24,06,82,087/-.

The appellant adopted Transactional Net Margin Method (TNMM) to justify the price charged in the international transactions. The appellant conducted a methodical search process on Prowess database to identify comparable companies. After adopting various search filters, the appellant selected 49 companies as comparables. The arithmetic mean of these comparables was 11.01%. The appellant's operating margin on cost was 10.70%. Since the appellant's margin of 11.01% was within the 5% range as provided in proviso to s. 92C (2), it was concluded that the international transactions relating to software development services are at arm's length.

In the final Order passed u/s 92CA, the TPO selected 20 companies as comparables. The TPO considered 6 additional companies as

comparables (apart from 14 companies as proposed in the show-cause notice). These six new companies were adopted as comparables without proposing the same in the notice or affording an opportunity to the appellant to present its objection to their adoption. The arithmetic mean was determined at 20.68%. After factoring a working capital adjustment of 1.55%, the adjusted arithmetic mean was determined at 19.13%. The transfer pricing adjustment for the software development services was accordingly determined at Rs. 1.74 crores.

The appellant filed detailed objections with the DRP which have been rejected by DRP except for correcting an error in the margin computation of one comparable, namely, Megasoft Limited and that the Order of the DRP was brief. The AO accordingly incorporated the TP adjustment, while determining the total income.

TURNOVER FILTER:

(2) In its transfer pricing analysis, the appellant had adopted the lower turnover criteria to select the comparables. During the proceedings u/s 92CA, the appellant submitted that if the lower turnover filter was to be applied, then the upper turnover filter limit of Rs. 200 crores should be applied. The TPO had applied a lower turnover filter of Rs. 1 crore on the ground that there was no relationship between sales and margins to apply the upper turnover limit.

The appellant submitted that size of the comparable was an important factor in comparability. This was also recognised by the statute i.e., rule 10B (3) lays down guidelines for comparing an uncontrolled transaction with an international transaction.

(3) Differences for transfer pricing purposes can be of two types: (i) differences in transactions being compared or (ii) differences in enterprises. A comparable should be rejected if any of the above difference materially affects the price charged or cost paid, or profit arising, from such transactions in the open market unless an accurate adjustment can be made for removing the effect of such differences.

While applying any of the methods, the Rule provides an adjustment being effected for ironing out the enterprise wide differences. The TNMM (which is adopted by the TPO as the most appropriate method in the instant case), for e.g., contemplates an adjustment for an enterprise wide difference (Rule 10B(1)(e)).

Rule 10B (3) outlines various conditions for comparability that in judging whether an uncontrolled transaction is comparable, the enterprise level differences will have to be reckoned. In choosing the most appropriate method, Rule 10C (2)(e) factors the ability of making reliable and accurate adjustment to account for the differences in the enterprises levels.

Size is an important facet of an enterprise level difference. Size of an enterprise is thus to be examined for comparability purposes. Significant differences in size of companies would impact comparability. Comparable means something that is similar or equivalent. It is something which possesses the same or almost the same characteristics. It is not that every company in the industry becomes a comparable. To use a simile, a Maruti 800 car cannot be compared to Benz car. In business, size matters. Unusual patterns, stray cases, wide disparities have to be eliminated as they don't satisfy the test of comparability.

Companies operating on a large scale benefit from economies of scale, higher risk taking capabilities, robust global delivery and business models as opposed to the smaller or medium-sized companies. Size therefore matters. Two companies of dissimilar size therefore cannot be assumed to earn comparable margins. Impact of difference in size could be removed by a quantitative adjustment to the margin or price being compared, if it is possible to do so reasonably accurately. Otherwise the uncontrolled transactions may have to be rejected from the comparability exercise. It is generally difficult to quantify mathematically, the impact of size on margins. Companies of dis-similar sizes therefore are not to be compared.

Size as one of the selection criteria has also been approved by various benches of ITATs. The Chandigarh S. B of ITAT in the case of DCIT vs. Quark Systems Pvt Ltd 38 SOT 207 has specifically rejected adoption of the turnover range of one crore on lower end and infinity on the higher end.

Relies on the case laws:

- ***Egain Communications Private Limited v ITO 118 TTJ 354 (Pune)***
- ***M/s Sony India (P) Limited v DCIT 114 ITD 448 (Delhi)***
- ***DCIT vs. Indo American Jewellery Ltd ITA No. 6194/Mum/2008***
- ***Agnity India Technologies Pvt. Ltd v Income-tax Officer ITA No. 3856 (Del) / 2010***
- ***Philips Software Centre Private Limited 26 SOT 226 (Bang)***
- ***ACIT v NIT 10 Taxman.com 42***
- ***DHL Express India Pvt Ltd v ACIT (2011) 11 Taxmann.com 40***
- ***Deloitte Consulting India Pvt Ltd v DCIT ITA No.1084/Hyd/2010***

(4) that the size as a criteria for selection of comparables is also recommended by OECD in its TP Guidelines, 2010. Para 3.43 of the Chapter on guidelines dealing with selecting or rejecting potential comparables, the OECD TP Guidelines enumerates the list of most commonly used quantitative criteria

- In para 15.4 of ICAI TP Guidance Note it has been observed that a transaction entered into by Rs 1,000 crore company cannot be compared with the transaction entered into by Rs 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate.

(5) that the TPO's range of Rs. 1 crore had resulted in selection of companies like Infosys which is 375 times - turnover of Rs. 9,028 crores against Rs. 24.07 crores of appellant's AE transactions - bigger than the appellant.

- that based on the above, an appropriate turnover range should have been applied in selecting comparable uncontrolled companies; that selection on basis of size may be made based on Dun and Bradstreet's analysis, the classification of the software companies of which is:

> "The IT industry has been logically divided into 3 categories based on the net sales turnover.
> Large size firms (> Rs 20,000 mn)
> Medium size firms (Rs 2,000 – 20,000 mn)
> Small size firms (< Rs 2,000 mn)"

The assessee submits that above extract forms part of TPO's own order passed u/s 92CA. Accordingly, a turnover range of Rs. 1 crore at the lower end and Rs. 200 crores at the higher end may be adopted while choosing the comparables.

In the alternative, a selection on the basis of size may be made based on the NASSCOM categorisation. NASSCOM recognises three categories based on turnover:

Tier I: Greater than USD 1 billion (approx Rs. 5,000 crores)
Tier II: between USD 100 million to USD 1 billion (Rs. 500 crores to Rs. 5,000 crores)
Others: less than USD 100 million (Rs. 500 crores)

With regard to use of Information received in pursuance to notice u/s 133(6)

For the comparability analysis, the TPO conducted enquiries from certain companies by exercising powers conferred by law u/s 133(6) of the Act. The appellant was provided these notices and replies received in a CD. The TPO proposed to accept/ reject these companies as comparables based on the responses received from these companies. In case of variance between reply u/s 133(6) and annual report, reply u/s 133(6) was given preference. The appellant submits that process adopted for issue of notice and use of such information is inappropriate for the following reasons.

Arbitrary selection of companies for issue of notice

From the details provided, it appears that in all 154 companies were issued notices and how these companies were selected was not clear as the basis of selection of these companies for issuance of notice u/s 133(6) was not provided and that the entire process lacks in transparency and fairness. It was also not clear as to whether all the responses have been incorporated in the CD provided? The whole procedure appears to be a selective exercise which was clear from the fact that six companies did not even find place in the initial list of companies generated by the TPO.

- that from the details provided along with the initial show cause notice, Megasoft Limited was rejected as a comparable on the ground that it fails RPT filter and employee cost filter. The TPO had stated that a company was not issued notice u/s 133(6), if it fails RPT filter. In case of Megasoft, a

notice was nevertheless issued. What prompted the issue of notice was not spelt out. The appellant submits that the approach of TPO in issuing notices is arbitrary as also selective and hence faulty.

- that these issues have been raised before the DRP also. The DRP has stated that not giving of all the information is intentional. The DRP had stated that what was relevant only is given. The DRP's order is, therefore, bad in law and liable to be quashed.

The assessee had detailed the process adopted by it in the selection of comparables. The TPO also, in its initial show cause notice, has detailed the process adopted. However, in detailing the process of how the powers u/s 133(6) have been exercised and the disclosure of information obtained there-under, he was being secretive. It is said that only relevant information was provided. The assessee demanded a disclosure of the entire process as also the furnishing of all the replies. This has not been done. Withholding such information results in prejudice to the assessee and is against principles of natural justice.

Authenticity of the Information received

Rule 10D (3) provides that information specified in sub-rule (1) shall be supported by authentic documents. The TPO had not established whether the information obtained by way of notice u/s 133(6) was authentic and complete. In spite of these differences, the TPO had relied and completed the assessment based on replies received u/s 133(6), in preference to Annual Report of the companies which were audited by professionally qualified CA and approved by Board of Directors and that such reliance is bad in law.

The TPO had relied on segmental information received u/s 133(6), which did not form part of Annual Report. The bifurcation and reporting of income and expense into different segments as done by the company, was not audited by a CA. It was possible that the same may not be as per Accounting Standard 17 issued by the Institute of Chartered Accountants of India and, hence, either incomplete or unreliable apart from being unverifiable.

Sankhya Infotech for e.g. was selected as comparable in preceding AY on the ground that it was software development company. The decision was based on reply received u/s 133(6). For the year under consideration, Sankhya Infotech has been rejected on the ground that it was a software product company [again based on reply received u/s 133(6)]. This inconsistency indicates that the entire process was neither transparent nor fair.

Information obtained by process of issuing notice u/s 133(6) was not available in public domain or at the time of Study by the appellant

Rule 10D prescribes the document to be kept and maintained u/s 92D. Rule 10D (1), e, f, g, h, i, j deal with the process and the method to be adopted in making the comparability analysis. Sub-rule 4 of Rule 10D states that the information and documents specified under sub-rule (1) and (2) should as far as possible be contemporaneous.

As per Rule 10D, the information and documentation prescribed therein must be kept and maintained by the appellant latest by the prescribed date i.e. for AY 2006-07 by 31-10-2006. The appellant has kept and maintained the information and documents required under Rule 10D accordingly.

The TPO was collecting and compiling data two/three years after the date of the appellant's documentation. This was impermissible. There was no finding that a particular company has been rejected or ignored as comparable although the data was available in the public domain by the specified date. It was not alleged that the data in existence by the specified date and adopted was incorrect. In choosing the most appropriate method the availability of data was a relevant factor (Rule 10C(2)(c)). The power u/s 133(6) is no doubt exercisable by the TPO. This power is however to be exercised to check and confirm the veracity of data used and adopted by a company. The power is not to be used to gather information that comes into public domain after the specified date.

S. 92CA (3), outlines circumstances on the basis of which the ALP computed by the company may be discarded and re-determined by the AO. Similar powers are available to the TPO. To invoke the powers u/s 92C(3), however, the material or document or information must be that which was in existence by the specified date. Otherwise, what was correct and complete on the basis of data existing by the specified date could become unreliable or incomplete in the light of data that comes into existence subsequently. Such a process or result is not contemplated. The powers u/s 133(6) is not to be used for gathering data not in existence in public domain by the specified date. The power u/s 133(6) is to be used for validating data that has been adopted. The power u/s 133(6) cannot be used to obtain information to enable selection of comparables. That the data has to be in existence by the specified date is also recognised by the amendment made to the definition of 'specified date' - 30th November. It has been clarified that the date has been extended as sufficient data was not available under the existing specified date to make the comparison meaningful. The extension of

the specified date is recognition as also an acceptance by the Legislature that the comparability analysis as also the determination of ALP has to be on the basis of data that is available in the public domain by the specified date. If subsequent information is permitted to be used, then the ALP would remain fluid. The assessee may determine ALP on the basis of a particular date. The TPO may re-determine ALP on the basis of data up-to another particular date. The DRP/ CIT(A) may re-determine ALP on the basis of updated information. The ITAT may improve the process further. This can lead to an ever changing ALP. The ALP is not a dynamic or fluid subject to vagaries of future. It is on the other hand a figure to be arrived at on the basis of data existing by the specified data.

The assessee cannot be expected to adopt data that was not in existence by the specified date. It is such data that should be validated by the TPO when a reference is made to him u/s 92CA.

The assessee submits that the data as available to it may be used for determination of the ALP. Data available subsequently or obtained through notice u/s 133(6) (which data is otherwise not available in the public domain) should be rejected and, thus, the approach adopted by learned TPO is bad in law.

Without prejudice that even adopting the subsequent data as used by the TPO, the assessee's margin satisfy the arm's length range if the following submissions are considered.

ALP COMPUTATION – IF THE ABOVE COMPANIES ARE EXCLUDED FROM COMPARABILITY

Based on all the above, the assessee has tabulated below, a list of comparables out of the TPO's comparables. Two tables have been prepared. The first table comprises of all companies falling within a turnover range of Rs. 1 crore to Rs. 200 crore (Dun & Bradstreet Analysis). The operating margins before and after working capital adjustment are detailed. The margins that remain after excluding companies that do not deserve to remain as comparables for the reasons already detailed are also mentioned in the notes to the table.

In second table, a similar exercise is carried out by adopting a turnover range of Rs. 1 crore to Rs. 500 crores (NASSCOM analysis).

TABLE 1 – TURNOVER RANGE 1 TO 200 CRORES

Sl.No.	Name of the Company	Operating Revenues	Operating Margin on Cost	WC Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,28,61,36,000	18.09%	18.61%
2	Geometric Software Limited(seg)	98,59,57,838	6.70%	5.62%
3	KALS Information Systems Limited	1,96,90,390	39.75%	41.21%
4	R Systems International Limited(seg)	79,41,94,053	22.20%	20.21%
5	Tata Elxsi Ltd(Seg.)	1,88,81,25,000	27.65%	27.56%
6	Lucid Software Limited	1,01,91,181	8.92%	5.36%
7	Media Soft Solutions Private Limited	1,75,77,145	6.29%	4.10%
8	R S Software (India) Limited	915,707,164	15.69%	15.16%
9	SIP Technologies & Exports Limited	6,53,44,634	3.06%	1.00%
10	Bodhtree Consulting Ltd	5,31,89,165	15.99%	14.85%

11	Accel Transmatics Ltd(seg)	8,02,05,000	44.07%	42.23%
12	Synfosys Business Solutions Ltd	4,48,86,725	10.61%	7.27%
13	Megasoft Ltd	19,21,85,451	16.97%	10.53%
14	Lanco Global Solutions Ltd	35,62,93,560	5.27%	4.78%
Arithmetic Mean			17.23%	15.61%
NOTES				
After removing KALS - Mean - 15.50% & WC adjusted mean 13.64%				
After removing KALS and Tata Elxsi - Mean - 14.49% & WC adjusted mean 12.48%				
After removing KALS, Tata Elxsi & Accel - Mean - 11.80% & WC adjusted mean 9.77%				

TABLE 2 – TURNOVER RANGE 1 TO 500 CRORES

Sl.No.	Name of the Company	Operating Revenues	Operating Margin on Cost	WC Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,28,61,36,000	18.09%	18.61%
2	Geometric Software Limited(seg)	98,59,57,838	6.70%	5.62%
3	KALS Information Systems Limited	1,96,90,390	39.75%	41.21%
4	Mindtree Consulting Limited	4,48,79,82,158	14.67%	13.34%
5	Persistent Systems Limited	2,09,17,76,542	24.67%	23.79%
6	R Systems International Limited(seg)	79,41,94,053	22.20%	20.21%
7	Sasken Communication Technologies Limited(seg)	2,40,03,42,000	13.90%	13.14%
8	Tata Elxsi Ltd(Seg.)	1,88,81,25,000	27.65%	27.56%
9	Lucid Software Limited	1,01,91,181	8.92%	5.36%
10	Media Soft Solutions Private Limited	1,75,77,145	6.29%	4.10%
11	R S Software (India) Limited	91,57,07,164	15.69%	15.16%
12	SIP Technologies & Exports Limited	6,53,44,634	3.06%	1.00%
13	Bodhtree Consulting Ltd	5,31,89,165	15.99%	14.85%
14	Accel Transmatics Ltd(seg)	8,02,05,000	44.07%	42.23%
15	Synfosys Business Solutions Ltd	4,48,86,725	10.61%	7.27%

16	Megasoft Ltd	19,21,85,451	16.97%	10.53%
17	Lanco Global Solutions Ltd	35,62,93,560	5.27%	4.78%
Arithmetic Mean			17.32%	15.81%
NOTES				
After removing KALS - Mean - 15.92% & WC adjusted mean 14.22%				
After removing KALS and Tata Elxsi - Mean – 15.14% & WC adjusted mean 13.33%				
After removing KALS, Tata Elxsi & Accel - Mean - 13.07% & WC adjusted mean 11.27%				

Computation of Margins of the Appellant

The appellant's margins are tabulated below:

Particulars	*Amount in INR*
Operating Revenues	*24,06,82,087*
Operating Expenses	*21,67,21,274*
Net Profit	*2,39,60,813*
Operating profit/Operating cost	*11.05%*

The margin of the appellant as above is more than the arithmetic mean of comparables under Table 1 (Turnover range of Rs. 1 crore to Rs. 200 crore), after eliminating KALS, Tata Elxsi and Accel is within the 5% range.

The differential between the margins of the appellant as above and of the comparables under the Tables 2 above (Turnover range of Rs. 1 crore to Rs. 500 crore), after eliminating KALS, Tata Elxsi and Accel are within the 5% range. Applying, the ratio of Circular No 12 of 2001, which has been statutorily thereafter incorporated in the proviso to section 92C (2), no adjustment is required to be made to the reported values of the appellant's transactions with its associated enterprises.

Based on all the above, the appellant submits that its international transactions relating to software development services are at arm's length and addition made by the TPO and sustained by the DRP in this regard need to be deleted.

Based on all the above, the appellant has tabulated below, a list of comparables out of the TPO's comparables without applying turnover filter and rejecting the comparables for reasons already detailed and after considering the margins of the Megasoft at the segment level.

TABLE 3 – WITHOUT TURNOVER FILTER AND REJECTING COMPARABLES AS DETAILED ABOVE

Sl.No.	Name of the Company	Operating Revenues	Operating Margin on Cost	Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,286,136,000	18.09%	18.61%
2	Geometric Software Limited(seg)	985,957,838	6.70%	5.62%
3	iGate Global Solutions LLtd (Seg.)	5,279,075,000	15.61%	13.57%
4	Persistent Systems Limited	2,091,776,542	24.67%	23.79%
5	R Systems International Limited(seg)	794,194,053	22.20%	20.21%
6	Sasken Communication Technologies Limited(seg)	2,400,342,000	13.90%	13.14%
7	Lucid Software Limited	10,191,181	8.92%	5.36%
8	Media Soft Solutions Private Limited	17,577,145	6.29%	4.10%
9	R S Software (India) Limited	915,707,164	15.69%	15.16%
10	SIP Technologies & Exports Limited	65,344,634	3.06%	1.00%
11	Bodhtree Consulting Ltd	53,189,165	15.99%	14.85%
12	Synfosys Business Solutions Ltd	44,886,725	10.61%	7.27%
13	Megasoft Ltd	192,185,451	16.97%	10.53%
14	Lanco Global Solutions Ltd	356,293,560	5.27%	4.78%
15	Flextronics Software Systems Ltd	5,951,198,183	27.24%	26.78%
Arithmetic Mean			14.08%	12.32%

The differential between the margins of the appellant as above and of the comparables under the Tables above, after eliminating KALS, Tata

Elxsi, Accel, Infosys Technologies and Mindtree is within the 5% range. Appling, the ratio of Circular No 12 of 2001, which has been statutorily thereafter incorporated in the proviso to section 92C(2), no adjustment is required to be made to the reported values of the appellant's transactions with its associated enterprises.

Based on all the above, the appellant submits that its transactions under software development segment are at arm's length and addition made by the TPO and sustained by the DRP in this regard need to be deleted.

Benefit of 5 percent range:

Assuming without admitting that a TP adjustment is to be made, the appellant submits that it should be given a standard deduction of 5% as provided under proviso to section 92C(2) before making adjustments for the transfer price.

The appellant submits that its above contention is supported by the following judicial precedents:

- M/s Sap Labs India Private Limited v ACIT 2010-TII-44-ITAT-BANG-TP
- Philips Software Centre Pvt Ltd 26 SOT 226
- MSS India Private Limited 32 SOT 132
- Customer Services India (P) Ltd v ACIT 30 SOT 486
- Skoda Auto India Pvt Limited v ACIT 2009-TIOL-214-ITAT-PUNE
- Development Consultants P Limited v DCIT 23 SOT 455
- Sony India P. Ltd. 315 ITR 150
- Cummins India Limited v DCIT ITA No. 277 & 1412/PN/07
- TNT India Pvt. Ltd. v ACIT 10 Taxmann.com 161
- Abhishek Auto Industries Ltd v DCIT 2010-TII-54-ITAT-DEL-TP
- Technimont ICB Pvt Ltd v ACIT 2011-TII-31-ITAT-MUM-TP

5.1. In conclusion, it was averred that even after adopting the comparables as chosen by the TPO subject to rejection of some companies for justifiable reasons, the margins of the appellant are within the arm's length range of the adjusted ALP. These margins would skew more favourably, if comparables of the appellant that deserve to be adopted are considered. In view of the favourable conclusion on facts, detailed arguments or submissions have not been made on legal issues likes (i) the reference to TPO being bad in law; (ii) the CIT's approval for reference to TPO also being bad in law; and (iii) the additions being unsustainable as the definition of income or the computation process under section 28 to 44 not envisaging a reference to or incorporation of an adjustment proposed under Chapter X.

DEDUCTION UNDER SECTION 10A

While computing deduction u/s 10A, the AO reduced Rs. 527,929 from the export turnover. However the same has not been reduced from the total turnover. In this regard, the appellant submits that what is reduced from export turnover should also be reduced from total turnover. The appellant's contention is supported by the Special Bench decision in the case of ITO v Sak Soft (2009) 313 ITR (AT) 353 and plethora of decisions listed on pages 373 to 375 of PB-I. The appellant submits that amount reduced from export turnover should also be reduced from total turnover.

6. On the other hand, the Ld. D.R came up with a spirited refutation of the Ld. A R's contentions. The learned DR also filed written submissions, essences of which are summarized, chronologically, as under:

(1) During the proceedings u/s 144C of the Act, the DRP had given opportunities twice to the assessee.

Relies on the case laws:

(a) Messe Dusseldorf Vs DCIT (2010) 320 ITR 565 (Del)
(b) Intimate Fashion (India) (P) Ltd vs. JCIT (2010) 321 ITR 265 (Mad).

With regard to procedure:

Ground No.2

The DRP after going through various submissions made by the assessee and also after considering various judicial pronouncements on the issue such as the decision of the special bench of Hon'ble ITAT in the case of M/s. Aztec Software and Technology Services Ltd Vs. ACIT reported in 107 ITD 141 (SB) (Bang) and Hon'ble High Court of Delhi in the case of Sony India Pvt. Ltd Vs CBDT reported in 288 ITR 52 and various other decisions held that there was no illegality or arbitration in the order of the Assessing Officer in making a reference to the TPO or in adopting the computation of 'ALP' determined by the TPO.

Further placed reliance on the judicial pronouncement on this issue as follows:-

- Morgan Stanley & co.(2006) 284 ITR 260, (AAR)
- Sony India (P) Ltd Vs CBDT (2006), 288 ITR 52 (Delhi),
- Ranbaxy Laboratories Ltd. Vs Addl. CIT (2008) 299 ITR 175 (Delhi)
- M/s. TNT India Pvt. Ltd Vs ACIT ITA No. 1442/Bang/08
- M/s. SAP LABS India Pvt. Ltd Vs ACIT ITA No398/Bang/2008
- M/s. Deloitte Consulting India Pvt. Ltd Vs DCIT ITA No 1084/Hyd/2010
- M/s. Tally Solutions Pvt. Ltd./ Vs DCIT ITA No 1235/bang/2010

These objections of the assessee with reference to the procedure are covered against the assessee by the decisions referred supra and, hence, there is no merit on the grounds and liable to be rejected.

Ground Nos. 3 & 4

These grounds relate to administrative matters and the DRP constituted by the CBDT by specific notification and, hence, validly constituted as per provisions of Act. Moreover, appeal in ground nos. 3 and 4 are not emanating from the order of the TPO and the DRP; hence not maintainable.

Ground No. 5 Relating to Charge of Income-tax

That s. 92(1) of Chapter X clearly provides the procedure for computation of income arising from an international transaction. S. 92(1), says that "Any income arising from an international transaction shall be computed having regard to the arm's length price."

The term international transaction has been defined in s. 92B and the procedure for determining arm's length price in relation to an international transaction has been provided in s. 92C. Therefore, there remains no doubt that the adjustments have to be made to the income on the basis of arms length price determined, and, therefore, while computing the income of the assessee the provisions of Ch. X are clearly applicable.

Ground No.6

In regard to the issue of notices u/s 133(6), it was stated that the TPO discussed in detail in para 14.5 to 14.5.1, which reveals that copies of notices u/s 133(6) issued to the companies as well as the copies of the replies received from companies were in fact given to the assessee in a soft copy for its comments. The decision of the TPO based on information collected was also duly communicated to the assessee. The DRP have upheld the AO's action and after considering the assessee's objection and held that TPO is

empowered to collect the details relevant to the transfer pricing proceedings and the TPO used his power to collect relevant information requiring for better comparability analysis. The TPO used the data for information that was available to him in the public domain whenever a company did not submit the information or wherever the notice u/s 133(6) not served at the latest address available even after repeated attempts. The TP order transpires that the assessee had furnished its reply vide letter dated 21-09-2009 and no issue was raised in regard to the cross-examination of the concerned parties which dispel the assessee's contention that it was not given opportunity to cross-examine the parties involved . In this connection, the Revenue relies on the pronouncements of the Hon'ble ITAT Bangalore in the case of M/s. Genesis Integrating System (India) Pvt. Ltd Vs. DCIT in ITA No/231/(Bang)/2010 and by the Mumbai Tribunal in M/s. Symantec Software Solution Vs. ACIT in ITA No 7894/Mum/2010.

From the facts as well as legal position discussed above, the TPO's action would be according to the statutory provision of the Act and notices U/s 133(6) were validly issued

Section 92CA(3) empower the TPO to consider such evidence as he may require on any specified point and after taking into account all relevant materials which he has gathered, he shall determine the ALP in relation to the international transaction in accordance with the provisions of s. 92C. Thus, if the information as gathered by the TPO is relevant material for the purpose of determining the ALP in relation to the international transaction then it was not wrong in using the updated data.

Ground Nos.7 & 11

The assessee selected comparables out of which the ITO accepted 7 comparables. Filter matrix adopted by the TPO has discussed in

para – 11.1 based on the filter criteria the TPO discussed each comparable from page No 62 to 72 and eliminated 42 comparables. The DRP also discussed this issue elaborately.

It is relevant to mention the ruling of the Hon'ble ITAT, Mumbai in ACIT Vs M/s Maersk Global Services Centre (India) Pvt. Ltd. ITA No 3774/Mum/2011.

In the instant case, since the TPO has excluded comparables chosen by the assessee which can be seen in the order u/s 92CA of the Act cited.

TURN OVER FILTER

The assessee had contended that TNMM method followed by the TPO, adopting a turn over filters of Rs. 1 crore on the lower end and infinity on the higher side is wrong. The assessee submitted new study order TNMM adopting turn over range of Rs. 1 crore at the lower end and Rs. 200 crores at the higher end while choosing the comparables is based on Dan & Bradstreet analysis of classification of software companies. Further, the assessee had provided fresh comparables having a turnover filter range of Rs. 1 c rore to 500 crores based on Nasscom categorisation.

It was submitted by the learned DR that the ICAI TP Guideline note and NASSCOM categorisation are only certain opinion formed by the agencies and general in nature. Against the assessee's argument, it was submitted that the TPO in his order stated that the tax payer's argument of size, scale and nature of operation was also raised during the proceeding U/s 92CA of the Act and the same has been dealt with in detail in the order (in para 9.2). Further it also held that lesser known companies like Mega Soft

Ltd, Accel Transmatic Ltd, KALS Info Systems Ltd etc are having almost the profit margin equivalent to the margin of Infosys Technology Ltd. which means that brand per se does not effect the margins. Thus brand name may get higher turnover but it does not necessarily mean that it would generate higher margin. It was stated that the observation of the TPO has also supported by the decision of Hon'ble ITAT, Mumbai 'E' Bench in u/s Symantec software solutions private Limited vs ACIT in ITA No 7894/MUM/2010.

Submission of learned DR relating to use of information received in pursuance to notice u/s133 (6).

For the comparability analysis, the TPO conducted enquiries from certain companies by exercising power conferred by law u/s 133(6) of the Act. The assessee was provided these notices and replies received in a CD. The TPO proposed to accept/reject these companies as comparable based on the response received from these companies. It was urged that this issue has already been discussed in ground no 6. Hence not deem fit for further comments for sake of repetition.

Submission on the margin or adoption of various companies as comparable:

The A.R. of the assessee urged that the following companies may be excluded as comparable in view of the unusual features:-

	Company Name	OP to Total Cost
i)	Ms/. Megasoft Ltd	52.74
ii)	M/s. KALS Information System Limited	39.75
iii)	M/s. TATA Elexi Limited	27.65
iv)	M/s. Accel Transmatic Limited	44.07
v)	M/s. Mind Tree Consulting Private Limited	14.67
vi)	M/s. Infosys Technologies Limited	40.38

The A.R. of the assessee pointed out several deficiencies in adopting these companies as comparable, hence it is appropriate to offer comments company wise in following paragraphs:-

i) MEGASOFT LTD

It was contended by the Revenue that while considering reference petition in the case of M/s Yadlee Infotech Pvt. Ltd. The DRP held that -

> Sub-section (7) of section 92CA has empowered the TPO to exercise all or any of the powers mentioned in section 131 or sub-section (6) of section 133 for determination of ALP. The object is clearly to enable the TPO to seek clarifications where there is ambiguity or insufficiency or obfuscation of data or information in public domain so that the ALP can be arrived at in a more precise manner. As long as the TPO has acted objectively, fairly and without any bias, the assessee cannot have any grievance on the issue. As far as use of M/s Megasoft Ltd as a comparable is concerned, any lacuna on the part of the TPO to giving of opportunity to the assessee before including the company as a comparable gets cured by the DRP taking into consideration assessee's objections in the matter.

The DRP discussed comparability in regard to M/s Megasoft Ltd and this is common in both the case, hence the DRP's findings are equally applicable in the instant case.

Further, it was submitted that:

M/s Megasoft has furnished segmental information in pursuance to the notice issued u/s 133(6) which is given below:

Financial statement for year ending 31-03-2006 operating Revenue (excluding non operating Revenue) are:

Particulars	Blue ally(consulting Division) in Rs.	XIUS-Bcits Division (product Division) in Rs.	Total in Rs.
Sale/service Export	17,07,45,151	24,32,21,163	41,39,66,314
Domestic	2,14,40,300	12,60,56,269	14,74,96,569
Total	19,21,85,451	36,92,77,432	56,14,62,883
As per TPO			56,14,62,883
Expenditures			
Personnel Cost	9,66,62,247	9,11,68,236	18,78,30,483
Increase/Decrease in work-in-progress	98,62,642	49,62,180	1,48,24,822
Operating Expenses (excluding net loss on foreign exchange , loss on sale of assets, finance changes and provision made on debtors)	4,18,62,533	9,61,41,392	13,80,03,925
Depreciation	1,59,14,244	1,68,55,710	3,27,69,954
Total	16,43,01,666	20,91,27,519	37,34,29,185
As per TPO			36,75,94,111
Profit Before Tax	2,78,83,785	16,01,49,913	18,80,33,698

It is also clarified by the company that:

1) Blue ally division is an offshore and on limit consulting division and does jobs based on customers requirements and billing done on hourly basis.
2) XIUS-BCCIL is a product which caters the need of mobile software industries. This product is not readymade to the industry. It has to be customise to the requirement of each customer and pricing will be done accordingly.

The TPO in para 11 of the order and stated that a software development process is a structure imposed on the development of a software product. Synonyms include software life cycle and software process. These are several modes for such process even describing approaches to a variety or activities that take place during the process. In furtherance he also differential software development process or lifecycle.

a) Software product company
b) Software development company
c) Software customisable company
d) Software trading company

As regard to software customisation company buys software products in the form of license from third parties or uses its own software products for customisation to suit the requirements of the customer. In this case only right to use the software is passed on to the customers. But these may be companies which does only customisation based on the software products bought directly by the customers. In such situation customisation includes coding which in a way are a kin to software development service providers. Thus if a company is only into pure customisation, the same is also considered as a software development service providers.

M/s Megasoft limited vide letter dated 19-04-2010 clarified that XIUS-BCGI (product division) is a product which caters the needs of mobile software industries. This product is not ready made to the industry. It has to be customised to the requirement of each customer and pricing has been done accordingly. It indicate that company products are in the form of license from third parties and customised as per requirement of its customers, under these circumstances M/s Megasoft Limited as a service provider akin to software development services.

The A.R of the assessee stated that company has made extraordinary or supernormal profit of Rs. 34,62,63,000/- This figures nowhere appears in the financial statement furnished in the company. In fact operating profit of the comparable company is Rs. 18,80,33,698. Arm's length price is the basic foundations for determinations of income from international transactional. It is provided that any income arising from an international transaction would be determined by adopting the arm's length price as the basis disregarding transfer price recorded by the eternises concerned. The AR of the assessee stated that M/s Megasoft limited owns intellectual

property right and patents is however how far these influenced the International Transactions, no explanation has been furnished.

Further it is also stated that company hold opening invention of Rs. 3,20,26,000/- as on 31-12-2005 however no such figures appears at page 212 of the assessee's paper books. It is pertinent to note that in the annual report it is mentioned that (please refer column 12, page 215 of the assessee's paper book)

Quantitative details:

The company is in the business of development and maintenance of computer software. The development and sale of such software cannot be expressed in any generic unit. Hence it is not possible to furnish the quantitative details and the information required under paragraphs 3, 4 C and 4D of part II of schedule VI to the companies Act 1956.

Consumption particulars are given below:

Particulars	Year ended 31 Dec 2006 Rs. 000	Year ended 31 Dec 2005 Rs. 000
Computers and allied peripherals used for system integrations	51,259	64,821

From it reveals that the company is basically in the business of software development services. The facts stated above the TPO as well as the DRP has rightly computed operating profit margin considering both division i.e. consultancy division and product division. Thus the company satisfies the filter criteria adopted by the TPO hence cannot be rejected merely because extra ordinary or super normal profits, hence same may be retained as comparable.

ii) **KALS Info system limited**.

The TPO held that the company engaged in software development services. The software products constitute only 0.33% of its revenue and other income constitute only 0.7% of its revenue. Thus the revenues from software development services constitute almost 99% of the total operating revenues and it qualifies 75% revenues filter from software development, accordingly considered as comparable.

At the time of appeal hearing, the assessee's AR submitted written argument and in conclusion, it was urged that the company be not adopted as a comparable. In the alternative, an opportunity to cross examine the said company or authorised person was sought to test the information/data submitted.

The TPO and DRP have, however, considered this company as a comparables adopting the figures supplied in the reply to notice under section 133(6). In the reply to notice u/s 133(6), the company has contended that it is a pure software development company by stating that: (refer page 67 of the TP order):

> "The core of our business may be classified as that of Pure Software Development Service Provider."

The above is contrary to the factual information as available in the annual report of the company. In view of all the above, this company is not to be adopted as a comparable. Even otherwise, the opportunity of cross examination as requested was not granted.

However, it was the stand of the Revenue that on a perusal of the financial statement of KALS for year ending 31-03-2006, from it reveals that export receipt and other receipts disclosed as below:

	Rs.	
Application Software	1,93,29,198	97.54%
Other Receipts	3,61,192	1.82%
Training	1,25,949	.64%
Total	1,98,16,339	100%

Thus operating revenue consist software application, other receipts and training, same also appears in segmental information (please refer col-9 of notes on account). Further it also observed that auditors has not given quantitative details and corresponding amount in regard to purchase, production and sale of software products made during the year which requires as per part II of schedule VI to companies Act 1956. This clearly indicates that major revenue consist software development services. The auditor put remarks that "The Company is engaged in development of software and software products since its inception." This is general remarks put by the auditors in fact revenue for the year order consideration mainly from software development segment which constitute 97.54% of the total income . The A.R stated that the total turnover of KAL is Rs. 2.15 crores, and holds an inventory of Rs. 1.27 crores, however from the statement of account for year ending 31-03-2006 nowhere appears such figures(inventories the amount of Rs. 1.27 crores actually represents receivables. Debtors arising on rendering of software development services for evidence enclosed copy of statement of account as per annexure 'A'.

Thus, the assessee was giving misleading facts. In view of the facts discussed above, the TPO has rightly considered that the company is a

software development service provider and there is no merit in the assessee's contentions. The company's its letter dated 13-01-2009 clearly mentioned that "The core of our business may be classified as that of pure software development service provider" Thus company itself confirming being a software development service provider as such there is no question of major revenue from software products.

iii) TATA ELXSI LIMITED:

The TPO has order held that the TPO did not consider verticals or horizontals within the software industry. The turnover limit of the 100 crore is not accepted by the TPO and the functional difference has considered only the software development and service segment of the company, the RPT of the company is Rs. 8.39 crores and the segmental revenue of the company is 188.81 crores which constitute 4.4% of the sales. According to the TPO, the aforesaid company satisfies all the filters hence included as a comparable.

In written submission the assessee's AR concluded that:

"Hence even to judge our own performance we do not have a comparable company which is operating in all the areas we operate. Considering these facts, we feel it is not fair to use our financial numbers even to broadly compare the performance of any other company who we feel are not in any one of the complex segments we are operating". Despite such "warning" from the company, the same has been adopted as a comparable without rebutting the "warning" or conducting fresh investigation to disprove or discredit the limitation expressed.

Further Tata Elxsi Limited does substantial research and development and owns substantial intangibles. This fact is highlighted in the extracts of annual report of the

company. Based on all the above, it is submitted that this company should be rejected as comparable."

Similar submission also made before the TPO and considered the assessee's objections. The TPO have also asked information by issue of notice u/s 133(6) of the Income Tax Act and in compliance, M/s Tata Elxsi Limited clarified that product development services mainly develops software for customers who look for solution through embedded software.

Innovations design engineering provides products, design and engineering for automotive consumer goods and electronics enclosures. It delivers concept of now products though computers models, using a team of highly specialised industrial designers and graphics specialists and generals 3D CAD models and specification for products.

Visual computing labs order takes contests development and animation services using commercial and proprietary high end software for graphics, animation and image/video editing content or edit existing content to add special effects as specified by customers, using very high end computers and software.

As per financial statement segmental revenues disclosed as under:

Particulars	System integration and support (Rs. 000)	Software development and services(Rs. 000)
Revenues	4,733.42	18,882.42
Identifiable operating expenses	4,032.86	14,835.21
Segmental opening income	700.56	4,047.21

M/s Tata Elxsi Limited furnished the segmental revenue i.e. software development services for F.Y. 2005-06 as under:-

	Rs.
Sales	18,881.25
Other income	1.17
Total	18,882.42
Cost of sales	435.33
Personnel expenses	10,676.21
Administration expenses	3,058.91
Depreciation	620.43
Total	14,790.59
PBIT	4,091.53

PBIT after excluding exchange loss and interest.

Thus company has furnished segmental revenues and expenses. Merely because expenses from cash of the sub-activities are not available tantamount for rejection. In the directors report, company's operations are broadly classified into two business segments i.e. software development and services and systems integrations and support (please refer column 1 of director's report) and break up of both segment discussed above. Thus the assessee contention on this point is not tenable. Considering financial statements are segmental information furnished by M/s Tata Elxsi Limited and based on the same data, the TPO has computed operating profit on operating cost. In the light of facts stated above the TPO has rightly retained as a comparable.

iv) ACCEL TRANSMATIC LTD

Finding of the TPO is that the company has two divisions under the software services segment. The two divisions are (1) Ushus technologies dealing in software development concentrating on embedded software network system, imaging technology and outsourced product development and

(2) Accel animation studios- software services for 2D/3D Animations, Special effects creation and Game Asset Development. Though the animation services are in the nature of IT enabled services, the fact is that the division did not start its operating during the F.Y 2005-06.

From the software segment qualifies the employee cost filter as the segmental employee cost is Rs. 268.05 lakhs on the segmental revenues of Rs. 802.05 lakhs i.e. 33.30% on revenues. Thus the software segment qualifies the employee cost filter as the same is applied on the segment and not on each of the undertaking which make include inter-transfer that might not be reflected in the above unit wise. Holding thus considered as comparable.

i) "The assessee in its written submission contended that:-

4.3. On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different form 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 directed the Assessing Officer to exclude ACCEL Transmatic Ltd., form the final list of comparables for the purpose of determining TNMM margin."

Based on the above, the appellant submits that Accel Transmatic Limited should be rejected as comparable.

To refute the assessee's contentions, the Revenue has contended that on verification of relevant details reveal that the financial statement for the year 31-03-2006.

Sales income-income from operation:-

	Rs.	Rs.
Manufacture sales	43,143,255	
Trading Sales	71,758,548	
Total		114,901,803
Service income		
Maintenance and repairs services	25,341,956	
Training and education services	76,302,823	
Software services		
Domestic	24,705,319	
Export	55,500,099	
Total		181,850,197
Grand Total		296,752,000

M/s Accel Transmatic Ltd vide its letter dated 27-01-2009 clarified in regard to Ushus technologies that (kindly refer para 4 page 75 of paper book).

"Ushus Technologies is the technology division of M/s. Accel Transmatic Ltd that produces custom software development services to companies' world wide. Ushus technologies division services clients in offshore software development and on site consultancy"

From a clarification, it reveals that given by M/s.Accel Ushus Technologies division of Accel is exclusively software service division.

Further it is also contended that the IP Rights have been created/ developed by Ushus Technologies division and related cost of creation and transfer of IP Rights has also been recorded in this segment. In this context it is to be mentioned that the Accel is deriving revenues from manufacturing sales, trading sales and software development services, details of income each division is given above. Under schedule 16-B given the cost of sales of traded goods on which the cost of IP rights also embedded. It used

to receive royalty/on sale of software licenses not for the software services rendered to the off shore/on shore clients.

The A.R of the assessee submitted that out of service income to the tune of Rs. 18,18,50,157 rendered services to related parties amounting to Rs. 5,62,74,970, which constitutes 31% of the total services revenues. However as per statement account shows service income includes:

	Rs.
Maintenance and repairs services	25,341,956
Training and education services	76,302,823
Software services	80,205,618
Total	181,850,397

As per the schedule 'F' (page 73 of paper book) transaction with related parties would be Rs.5,62,74,970 shown against "Rendering of services" however there is no information appears towards software development services. Even though company has given segmental information (kindly refer column-20.15, based on these information, the TPO considered as comparable.

The fact discussed above Accel has rightly been retained as a comparable.

v) M/S MINDTREE CONSULTING LIMITED

The TPO has selected as a comparable since the company engaged in software development services and qualifies all the filters applied by her. As per final list of TPO's comparable M/s Megasoft having a turn over Just Rs. 56 crores and profit margin of 52.74%. Similarly M/s I Gate Global Solution Ltd having a turnover of Rs. 527 crores and profit margin only 15.61% even M/s Mindtree consulting Ltd. Having turnover of Rs. 448 crores has a profit

margin only 14.67%, thus the TPO held that there is no relationship between margin and turnover and, hence considered as a comparable.

In written argument the assessee stated that:-

> "As per the notes the Account (extract in page 87 of PB-II) Mindtree has entered into an agreement with the customers in December 2003 where by the warrant have been issued to the customer. The warrant can be converted into equity shares at an exercise price of Rs. 2 per share. A total of 8,266,777 warrants had been issued under this agreement. The customer can convert these warrants into equity shares based on revenue generated by the customers during the defined period and on fulfilling the conditions specified in the agreement.
>
> The issue price of Mindtree share was fixed at Rs. 425 per share as on the listing dated 7th March 2007. This provides an incentive of Rs. 423 per share to the customer. This is an indirect benefit to the customers to the tune of Rs.349.68 crores equity.

From the notes to accounts year ending 31-03-2006 reveals that as per agreement 82,66,777 warrants has been issued to the customer and same can be converted into shares at an exercise price of Rs. 2 per share, however there is no details available conversion of shares during the year. Even though how it influenced/factorised the international transaction with its AE owing to issue of warrants and conversion of shares remained unexplained. No such arguments were made before the TPO nor the DRP. It is to be noted that the margin of the comparable company on international transaction is relevant and not the AEs revenue in remunerated by assessee. The income from international transaction is computed having regard to ALP and nothing else. Therefore the arguments advanced by the assessee that the above strategy effectively moved the marketing expenditure from the profit and loss account to the balance sheet and is totally irrelevant because ALP is a deemed price.

The price is compared in the contest of margin profit of the assessee in relation to international transaction and not the share in the revenue of the AE. Thus what is relevant is the margin/profit of the assessee earned from international transaction and comparison with the uncontrolled transactions.

Hence there is no merit in this argument.

vi) INFOSYS TECHNOLOGIES LTD

While analysing the comparables the TPO observed that products revenue of the company for the F.Y. 2005-06 for Rs. 357 crores out of its operative revenues of Rs. 9028 crores i.e. 3.95% only to total operative revenue, thus more than 96% of its revenues are from software development services and accordingly qualifies filter of 75% from software development services.

The TPO further held that margins of the lesser known companies like M/s Accel Transmatic Ltd. 44%, M/s. KALS Info System 39.75%, M/s Megasoft Ltd. 52.74% are having same or better margins than Infosys which means that brand or size per se does not affect the margins though brand name may set higher turnover but it does not necessarily generate higher margin. The margins does not automatically indicate that the company charged premium over market for the services rendered, however the assessee did not produced any evidence except making statement that it charges premium over market for its services. Holding thus the TPO retained this company as a comparable.

The AR of the assessee argued in writing and the same is reproduced below:

"Infosys Technologies Limited is 443 times bigger than the appellant and is thus significantly dissimilar in size. For the reasons already detailed, Infosys Technologies Limited should not be accepted as a comparable. The Delhi Tribunal decision in the case of Agnity India Technologies Pvt. Ltd Vs Income-tax Officer ITA No. 3856 (Del)/ 2010 has held that Infosys Technologies limited cannot be compared with small companies having nominal turnover and bearing minimal risks".

Against the assessee's argument it was submitted that the observation of the TPO is that Infosys Technologies Limited engaged n software development services and brand name may get higher turnover but it does not necessarily would generate higher margin. The assessee has not demonstrated as to how the difference in turnover has influenced the result of the comparables it is accepted economic principle and commercial practice that highly competitive market condition one can survive and sustain only by keeping low margin but high turnover as held by the Hon'ble ITAT Mumbai "E" Bench in the case of M/s Symantec Software Solution Pvt. Ltd Vs ACIT(supra). Further, the assessee referring an article published in the Economic Times dated 12-01-2011 which show in general nature and no specific instance has been brought on record. Secondly article relates for the F.Y. 2010-11 where as transaction in question for F.Y. 2005-06 i.e. after five years and competitive market conditions also varies during the relevant period.

Thus, merely because profit margin is on the higher side cannot the reason for elimination as comparable; it is not the general rule to exclude the same unless specific fact has been added.

Relying on the judicial decision cited above the TPO has rightly chosen the comparable and the assessee argument in this regards deserves to be rejected, more so because the assessee itself considered as comparable

The AR of the assessee submitted list of 14 comparable, (Table-I) adopting turnover of Rs.1 Crore to Rs.500 crores based on NASSCOM and remaining comparable excluded on the please that turnover exceed Rs.500 crores as under:

Sl.No	Company Name	Sales (Rs. Crores)	OP to total cost%
1	Infosys Limited	9,028.00	40.38
2	Mindtree Consulting Ltd	448.79	14.67
3	Persistent systems Ltd	209.18	24.67
4	Sasken Communication	240.03	13.90
5	Flactronics Software System Limited	595.12	27.24
6	I Gate Global Solution Ltd (Seg	527.91	15.61

In this connection it is to be mentioned that comparable selected by the TPO is justified as discussed above and, hence, the assessee's plea for exclusion of comparable turnover basis is not justifiable.

Secondly operating profit to total cost computed by the assessee at 16.97% instead of 51.73 (as per DRP's direction) in respect of Megasoft Ltd. This point also discussed in the preceding paras, and, hence, the assessee's contention is objectionable. If margin of Megasoft be at 51.73% arithmetic mean as per

Table - 1 would be 19.71%
Table - 2 at 19.36% and as per
Table – 3 at 16.39%

Alternatively, the assessee listed 17 comparables based on turnover range Rs. 1 crore to 500 crores and in Table B 15 comparables after

excluding KALS, Tata Elxsi, Accel, Infosys Technologies and Mindtree also not acceptable as discussed in preceding paragraphs.

Relies on the case laws:

i) *Exxon Mobil Company India Pvt. Ltd Vs DCIT ITA No. 8311/mum/2010;*
ii) *Symantec Software Solution Pvt. Ltd Vs ACIT ITA No. 7894/mum/2010*

As held by the Hon'ble ITAT, Mumbai in the case of Symantec Software Solution Pvt. Ltd (supra) that in the case of hand, the assessee raised objections only because some of the comparables are having profit and also high difference in the turnover and not because of high or low turnover has influenced the operating margin of the comparables. All the objectives and contentions raised by the assessee are discussed above and the TPO as well as the DRP were justified in retaining as comparables.

APPELLANT'S COMPATEBLES:-

In the written submission the assessee submitted that certain comparables proposed by the appellant have been rejected by the lower authorities. The proposed comparables are:-

1) *Goldstone Technologies Pvt. Ltd.*
2) *TVS Infotech Ltd.*
3) *VMF Soft tech Ltd.*
4) *Visu International Ltd.*
5) *Visual Soft Technologies Ltd.*
6) *VJIL Consulting Ltd.*

Further it is also submitted that comparables selected by the assessee have not been factored in the analysis shown in three tables and if the analysis under any of the three tables are modified incorporating the above comparables, the result would be increasingly skew in favour of the appellant.

In this connection it was submitted that these comparables were not listed in the TP study documents maintain by the assessee. Even proposal for inclusion for aforesaid comparables also was not made before the TPO. Thus, no such matters were before the TPO. The proposal of comparables were before the DRP first time (please refer page- 348 to 356 of paper book-1 of the assessee filed before the DRP) since the comparables selected by the assessee not before the TPO, except VMF Soft tech Limited (please refer page -141 of paper book-1 of the assessee). Furthermore no analysis has been given by the assessee to determine whether comparables qualifies filter criteria adopted by the TPO. Therefore the same cannot be accepted at this stage; hence the assessee's contentions on this point may be rejected.

i Gate Global Solution Limited:

The assessee had raised contentions in computing margin in the case of M/s. iGate Global Solution Limited. It was submitted that use of information which is not available in public domain and sourcing the same through private mean and labelling it as information under section 133(6) is bad in law. It was also submitted that :-

> *Further assuming without admitting that this segmental information can be used, the assessee submits that the same is incomplete and improper. In the segmental data on page 98 of the Order, the operating profit (before depreciation) of the company has been arrived at Rs. 53,93,57,000/-. This amount tallies with the operating profit before depreciation as reflected in the company's audited financial statements. After this an addition to expenses has been made for depreciation and reduction from expenses has been made for "extraordinary expenses". The adjustment for "extraordinary expenses" for software service segment is Rs. 56,86,28,000/-. What are these "extraordinary expenses" is not detailed. The amount of "extraordinary expenses" is 10.77% of revenues. However no*

details on the nature of expense or reasons for treating this as "extraordinary expenses" are forthcoming. Further, from the audited financial statements of iGate it is clear that it has not treated any expense as "extraordinary expenses". Possibly, iGate has during the course of its own TP assessment claimed these expenses "extraordinary expenses". The TPO has possibly taken those margins for comparability purposes without detailing the reasons for treating the expenses as "extraordinary expenses". Accordingly, the assessee submits that these expenses should be considered as normal operating expenses.

The revised operating margin of iGate would then be as follows:

Description	*Amount(Rs. In 000s)*
Operating Revenues	*5,279,075*
Expenses debited to P&L Account	*5,135,006*
Less: Non-operating items	*-*
Operating Expenses	*5,135,006*
Operating Profit	*144,069*
Op Margin	*2.81%*

The assessee submitted that the revised operating margin of 2.81% percent on cost as computed above be considered for comparability purpose.

In this connection it was mentioned that originally the assessee itself had chosen aforesaid company as a comparable, however while issuing show-cause the TPO had not considered as a comparable. After receiving the company's letter in compliance to the notice u/s 133(6), the TPO examined the data, it found acceptable as comparable. Therefore issue of notice under said section cannot be construed bad in law.

From the segmental information available on financial statement for F.Y. 2005-06 in respect of M/s. i Gate Global Solution Ltd, reveals that operating cost consist, salaries and wages, selling and marketing, depreciation etc totalling to Rs. 5,13,50,06,000 which includes certain extra ordinary item like payment of deferred ESOP compensation of Rs. 25.93 crores bad debts

of Rs. 33.08 lakhs and also other miscellaneous expense which not relatable into the international transactions. The TPO has worked out extraordinary items after analysing the financial statement for the F.Y. 2005-06.

However, according to the assessee operating cost would be Rs. 5,13,50,06,000 (Rs. 4,56,63,78,000+5,68,628,000), resulting margin would be at 2.81%. Whereas TPO computed margin at 15.61% after considering extra ordinary items of Rs. 56,86,28,000, increased operating profit (segmental) by Rs. 71,26,97,000. Here it is to be mentioned that either extra ordinary items to be included to the segmental profit or excluded from the segmental operating cost there is no difference so far as the margin of the comparable. The facts discussed above the TPO has rightly computed margin at 15.61%. The DRP had also held that margin in respect iGate Global Solution has correctly been worked out by the TPO. In view of the above facts there is no merit in the assessee objections and the same may be rejected.

Ground No.10

The TPO and the DRP had rejected the assessee's claim of risk adjustment on the ground that the assessee failed to bring any evidence on the record to show that there exists any difference in the risk profile of the comparable companies vis-a-vis of the assessee. In order to take benefit of this adjustment information should be submitted along with details under rule 10D maintained by the assessee. Under s. 92D(I) of the Act provide that every person entering in to an international transaction is required to keep and maintain such information and document in respect thereof, as is being prescribed under rule 10D (I) of IT Rules. This rules required maintenance of a record of the analysis performed to evaluate comparable as well as a record of the actual working carried out for determining the ALP. Under rule 10D (4)

of the I.T. rules requires that the information and documentation to be maintained. Under rule 10D(1) should be contemporaneous as for as possible and should exist latest by the due date of filing of the return. The assessee admitted that they did not undertake any risk adjustment in the TP document report. In the absence of that comparability, it is difficult to make adjustment. As for as the decision of the ITAT is concerned, that relates to facts of the relevant cases. In a given circumstance, some estimate mark upon may not be applied for risk adjustment. The assessee ought to have demonstrated this factor before the TPO as well as before the DRP.

Rely on the following case laws.

- M/s. Marubeni India Private Limited Vs Addl. CIT ITA No 945/Del/2009.
- Symantec Software Solution Private Limited Vs ACIT ITA No/7894/Mum/2010
- Exxon Mobil Company India Pvt. Ltd Vs DCIT ITA No 8311/Mum/2010
- ADP (P) Ltd Vs. DCIT, ITA No 106/Hyd/2009
- Vedaris Technology (P) Ltd Vs. ACIT (2010) 131 TTJ (Del) 309
- M/s. Deloitte Consulting India Pvt. Ltd Vs DCIT
- ST Micro Electronics Pvt. Ltd Vs. CIT(A), ITA No 1806, 1807/Del/2008

In view of the facts as well as legal position discussed above, this issue raised by the assessee is devoid of merit and is liable to be rejected.

Benefit of 5 percent range.

In para-16 of the TPO's order held that proviso to s. 92C (2) was amended with effect from 01.10.2009 by introducing a clarificatory amendment. The second provision says that if arithmetical mean price determined is within +/-5% from price charged in the international transaction, the price charged by the tax payer has been treated as arm's length price. No adjustment would be made, if the arithmetical mean price falls beyond +/-5% from the price charged in the international transaction,

and then second proviso is not applicable. In such case, only the first proviso shall alone applicable as per which the arithmetical mean price shall be taken to be the arm's length price. Meaning thereby, the transfer pricing adjustment would be made only from arithmetical mean price. Thus according to the TPO, by virtue of amendment the +/-5% variation is allowable only the case of the price charged in the international transactions and not for the adjustment. The DRP also uphold the TPO's stands.

On the other hand, the assessee submitted that the proviso to sub- section (2) of section 92C as added by finance (No-2) Act 2009 is prospective in operation will be applicable only after 1.10.2009 therefore they prayed that the TPO may be directed to provide deduction of 5% from the ALP determined by him. It had placed reliance on a number of case laws:-

In this context, the Revenue had relied on the findings of the Hon'ble ITAT, Delhi in the case of M/s. Marubeni India Private Limited Vs Addl.CIT ITA No 935/DEL/2009. Similar view also taken in the case of -

- *DCIT Vs Global Vantadge Pvt. Ltd (2010-T10L-24-ITAT-DEL)*
- *DCIT Vs Bast India Ltd (41 SOT 10)*
- *M/s.Deloitte Consultancy India Pvt. Ltd Vs. DCIT ITA No 1084/Hyd/2010*
- *Exxon Mobil Company India Pvt. Ltd Vs DCIT ITA No 8311/Mum/2010*
- *ST Micro Electronics Pvt. Ltd Vs. CIT (A) ITA No.1806,1807/Del/2008*
- *ADP (P) Ltd Vs DCIT, ITA No 106/Hyd/2009*
- *Wrigley India (P) Ltd Vs. Addl. CIT, ITA No 5224/Del/2010, (2011) 62 DTR (Del) (Trib) 201*

The decisions cited above, support the TPO's view. Therefore the claim of the assessee on this issue deserves for rejection. In conclusion, the Ld. D R forcefully pleaded that the stand of the TPO and the DRP requires to be sustained.

In the rejoinder, it was submitted by the learned counsel for the assessee that on page 4 of the Note filed by the Ld. D.R, it is stated that the appellant did not raise the issue of cross examination before TPO/DRP. In this regard, the appellant submitted that it made specific request for cross examination before the TPO as well as DRP. It was submitted that the appellant's contention was also supported the Note of the Ld. DR (page 26) wherein the Ld. DR had extracted the submission of the appellant and acknowledged therein that appellant had requested for cross examination.

The Ld. D R (on pages 27 & 28 of the Note), it was stated that in case of KALS, Rs.1.27 crores which was contended by the appellant as inventory was actually receivable from customers. It was, further, contended by the Ld. D.R that the appellant was giving misleading facts. To counter this, it was submitted by the appellant that as per Annual Report of KALS Rs.1.27 crores was in fact inventory. Sundry debtors were separately mentioned in the Annual Report. This was clear from the annual report of KALS for FY 2005-06 wherein Rs.1.27 crores was reflected as inventory and sundry debtors were separately shown. The Ld. D.R'S contention that the appellant did not raise the issue of conversion of warrants in case of Mindtree before the TPO/DRP was also factually incorrect as the appellant had made submissions on this issue before the TPO as well as DRP.

7. We have duly considered rival submissions, diligently perused the relevant case records and also voluminous Paper Books furnished by the Ld. A.R. With due respects, we have also perused various case laws on which either party had placed their unstinted confidence.

The prime thrust and grievances of the appellant being:

(i) no reasonable opportunity of hearing provided by the Ld. TPO and during the hearing before the DRP, only one opportunity was afforded;

(ii) that the TPO had selected six companies in the order passed u/s 92CA of the Act as comparables in addition to those proposed in the notice without giving an opportunity to the appellant to present its objection(s)/comments;

(iii) Even under TNMM, considering turnover range of Rs.1 crore to Rs.200 crores and Rs.1 crore to Rs.500 crores and rejecting certain comparables selected by TPO, the appellant's transactions were at arm's length;

(iv) Six companies which did not even appear in the initial search list of the TPO were issued notice u/s 133(6) of the Act to collate information. The process adopted in issuing notice u/s 133 (6) of the Act was not detailed. The information obtained in response thereto had not been fully shared;

(v) Details of information were not given to the appellant and that the DRP had stated that was intentional;

(vi) Copies of subsequent notices u/s 133(6) of the Act issued by the TPO and replies received there-from were not given to the appellant, for which, DRP in its impugned orders stated that the same was not relevant and, hence, not required to be given'

(vii) Difference between replies received u/s 133(6) and annual reports have been tabulated by the appellant. No comments have been made on the same either by the TPO or DRP. No opportunity was extended as sought for to cross-examine in cases where replies u/s 133(6) of the Act have been relied upon; The DRP in its impugned order stated that the office of the TPO cannot be converted into an office granting opportunity of cross –examination to the appellant;

(viii) The appellant had made detailed submissions for rejection of KALS as comparable, however, the appellants submissions have not been commented either by the TPO or the DRP;

(ix) In the case of Megasoft, the TPO and the DRP have considered entity-wide margins on the ground that software product segment also consists software services and, therefore, at entity level software services were more than 75% of operating revenues. However, similar situation in the case of other comparables have been ignored. If at all

Megasoft was to be adopted as a comparable, the margin of the software segment may be used; &

(x) Benefit of 5% deduction in determining the arm's length price in accordance with proviso to s.92C of the Act not given.

7.1. After analyzing the submissions of rival parties and also deliberating the specific apprehensions of the appellant as narrated above, the matter has now been narrowed down for consideration to twin issues, namely:

(1) ***What is the data to be considered by the TPO at the time of determining ALP? &***

(2) ***Whether the appellant should have been given an opportunity to refute the material sought to be utilized by the TPO?***

7.2. As far as the data to be used by the TPO while determining the ALP was concerned, it is observed that it is covered by the provisions of rule 10D sub-rule 4 of the Income-tax Rules. Section 92 C provides that the arm's length price in relation to an international transaction shall be determined by any of the methods being the most appropriate method having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors for computing the ALP and also any other method as may be prescribed by the Board. S. 92D provides that (i) every person who has entered into an international transaction shall maintain and keep such information and documents in respect thereof; (ii) the Board may also prescribe the period for which the information and documents shall be kept and maintained; and (iii) the AO or the CIT (A) may, in the course of any proceeding under the Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof. Thus, it subscribes that the requirement is only to maintain and keep the information and

documents relating to international transactions so that they are available as and when required during any proceeding under the Act. The section does not provide that the information and documents are to be kept and maintained for a period of eight years. Rule 10-D (1) specifies the documents and information which are to be kept and maintained by the assessee and sub-rule 2 thereof provides that nothing contained in sub-rule 1 shall apply in a case where the aggregate value as recorded in the books of accounts, the international transactions entered into by the assessee does not exceed Rs.1 crore. Sub-rule 3 provides the supporting authentic documents which are to be kept and maintained and sub-rule 4 thereof provides that the information and documents specified under sub-rule 1 & 2 should as far as possible be contemporaneous and should exists latest by the 'specified date' referred to in clause-4 of s.92F. Clause 4 of s. 92F gives the definition of 'specified date' to have the same meaning as assigned to 'due date' in Expln. 2 below sub-section 1 of s.139. Explanation 2 to s.139 defines 'due date' in a case of a company to be 30th of September of the relevant assessment year, the assessee is supposed to maintain information and documents. After going through the above provisions of law, it is clear that the Act has not provided for any cut off date up-to which only the information available in public domain has to be taken into consideration by the TPO, while making the transfer pricing adjustments and arriving at arm's length price. The assessee as well as the Revenue is both bound by the Act and the rules there-under and, therefore, as provided under the Act and rules, they are supposed to be taking into consideration, the contemporaneous data relevant to the previous year in which the transaction has taken place. The assessee had strenuously argued that the provisions of s.92D and Rule 10D is defeated, if the TPO takes the data which is available in the public domain after the specified date and the ALP would be fluid and there would be no certainty for the same. We

are, however, not in agreement with the arguments put-forth by the Ld. A.R. The ALP has to be determined by the TPO in accordance with law and the Act provides that the TPO shall take into consideration the contemporaneous data. The assessee was only required to maintain the information and documents as may be necessary relating to the international transactions so that it can be made available to the TPO or the AO or any other authority in any proceedings under the Act. By providing a specified date in the Act, the obligation is cast upon the assessee to keep and maintain the documents for that period. But, it does not restrict the TPO from making enquiries thereafter for determining the correct ALP.

7.3 Having held so, we shall now glimpse at the next question, as to whether the TPO can make his own enquiries and call for information from various entities keeping the assessee in the dark. Under sub-sec. (3) & (7) of Sec. 92CA, the TPO is entrusted with all the powers under clauses (a) to (d) of sub-section (1) of 131 or sub-section (6) of s.133 to call for and gather any information as may be required. When the TPO is making the search for a relevant comparable, he can issue notices to the parties whom he considers as relevant to gather requisite information and on being satisfied with regard to relevancy of the material which can be used against the assessee only then the assessee has to be given an opportunity of presenting its objections, if any. Thus, the TPO need not inform the assessee about the process used by him for issuing the notices u/s 133(6) of the Act nor is he under any obligation to furnish the entire information to the assessee.

7.4. However, we are of the firm view that the principles of natural justice requires that when any information is sought to be used against the appellant, the appellant has to be given a reasonable opportunity of hearing on

that material. In the present case, the TPO had furnished all the information to the appellant in the form of CD and the appellant, after perusing the same, had submitted a detailed submission along with its objections for taking various companies as comparables. It was another matter, if the TPO had not considered the objections of the appellant judiciously. In such a case, it would be an error of judgment, but, not violation of principles of natural justice. The objections of the appellant were that certain companies have been taken into consideration by the TPO as comparables without affording the appellant an opportunity of furnishing its objections, if any, and also with regard to certain other companies, it had sought opportunity to cross-examine them, but, it has been observed that no such an opportunity has been extended to the appellant.

7.5. As recorded earlier, if any information is sought to be used against the appellant, the same has to be furnished to the appellant and thereafter, taking into consideration the appellant's objections, if any, only then can the TPO proceed to take a decision. If the appellant seeks an opportunity to cross-examine the parties concerned, the appellant shall be provided such an opportunity. It is only during a cross-examination that the appellant can rebut the stand of that particular party (company). As listed out earlier, the appellant had also brought out various defects in the additional comparables selected by the TPO and had brought out the striking differences between the functions of those comparables as compared to the appellant and also as to how the entire revenue of the appellant has been taken into consideration in spite of there being income from unrelated party transactions also. All these objections have been detailed in its written submission which has also been incorporated in this order in a summarized manner. It has been observed that the TPO had not considered those

objections while determining the ALP. Further, it was also the stand of the appellant that it should be given a standard deduction of 5% as provided under the proviso to s.92C (2) before making adjustments for the transfer price. To drive home its point, the appellant had placed strong reliance on the following decisions:

- *M/s. Sap Labs India Pvt. Ltd v. ACIT 2010-T II-44-ITT-BANG-TP;*
- *Philips Software Centre Pvt Ltd. 26 SOT 226;*
- *MSS India Private Limited 32 SOT 132*
- *Customer Services India (P) Ltd v. ACIT 30 SOT 486;*
- *Skoda Auto India Pvt. Limited v. ACIT 2009-TIOL-214-ITAT-Pune;*
- *Development Consultants P. Ltd v. DCIT 23 SOT 455;*
- *Sony India P. Ltd 315 ITR 150;*
- *Cummins India Limited v. DCIT ITA No.277 & 1412/PN/07;*
- *TNT India Pvt. Ltd v. ACIT 10 Taxmann. Com 161;*
- *(10)Abhishek Auto Industries Ltd v. DCIT 2010-T II-54-ITAT, DEL-TP; &*
- *(11)Technimont ICB Pvt. Ltd v. ACIT 2011-T II-31-ITAT-MUM-TP*

7.6. On the other hand, the Ld. D R, placing strong reliance on the stand of the authorities below, submitted that 5% was not the standard, but, it was the range within which if the ALP fails, then, the ALP of the appellant has to be accepted. We have considered rival submissions and of the firm view that this issue has already been covered by the decisions which have been relied on by the appellant.

7.7. Turnover Filter : As regard the assessee's objection of TPO adopting infinity figures for upper limit turnover for the selection of comparables, we find that the issue is squarely covered by the order of Bangalore Bench of Tribunal in the case of M/s Genisys Integrating Systems (India) Pvt. Ltd. The relevant finding of the Tribunal at para 9 reads as follows:-

> *"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.1.00 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 200.00 crores only should be taken into consideration for the purpose of making TP study".

In the instant case, the turnover of the company is in the range of 24 crores, therefore, the companies, which have turnover of Rs.1.00 crores to 200 crores alone should be taken into consideration for the purpose of making TP study.

7.8 In these circumstances, we are of the considered view that this issue requires to be remitted back to the file of the TPO for fresh consideration with the following directions:

(i) the operating revenue and the operating cost of the transactions relating to associated enterprises only shall be considered;

(ii) the comparables having the turnover of more than Rs.1 crore, but, less than Rs.200 crores only shall be taken into consideration;

(iii) all the information relating to comparables which were sought to be used against the appellant shall be furnished to the appellant;

(iv) the appellant shall also be extended an opportunity to cross-examine the parties whose replies were sought to be used against the appellant;

(v) to consider the objections of the appellant that relate to additional comparables sought to be adopted by the TPO and to pass a detailed order; and

(vi) to give the standard deduction of 5% under the proviso to s.92C(2) of the Act.

7.9. Before parting with, we would like to recall that most of the issues raised in this appeal with regard to TP study had also cropped up in the case of M/s. Genisys Integrating Systems (India) Pvt. Ltd v. DCIT in ITA No.1231 (Bang)/2010 dated: 5-8-2011 (Assessment Year 2006-07) wherein the Hon'ble Bench, after due consideration, had taken similar views.

8. With regard to deduction u/s 10A of the Act, it was contended by the appellant that the AO reduced Rs.5,27,929/- from the export turnover, however, the same has not been reduced from the total turnover. It was, further, submitted that what was reduced from export turnover should also be reduced from the total turnover.

8.1 The learned AR submitted that the issue in question is squarely covered by the judgement of the Hon'ble Karnataka High Court in the case of CIT v M/s Tata Elxsi Ltd. & Others (2011-TIOL-684-HC-KAR-II), Hon'ble Mumbai High Court in the case of CIT v Gem Plus Jewellery India Ltd. 330 ITR 175 and the order of the Special Bench in the case of ITO v M/s Sak Soft Ltd. 313 ITR 353. The learned DR was unable to controvert the submissions of the learned AR.

8.2. We have heard the rival submission and perused the material on record. The Hon'ble Karnataka High Court in the case of CIT v M/s Tata Elxsi Ltd. & Others had held that while computing the exemption u/s 10A, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The relevant finding of the Hon'ble jurisdictional High Court reads as follows:-

> *".....Section 10A is enacted as an incentive to exporters to enable their products to be competitive in the global market and consequently earn precious foreign exchange for the country. This aspect has to be borne in mind. While computing the consideration received from such export turnover, the expenses incurred towards freight, telecommunication charges, or insurance attributable to the delivery of the articles or things or computer software outside India, or expenses if any incurred in foreign exchange, in providing the technical services outside India should not be included. However, the word total turnover is not defined for the purpose of this section. It is because of this omission to define 'total turnover', the word 'total turnover' falls for interpretation by this Court;*

……..In section 10A, not only the word 'total turnover' is not defined, there is no clue regarding what is to be excluded while arriving at the total turnover. However, while interpreting the provisions of section 80HHC, the courts have laid down various principles, which are independent of the statutory provisions. There should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10A is a beneficial section which intends to provide incentives to promote exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the case of section 80HHC, the export profit is to be derived from the total business income of the assxcessee, whereas in section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. To the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. If the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in section 10A, there is nothing in the said section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. When the statute prescribed a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the

legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. Thus, there is no error committed by the Tribunal in following the judgements rendered in the context of section 80HHC in interpreting section 10A when the principle underlying both these provisions is one and the same".

8.3. The Hon'ble Mumbai High Court in the case of Gem Plus Jewellery India Ltd. (supra), in identical circumstances, held that since the export turnover forms part of the total turnover, if an item is excluded from the export turnover, the same should also be reduced from the total turnover to maintain parity between numerator and denominator while calculating deduction u/s 10A of the Act. The relevant finding of the Hon'ble Mumbai High Court reads as follows:-

"The total turnover of the business carried on by the undertaking would consist of the turnover from export and the turnover from local sales. The export turnover constitutes the numerator in the formula prescribed by sub-section (4). Export turnover also forms a constituent element of the denominator in as much as the export turnover is a part of the total turnover. The export turnover, in the numerator must have the same meaning as the export turnover which is constituent element of the total turnover in the denominator. The legislature has provided a definition of the expression "export turnover" in Expln.2 to s.10A which the expression is defined to mean the consideration in respect of export by the undertaking of articles, things or computer software received in or brought into India by the assessee in convertible foreign exchange but so as not to include inter alia freight, telecommunication charges or insurance attributable to the delivery of the

articles, things or software outside India. Therefore in computing the export turnover the legislature has made a specific exclusion of freight and insurance charges. The submission which has been urged on behalf of the revenue is that while freight and insurance charges are liable to be excluded in computing export turnover, a similar exclusion has not been provided in regard to total turnover. The submission of the revenue, however, misses the point that the expression "total turnover" has not been defined at all by Parliament for the purposes of s.10A. However, the expression "export turnover" has been defined. The definition of "export turnover" excludes freight and insurance. Since export turnover has been defined by Parliament and there is a specific exclusion of freight and insurance, the expression "export turnover" cannot have a different meaning when it forms a constituent part of the total turnover for the purposes of the application of the formula. Undoubtedly, it was open to Parliament to make a provision which has been enunciated earlier must prevail as a matter of correct statutory interpretation. Any other interpretation would lead to an absurdity. If the contention of the Revenue were to be accepted, the same expression viz. 'export turnover' would have a different connotation in the application of the same formula. The submission of the Revenue would lead to a situation where freight and insurance, though these have been specifically excluded from 'export turnover' for the purposes of the numerator would be brought in as part of the 'export turnover' when it forms an element of the total turnover as a denominator in the formula. A construction of a statutory provision which would lead to an absurdity must be avoided. Moreover, a receipt such as freight and insurance which does not have any element of profit cannot be included in the total turnover. Freight and insurance charges do not have any element of turnover. For this reason in addition, these two items would have to be excluded from the total turnover particularly in the absence of a legislative prescription to the contrary – CIT v Sudarshan Chemicals Industries Ltd. (2000) 163 CTR (Bom) 596: (2000) 245 ITR 769 (Bom) applied; CIT v Lakshmi Machine Works (2007) 210 CTR (SC) 1: (2007) 290

ITR 667 (SC) and CIT v Catapharma (India) (P) Ltd. (2007) 211 CTR (SC) 83: (2007) 292 ITR 641 (SC) relied on"

8.4. In the case of Sak Soft Ltd. (supra), the assessee was engaged in the business of exporting computer software and claimed deduction u/s 10B of the Act. In completing the assessment u/s 143(3) of the Act, the AO reduced the expenditure incurred in foreign exchange in providing the technical services outside India, from the export turnover without corresponding reduction from total turnover, thereby reducing the deduction claimed by the assessment u/s 10B of the Act.

8.5. In light of the above facts, the Special Bench held as under:-

"For the above reasons, we hold that for the purpose of applying the formula under sub-section (4) of section 10B, the freight, telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or the expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula. The appeals filed by the department are thus dismissed".

Although the order of Special Bench is in the context of section 10B of the Act, the ratio laid down in the above decision applies to section 10A of the Act as well, as the provisions of sections 10A and 10B are identical on all material aspects. More particularly, both the sections define only export turnover but not total turnover and sub-section (4) of both the sections prescribe an identical formula for computing the export profits.

8.6. Therefore, we direct that Rs.5,72,929/- should be reduced not only from export turnover but also from the total turnover while computing deduction u/s 10A of the Act.

9. The issue of levying of interest u/s 234B and u/s 234D of the Act is mandatory and consequential in nature and, therefore, it has not been addressed to.

10. In the result, the appellant's appeal is treated as partly allowed for statistical purposes.

Order pronounced in the open court on 27th day of January, 2012

Sd/-	Sd/-
(N BARATHVAJA SANKAR)	(GEORGE GEORGE K)
VICE PRESIDENT	JUDICIAL MEMBER

Copy to:-

1.The Revenue 2. The Assessee 3. The CIT concerned 4. The CIT(A) concerned 5. The DR 6. GF

MSP/- By Order

Asst. Registrar, ITAT, Bangalore.