

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

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

IT(TP)A No.52/Bang/2016
Assessment year: 2011-12

M/s. LG Soft India Pvt. Ltd., Embassy Tech Square, Marathahalli Sarjapur Outer Ring Road, Marathahalli, Bangalore – 560 103. PAN: AAACL 3009P	Vs.	The Deputy Commissioner of Income Tax, Circle 4(1)(1), Bangalore.
APPELLANT		RESPONDENT

IT(TP)A No.97/Bang/2016
Assessment year: 2011-12

The Deputy Commissioner of Income Tax, Circle 4(1)(1), Bangalore.	Vs.	M/s. LG Soft India Pvt. Ltd., Bangalore – 560 103. PAN: AAACL 3009P
APPELLANT		RESPONDENT

Appellant by	:	Shri K.R. Vasudevan, Advocate
Respondent by	:	Shri Pradeep Kumar, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	30.07.2020
Date of Pronouncement	:	05.08.2020

ORDER

Per N.V. Vasudevan, Vice President

IT(TP)A No.97/Bang/2016 is an appeal by the revenue while IT(TP)A No.52/Bang/2016 is an appeal by the assessee. Both these appeals are directed against the final order of assessment dated 30.11.2015 of DCIT, Circle 4(1)(1), Bengaluru, passed u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [the Act] in relation to assessment year 2011-12.

2. The main issue to be decided in this appeal is with regard to the correctness of the determination of Arm's Length Price [ALP] in respect of international transaction entered into by the assessee with its Associate Enterprise [AE]. The assessee is an Indian company and is a 100% owned subsidiary of LG Electronics, South Korea. The assessee provides software development [SWD] services to its AE. It was not in dispute that the rendering of SWD services by the assessee to its AE is an international transaction and that the income arising from the said international transaction has to be determined keeping in view the ALP as is required u/s. 92 of the Act.

3. It is not in dispute between the Assessee and the revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for determination of ALP and that the profit level indicator to be adopted for comparison of the Assessee's profit with that of comparable companies was Operating Profit/Total Cost (OP/TC). The OP/TC of the Assessee was 14.20%. The Assessee in its TP study selected 13 comparable companies whose arithmetic mean of OP/TC was arrived at 13.71%. Since the profit margin of the Assessee was more than the arithmetic mean of OP/TC of the 13 comparables selected by the Assessee, it was claimed by the Assessee that the price charged by it in

the international transaction was at Arm's Length. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred by the AO, accepted 2 (Acropetal Technologies Ltd., and R.S. Software India Ltd.) out of the 13 comparable companies suggested in the TP study by the Assessee as comparable with the Assessee. The TPO on his own selected 11 other companies as comparable companies with the Assessee. Thus a final set of 13 comparable companies was chosen by the TPO as comparable companies. The arithmetic mean of profit margin of these companies after and before adjustment towards working capital adjustment was as follows:-

Sl. No.	Name of the company	Margin on Cost (2011)	Adjusted Margin
1.	Acropetal Technologies Ltd.	4.58%	30.32%
2.	e-Zest Solutions	21.03%	20.96%
3.	E-Infochips Ltd.	56.44%	56.68%
4.	Evoke Technologies Ltd.	8.11%	10.42%
5.	ICRA Techno Analytics Ltd.	24.83%	24.68%
6.	Infosys Ltd.	43.39%	44.51%
7.	Larsen & Toubro Infotech Ltd	19.83%	21.85%
8.	Mindtree Ltd. (Seg)	10.66%	11/62%
9.	Persistent Systems & Solutions Ltd.	22.12%	23.10%
10.	Persistent Systems Ltd.	22.84%	23.52%
11.	R S Software India Ltd.	16.37%	18.32%
12.	Sasken Communication Technologies Ltd.	24.13%	26.31%
13.	Tata Elxsi Ltd.	20.91%	20.96%
	Arithmetic Mean	24.82%	25.24%
	Less: Working Capital Adjustment	- 1.02%	
	Adjusted Arithmetic Mean	25.84%	

4. Based on the above, the TPO determined the Average arithmetic profit margin of comparable companies to be 24.82% and hence proposed the transfer pricing adjustment of Rs. 23,50,98,339 as follows:

Computation of arm's length price

Arm's Length Margin	24.82%
Less: Working Capital Adjustment	- 1.02%
Adjusted arithmetic mean PLI (A)	25.84%
Operating Cost (B)	2,02,00,61,707
ALP [125.84% of B]	2,54,20,45,652
Price Received	2,30,69,47,313
Shortfall being adjustment u/s. 92CA	23,50,98,339

5. The AO incorporated the addition to total income of the assessee on account of shortfall in ALP in his draft assessment order. The assessee filed objections before the Disputes Resolution Panel (DRP) against the draft order of assessment.

6. The DRP excluded 10 out of 13 comparable companies selected by the TPO and retained three comparable companies viz., Persistent Systems & Solutions Ltd., Sasken Communication Technologies Ltd. & Persistent Systems Ltd. The AO passed final order of assessment in accordance with the directions of the DRP. Aggrieved by the final order of assessment excluding 10 comparable companies, the revenue has filed the present appeal before the Tribunal and the grounds of appeal reads as follows:-

“1. The directions of the Dispute Resolution Panel are opposed to law and facts of the case.

2. The Hon'ble DRP is correct in holding that M/s Acropetal Technologies Ltd, E-Zest Solutions Ltd, E-Infochips Ltd, ICRA Techno Analytics, Infosys Technologies Ltd, Larsen & Toubro Infotech Ltd, RS Software, Evoke Technologies, Mind tree Ltd, & Tata Elxsi cannot be taken as comparables, being functionally different when it satisfies all the qualitative and quantitative filters applied by the TPO.

3. The Hon'ble DRP Bangalore, instead of relying on decision of ITAT, ought to have decided the comparability of these companies on the basis of specific facts brought on record by the TPO in the case of the assessee.

4. Whether a comparable may be considered as engaged in Software product business merely because it has developed software product by following software development process without having legal ownership on such software product?

5. Whether while seeking the exact comparability as mentioned above the DRP was right in fact and in law in imposing condition beyond law where the requirement of law is to acknowledge only those differences that are likely to materially affect the margin.

6. Whether the DRP was right in seeking exact comparability while searching for comparables companies of the assessee under TNMM method whereas requirement of law and international jurisprudence require seeking similar comparable companies.

7. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.”

7. As far as the assessee's appeal is concerned, the assessee has raised as many as 16 grounds of appeal against the adjustment on account of determination of ALP in the final order of assessment. However, at the time of hearing of appeal, the Id. counsel for the assessee pressed for adjudication of only grounds No.13 & 15, which read as under:-

“13. The learned AO/learned TPO erred in including companies that do not satisfy the test of comparability. Specifically, the following company should have been rejected:

- 1) Persistent Systems and Solutions Limited
- 2) Sasken Communications Technologies Limited
- 3) Persistent Systems Limited

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15. The learned AO erred in rejecting companies as per the directions of the Hon'ble DRP which are otherwise acceptable to both the Appellant and the learned TPO:

- 1) R S Software (India) Limited
- 2) Evoke Technologies"

8. Out of 10 comparables that were excluded by the DRP, the assessee and the revenue seek inclusion of R S Software India Ltd. and Evoke Technologies Ltd. in Gr.No.2 of the grounds of appeal by the revenue and ground No.15 of the grounds of appeal by the Assessee in its appeal. The Id. counsel for the assessee and the revenue has no objection for inclusion of the aforesaid two companies and hence ground No.2 raised by the revenue and Gr.No.15 raised by the Assessee in respect of the aforesaid two companies is allowed.

9. Apart from the above, the assessee also expressed no objection to Mindtree Ltd. being included as a comparable and hence ground No.2 raised by the revenue in so far as inclusion of Mindtree Ltd. is concerned, is allowed.

10. With regard to the other 7 comparable companies, whose exclusion is challenged by the revenue in ground No.2 of its appeal, we find that exclusion of these comparables from the list of companies selected by the TPO had come up for consideration before the Bangalore ITAT in the case of *Electronic for Imaging (I) Pvt. Ltd. v. DCIT [2017] 85 taxmann.com 124 [Bang. Trib]. ; Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No.614/Mds/2016; DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137/Bang/2015; Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA No.696/Mum/2016* which are also decisions rendered in relation to AY 2011-12 in the case of a companies providing SWD services such as the assessee in the present appeal. It is also relevant to point out that the very same comparable companies chosen by the TPO in the present appeal

had been chosen by the TPO as comparable companies in the case of *Electronic for Imaging (I) Pvt. Ltd. (supra)*. The Tribunal in its order dated 14.7.2017 in the aforesaid case dealt with the comparability of these companies.

11. As far as **Acropetal Technologies Ltd.** is concerned, vide para 8 of the order of Tribunal in *Electronics for Imaging (I) Pvt. Ltd. (supra)*, exclusion of Acropetal was upheld on the ground that this company was into development of computer products. The Tribunal also held that L&T Infotech Ltd. had RPT at 18.66% and since the RPT was beyond the threshold limit of 15%, this company was directed to be excluded from the list of comparable companies. The Tribunal further excluded **Tata Elxsi Ltd.** from the list of comparables on the ground that this company was engaged in diversified activities and was not a pure SWD services provider such as the assessee. In para 9 of the aforesaid order, the Tribunal held **e-Infochips Ltd.**, was earning revenue both from the software services and software products and though the break-up of revenue from the two segments were available, but the break-up of Operating Cost and Net Operating revenue and segmental details were not available.

12. As regards **e-Zest Solutions Ltd.**, in the case of *Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No.614/Mds/2016*, this company was held to be engaged in Knowledge Process Outsourcing (KPO) and cannot be regarded as a SWD services company.

13. The Tribunal in the case of *DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137/Bang/2015* excluded the company, **ICRA Techno Analytics Ltd.**, on the ground that it was engaged in engineering and consulting services, besides licensing and sub-licensing and no segmental information was available to compare the margins of SWD services segment.

14. The Mumbai Tribunal in the case of *Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA No.696/Mum/2016* held **Infosys Ltd.** to be not comparable for the reason that this company was engaged in manufacturing of software products and was a giant company assuming various risks. As far as **Larsen & Toubro Infotech Ltd.**, is concerned, vide paragraph-8 page-16 of the order in the case of Electronics for imaging India Pvt. Ltd., (supra) this tribunal excluded this company on the ground of presence of onsite revenue of more than 50% and that the related party transaction was more than 15% (18.66%).

15. Respectfully following the aforesaid decisions, we uphold the exclusion of the aforesaid 7 companies from the list of comparable companies and ground No.2 raised by the assessee to this extent is dismissed. We may add that the other grounds raised by the revenue in its appeal are purely supportive of ground No.2 and are general grounds with no specific reference to instances of comparables excluded and hence dismissed.

16. Now we shall take up the appeal of the assessee. The assessee in ground No.13 seeks exclusion of 3 companies viz., Persistent Systems & Solutions Ltd., Sasken Communication Technologies Ltd. and Persistent Systems Ltd. Exclusion of these 3 companies was considered by the Tribunal in the case of *Electronics for Imaging (I) Pvt. Ltd. (supra)*. In para 8 of the order, this Tribunal held that Persistent Systems & Solutions Ltd. was a company engaged in SWD services and products with no segmental details and excluded it. Similarly, Persistent Systems Ltd. was also excluded on the ground that it was engaged in diverse activities with no segmental break-up. As far as Sasken Communication Technologies Ltd. is concerned, this Tribunal in the case of *Symantech Software & Services (I) Pvt. Ltd. (supra)* has excluded this company on the ground of functional

dissimilarity viz., dealing with multimedia products and R&D activities with no break-up of segmental information.

17. Following the aforesaid decisions, we direct exclusion of the aforesaid 3 comparable companies. The TPO is directed to compute the ALP of the international transaction in accordance with the directions given above in this order, after affording Assessee opportunity of being heard.

18. The only other ground that remains for consideration in the assessee's appeal on Corporate issue is ground No.17 which reads as follows:-

“17. The learned AO / learned TPO erred in ignoring the limited risk nature of the contractual services provided by the Appellant and in not providing an appropriate adjustment towards the risk differential, even when full-fledged entrepreneurial companies are selected as comparable companies.”

19. We are of the view that the grievance projected by the assessee in the above ground of appeal requires verification by the AO. Therefore the AO is directed to verify the claim of the assessee as projected in ground No.17 and give correct credit for advance taxes paid.

20. In the result, both the appeals by the revenue and the assessee are partly allowed.

Pronounced in the open court on this 05th day of August, 2020.

Sd/-
(B R BASKARAN)
ACCOUNTANT MEMBER

Sd/-
(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 05th August, 2020.

/Desai S Murthy /

Copy to:

1. The Revenue
2. The Assessee
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.