

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH: BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

IT(TP)A No.184/Bang/2016
Assessment Year: 2011-12

M/s. Galax E Solutions India Pvt. Ltd. Unit No.4, 8 th Floor, Innovator Block ITPL Whitefield Road Bangalore-560 066 And Sridhar & Brito Chartered Accountants No.82, Third Floor ST BED Koramangala 4 th Block Bangalore-560 034 PAN NO : AABCG9007F	Vs.	ITO Ward-3(1)(2) Bangalore
APPELLANT		RESPONDENT

IT(TP)A No.494/Bang/2016
Assessment Year: 2011-12

ITO Ward-3(1)(2) Bangalore	Vs.	M/s. Galax E Solutions India Pvt. Ltd. Unit No.4, 8 th Floor, Innovator Block ITPL Whitefield Road Bangalore-560 066 And Sridhar & Brito Chartered Accountants No.82, Third Floor ST BED Koramangala 4 th Block Bangalore-560 034
APPELLANT		RESPONDENT

Appellant by	:	Shri Brito B., A.R.
Respondent by	:	Shri Muzaffar Hussain, D.R.

Date of Hearing	:	15.10.2020
Date of Pronouncement	:	21.10.2020

ORDER

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

These cross appeals are directed against the assessment order dated 18-01-2016 passed by the assessing officer for assessment year 2011-12 u/s 143(3) r.w.s 144C of the Income-tax Act,1961 ['the Act' for short] in pursuance of directions given by Ld Dispute Resolution Panel (DRP).

2. The grounds urged by the assessee relate to the addition made towards transfer pricing adjustment

3. The revenue is in appeal in respect of following issues:-

- (a) Whether foreign exchange gains/loss are operating in nature or not?
- (b) Whether the Ld DRP was justified in directing the AO to follow the decision of Karnataka High Court rendered in the case of Tata Elxsi Ltd, i.e., exclusion of expenses incurred in foreign currency from both export turnover and total turnover.
- (c) Relief granted by Ld DRP in respect of addition made on account of transfer pricing adjustment.

4. The facts relating to the case are discussed in brief. The assessee company is wholly owned subsidiary of M/s Galax E Solutions Inc. It is providing software development services to its AE relating to internet client-server, more particularly it offers:-

1. Independent verification and validation.
2. Enterprise Application Integration
3. Enterprise shared services implementation
4. Enterprises IT solutions
5. Services level management
6. Enterprise reliability framework
7. Technical support.

The TPO has made transfer pricing adjustment in respect of Provision of software development services only.

5. Both the parties are in appeal in respect of addition relating to Transfer pricing adjustment. The facts relating to the same are discussed in brief. The assessee has provided software development services to its Associated Enterprises (AEs). The turnover of the assessee in the segment of Provision of software development services was Rs.32.16 crores. The assessee adopted Transactional Net Margin Method (TNMM) as most appropriate method. It adopted Operating Profit/Operating Cost (OP/OC) as the Profit level indicator (PLI). The assessee declared a margin of 11.48% in the software development segment.

5.1 The assessee had selected 5 comparable companies in its transfer pricing study. The TPO rejected the transfer pricing study of the assessee and he finally selected following 13 comparable companies, whose average margin worked out to 24.82%:-

<i>Sl. No.</i>	<i>Name</i>	<i>Sales</i>	<i>Cost</i>	<i>PLI</i>
1	<i>Acropetal Technologies Ltd. (seg)</i>	<i>814,016,893</i>	<i>616,754,876</i>	<i>31.98%</i>
2	<i>E zest solutions (from Capitaline)</i>	<i>112866098</i>	<i>93255341</i>	<i>21.03%</i>
3	<i>E-infochips Ltd</i>	<i>260384251</i>	<i>166447527</i>	<i>56.44%</i>
4	<i>Evoke (from Capitaline)</i>	<i>144869912</i>	<i>133996568</i>	<i>8.11%</i>

<i>Sl. No.</i>	<i>Name</i>	<i>Sales</i>	<i>Cost</i>	<i>PLI</i>
5	<i>ICRA Techno Analytics Ltd. (in 000)</i>	<i>158401000</i>	<i>126894000</i>	<i>24.83%</i>
6	<i>Infosys Ltd.</i>	<i>253850000000</i>	<i>177,030,000,000</i>	<i>43.39%</i>
7	<i>Larsen & Toubro Infotech Ltd.</i>	<i>23318122096</i>	<i>19,764,861,289</i>	<i>19.83%</i>
8	<i>Mindtree Ltd. (seg)</i>	<i>8,783,000,000</i>	<i>7,937,143,242</i>	<i>10.66%</i>
9	<i>Persistent Systems & Solutions Ltd.</i>	<i>189,490,457</i>	<i>155,172,089</i>	<i>22.12%</i>
10	<i>Persistent Systems Ltd.</i>	<i>6,101,270,000</i>	<i>4,971,860,000</i>	<i>22.84%</i>
11	<i>R.S. Software (India) Ltd.</i>	<i>1,882,638,471</i>	<i>1,617,804,170</i>	<i>16.37%</i>
12	<i>Sasken Communication Technologies Ltd.</i>	<i>3,941,962,000</i>	<i>3,175,616,000</i>	<i>24.13%</i>
13	<i>Tata Elxsi Ltd. (seg)</i>	<i>3,581,985,000</i>	<i>2,962,533,352</i>	<i>20.91%</i>
	<i>AVERAGE MARGIN</i>			<i>24.82%</i>

After deducting working capital adjustment of 1.26%, the TPO arrived at adjusted margin of 23.56%. Accordingly, he made transfer pricing adjustment of Rs.4.38 crores.

5.2 The Ld DRP directed the AO/TPO to exclude following ten companies:-

- (a) Acropetal Technologies Limited
- (b) E-Zest Solutions Limited
- (c) E-infochips Limited
- (d) ICRA Techno Analytics Limited
- (e) Infosys Technologies Limited
- (f) Larsen & Toubro Infotech
- (g) Mindtree Limited
- (h) Tata Elxsi Ltd
- (i) Evoke Technologies Limited
- (j) R S software (India) Ltd

The Ld DRP upheld the selection of following three companies:-

- (a) Persistent Systems & Solutions Limited
- (b) Persistent Systems Limited
- (c) Sasken Communications Technologies Ltd

5.3 At the time of hearing, the Ld A.R pressed ground nos.1, 2, 5 and 7. Remaining grounds are dismissed as not pressed. The assessee has also raised an additional ground, which reads as under:-

“12. The DRP erred by rejecting Mindtree Ltd as a comparable which was selected by the TPO, stating that Mindtree Ltd undertakes ‘on site’ activities through its branches and therefore not comparable to the assessee company. This filter (on site) was neither used by the assessee nor by the TPO in selecting the comparables.”

The grounds and additional ground urged by the assessee seek exclusion of

- (a) Persistent Systems & Solutions Limited
- (b) Persistent Systems Limited
- (c) Sasken Communications Technologies Ltd

and inclusion of

- (a) R.S Software Ltd
- (b) Evoke Technologies Ltd
- (c) Mindtree Ltd.

5.4 The Ld A.R submitted that all his submissions are supported by the decision rendered by co-ordinate bench of Tribunal in the case of

- (i) M/s AMD India Private Limited vs. ACIT (IT(TP)A No.1487/Bang/2015
- (ii) M/s Applied Materials India Pvt Ltd vs. ACIT (IT(TP)A No.17/Bang/2016)

(iii) M/s L G Soft India P Ltd vs. DCIT (IT(TP)A
No.52/Bang/2016 dated 05th August, 2020)

5.5 The revenue is challenging the decision of Ld DRP in excluding all ten comparable companies listed earlier.

5.6 The Ld D.R submitted that the assessee has accepted R.S. Software before TPO and hence the Ld DRP was not justified in excluding the same. He further submitted that identical observations have been recorded by Ld DRP against E-zest Solutions and E infochips Ltd. Hence there is a confusion in the reasoning given by Ld DRP in respect of these two companies. Accordingly he submitted that these two companies may be restored to the file of Ld DRP. He submitted that the co-ordinate bench has excluded L & T infotech Ltd in the case of M/s L G Soft India P Ltd (supra). The reasoning given by Tribunal is mentioned in paragraph 11 and 14 of its order. However, these filters have not been applied by TPO in his order. Accordingly, he submitted that this company may be restored to the file of TPO. He further submitted that both TPO and DRP has not applied Turnover filter and hence the same should not be applied.

5.7 The Ld A.R, in the rejoinder, submitted that the assessee is now accepting for inclusion of M/s R.S. Software (India) Ltd, M/s Evoke Technologies Ltd and M/s Mind Tree Ltd. He further submitted that the remaining companies have been held to be not good comparable companies by hosts of case laws. Since the comparability of companies depends upon parity of facts and since the said aspect has been examined by the Tribunal, the decisions rendered by the Tribunal may be followed.

5.8 We notice that, out of the ten comparable companies excluded by Ld DRP, the assessee now seeks inclusion of three companies, viz.,

M/s Evoke Technologies Ltd, M/s R S Software (India) Ltd and M/s Mindtree Limited. Hence the grievance of revenue now remains with regard to the following seven companies only:-

- a) Acropetal Technologies Limited
- (b) E-Zest Solutions Limited
- (c) E-infochips Limited
- (d) ICRA Techno Analytics Limited
- (e) Infosys Limited
- (f) Tata Elxsi Ltd (seg)
- (g) Larsen & Toubro Infotech

5.9 We have heard rival contentions and perused the record. The Ld A.R submitted that all the above said companies have been directed to be excluded by the co-ordinate bench in the case of Applied Materials India P Ltd (supra) and also in the case of M/s LG Soft India P Ltd (IT(TP)A No.52/Bang/2016 and IT(TP)A No.97/Bang/2016 dated 05-08-2020. We notice that the co-ordinate bench, in the case of M/s LG soft India P Ltd (supra) has followed the decision rendered by another co-ordinate bench in the case of Electronic for Imaging (I) Pvt Ltd (2017)(85 taxmann.com 124). For the sake of convenience, we extract below the discussions made and the decision taken by the Tribunal in the case of L G Soft India P Ltd (supra):-

“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 IT(TP)A

Nos.52 & 97/Bang/2016 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.”

5.10 Following above said order of co-ordinate bench, we confirm exclusion of above said seven companies. Since the assessee has sought for inclusion of three companies out of the ten companies excluded by Ld DRP, viz., M/s Evoke Technologies Ltd, R.S software India Ltd, Mindtree Limited, the ground of revenue in respect of above said three companies are allowed.

5.11 In the appeal of the assessee, the assessee seeks exclusion of all the three companies retained by Ld DRP, viz., M/s Persistent Ltd, M/s Persistent Systems & Solutions Ltd and M/s Sasken Communications Ltd.

5.12 The above said three companies, viz., M/s Persistent Ltd, M/s Persistent Systems & Solutions Ltd and M/s Sasken Communications Ltd have been dealt by the co-ordinate bench in the case of LG Soft India P Ltd (supra) as under:-

“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 IT(TP)A Nos.52 & 97/Bang/2016 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.”

5.13 Consistent with the view taken by the co-ordinate benches in the above said cases, we direct exclusion of aforesaid three comparable companies.

5.14 Accordingly, we direct the AO/TPO to compute the ALP of the international transaction in accordance with the directions given above, after affording adequate opportunity of being heard to the assessee.

6. The revenue has raised a ground as to whether the Ld DRP was justified in directing the AO to follow the decision of Karnataka High Court rendered in the case of Tata Elxsi Ltd, i.e., exclusion of expenses incurred in foreign currency from both export turnover and total turnover.

6.1 The Hon'ble Supreme Court has settled this issue in the case of CIT vs. HCL Technologies Ltd (TS – 218 – SC -2018). The relevant observations made by Hon'ble Supreme Court are extracted below:-

“20) Even in common parlance, when the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover also. Otherwise, any other interpretation makes the formula unworkable and absurd. Hence, we are satisfied that such deduction shall be allowed from the total turnover in same proportion as well.

21. On the issue of expenses on technical services provided outside, we have to follow the same principle of interpretation as followed in the case of expenses of freight, telecommunication etc., otherwise the formula of calculation would be futile. Hence, in the same way, expenses incurred in foreign exchange for providing the technical services outside shall be allowed to exclude from the total turnover.”

Accordingly, following the decision rendered by Hon'ble Supreme Court, we uphold the order passed by Ld DRP on this issue.

7. The revenue is assailing the decision of Ld DRP in holding that the gain/loss arising on account of fluctuation in foreign exchange is operating income/expenses. We notice that the Ld DRP has followed the decision rendered by the Tribunal in the case of Sap Labs India (P) Ltd (2011)(44 SOT 156) and Cisco Systems Services BV (IT(TP)A No.270/Bang/2014) and accordingly held that the foreign exchange fluctuation gain/loss arising to the assessee on realization of trade debtors, payment to creditors etc were nothing but operation income. Accordingly, the Ld DRP has directed the AO to consider the foreign exchange fluctuation gain/loss as operating in nature both in the hands of the assessee and in the hands of comparable companies. Since the Ld DRP has followed the decision rendered by the Tribunal in this regard, we do not find any infirmity in its decision rendered on this issue.

8. In the result, the appeal of the assessee is treated as allowed and the appeal of the revenue is treated as partly allowed.

Order pronounced in the open court on 21st Oct, 2020

Sd/-
(George George K.)
Judicial Member

Sd/-
(B.R. Baskaran)
Accountant Member

Bangalore,
Dated 21st Oct, 2020.
VG/SPS

Copy to:

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

By order

Asst. Registrar, ITAT, Bangalore.