

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES 'I' NEW DELHI

BEFORE SHRI J.SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND
SHRI CHANDRAMOHAN GARG, JUDICIAL MEMBER

ITA NO. 5401/DEL/2012
ASSTT.YEAR: 2008-09

Pyramid IT Consulting Private vs Income Tax Officer,
Lmtied, 325, Tarun Enclave, Ward 14(4),
Pitampura, New Delhi.
New Delhi-110034
(Appellant) (Respondent)

Appellant by: Shri Ashutosh Mohan Rastogi, Adv.
Respondent by: Shri Peeyush Jain, CIT, DR & Yogesh Verma, CIT DR

O R D E R

PER CHANDRAMOHAN GARG, J.M.

This appeal has been preferred against the assessment order dated 26.9.2012 passed u/s 143(3) r/w section 144C in pursuance to the order of the Dispute Resolution Panel-II, New Delhi dated 20.7.2012 passed u/s 144C(v) of the Act.

2. In the beginning of the argument, ld. Counsel appearing for the assessee submitted that except ground no. 2.3 and 2.4, the assessee company does not want to press other grounds, therefore, except 2.3 and 2.4, other grounds are

dismissed as not pressed. The remaining ground for adjudication before us read as under:-

“That on the facts and circumstances of the case, and in law;

1. The assessment order passed by the Learned Assessing Officer ('Ld. AO') pursuant to the directions of Learned Dispute Resolution Panel ('Ld. DRP') is bad in law and void ab-initio.

2. The Ld. TPO/Ld. AO erred in enhancing the income of the Appellant by Rs 78,53,275 holding that the international transactions pertaining to its contract software development business segment do not satisfy the arm's length principle envisaged under the Act and in doing so have grossly erred in;

2.3 including certain 'companies that are not comparable to the Appellant in terms of functions performed, assets employed (or size) and risks assumed;

2.4 including certain companies that are functionally not comparable to the Appellant inasmuch as they have significantly high turnover, own significant intangibles and/ or own and develop software products whereas the Appellant is only a service provider as regards its captive contract software development services segment; ”

3. Brief facts of the case as per para 3 at page 3 of the DRP order read as under:-

“The assessee is engaged in providing Software Development and IT consulting services. It is a captive service provider and the entire revenue earned from the services is received from its various AEs. During the relevant year, the assessee undertook the following transactions:

<u>S.No</u>	<u>International Transaction</u>	<u>Value</u>
1.	Contract software development services	7,24,75,317
2.	Staffing Services (or also referred to as IT (Consulting services)	<u>6,97,70,977</u>
	Total Value of International Transactions	142,246,294

The assessee charges its AE on Full Time Equivalent basis (FTE) at the rate of US\$ 10 per hour. There is no dispute regarding the determination of Arm's Length Price(ALP) of the Staffing services. In respect of contract software development services, the assessee applied the Cost Plus Method (CPM) to benchmark its international transactions. However, the TPO rejected the method chosen by the assessee and used Transaction Net Margin Method (TNMM) for benchmarking the transactions and determination of ALP. During the course of hearing before the panel, the assessee did not dispute the method chosen by the TPO. i.e., TNMM.”

4. During proceedings before the TPO, the assessee had applied Cost Plus Method (CPM) for benchmarking above impugned international transaction of contract software development service providing (CSD segment) in the transfer pricing study. In response to TPO's request, the assessee undertook a fresh search based on Transactional Net Margin Method (TNMM) without prejudice and demonstrated its international transactions to be at arm's length based on TNMM. The TPO only adjusted the profitability of the "CSD segment" adjusting the international transaction pertaining to staffing service segment to be at arm's length. The TPO rejected the transfer pricing analysis furnished by the assessee and the TPO undertook a total adjustment of Rs.78,76,782/- from CSD segment by arbitrarily rejecting the same of the quantitative filters adopted

by the AO in the fresh search and also imposed additional filters for selection of comparables (TPO order page 21 and 22). The TPO held that the arm's length price on international transaction related to contract software development services was determined at Rs.8,03,52,100/- as against the declared receipt by the assessee amounting to Rs.7,24,75,317 and the TPO directed the AO to enhance the income of the assessee by Rs.78,76,782/-.

5. In pursuance to above directions of the TPO dated 31.10.2011, the AO passed a draft assessment order u/s 143(3) r/w section 144C of the Act dated 7.12.2011. The assessee was afforded an opportunity to file its objections before DRP-II, New Delhi and the assessee filed its objections on 5.1.2012 to the draft assessment order. The DRP, after consideration of the objections of the assessee, declined to interfere with the action and order of the TPO as well as in the draft assessment order and rejected the objections of the assessee by issuing directions to the AO u/s 144C(5) of the Act. The AO passed assessment order u/s 143(3) r/w section 144C of the Act on 20.9.2012 by adding the sum of Rs.74,18,897/- to the total income of the assessee being the difference between the transaction value and the ALP as computed by the TPO. Now, the aggrieved assessee is before this Tribunal with the grounds as reproduced hereinabove.

6. We have heard arguments of both the sides and carefully perused the relevant material placed on record. Ld. Counsel for the assessee mainly

contended that the DRP was not justified in accepting the following companies as suitable comparables and enhancing the income of the assessee by Rs.78,53,275/- by holding that the international transaction pertaining to its contract software development business segment do not satisfy the arm's length principle envisaged under the Act.

1. Infosys Ltd.
2. Kals Information Systems Ltd. (Seg)
3. Avani Cincom Technologies
4. Persistent Systems Ltd.
5. Quintegra Solution Ltd.
6. Tata Elxsi (Seg)
7. Lucid Software

7. Ld. Counsel further contended that the aforementioned companies have been included by the TPO/AO which are not comparable to the assessee company in the terms of functions performed/assets employed (or size) and risk assumed. Ld. Counsel further contended that the TPO/AO also erred in including aforementioned companies which are functionally not comparable to the assessee company inasmuch as they have significantly high turnover, significant intangibles and also own and develop software products and maximum companies incur heavy amount on Research & Development and

advertisement wherein the assessee is only a service provider as regards its captive contract software development service segment (CSD segment).

8. The contentions of the assessee company in regard to each impugned aforementioned seven companies may be summarised as under:-

i) **Infosys Limited**

9. Ld. Counsel of the assessee submitted that due to different functional profile, branding and intangibles and high turnover, the Infosys Ltd. is a giant company which is not a suitable comparable to the case of the assessee. Ld. Counsel has placed reliance on several decisions including decision of Agnity India Technologies Pvt. Ltd. in ITA No. 3856/2010, Telcordia Technologies India Pvt. Ltd. in ITA No. 7821/Mum/2011 and M/s Insilica Semiconductors India Pvt. Ltd. in ITA No. 1399(Bang)/2010.

ii) **Kals Information Systems**

10. Ld. Counsel of the assessee has submitted that there is a vast difference in the functional profile of Kals Information Systems in comparison to assessee's company functional profile and the same was specifically rejected due to different functional profile (sale of software product). Ld. Counsel has placed reliance on the decision of the Tribunal in the case of Bindview India P. Ltd. in ITA No. 1386/PN/10, M/s Trilogy E-Business in ITA No. 1054/Bang/2011, and

M/s CSR India Ltd. vs ITO in IT(TP)A No. 1119/Bang/2011, M/s LG Soft India Pvt. Ltd. vs DCIT in IT(TP)A No.1121/Bang/2011.

iii) AvaniCincom Technologies

11. Ld. Counsel of the assessee has submitted that Avani Cincom Technologies Limited has specifically rejected due to different functional profile. Ld. Counsel of the assessee has placed reliance on the decision of M/s Trilogy E-Business (ITA No. 1054/Bang/2011).

iv) Persistent Systems Pvt. Ltd.

12. Ld. counsel of the assessee submitted that Persistent Systems Ltd. deserves to be excluded by the same reasoning applying the comparable principles due to different personal profile in comparison to the assessee company. The Ld. Counsel elaborating arguments further contended that the annual report of the Persistent Systems Ltd. clearly states that the company develops and owns software products and also earns revenue from licensing of software products. Ld. Counsel placed reliance on the decisions of the coordinate benches of the tribunal in the cases of Bind View India P. Ltd. (supra), Trilogy E-Business (supra) and Telcordia Technologies India Pvt. Ltd. (supra) wherein this company has been held to be excludable from suitable comparables by applying comparability principles.

v) **Quintegra Solution Ltd.**

13. Ld. Counsel of the assessee further submitted that Quintegra Solution Ltd. be excluded due to different functional profile, high Ad-marketing spend and research and development and super normal growth as compared to the assessee company. Ld. counsel of the assessee placed reliance on the decision of Bangalore Tribunal in the case of M/s 3DPLM Software Solutions Ltd. vs DCIT in ITA No.1303/Bang/2012.

vi) **Tata Elxsi (Seg)**

14. Ld. Counsel of the assessee also contended that Tata Elxsi (Seg) is not a suitable comparable and the same was specifically rejected due to different nature of services, different profile and ownership of intangibles with significant R&D leading to development of intellectual property rights. The Id. Counsel pointed out that the “software development and service segment” of Tata Elxsi includes product design services which also includes design and development of Hardware & software, innovation design engineering and visual computing i.e. animation and special effect. The Id. Counsel further added that these activities are completely different from contract software services profile of assessee company. To support above contentions, Id. Counsel relied on the following decisions:-

- i) Telcordia Technologies India Pvt. Ltd. in ITA No. 7821/mum/2011
- ii) M/s Yodlee Infotech Pvt. Ltd. vs ITO in ITA No.1397/Bang/2010
- iii) M/s 3DPLM Software Solutions Ltd. vs DCIT (ITA No.1303/Bang/2012
- iv) Mentor Graphics (Noida) Pvt. Ltd. 112 TTJ 408

vii) Lucid Software Limited

15. Ld. counsel of the assessee lastly contended that Lucid Software was specifically rejected as suitable comparable due to different personal profiles as the company is a product company focussing on advanced non-destructive technologies and is actively involved in research and development with leading scientific and educational institutions. To support this contention, ld. Counsel of the assessee has placed reliance on the following decisions:-

- i) Telcordia Technologies India Pvt. Ltd. in ITA No. 7821/mum/2011
- ii) Virtusa (India) Pvt. Ltd. vs DCIT in ITA No. 1962/Hyd/2011
Hyderabad Tribunal
- iii) M/s 3DPLM Software Solutions Ltd. vs DCIT in ITA No. 1303/Bang/2012

16. Ld. Counsel of the assessee submitted that the assessee company is primarily engaged in providing Software Development and IT consulting services. Ld. Counsel further submitted that during financial year 2007-08, the

assessee was also entitled to avail benefits u/s 10A of the Act and made the necessary statutory filings with the Software Technology Park of India (STPI). On behalf of the assessee, it was further submitted that during relevant financial year in respect of its software services filing within CSD segment, the assessee provided contracts services to its Associated Enterprise (AE) i.e. Pyramid USA. Elaborating the functional profile of the assessee company, it was further submitted that the initial code design as well as specification for software development was to be carried out by the assessee and undertaken and provided by the AE Pyramid USA and the assessee merely undertakes contract software services in line with the detailed specifications provided by the Pyramid USA which include the content activities, time schedules, quality assurance etc. necessary to reach expected outcome/development/assignment.

17. Reiterating the assessee's objections before the DRP, ld. Counsel further contended that the assessee was responsible for development/coding and testing functions based on the functional specifications received from AE Pyramid USA on a sub-contract basis. Ld. Counsel further elaborated that owing to the captive nature operations of the contract software development in CSD segment, the assessee did not undertake any significant R&D or advertising/brand building and, therefore, also does not face any R&D and marketing related risk. Ld. Counsel vehemently contended that the international transactions undertaken by the assessee in CSD segment during relevant

financial year were duly reported in the accountant's report (Form No. 3CEB) and filed along with the assessee's return of income. Ld. Counsel submitted that the assessee had applied Cost Plus Method (CUP) for benchmarking the above transactions in the TP study but on the directions of the TPO, the assessee undertook a fresh search based on Transactional Net Margin Method (TNMM) and the assessee was able to demonstrate its functional transaction to be at arm's length based on TNMM without prejudice to the benchmarking method.

18. Ld. Counsel also contended that despite proper analysis furnished by the assessee, the TPO undertook impugned assessment from CSD segment by arbitrarily rejecting some of the quantitative filters adopted by the assessee in the fresh search and by imposing and adding uncomparable additional filters in the final set of comparables. Ld. counsel reiterated its arguments to the aforementioned seven comparables and submitted that the approach of the TPO in including impugned seven comparables was not justified and the DRP rejected the objections of the assessee at the threshold without any justified and cogent grounds. Ld. Counsel finally prayed that all seven irrelevant comparable deserve to be deleted from the final set of comparables and ALP may be based on proper comparables.

19. Replying to the above, ld. DR supported the action of the TPO, AO and the DRP and submitted that despite directions of the TPO, the assessee did not conduct fresh search in a proper manner and adopted irrelevant filters in the

fresh search. Ld. DR further contended that in this situation when assessee is not following the directions of the TPO in the fresh search, then the TPO had no option but to impose and add comparable additional filters to the final set of comparables. The DR has drawn our attention towards internal page 20 to 22 of the TPO order dated 31.10.11 (supra) and submitted that the TPO was right in directing the AO to enhance the income of the assessee by the difference between ALP (as per the assessee) and the ALP (derived by the TPO) of Rs. 78,76,782/-. The DR also contended that the assessee is merely challenging and alleging seven impugned comparables which were added by the TPO in the final set of comparables but the assessee is not able to substantiate that these are not suitable comparables as the facts and circumstances of every case are always different from another case. The DR also contended that the assessee could not demonstrate that the comparables adopted and added by the assessee in the fresh search were found to be suitable comparable for benchmarking the international transaction undertaken by the assessee in the CSD segment during the relevant financial year.

20. On careful consideration of above rival submissions and contentions and careful perusal of the relevant material placed on record, at the outset, we note that as per DRP order internal page 3, the assessee is engaged in providing contract software development and IT consulting services and assessee is a consultancy service provider and the entire revenue earned from the services

which are received from its various Associated Enterprises (AE). As per the order of the DRP, it is also undisputed that the assessee is a consultancy services provider and the entire revenue earned from the services which are received from its various Associated Enterprises. As per the order of the DRP, it is also undisputed that the assessee is a group company primarily engaged in providing contract computer software development services (CSD segment) and IT software services and assessee was also entitled to avail benefits u/s 10A of the Act and had made necessary statutory filings with the Software Technology Park of India (STPI).

21. From the order of the TPO, we also observe that the TPO did not dispute the receipt of the assessee from its AE i.e. Pyramid USA received towards staffing services/IT selling services but the TPO did not accept the receipt of the assessee from its AE towards production of contract development services (CSD segment) at arm's length and after framing final set of 15 comparables, including 7 impugned comparables, the TPO held that the assessee's international transaction related to provision of software development services are not at arm's length and directed the AO to enhance the income of the assessee by the different ALP (as per the assessee) and the ALP (derived by the TPO) amounting to Rs.78,76,782/- which is the heart and soul of the dispute in this assessee's appeal.

22. Now, we proceed to analyse suitability of impugned comparables as adopted and added by the TPO to the final set of comparables for benchmarking the ALP of the assessee's CSD segment received from this AE i.e. Pyramid USA.

Infosys Ltd.

23. Ld. Counsel of the assessee, relying on the decision of Coordinate Bench of the Tribunal in the case of Agnity India Technologies Pvt. Ltd. (supra), Telcordia Technologies India Pvt. Ltd. (supra), Insilica Semiconductors (supra), submitted that in the case of Agnity India Technologies Pvt. Ltd. which was also a contract software services providing company, the Tribunal found that the Tata Infosys Ltd. was not a suitable comparable due to different functional profile, substantial intangible assets and expenditure on advertising and marketing and due to high turnover and giant size of profile. Ld. DR replied that Infosys Ltd is also providing contract software development services and IT staffing services, therefore, the TPO was right in adding the same to the final set of comparables.

24. In the case of Agnity India Technologies Pvt. Ltd. (supra), it was held that Infosys and Agnity India (assesseees of that appeal) are not comparable at all as seen from the financial data etc. In the case of Telcardia Technologies (supra), the ITAT Mumbai held as under:-

“40. Mumbai Tribunal in case of Telcordia technologies India Pvt Ltd [ITA No. 7821 (mum)/2011] held [refer pgs45 - 46 of the compendium of Case Laws/ Commentary]

“”The parameter for identifying comparable entity has to be seen from the angle of functions formed by the company, size of the company in terms of the sales revenue, stage of business cycle and company's growth cycle. In the case of Infosys, there are huge intangible assets which as per the information provided by the learned AR are valued at Rs.69,552 crores, which comprises of brand value itself at Rs.22,915 crores. Based on such fund valuation, the profit of Infosys is predominantly due to its premium branding. It is India's No.2 software service exporter and Third in the world as an IT Service company. It is a giant company which is evident from its revenue fund from the sales which itself is more than Rs.13145 crores and expenditure on advertisement/sales promotion and expenditure on R & D is at Rs.69 crores and Rs.167 crores respectively, whereas in the case of the assessee the revenue is only 10.7 crores with no expenditure on advertisement, sales and promotion etc., which are borne by the associated enterprises.”

25. In view of above, we are of the considered opinion that Infosys is not a suitable comparable to the case of the present assessee i.e. Pyramid India because there is a vast difference between functional profile of Infosys and the assessee company. We also note that the assessee is only providing contract software development services and IT staffing services and, on the other hand, Infosys being a high turnover giant company having a different functional profile, along with huge expenses on advertising and marketing and having substantial intangible assets, cannot be held to be a suitable comparable for the assessee company which is only having turnover of Rs.7.24 crore from the contract software development services segment, hence, in our opinion, Infosys

Ltd., being significantly dissimilar in size, should not have been considered as suitable comparable to the assessee company.

KALS Information Systems

26. Ld. Counsel of the assessee, placing reliance on the decision of Bindview India P. Ltd. (supra), M/s Trilogy E-Business (supra), M/s CSR India Pvt. Ltd. vs ITO (supra) and M/s LG Soft India Pvt. Ltd. vs DCIT (supra), submitted that on perusal of information provided by Kals Information System in the annual report, it reveals that KALS is engaged in the business of software services, software products since its inception. Ld. Counsel further submitted that the main products of the company are Shine- ERP Software, Docuflo- Document Management Software, Dac4Cast, La Vision – Order Management Software, Virtual Insure- Integrated Software for Life & General Insurers, Aldon – Application Life Cycle Management Software, Consultant Management Sales System etc., therefore, KALS is not a suitable comparable to the assessee company. Ld. Counsel also pointed out that there is no segmental information about the segregation of profitability from sale of software products and provision of services is available in the annual report and public domain and, hence, KALS should be excluded from the final set of comparables. Ld. DR fairly accepted that besides software development services segment, KALS is also engaged in software products manufacturing and selling and no segmental

information of profitability from sale of products and from provision of services is available.

27. On careful consideration of above and in the light of ratio of the decision of Pune Bench of the Tribunal in the case of Bindview India P. Ltd. (supra), we observe that Kals Information Systems has been found functionally different from the software development services provider companies and KALS was rejected as a suitable comparable. The relevant operative part of the said decision of Pune Tribunal reads as under:-

"Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of IT enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds."

28. In view of above observations of the Coordinate Bench of the Tribunal and following the same, Bangalore Bench of the Tribunal in the case of M/s Trilogy E-Business (supra), also held that KALS is not a suitable comparable as this company was developing software products and was not merely, purely or mainly a software provider company and, thus, respectfully following the

decision of the Tribunal on the issue, we hold that the same company i.e. KALS Information Systems Ltd. is not found to be a suitable comparable to the case of the present assessee and, hence, KALS is directed to be omitted from the list of comparable companies adopted by the TPO in the final set of comparables.

Avani Cincom Technologies

29. Ld. Counsel further agitated that the TPO included Avni Cincom Technologies as a suitable comparable to the assessee but Avni Cincom was specifically rejected due to its different functional profile as it owns and sells software products like DEchange, CARMA, Central Reservation System (CRS), Biz Rule Engine, CotNetNuke technology etc.. Ld. Counsel further pointed out that no segmental information on income from provision of services and sale of products is separately available and, therefore, AvaniCincom Technologies should have been excluded by the TPO from the final set of comparables. Ld. DR supported the action of the TPO and submitted that the AvaniCincom, having a turnover of Rs.2.93 crore, is a suitable comparable to the assessee company having a turnover of Rs.7.24 crore. Ld. DR fairly accepted that the AvaniCincom owns and sells aforementioned software products and no segmental information is available in the public domain in regard to receipt from provision of software services and sale of software products about AvaniCincom Technologies.

30. On careful consideration of above submissions and from a bare reading of the decision of ITAT Bangalore in the case of M/s Trilogy E-Business (supra), we observe that following the decision of ITAT Mumbai in the case of Telcordia Technolgoies Ltd. vs ACIT(supra), it was held that AvaniCincom Technologies earns revenue from sale of software products and software services and in absence of segmental details and data, AvaniCincom Technologies cannot be considered as comparable to the assessee company who was providing contract software development services only. The relevant operative part of the decision of Bangalore Tribunal reads as under:-

“As far as this company is concerned, the plea of the Assessee has been that this company is functionally different from the assessee. Based on the information available in the company's website, which reveals that this company has developed a software product by name "DXchange", it was submitted that this company would have revenue from software product sales apart from rendering of software services and therefore is functionally different from the assessee. It was further submitted that the Mumbai Bench of the Tribunal to the decision in the case of Telcordia technologies Pvt. Ltd. v. ACIT - ITA NO.7821/Mum/2011 wherein the Tribunal accepted the assessee's contention that this company has revenue from software product and observed that in the absence of segmental details, AvaniCincom cannot be considered as comparable to the assessee who was rendering software development services only. ”

"We have given a careful consideration to the submissions made on behalf of the Assessee and are of the view that the same deserves to be accepted. The reasons given by the Assessee for excluding this company as comparable are found to be acceptable. The decision of ITAT (Mumbai) in the case of Telcordia Technologies Pvt. Ltd. v. ACIT (supra) also supports

the plea of the assessee. We therefore accept the plea of the Assessee to reject this company as a comparable."

31. On the basis of aforementioned discussion, we are of the considered opinion that the assessee company, having turnover of Rs.7.24 crore only, earns revenue from providing contract development services (CSD segment), staffing services/IT consultancy services and on the other hand, AvaniCincom Technologies owns and sells aforementioned software products and also provides software development services. In the absence of segmental information about profitability from sale of products and profitability from provision of software services, AvaniCincom Technologies being a product company cannot be used and added as suitable comparable for the assessee company. Hence, reasons given by the Id. Counsel for the assessee for excluding this company as comparable are found to be acceptable and we accept the plea of the assessee to reject AvaniCincom Technologies as a suitable comparable. We order accordingly.

Persistent Systems Ltd.

32. Ld. Counsel of the assessee further agitated that the TPO included Persistent Systems Ltd. as a suitable comparable in the final set of comparable but Persistent Systems Ltd. having turnover of Rs.382.877 cores with different functional profile is not a suitable comparable. Relying on the decisions of the Tribunal in the case of Bindview India (P) Ltd. (supra), M/s Trilogy E-Business and Telecordia India P. Ltd. (supra), Id. Counsel submitted that the annual

report of Persistent Systems Ltd. clearly states that the company develops and owns software products and earns revenue from licensing of software products. Ld. Counsel further submitted that as per annual report available in the public domain for financial year under consideration, the main products of the company are PaxPro, ChemLMS, ViewMOR-Mail Discovery Platform, Persistent Enterprise Community Portal, Enterprise Search –Exlead, Exploriments, e-2GMigrator-mail Migration, DriverCentral, TLALOC, CLAP-Cloud Based Load Testing and Performance Tool, Device Monitoring System (DMS) and eMee etc. The ld. Counsel further contended that in the absence of segmental information about profitability from sale of products and profitability from provision of services, this company should be excluded from the final set of comparables applying comparability principles enunciated in the aforementioned orders of the Tribunal.

33. Ld. DR, supporting the action of the TPO and DRP, submitted that the facts and circumstances of every case are different from another, therefore, arguments of the assessee are not acceptable. However, ld. DR fairly accepted that the turnover of the Persistent System Ltd. is more than Rs.200 crore and more than 50 times of assessee's turnover.

34. On careful consideration of above, we take note of the decision of ITAT Bangalore in the case of M/s 3DPLM Software Solutions Ltd. vs DCIT (supra), wherein following the principles enunciated in the decision of ITAT Mumbai In

the case of Telecordia Technologies Ltd. (supra), it has been held that Persistent System was engaged in the product development and product design services while the assessee of that case/appeal (M/s 3DPLM Software Solutions Ltd.) was a software development services provider. The Tribunal further held that in absence of segmental details/information about segregated income from both the segments, the company cannot be taken into account for comparability analysis and, therefore, Persistent Systems Ltd. ought to have been omitted from the final set of comparable. The relevant operative part of the order of Bangalore Bench in the case of 3DPLM Software Solutions Ltd. (supra) reads as under:-

"We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (supra) that in the absence of segmental details/information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems. Ltd. ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly."

35. Thus, on the basis of aforementioned discussion, we note that Persistent System Ltd., having turnover of more than Rs.200 crore and more than 50 times of the present assessee's turnover, cannot be said to be a suitable comparable for

benchmarking the international transaction of the assessee company which only provides contract software development services and staffing/IT Consulting Services because Persistent System Ltd. earns high profitability from sale of products and also from production of software development services but in absence of segmental details and information, this company cannot be taken into account for comparability analysis and we further hold that the TPO as well as the DRP were not justified in including the same to the list of final set of comparable for the purpose of valuation of ALP of the impugned international transaction of the assessee company. We direct the TPO/AO to delete the same from final set of comparables.

Quintegra Solutions Ltd.

36. Ld. Counsel of the assessee, relying on the decision of the Tribunal in the case of Bindview India P. Ltd. (supra), M/s Trilogy E-Business (supra) and M/s Telecordia India Pvt. Ltd. (supra), submitted that the TPO in the final set of comparables also included Quintegra Solution Ltd. which also found place in the final set of comparables at sl. No. 9 is also not a suitable comparable. Ld. counsel vehemently contended that as per annual report of the company, Quintegra develops and owns software products such as HBfx, HMIS and EduCampus etc. and in absence of segmental information about profitability from sale of software products and profitability from provision of software development services, this company cannot be held as a suitable comparable.

Ld. Counsel has also drawn our attention towards page no. 461 of the Paper Book-I of the assessee and submitted that the company experienced exceptionally and abnormally high growth of 514% in the revenue and 450% in the profit and, hence, the same cannot be a suitable comparable for the assessee company by the same reasoning and applying comparability principles enunciated in the aforementioned orders of the Tribunal.

37. Ld. DR replied that in absence of earlier data, exceptionally and abnormally high growth in revenue and in profit cannot be estimated. Ld. DR further contended that Quintegra Solution Ltd. also provides contract software development services, therefore, the same was properly included in the final set of comparables.

38. On careful consideration of above submissions, we observe that ITAT Bangalore in the case of M/s 3DPLM Software Solutions Ltd. (supra) has held as under:-

“We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details brought on record that this company i.e. Quintegra Solutions Ltd. is engaged in product engineering services and is not purely a software development service provider as is the assessee in the case on hand. It is also seen that this company is also engaged in proprietary software products and has substantial R&D activity which has resulted in creation of its IPRs. Having applied for trade mark registration of its products, it evidences the fact that this company owns intangible assets. The co-ordinate bench of this Tribunal in the case of 2417 Customer.Com Pvt. Ltd. (ITA No.227/8ang/2010 dt.9.11.2012) has held that if a company possesses or owns

intangibles or IPRs, then it cannot be considered as a comparable company to one that does not own intangibles and requires to be omitted from the list of comparables, as in the case on hand.”

39. At the outset, we note that the AR has not disputed the fact that Quintegra Solutions Ltd. experienced exceptional and abnormal high growth in revenue and in profit during relevant period and this company undertook significant R & D and incurred heavy expenditure on ad-marketing which was approximately 4% of its total sales. Ld. DR has also not disputed the fact that the company develops, owns and sells the aforementioned software products and segmental information about profitability from sale of software products and from software development services is not available. Under these circumstances, we are of the considered opinion that the contentions of the Id. Counsel of the assessee are acceptable because Quntegra Solution Ltd. is engaged in product engineering services and is not a purely software development service provider. As we have already mentioned that Quintegra Solutions Ltd. enjoyed exceptional and abnormal high growth of about five times in the revenue and in profit (pls. see page 461 of Paper Book -I of the assessee). The DR has also not disputed the fact that the company undertook significant R&D and incurred heavy expenditure on ad- marketing and spent approximately 3.73% and 4% of its sales respectively towards R&D and ad-marketing. Thus, Quintegra Solution Ltd. cannot be considered as a suitable comparable company for benchmarking of ALP of the impugned international transactions of the assessee i.e. Pyramid

IT India as undisputedly, present assessee company is primarily engaged in provision of contract software development services (CSD segment) and IT staffing services. Therefore, we are inclined to hold that the TPO was not justified in including Quintegra as a suitable comparable in the final set of comparables and we hold that Quintegra Solution Ltd. ought to have been omitted from the final set of comparables for the year under consideration. We order accordingly.

Tata Elxsi (Seg)

40. Ld. Counsel during the arguments also contended that Tata Elxsi, having turnover of Rs. 342.86 crore which is more than 50 times of assessee's turnover of Rs.7.24 crore during the financial year under consideration, is not a suitable comparable for benchmarking ALP of the impugned international transactions undertaken by the assessee with its AE. Ld. Counsel also contended that Tata Elxsi includes product design service which also include design and development of hardware and software and the activities of Tata Elxsi are completely different from contract software development service provider assessee company which also does not have intangible assets and does not incur any expenditure on R&D and advertising and marketing. Placing reliance on the various decisions of the Tribunal, including decision of ITAT Mumbai in the case of Telecordia Technologies Pvt. Ltd. (supra), ld. Counsel submitted that Tata Elxsi is engaged in development of niche product and development

services which is entirely different from the functional profile of the assessee and in absence of segmental details, the same cannot be held as a suitable comparable to the assessee company.

41. Ld. Counsel has also drawn our attention towards Paper Book -I of the assessee from page no. 486 to 519 and submitted that there is a vast difference in the functional profile of the assessee company and Tata Elxsi which is a technology arm of Tata Group which owns several intellectual property rights such as Multimedia IPs, Networking IPs, Semiconductor IPs etc. Ld. Counsel referring to the annual report available at page 487 of paper book -I submitted that Tata Elxsi undertakes significant R&D leading to development of IPRs and the company also has intangible assets worth Rs.11.86 crores as shown in its balance sheet which amount to 12% of its total net fixed assets, therefore, Tata Elxsi cannot be held as a suitable comparable and ought to have been rejected by the TPO due to different nature of services/IPRs/intangibles and R&D activity.

42. Ld. DR replied that although the turnover of Tata Elxsi is more than 200 crores and more than 50 times of assessee's turnover but there is no difference in the functional profile of Tata Elxsi with the assessee company as both are providing software development services. Ld. DR supported the order of the TPO and DRP and submitted that Tata Elxsi being an Indian company was a

suitable comparable and the TPO was justified in including the same to the final set of comparables.

43. From careful reading of the decision of ITAT Mumbai in the case of Telecordia Technologies India Pvt. Ltd. (supra), we observe that Tata Elxsi has been treated as not fit for comparability analysis for determining the ALP of the assessee of that appeal i.e. Telecordia Technologies India Pvt. Ltd. (supra) and the Tribunal directed to exclude the same from the list of comparables. The relevant operative part of the order of the Mumbai Tribunal (supra) reads as under:-

“Mumbai Tribunal in case of Telcordia technologies India Pvt Ltd [ITA No. 7821 (mum)/2011] [refer pg 48 of the compendium of Case Laws/ Commentary] held:

"From the facts and material on record and submissions made by the learned AR, it is seen that the Tata Elxsi is engaged in development of niche product and development services, which is entirely different from the assessee company. We agree with the contention of the learned AR that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties."

44. On vigilant consideration of above contentions, we observe that the Id. DR has not disputed the fact that Tata Elxsi, having turnover of more than Rs.

200 crore and more than 50 times of the assessee's turnover, also owns several intellectual property rights and intangible assets worth 11.86 crores which are 12% of its total net fixed assets. The DR has also not disputed the fact that the company undertook significant R&D leading to development of various intellectual property rights in the field of multimedia networking and semi conductors etc. In this situation, the assessee of the present case, having turnover of 7.24 crore without owning any intellectual property rights and intangible assets and without taking any R&D activities, cannot be held a suitable comparable.

45. We may also note that the comparability does not confine to the activities undertaken as per comparability principles enunciated by the ITAT Mumbai in the case of Telecordia Technologies (supra) and in the peculiar factum that the proposed comparable company having more than 50 times of assessee's turnover which is more than 200 crores supported by ownership of several intellectual property rights and intangible assets cannot be held as a suitable comparable for benchmarking the ALP of the impugned transactions of the assessee company which earns revenue of only R.s 7.24 crore confining its activities to contract software development services only, without having any intellectual property rights and intangible assets and without incurring any expenditure on R&D.

46. Accordingly, we are inclined to accept the contention of the Id. Counsel of the assessee that Tata Elxsi is not a suitable comparable and the same was wrongly included in the final set of comparables of the TPO and the DRP was also not justified in upholding the action of the TPO in this regard. Therefore, we order that Tata Elxsi should be excluded from the final set of comparables for the benchmarking of ALP of the international transaction with regard to contract software development services (CSD segment) of the assessee company. We order accordingly.

Lucid Software

47. Ld. Counsel of the assessee submitted that Lucid Software is a product company focussing on Advanced Non Destructive Testing (NDT) Technologies and is actively involved in Research and Development with leading scientific and educational institutions. Ld. Counsel further submitted that the main products of the company are Kovid-RT – Decision Support System for NDT and Muulam. He has drawn our attention towards pages 522 to 532 of the Paper Book-I of the assessee and submitted that no segmental information for profitability from sale of products and profitability from provision of services is separately available and, therefore, this company should be excluded from final set of comparables. Ld. Counsel has drawn our attention towards various decisions on the issue including decision of ITAT, Mumbai in the case of Telcordia Technologies India Pvt. Ltd. (supra) and submitted that this entity

cannot be considered for comparability analysis for determination of ALP in the case of present assessee as present assessee is purely involved in service sector.

47. Ld. DR replied that Lucid Software having turnover of only Rs. 2.31 crore with OP/TC of 14.61% is a suitable comparable for the present assessee. However, ld. DR has not disputed the fact that Lucid Software is actively involved in R&D and also has developed a software product named “Muulam” which is used for civil engineering structures and the product development expenditure itself is substantial.

48. On careful consideration of above submissions and rival contentions, at the outset, we note that ITAT, Mumbai in the case of Telcordia Technologies (supra) has held that if a company has employed heavy capital in development of product, then profitability in the sale of product would be entirely from the company who is involved in service sector only. The relevant operative part of this decision reads thus:-

“Looking to the fact that it has developed a software product named as "Muulam" which is used for civil engineering structures and the product development expenditure itself is substantial vis-a-vis the capital employed by the said company, this criteria for being taken as comparable party, gets vitiated. For the purpose of comparability analysis, it is essential that the characteristics and the functions are by and large similar as that of the assessee company and T.P. analysis/study can be made with fewest and most reliable adjustment. If a company has employed heavy capital in development of a product then profitability in -the sale of product would be entirely different from the company, who is involved in service sector.

Therefore, this company cannot be treated as having same function and profitability ratio.”

"In our view, due to non-availability of full information about the segmental details as to how much is the sale of product and how much is from the services, therefore, this entity cannot be taken into account for comparability analysis for determining arms length price in the case of the assessee."

49. In our considered opinion, Lucid Software has developed a software product named “Muulam” and for this purpose, the company has employed heavy capital in development of a specific product, then profitability in the sale of product would be certainly high in comparison to the company which is only involved in the service sector. We also note that full information about segmental details about profitability from sale of product and profitability from provision of software development services is not available separately. Therefore, Lucid Software cannot be taken into account for comparability analysis for determining ALP of impugned international transactions related to contract software development services of the present assessee. Accordingly, we are inclined to hold that the TPO grossly erred in including the Lucid Software as suitable comparable in the final set of comparables. Therefore, we reach to a conclusion that Lucid Software is not a suitable comparable for the purpose of determination of ALP of the impugned transaction of the present assessee and this entity deserves to be deleted from the final set of comparables. We order accordingly.

50. On the basis of foregoing discussion, we reach to a final conclusion that the TPO was not justified in including Avani Cincom Tehcnologies, Infosys Ltd., KALS Information System Ltd., Persistent Systems Ltd., Quintegra Solution Ltd., Lucid Software and Tata Elxsi (Seg) as a suitable comparable for the comparability analysis for the purpose of determination of ALP of the international transaction of the assessee pertaining to CSD segment as these companies are not a suitable comparable to the present assessee company in terms of functions performed, assets employed and risk assumed. We also hold that aforementioned all seven companies are functionally not comparable to the assessee inasmuch as some companies have significantly high turnover, own significant intangibles, own, develop and sell specific software products and some companies incur heavy expenditure on R&D and ad-marketing. On the other hand, the assessee company is only a service provider company as regards its captive contract software development service segment and assessee company is not incurring notable amount on R&D and ad-marketing and also not having any intangible assets and, hence, on the basis of foregoing discussion, we reach to a conclusion that the TPO was not justified in including these seven companies in the final set of comparables and all these companies deserve to be excluded from the final set of comparables. We order accordingly. Finally, ground no. 2.3 and 2.4 of the assessee are allowed.

51. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 11.12.2014.

Sd/-

(J.S. REDDY)
ACCOUNTANT MEMBER

Sd/-

(CHANDRAMOHAN GARG)
JUDICIAL MEMBER

DT. 11th DECEMBER, 2014
'GS'

Copy forwarded to:-

1. Appellant
2. Respondent
3. C.I.T.(A)
4. C.I.T. 5. DR

By Order

Asstt. Registrar