IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH: BANGALORE

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

IT(TP)A No.213/Bang/2021
Assessment Year: 2016-17

M/s. Hewlett Packard (India) Software Operation Pvt. Ltd. Survey No.192, Whitefield Road Mahadevapura Post Bangalore 560 048 **PAN NO : AAACH7164B**	**Vs.**	Deputy Commissioner of Income-tax Circle-3(1)(1) Bengaluru
APPELLANT		**RESPONDENT**

Appellant by	**:**	Shri Padam Chand Khincha, A.R.
Respondent by	**:**	Capt. Pradeep Arya, D.R.

Date of Hearing	**:**	03.10.2022
Date of Pronouncement	**:**	03.10.2022

O R D E R

PER CHANDRA POOJARI, ACCOUNTANT MEMBER:

This appeal by the assessee is directed against the final assessment order passed by the Deputy Commissioner of Income-tax, Circle-3(1)(1) dated 31.3.2021 u/s 143(3) r.w.s. 144C(13) and 144C(13) r.w.s.143(3A) & 143(3B) of the Income-tax Act,1961 ['the Act' for short]. The assessee has raised following grounds of appeal:-

Transfer Pricing

The grounds mentioned hereinafter are without prejudice to one another.

1.1. The learned Assessing Officer ('learned AO'), learned Transfer Pricing Officer ('learned TPO') and the Honourable Dispute Resolution Panel ('Hon'ble DRP') grossly erred in adjusting the transfer price by INR 1,18,75,36,269/- with respect to the international transactions undertaken by the Appellant, under section 92CA of the Income Tax Act, 1961 ("the Act").

1.2. The learned AO/ learned TPO/ Hon'ble DRP erred in rejecting the Transfer Pricing ("TP") documentation maintained by the Appellant by invoking provisions of sub-section (3) of section 92C of the Act.

1.3. The learned AO/ learned TPO/ Hon'ble DRP erred in rejecting the economic and comparability analysis undertaken in the TP documentation and in conducting a fresh comparability analysis by introducing various filters for the purpose of determining the Arm's Length Price ('ALP') of the international transactions thereby following a non-transparent approach.

1.4. The learned AO/ learned TPO/ Hon'ble DRP erred in selecting the companies only if the data pertaining to Financial Year ("FY") 2015-16 is available in the public databases.

1.5. The learned AO/ learned TPO/ Hon'ble DRP erred in applying different financial year ending filter while selecting the comparable companies thereby not considering the fact that the relevant data for the concerned financial year could be deduced from the corresponding financials.

1.6 The Learned AO/learned TPO/Hon’ble DRP erred in rejecting companies having employee cost filter less than 25% of total sales.

1.7 The learned AO/learned TPO/Hon'ble DRP erred in applying export earning filter of 75% of the total sales, leading to a narrower set of comparable companies.

1.8. The learned AO/ learned TPO/ Hon'ble DRP erred in considering bad and doubtful debts as non-operating in nature.

1.9. The learned AO/ learned TPO/ Hon'ble DRP erred in collating the information that are not publicly available using powers under section 133(6) of the Act.

1.10. The learned AO/ learned TPO/ Hon'ble DRP erred in law and facts in the methodology applied for computing Related Party Transactions ("RPT") filter.

1.11. The learned AO/ learned TPO/ Hon'ble DRP have erred in not allowing appropriate adjustments towards working capital differential existing between the Appellant vis-a-vis independent comparable companies.

1.12. The learned AO/ learned TPO/ Hon'ble DRP have erred in not allowing appropriate adjustment towards the risk difference between the Appellant vis-a-vis the comparable companies.

1.13. The Hon'ble DRP have erred in not accepting the fresh search submitted during TP proceedings for inclusion of additional comparable companies.

<u>Software Development Segment ("SWD")</u>

1.14. The learned AO/ learned TPO/ Hon'ble DRP have grossly erred in not rejecting the following companies:

Inteq Software Private Limited;
Larsen & Toubro Infotech Limited;
Nihilent Limited;
Persistent Systems Limited;
Infobeans Technologies Limited;
Aspire Systems (India) Private Limited;
Infosys Limited
Thirdware Solution Limited; and
Cybage Software Private Limited.

1.15 The learned AO/learned TPO/Hon’ble DRP have grossly erred in rejecting following companies that ought to have been accepted as comparable:

Sasken Communication technologies Limited;
Minvesta Infotech Limited
Agilisys IT Services India Pvt. Ltd.;
Batchmaster Software Private Ltd.;
DCIS Dot Com Solutions India Pvt. Ltd.;
Evoke Technologies Private Limited;
Eluminous Technologies Private Limited;
Sagarsoft (India) Limited;

Ace Software Exports Limited;
Synfosys Business Solutions Limited;
ksummation Technologies Private Limited;
frifoMile Technologies Limited; and
Mildunuru Limited.

1.16, The learned AO/ learned TPO/ Hon'ble DRP has grossly erred in computing the margin of the following companies:

CG-Vak Software & Exports Ltd;
kals Information Systems Ltd;
Cybage Software Pvt. Ltd;
Harbinger Systems Pvt. Ltd; and
Orion India Systems Pvt. Ltd.

INTEREST ON RECEIVABLES

1.17. The learned AO/ learned TPO/ Hon'ble DRP erred in treating a delay in receivables or deferred receivables as an international transaction.

1.18. The learned AO/ learned TPO/ Hon'ble DRP erred in not appreciating the fact that TP adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income.

1.19. The learned AO/ learned TPO/ Hon'ble DRP erred in disregarding the fact that the receivables are arising out of transactions that are being determined to ˉbe at arm's length by application of Transactional Net Margin Method ("TNMM") and in separately adjusting the ˉreceivables on account of excess credit period.

1.20. The learned AO/ learned TPO/ Hon'ble DRP erred in not4considering the fact that the outstanding amount from the money advanced by the Appellant would get adjusted in the working capital adjustment and hence no separate adjustment is required.

1.21 The learned AO/learned TPO/Hon'ble DRP erred in computing interest on the outstanding balance from the AE by evaluating on invoice by invoice basis even though the weighted average period period of receivables of the Appellant is only 24 days, which is less than 30 days as accepted by the Ld. TPO.

1.22 *The learned AO/ learned TPO/ Hon'ble DRP erred in imputing interest on the outstanding receivables from AEs ignoring the fact that the Appellant followed the same policy of not charging any interest on trade receivables from both AEs as well as Non-AEs.*

1.23. *Without prejudice, the learned AO/ learned TPO/ Hon'ble DRP erred in computing notional interest by considering entire year after providing 30 days grace period rather than limiting it to the delay beyond the average credit cycle of the comparable companies selected by the TPO while proposing the TP adjustment. Further without prejudice, the learned TPO has committed arithmetical mistakes in computation of interest.*

1.24. *Without prejudice, the Honorable DRP has erroneously directed the learned TPO to adopt State Bank of India ("SBI") short term deposit interest rate instead of adopting London Inter-Bank Offered Rate ("LIBOR"). In this regard, the Honorable DRP have erred in law by not giving an opportunity to the Appellant as per Section 144C(11) of the Act and passing direction which is prejudicial to the interest of the Appellant.*

B. Corporate Tax

2. <u>Incorrect disallowance with respect to expenditure on Employee Stock Option Plan ("ESOP") under section 37 of the Act — INR 18,18,00,000</u>

2.1. *The Learned AO and Honorable DRP has erred in law and on facts, in disallowing the expenditure on ESOP of INR 18,18,00,000 under section 37 of the Act without appreciating the submissions furnished by the Appellant.*

2.2. *The Learned AO and Honorable DRP has erred in law, in disregarding the decision of Jurisdictional Karnataka High Court in the case of Biocon Limited, [2020] 121 <u>taxmann.com</u> 351 (Kar.) and Bangalore Tribunal in the case of Novo Nordisk, [2014] 42 <u>taxmann.com</u> 168 wherein it was held that discount on issuance of ESOP is an allowable business expenditure under section 37 of the Act*

2.3. *The learned AO and Honorable DRP has erred in law and on facts by stating that there is no outflow of money resulting in an expense whereas the fact is that there is a clear outflow of economic*

resources/cash in the hands of the appellant, which is wholly and exclusively used for the purpose of business in India.

2.4 *The learned AO and Honorable DRP has erred in law and on facts by not appreciating that the difference between the market value and the purchase price of shares is being taxed as perquisite in the hands of the employees.*

2.5. *The Learned AO and Honorable DRP has erred in law and on facts, in disregarding the sample debit note/invoices, Employee listing, sample Form 16 copies, cost reimbursement agreement, sample RSU agreement and scheme document submitted during the DRP proceedings by the Appellant.*

2.6. *The Learned AO and Honorable DRP has erred in law and on facts, in considering the ESOP expenditure as fictitious expenditure and making false allegation that the ESOP expenditure is a colorable device adopted for avoidance of tax which is totally inappropriate and misdirected. Further, Learned AO/Honorable DRP has considered the ESOP cross charge by the Ultimate holding company as fictional and notional in nature which is totally misplaced.*

2.7. *The Honorable DRP has erred in law and on facts by placing reliance on the case laws decided in different context and not applicable to the facts of the Appellant.*

2.8. *The Honorable DRP has erred in law and on facts by stating that the ESOP is uncertain by not appreciating the fact that the ESOP expenses are actual expenses claimed by the Appellant, based on actual invoices issued and actual payments made.*

Non-Applicability of section 195 of the Act

2.9. *The learned AO has erred in law and on facts by disregarding that the ESOP expense is liable to TDS under section 192 of the Act as perquisite in the hands of the employees and appropriate taxes are deducted and remitted by the Appellant, which is evidenced by sample Form 16 copies.*

2.10. *The learned AO has erred in law and on facts by stating that the provisions of section 195 of the Act shall be applicable on the remittance of reimbursement towards ESOP without taking cognizance of the fact that there was no income element arising to the recipient of such remittances.*

2.11. The learned AO has erred in law and on facts by stating that the provisions of section 195 of the Act has not been complied with and consequently reimbursement towards ESOP shall suffer disallowance under section 40(a)(i) of the Act without evaluating the fact that the provision of section 195 of the Act is prima facie not applicable on such remittances.

2.12 The learned AO has erred in law and on facts by relying on decision of Danfoss Industries P Ltd (2004) 268 ITR 1 pronounced by the Hon'ble Authority for Advance Ruling ("AAR") as the same is very specific to the given transaction of that Appellant. The transaction covered by the said decision is very different on facts as compared to the Appellant and the same cannot be applied here.

2.13. The learned AO has erred in law and on facts, in disregarding that the remittance towards recovery of ESOP charges is not taxable under the provisions of India-USA Double Taxation Avoidance Agreement

2.14. The learned AO has erred in law and on facts by contending that the said ESOP cross charge is liable to TDS under section 192 of the Act as perquisite in the hands of the employees and same is also liable to TDS under section 195 of the Act on the reimbursement to the Ultimate Holding Company thereby resulting in double taxation of same amount.

2.15. The learned AO has erred in law and on facts by contradicting his own statement by stating that in one hand there is an element of income included in the reimbursement made to the Ultimate Holding Company for the expenditure on ESOP whereas on the other hand the learned AO states that the said expenditure is notional/fictitious in nature.

3. Other Corporate Tax related grounds

3.1. The Learned AO, while assessing the total income of the Appellant for the year under consideration, have erred in not allowing a deduction for education cess and secondary & higher education cess (collectively known as "education cess") for the year under consideration, although not claimed as a deduction by the Appellant in the return of income.

3.2. The Learned AO, while assessing the total income of the Appellant for the year under consideration, have erred in not considering the depreciation claim on written down value of software which was purchased in preceding previous years and claimed as revenue expenditure, which the erstwhile AO had disallowed in the said years and allowed a claim towards depreciation. Thus, consequential depreciation of the said software ought to be provided in the year under consideration.

4. Other Matters:

4.1 The learned AO has erred, in law and on facts, in initiating penalty proceedings under section 271(1)(c) of the Act.

4.2 The learned AO has erred in law and on facts in levying interest under section 234B and section 234C of the Act.

2. Ground Nos.1.1 to 1.13 are general in nature, which do not require any adjudication. Ground No.1.14 is as follows:-

Software Development Segment ("SWD")

1.14. The learned AO/ learned TPO/ Hon'ble DRP have grossly erred in not rejecting the following companies:
Inteq Software Private Limited;
Larsen & Toubro Infotech Limited;
Nihilent Limited;
Persistent Systems Limited;
Infobeans Technologies Limited;
Aspire Systems (India) Private Limited;
Infosys Limited
Thirdware Solution Limited; and
Cybage Software Private Limited.

2.1 Out of above comparables, the assessee seeks exclusion of 3 comparables namely (1) Larsen & Toubro Infotech Limited (2) Persistent Systems Ltd. (3) Infosys Limited.

Larsen & Toubro Infotech Limited:-

4. The Ld. A.R. submitted that there is no information in AR as to any IPR developed or licensed or owned by this company. The

amalgamation has not impacted in increasing the profitability. Selling and marketing by this company constitutes only 0.24% of total expenses. In this regard, Ld. A.R. relied on the following decisions of the coordinate benches of ITAT Bangalore & Hyderabad as mentioned below:-

1) M/s. Advice America Software Development Centre Private Limited, AY 2013-14; ITA (TP) No. 2531/Bang/2017 dated 23.05.2018

2) Oracle Solution Services v DCIT, (IT (TP) A No.880/Bang/2013-14.
3) EIT Services India Pvt. Ltd., AY 2016-17; Bangalore ITAT, IT(TP)A No.210/Bang/2021

4) LG Soft India Pvt. Ltd, AY 2016-17; Bangalore ITAT IT(TP)A No.266/Bang/2021

5) ADP Pvt. Ltd., AY 2016-17; Hyderabad ITAT ITA Nos. 227 & 228 /H/2021

6) Yahoo Software Development India Private Limited, AY 2017-18; IT(TP)A No. 178/Bang/2022

7) Yahoo Software Development India Private Limited, AY 2015-16; IT(TP)ANo.2657/Bang/2018 & IT(TP)ANo.2365/Bang/2019

8) Goldman Sachs Services Private Limited, AY 2015-16; IT(TP)A No. 2355/Bang/2019

9) LG Soft India Pvt. Ltd, AY 2015-16; Bangalore ITAT IT(TP)A No.2412/Bang/2019

10) Hewlett Packard India Software Operation Pvt. Ltd., AY 2014-15 Bangalore ITAT, IT(TP)A No. 3400/Bang/2018

11) Hewlett Packard India Software Operation Pvt. Ltd., AY 2013-14 Bangalore ITAT, IT(TP)A No. 2866/Bang/2017

4. Ld. D.R. submitted that the company is engaged in providing Application Maintenance and Development, Enterprise Resource Planning and specialized services like Data Warehousing and Business Intelligence, Testing Services and Infrastructure Management Services. The services offerings are focussed mainly towards four verticals namely

manufacturing, utilities, financial services and telecom, For the period ended March 31, 2016, March 31, 2015 and March 31, 2014, as per the information in the annual reports, 100 percent of the operating revenues respectively were derived from software development services. The activities- Application maintenance and Development, Enterprise Resource Planning and Testing are all software development activities and fall within the umbrella IT services, as per NASSCOM. These activities are also functionally comparable to the assessee company, as evident from the nature of services rendered by it as stated in its TP study report. Taking into account the nature of industries, to which these services were rendered, the assessee has classified its business into Service Cluster and Industry Cluster. This is clearly stated in pages 113-114 of the annual report. Therefore, the plea that this company performs different functions has no basis. The nature of activity performed by this company is given at page 62 of the annual report, as follows:-

> *"We offer an extensive ranee of IT services to our clients in diverse industries such as banking and financial services, insurance, energy and process, consumer packaged goods, retail and pharmaceuticals, media and entertainment, hi-tech and consumer electronics and automotive and aerospace. Our range of services includes application development, maintenance and outsourcing, enterprise solutions, infrastructure management services, testing, digital solutions and platform-based solutions"*
>
> *The nature of activities and the nature of its revenue, is also discussed at page-68 of the annual report as under:*
>
>> *"We generate revenue from our continuing operations through time-and-materials contracts and fixed-price contracts by providing IT services and solutions to our clients in our industrials and services clusters"*

4.1 In view of the above information, Ld. D.R. submitted that it is very clear that this company is engaged in software development services only and hence functionally comparable. The plea that it has diversified activities has no basis, as could be seen from the above

information and discussion in the annual report of this company. Further, we also note that as per Note 3, regarding Accounting principle on Revenue Recognition, it is stated that revenue is recognised when services are rendered and related costs incurred; and there is no reference to sale of products. The financial statements do not mention about any product sale or inventory. As there is no revenue stream on account of product sales, there is no merit in the argument that the company is engaged in product sales. Accordingly, Ld. DRP hold that this company is functionally comparable to the assessee.

4.2 On the pleas as to presence of brand, Ld. DR stated that Ld. DRP in his order noted that, there is no specific information in the financial statements to indicate that the brand has contributed to revenue growth of the company. On the other hand, the company has recognized client relationships and employee relationships as significant factor that has contributed to the revenue growth of the company. As to the significant factors contributing to the revenue growth, the annual report recognizes, "Client relationships are at the core of our business. We have a history of high client retention and derive a significant proportion of our revenue from repeat business built on our successful execution of prior engagements"; and further states, "A principal component of our ability to compete effectively is our ability to attract and retain qualified employees: our employee benefit expenses constituted 57.5% and 57.7% for the year ended 31-3-2016 and 31-3-2015." (Ref: page 63-64 of the annual report). It is pertinent to note that brand was not recognized as the significant factor for revenue from operations. In other words, its operational efficiency has contributed to its revenue growth and brand name and not the other way. There is no information to indicate that the brand has impacted the revenue or profit of the company. Besides, the assessee has failed to

establish that such differences have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B. Hence, these pleas are rejected by Ld. DRP.

4.3 It was argued before Ld. DRP that this company owns intangible assets in the form of Intellectual property rights worth Rs.741.07 million, and which constitutes 21.85% unlike the assessee which does not own any intangibles and hence this company has to be excluded.

4.4 Having examined the pleas, Ld. DRP noted that the details of intangible assets are given at page 96 of the annual report. As per that information, the company has reported intangible assets worth Rs.741.07 million as at 31-3-2016, which comprises computer software of value Rs.553.51 million and intangible assets under development of Rs.187.56 million. There is no information as to any intellectual property rights developed or license owned by the company. The computer software referred to were normal software used by any software company and hence it cannot be construed as a unique or non-routine asset. The reference to intangibles under development also indicates that as at the end of the year, it does not possess its own intellectual property rights; and does not have any revenue stream on account of IPR. Thus, Ld. DRP did not find any material difference as to the intangibles owned by the assessee company and the comparable company. The assessee also failed to demonstrate as to any material effect on the profits of the enterprise. In view of the above discussion, Ld. DRP did not find any merit in these pleas and are accordingly rejected.

4.5 Ld. D.R. stated that it was argued before Ld. DRP that the amalgamation of M/s. Information Systems Resources Centre Private Limited, is an extraordinary event and will have an impact on the

profit of the company. The assessee has not furnished any information to demonstrate the said plea. Having examined the plea, Ld. DRP noted that with the acquisition of M/s. Information Systems Resources Centre Private Limited, it had become wholly owned subsidiary in the earlier year operating in the same field of rendering software services. The Scheme of amalgamation was approved by the Hon'ble High Court of Bombay, vide its order dated 4 Sept 2015 with effect from 17th Oct 2014. The method of accounting to give effect to the amalgamation into the accounts is discussed at pages 115-116 of the annual report. As per the said information, net assets to the tune of Rs.192.41 million has been transferred to the comparable company as on 31.3.2015; the profit of the transferor company for the period 17th Oct 2014 to 31.3.2015 was given to be Rs.27.35 million. For the current year, there is no impact as such, as the transferor company is also in the same line of business activity- namely software development services. Thus, there is no functional difference so as to affect comparability on account of the said acquisition. On further perusal of the financial reports for the three years, Ld. DRP noted that there is no impact on the profitability of the transferee company on account of such acquisition, as could be seen from the following information extracted from the annual report:

Financial Year	Operating
2012-13	22.7%
2013-14	21.19%
2014-15	21.6%
2015-16	21.7 %

4.6 Ld. DR stated that the above information clearly shows that the amalgamation has not impacted in increasing the profitability of the transferee company. Besides, it is also seen that the company has not reported amalgamation as a significant factor

affecting its revenue growth or profitability. With regard to amalgamation of the company GDA Technologies, it is seen that the Scheme is awaiting approval; and hence there is no impact on profitability. In view of these, Ld. DRP rejected the plea that this company has to be excluded on account of amalgamation.

4.7 The assessee contended before Ld. DRP that this comparable has incurred significant selling, marketing expense. From the perusal of the annual report, Ld. DRP noted that the expenses on this count is only 0.24% of the total expense and which is not at all significant to affect the profitability of the comparable. Accordingly, this plea is rejected by Ld. DRP.

4.8 Further, Ld. DR stated that it is seen that this company was upheld to be functionally comparable to a software service provider company, by the ITAT Bangalore in the case of M/s. Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 201344). The ITAT Bangalore in the case of Oracle Solution Services v DCIT, (IT (TP) A No.880/Bang/2013 held that turnover is not a relevant criteria and rejected the contention of the assessee to exclude the comparable L&T Infotech on the ground of high turnover.

5. We have heard the rival submissions and perused the materials available on record. This comparable has been considered as not comparable in the case of EIT Services India Pvt. Ltd. in IT(TP)A No.210/Bang/2021 dated 22.8.2022 wherein it was held as under:-

"3.5 We have heard the rival submissions and perused the materials available on record. As rightly pointed out by the Ld. A.R. in the assessment year 2015-16 in assessee's own case in ITA No.2498/Bang/2019, the Tribunal vide order dated 3.9.2021 has held as under:-

"7. We notice that the coordinate bench in the case of Yahoo Software Development India Pvt. Ltd. (supra) has excluded following 3 companies holding them as not good comparable companies.

(A) Persistent Systems Ltd:-

33. We have considered the rival submissions. We find that on the question of application of RPT filter, the assessee had made the following submission before the DRP:-

4. Fails the Related Party Transaction to Sales filter applied by the learned TPO

In the show-cause notice issued, the learned TPO has excluded companies for which the ratio of RPT to sales exceeds 25% during the current year i.e., during FY 2014-15. The relevant extract from the show-cause notice is reproduced below for ease of reference:

e) Companies who have more than 25% related parry transactions of the sales were excluded.
Companies having related party transactions of more than 25% are proposed to be excluded. A threshold of 25% is being applied following the provisions of Section 92A(2)(a) which provides a limit of 26% of the equity capital carrying voting rights for treating an enterprise as Associated Enterprise. if the limit is reduced further it would only result in eliminating more and more companies, on the other hand if the limit is relaxed then companies with predominantly related party transactions would get included which would not represent uncontrolled transactions. Therefore, on a balancing note, 25% is a proper threshold limit for related party transactions. The companies having more than 25% related party transactions should therefore be rejected as comparables.

The Hon'ble ITAT has upheld the application of this filter by the TPO in its order in the case of M/s. Supporisoft India Pvt. Ltd for AY 2005-G6 in IT (TP)A 1372/B/11 & 20/2012 dated 28.03.2013 following its own decision in the case of M/s. Actis Advertisers Pvt. Ltd vide ITA No.5277/De1/2011 dated 12.10.2012.

On perusal of the Annual Report of Persistent, we observe that the company has RPT in excess of 25% of the sales. The calculation of the same has been provided below for your ease of reference:

R PT to Sales ratio for FY 2014-15 Particulars	***Amount (INR Million)***
Sale of services	*2,410.02*
Commission received	*10.26*

Purchase of software	*1.49*
Cost of technical professional	*1,339.1*
Commission paid on sales	*111.79*
Traveling and conveyance	*19.27*
Total related party transactions (A)	***3,891.93***
Total Sales (B)	***12,424.98***
RPT % of Sales (A/B)	***31.32%***

From the above computation, it is clear that the ***controlled transactions of Persistent constitutes 31.32% of sales****. Based on the above, it can be seen that Persistent fails the `RPT to sales ratio' filter applied by the learned TPO and should therefore not be considered as a comparable."*

34. This argument has been addressed by the DRP in its order as follows:-

"4.4.9We note that the approach of the TPO in treatment of related party transaction into two sets, are for revenue transactions and other for expense transaction islogical and correct. We also note that the RPT filter was adopted by the TPO was with the above conditions and has adopted consistently. Hence, we do not find any infirmity the approach. Hence, we reject the assessee's plea. We hold that onsite expenses do not adversely affect comparability and hence, such plea is rejected."

35.Further, the assessee had also raised plea with regard to onsite revenue filter by pointing out that onsite revenue is substantial and therefore this company should not be regarded as a comparable company with a company which does not have any onsite revenue. In this regard, the ld. counsel for the assessee placed reliance on the decision of the ITAT Bangalore Bench in the case of Trilogy e-business Software India P. Ltd. v. DCIT, ITA No.1054/Bang/2011 for AY 2007-08 dated 23.11.2012 wherein this Tribunal took the following view:-

"64. The next objection of the Assessee is that when the most appropriate method selected for determining ALP is the TNMM there is no reason as to why one should look at price difference in offshore software development and onsite software development. It is no doubt true that in TNMM it is only the margins in an uncontrolled transaction that is tested with reference to the controlled transaction but it is not possible to ignore the fact that pricing will have an effect on the margins obtained in a transaction. The argument that if pricing structure were to be considered as criteria, then it will have to be seen as to what is the pricing structure of all the comparable for various projects cannot be accepted because the TPO has not chosen any other onsite software service provider with a revenue composition of more than 75% from onsite software services as comparable. As rightly observed by the TPO, the pricing is different in onsite when compared to offshore operations. The further

observations of the TPO that the reasons for the same lie in the fact that while in the case of OFFSHORE projects most of the costs are incurred in India; an ONSITE project has to be carried out abroad significantly increasing the employee cost and other costs.

65. The next objection of the Assessee is with regard to Assets employed. The companies, which predominantly generate revenues from onsite activity, do not have significant assets as most of the work is carried on the site of customer outside India. The argument that the TPO has himself observed that software service providers do not require much assets cannot be basis to accept the Assessee's plea. Those observations are made by the TPO in the context of application of turnover filter and have been quoted out of context by the Assessee.

66. The next argument of the Assessee is that TPO has held that margins are lower in onsite software services and that margin is not a criteria to select or reject a comparable under Rule I0B(2) of the I.T. Rules. We are of the view that this argument again ignores the fact that the approach of the TPO has been to highlight the fact that there can be no functional comparability, if the assets employed and risks assumed are taken into consideration. It is in that context the TPO has referred to the margins.

67. The companies who generate more than 75% of the export revenues from onsite operations outside India are effectively companies working outside India having their own geographical markets, cost of labour etc., and also return commensurate with the economic conditions in those countries. Thus assets and risk profile, pricing as well as prevailing market conditions are different in predominantly onsite companies from predominantly offshore companies like the taxpayer. Since, the entire operations of the tax payer are taking place offshore i.e. in India; it is but natural that it should be compared with companies with major operations offshore, due to the reason that the economics and profitability of onsite operations are different from that of offshore business model. As already stated the Assessee has limited its analysis only to functions but not to the assets, risks as well as prevailing market conditions in which both the buyer and seller of services located. Hence, the companies in which more than 75% of their export revenues come from onsite operations are to be excluded from the comparability study as they are not functioning in similar economic circumstances to that of the tax payer. Hence, it is held that this filter is appropriately applied by the TPO.

68. Admittedly the onsite revenue in the case of the following comparable companies identified by the Assessee was more than 75% of its export revenues viz., a) Visu International Ltd. b) Maars Software International Ltd. c) Akshay Software Technologies Ltd. d) VJIL Consulting Ltd. e) Synfosys Business Solutions Ltd. The above companies

were therefore rightly not considered as comparable by the TPO. We hold accordingly."

36. It is seen that the TPO in coming to the conclusion that the onsite revenue filter is not applicable has placed reliance on the decision of the ITAT Mumbai Bench in the case of Capegemini as quoted in para 16 in para 14 of the TPO's order, but that decision does not deal with a case of onsite revenue filter and the decision was rendered on the facts of its own case.

37. On the issue of RPT filter, we notice that the TPO in para 16 has accepted that the RPT filter should be @ 25%. In the case of Persistent Systems Ltd., the RPT is at 31.32% as extracted in the earlier part of this order and therefore this company should be excluded by application of RPT filter. In view of the above, we do not wish to go into other grounds on which this company is sought to be excluded viz., that it is a product company and there is no segmental data between product and services segment, presence of onsite activity and the impact of extra-ordinary event of acquisition during the relevant previous year. ***Therefore, this company is directed to be excluded from the list of comparable company****.*

38. (B) LARSEN & TOUBRO INFOTECH LTD:-

39. As far as L&T Infotech Ltd. is concerned, the ld. counsel for the assessee brought to our notice the decision of ITAT Delhi Bench in the case of Saxo India Pvt. Ltd. v. ACIT, ITA No.6148/Del/2015 for AY 2011-12, order dated 5.2.2016, wherein the Tribunal took note of the fact that this company was also trading in software and owned insignificant intangible assets. ***The company was excluded from the list of comparable companies with reference to SWD services provider such as the assessee.*** *The ld. Counsel pointed out that though this decision was rendered with reference to AY 2011-12, the same reasoning would apply to AY 2015-16 also and in this regard, he drew our attention to page 696 of assessee's PB, which gives the details of the revenue generated by this company without any segmental break-up. Our attention was also drawn to page 682 of PB which shows that there is substantial onsite revenue activity as well as cost incurred on onsite software development. We notice from page 676 of assessee's PB that this company as part of its operating profit in Schedule-O of profit & loss account contains expenditure for 'cost of bought out items for resale' and this is a significant part of the operating expenditure. When we see the revenue in Schedule M of the profit & loss account, there is no break-up of the revenue with regard to software services and software product. In our opinion, this distinction is enough to exclude this company from the list of comparable companies as held by the Hon'ble Delhi ITAT in the case of Saxo India Pvt. Ltd. (supra) which decision was also confirmed by the Hon'ble Delhi High Court*

(C) INFOSYS LTD*.*

39.The next company which the assessee seeks to exclude is Infosys Ltd. As far as this company is concerned, it is seen that the following are the functional dissimilarities brought to our notice:-

"Functionally dissimilar - owns intellectual properties, incurs significant R&D costs & onsite activity.

- *Engaged in diversified business activities.*
- *Involved in development of software products in addition to software services.*
- *Owns intellectual property rights.*
- *Incurs significant research and development costs.*
- *Carries out significant activities based on onsite business.*
- *Owns products such as Finacle, Edge Verve and other product based solutions.*

Extra-ordinary event of merger with Infosys Consulting India Ltd.

Segmental profit & loss account not available.
Commands substantial brand value.

40. The DRP, however, has not thought it fit to exclude this company by observing that this company has substantial pre-dominant revenue from software services and the growth was not attributable to any brand value. Presence of onsite activity and the expenses on R&D have all been brushed aside. ***In our view, the difference pointed out by the ld. counsel for the assessee before us show that this company cannot be compared with that of the assessee*** *basically because of its business model, presence of onsite revenue generation and other reasons cited before us. Besides, the reason that turnover of this company is huge and more than 10 times that of the assessee."*

8. We notice that M/s. Infobeans Technologies Ltd. have been directed to be excluded by the coordinate bench in the case of Metric Stream Infotech (India) Pvt. Ltd. with the following observations:

<u>"14.3. Infobeans Technologies Ltd.,</u>

Ld.AR submitted that this comparable was selected by authorities below as it passes all filters, based upon response received from this company under section 133 (6) of the act. He submitted that this observation is contrary to the facts and figures appearing in annual report. Referring to page 1015 Ld.ARsubmitted that this company is operating at CMMI Level 3 and is a software service company specialising in business application development for web and mobile. In the company overview this company has been stated to be primarily engaged in providing custom developed services to offshore clients and it provides software engineering services primarily in custom application development, content management systems, enterprise mobility, Big Data analytics. Ld.AR thus submitted that this company is functionally not at all similar with a captive service provider like assessee that this providing Ltd services to its associated enterprises.

14.3.1.0n the contrary Ld. CIT DR, referring observations of DRP in para 3.6.1 submitted that the activities of company fall under the gamut of software development has categorised by company itself and that the

information obtained under section 133 (6) is sufficient enough to come to such conclusions. However he submitted that this comparable also may be sent back to learnt AO/TPO for verification.

14.3.2. *We have perused submissions advanced by both sides in light of records placed before us.*
It is observed that the annual report of this company categorises the diversify services provided by this company under software development segment. We also note that this company is basically into application development for web and mobile and provides customised services to its offshore clients comprising. Entire revenue received by this comparable ease under one single segment of sale of software. This company also owns software licenses.

14.3.3. *In our considered opinion this comparable cannot be considered to be functioning in 100% risk mitigated environment and is a full-fledged enterprise. Such a comparable cannot be compared with a captive service provider like assessee.*

Accordingly we direct this comparable to be excluded from finalist."

9. Following the above said decisions rendered by co-ordinate benches, we direct exclusion of Persistent Systems Ltd., Larsen & Toubro Infotech Ltd. and Infosys Ltd. & Infobeans Technologies Ltd. from the final list of comparables."

3.6 Further, in the assessment year 2016-17, the coordinate bench of Hyderabad Tribunal in the case of ADP Pvt. Ltd. in ITA Nos.227 & 228/Hyd/2021 dated 3.2.22 held as under:-

"4.3 We have considered the rival submissions and perused the material on record as well as gone through the orders of revenue authorities. We find substance in the submissions of the ld. AR and on going through the financial statements of Larsen & Toubro Infotech Ltd., in particular at page Nos. 1249 of paper book - Volume - 3 disclosure under the Companies Act, 2013, we observe that the company information system resource centre Pvt. Ltd. (ISRC) was amalgamated with the company with effect from September, 21, 2015 and the appointed for the scheme was October, 17 2014, which reads as under:

"Pursuant to the Scheme of Amalgamation sanctioned by the Hon'ble High Court of Bombay vide its order dated September 04, 2015, Information Systems Resource Centre Pvt. Ltd. (ISRC) was amalgamated with the Company with effect from September 21, 2015. The appointed date for the Scheme was October 17, 2014. Consequently, the entire business, assets, liabilities, duties and obligations of ISRC have been transferred to and vested in the Company with effect from

October 17, 2014. ISRC was engaged in the business of software services with respect to application development, information technology support and maintenance service to OTIS Elevator Company, USA and other companies of UTC group and was acquired by the Company on October 16, 2014."

4.4 From the above observations, which were extracted from the financial statements, the company named ISRC amalgamated with the company (Larsen & Toubro) and profitability with this amalgamation will impact. Therefore, If an extraordinary event has taken place by way of amalgamation in a company, that company cannot be considered as a comparable as held by the co-ordinate bench of ITAT, Pune, in the case of Entercoms Solutions (P.) Ltd. v. Asstt. CIT [2022] 134 taxmann.com 59 (Pune - Trib.). Accordingly, we direct the AO/TPO to exclude this company as comparable from the list of comparables.

3.7 In view of above order of the Tribunal, we take a consistent view and we direct the AO/TPO to exclude L&T Infotech Ltd. from the list of comparables."

5.1 In view of the above order, we exclude this company from the list of comparables.

Persistent Systems Ltd.

6. Ld. A.R. submitted that this company's core activity is rendering services to develop software products. The income from software license of assessee's company constitutes only 0.51% and R&D constitutes only 0.43% of operating revenue. Value of Intangible assets constitutes only 1.02% of operating revenue. It passes RPT filter. Assessee company's selling and marketing expenses constituted only 0.11% of total revenue. In this regard, Ld. A.R. relied on the following decisions of the coordinate benches of ITAT Bangalore & Hyderabad as mentioned below:-

1) M/s. Advice America Software Development Centre Private Limited ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14

2) Mercedes Benz in IT(TP)A No.1497/Bang/2017 for the A.Y. 2013-14.

3) EIT Services India Pvt. Ltd., AY 2016-17, Bangalore ITAT, IT(TP)A No.210/Bang/2021
4) LG Soft India Pvt. Ltd, AY 2016-17; Bangalore ITAT, IT(TP)A No.266/Bang/2021

5) Optiva Indian Technology Pvt. Ltd., AY 2016-17; Pune ITAT ITA No. 194/PUN/2021

6) ADP Pvt. Ltd., AY 2016-17, Hyderabad ITAT, ITA Nos. 227 & 228 /H/2021

7) Yahoo Software Development India Private Limited , AY 2017-18 IT(TP)A No. 178/Bang/2022

8) Yahoo Software Development India P Ltd, AY 2015-16 IT(TP)ANo.2657/Bang/2018 & IT(TP)ANo.2365/Bang/2019

9) Goldman Sachs Services Private Limited, AY 2015-16, IT(TP)A No. 2355/Bang/2019

10) LG Soft India Pvt. Ltd, AY 2015-16, Bangalore ITAT IT(TP)A No.2412/Bang/2019

11) EIT Services India Pvt. Ltd, AY 2015-16, Bangalore ITAT IT(TP)A No.2498/Bang/2019

12) LG Soft India Pvt Ltd, AY 2014-15, Bangalore ITAT IT(TP)A No 3122/Bang/2018

13) Hewlett Packard India Software Operation Pvt. Ltd., AY 2014-15 Bangalore ITAT

14) IT(TP)A No. 3400/Bang/2018, Hewlett Packard India Software Operation Pvt. Ltd., AY 2013-14, Bangalore ITAT, IT(TP)A No. 2866/Bang/2017

15) Hewlett Packard India Software Operation Pvt. Ltd., AY 2011-12, Bangalore ITAT, IT(TP)A No.668/B/2016, & IT(TP)A No.583/B/2016

7. Ld. D.R. relied on the order of Ld. DRP wherein he observed that on perusal of the annual report, Ld. DRP noted that the company's core activity was rendering product development services i.e., providing services to business enterprise to develop software products. As per the information at page 236 of the annual report, it has reported income from software services of Rs.14,232.56million and software

licenses of Rs.238.8 million aggregating to Rs.14,471.36 million. Thus, the income from software licences constitute a meagre 1.65% of its operating revenue. It is also noted by the Ld. DRP that this company in response to the notice u/s 133(6) had given details of such license income as under:-

Software product	Category	Revenue as per books of accounts (INR)
Radia	Acquired for distribution activity	16,46,585
Shareinsights	Internally developed	6,00,00,000*
Persistent identity API Toolnet	Internally developed	92,38,635*
WCM Connector (ECSC)	Internally developed	21,39,200*
SSIS Oracle Connector 2005	Internally developed	8,70,325*
OS Licenses and DR Site storage	Reselling activity	13,05,45,776
SAP Licenses	Reselling activity	3,40,93,575
APIGEE Licenses	Reselling activity	38,18,400
GEMS Licenses	Reselling activity	22,50,000
ODBC Test Heirness	Reselling activity	22,83,225
Others	Licensing activity	-80,84,107
Grand Total		23,88,01,634
Total #		#7.22 Crores

7.1 Ld. DR submitted that from the information in the above table it could be seen that only an amount of Rs.7.22 crore represent income on account of internally developed activity which constitute 0.51% of operating revenue, and all others licence revenue was from distribution or reselling activity. Besides, the company has also categorically clarified in its reply u/s 133(6) that it is predominantly engaged in software product development services only. The relevant extract of the reply is as under: -

> *"Persistent System Limited is predominantly engaged in the business of providing outsourced software product development services to customers across the globe from following industry verticals: Infrastructure and systems, Telecom and Wireless, Life science and Healthcare and Financial services.*
>
> *The company reports segment information based on the above industry verticals. The nature of services provided under each of these segments differs only in terms of the industry and specific requirements of customers in each of these industries. The essential activity across all business segments can be considered to be software product development services".*

7.2 Ld. D.R. submitted that as could be seen from the information contained in the annual report of this company, and the clarification submitted by the company in its reply to the notice under sec. 133(6) of the Act, it is very clear that the company is predominantly engaged in software product development services and hence it is functionally comparable to the assessee.

7.3 It was noted by the Ld. DRP that the assessee by referring to the annual report of the company contended that this company is predominantly into product development. Ld. DRP noted that these discussions are made with reference to the consolidated results of the company, and which included the business profile and operations of its subsidiary companies and associate companies. A careful perusal of the annual report would indicate that the financial results of this stand-alone company is discussed only from page 208 onwards, and the discussion in the earlier pages related to the entire group. Ld. DRP also noted that the Information submitted under sec.133(6) is totally in consonance with the information stated in the financial statements of this company. Ld. DRP was of the view, it would be totally incorrect to consider the information pertaining to the entire group as such, when the comparability is to be seen with reference to the stand-alone financials of Persistent Systems Ltd, which was examined

and considered by Ld. DRP for comparable analysis and accordingly, he found find that this company is functionally comparable to the assessee.

7.4 In this regard it is pertinent to note as per the consolidated annual report the revenue from software licence was Rs.764.84 million for the entire group whereas, such revenue in the case of M/s Persistent Systems Ltd was only Rs.238.8 million (Ref page 189 and page 236 of the annual report). It is also seen that in the P&L account of the consolidated financial statement expenses were debited towards Royalty expenses of Rs.138.06 million (refer page 190) and there is no such debit in the stand-alone P&L account of the company M/s. Persistent Systems Limited.

(Intangible assets of Group 2012-13)

(In ₹ Million)

	Software	Acquired contractual rights	Total
Gross block (At Cost)			
As at April 1, 2012	1,287.46	281.63	1,569.13
Additions	94.03	261.25	355.28
Disposals	116.10	-	116.10
Other adjustments			
- Exchange differences	23.86	(0.18)	23.68
As at March 31, 2013	1,289.28	542.68	1,931.96

7.5 Further, as per information at page 88 of the annual report for FY 2012-13 it was stated in the notes to the consolidated results that the increase of intangible block of assets during the year (2012-13), of Rs.262.84 million, was mainly on account of acquisition of various IPs during the year and the same is shown in the intangible Asset Schedule of the consolidated financial statement at page 115 as under: -

7.6 Ld. D.R stated that all these clearly show that the IP related and product revenue pertain to other group entities and does not pertain to M/s Persistent Systems Ltd, which is being compared. It is also relevant to note that this company has clarified in its reply given u/s 133(6), that M/s Persistent Systems Ltd is predominantly engaged in the business of

rendering software development services; the revenue reported is primarily on account of rendering of software development services only. The relevant extract is as under

> *"In respect of the information you have requested under 3(a) and 3(c) in respect of software products and innovations, overseas subsidiary companies of Persistent Group have acquired certain Intellectual Property (IP) products and generating some revenue from licencing and support of these products. in case of PSL India, which is predominantly engaged in the business of rendering software development services, the revenue reported is primarily on account of rendering of software development services only"*

The above clarification also makes it clear that this company is not into diversified activities.

7.7 Further, it is seen that the expenditure incurred towards R&D as per page 203 of the annual report was Rs.62.58 million, which constitute meagre 0.43% of operating revenue. Further, the capital expenditure towards R&D was only Rs.0.11 million, which clearly show that the R&D activities are routine. The value of intangible assets as on 31-3-2016 was only Rs.119.93 million (page no 214) constituting 1.02% of operating revenue. The intangible assets are computer software and licenses purchased for its business activity. There is no reference to. any IPR or patent owned or developed by the company, in the stand-alone annual report. There is also no acquisition of IPR during the year. Further as per note in page 171 of the annual report, 'research costs are expensed as incurred unless the technical and commercial feasibility of the project enable to use or sell the software, they are not capitalized'. Such a development is not reflected in the Asset schedule. Thus, it can be inferred that the R&D activities and intangible assets owned are routine and do not have impact on the revenue and profitability of the company. We also note that, the assessee has failed to establish that such differences, if any, on account of R&D, and the presence of these intangible assets have materially affected the comparability or profitability as required in clause (i) of sub-rule (3) of Rule 10B. The said

company also clarified u/s 133(6) that its intangible assets are in the nature of software licences acquired for use in the operation of the company and it is seen that they are not in the nature of inbuilt IPR generating revenue for the company. Hence, the intangible assets as such have not affected the profitability. Taking into account all these aspects, we do not find any material difference so as to affect comparability. Hence, these pleas are rejected.

7.8 A plea was raised that this company fails the RPT filter of 25% and hence has to be excluded. On verification of the information in the annual report, (pages 243-244 of the annual report), we note that this company does not fail the RPT filter adopted by the TPO. We noted that the assessee has computed by aggregating the transactions, on the revenue and expense side, without taking corresponding parity in the denominator. Such a computation is totally skewed. Thus, we do not find merit in the plea raised and accordingly rejected.

7.9 It was argued by the assessee before Ld. DRP that this company has incurred significant expenses towards cost of technical professionals, and hence cannot be taken as comparable. Ld. DRP failed to understand the plea as to how it affects comparability. He noted that these are routine operating expenses incurred by the company for its operational activities, and does not affect comparability as such. Besides under the TNMM, the net profit margins are compared and there is no requirement to make item to item comparison of expenses of the enterprises. Thus, Ld. DRP did not find merit. in the plea and accordingly rejected.

7.10 It was also pleaded that the company had incurred advertisement and sponsorship expenses to the tune of Rs.16.01 million, which constituted meagre 0.11% of total revenue and thus it is insignificant to materially affect comparability or profitability.

Besides, under TNMM methodology, there is no requirement to make item to item comparable analysis of expenditure. Hence, these pleas are rejected.

7.11 Further, it is seen that this company was held to be engaged in software development and not a product company and hence functionally comparable to a software service provider company, by the ITAT Bangalore in the case of M/s. Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/Bang/2017 dated 23.05.2018 relating to A.Y. 2013-14). In view of the above, we uphold the selection of this comparable. The ITAT Bangalore in the case of M/s Mercedes Benz Research and Development India Pvt Ltd v DCIT, (IT (TP) A No.1497/Bang/2017/AY 2013-14 dated 13.3.2018 (TS-466-ITAT- 2018-BANG-TP) upheld the selection of the comparable Persistent Systems Limited. In view of the above discussion, Ld. DRP upheld the selection of this company as comparable.

8. We have heard the rival submissions and perused the materials available on record. We are of the opinion that in the case of ADP Pvt. Ltd. in the assessment year 2016-17 reported in [2022] 135 taxmann.com 44 the coordinate bench of Hyderabad has considered this company as not comparable by observing as under:-

"6.2 We have considered the rival submissions and perused the material on record as well as gone through the orders of revenue authorities. The co-ordinate bench in assessee's own case in ADP (P.) Ltd. (supra) directed the AO to exclude this company from the list of comparables for determining ALP by observing as under:

> *"27. As regards Persistent Systems Ltd, the objections of the assessee are as under:*
> *(a) The Company is functionally not comparable. It is engaged in selling of the following:*
>
> *i. Software products (IP);*
>
> *. Platforms (Solutions & Integration); and iii. services (product engineering) b. There are no segmental details between software products and services.*

> *28.In the case of Tata Elxsi, the assessee has taken the following objections:*
> *(a) It is not functionally comparable to the assessee. In the financial statements of the company, the nature of business carried out by Tata Elxsi is given below:*
>
> *(i) Corpoprate Information "Tata Elxsi Ltd was incorporated in 1989. The Company provides product design and engineering services to the consumer electronics, communications and transportation industries and systems integration and support services for enterprise customers. It also provides digital content creation for media and entertainment industry"*
>
> *29.We find that in the case of Infor (India) (P.) Ltd. v. ACIT in ITA No. 2307/Hyd/2018, the Co-ordinate Bench of the Tribunal has considered similar objections of the assessee therein and has held that these two companies along with Thirdware Solutions Ltd is not comparable to the software development company like the assessee before us. The relevant portions has been reproduced by us in the above paras. Respectfully following the same, these two companies are also directed to be excluded from the final list of ITA No 2233 of 2018 ADP Private Ltd Hyderabad comparables. Thus, assessee's ground of appeal No. 2 is partly allowed."*

6.3 In the said decision, it has been held that the company is functionally different and engaged in diversified activities and since the revenue could not controvert the said decision nor brought any contrary decision, following the same, we direct the AO/TPO to exclude this company from the final list of comparables."

8.1 In view of the above decision of the Tribunal, we are inclined to hold that Persistent Systems Ltd. cannot be considered as a comparable and to be excluded from the list of comparables. In view of this, we exclude this company from the list of comparables.

<u>Infosys Limited:-</u>

9. Ld. A.R. submitted that this company's predominant revenue is from software service. Growth of revenue of this company is not on account of its brand or any exceptional event. Data analytics is not functionally different from SWD. R&D Expenditure of this company constitutes only 0.8% of total operating revenue. Value of

intangible is only Rs.30 crores (turnover – 53,983) in previous year. It is a common practice to give small portion of work to sub-contractors. Turnover does not influence margin. Hence, this company may be excluded from the list of comparables.

1) EIT Services India Pvt. Ltd., AY 2016-17; Bangalore ITAT IT(TP)A No.210/Bang/2021

2) LG Soft India Pvt. Ltd, AY 2016-17; Bangalore ITAT IT(TP)A No.266/Bang/2021

3) ADP Pvt. Ltd., AY 2016-17; Hyderabad ITAT, ITA Nos. 227 & 228 /H/2021

4) Yahoo Software Development India Private Limited, AY 2017-18 IT(TP)A No. 178/Bang/2022

5) Yahoo Software Development India P Ltd, AY 2015-16 IT(TP)ANo.2657/Bang/2018 & IT(TP)ANo.2365/Bang/2019

6) Goldman Sachs Services Private Limited, AY 2015-16; IT(TP)A No. 2355/Bang/2019

7) LG Soft India Pvt. Ltd, AY 2015-16; Bangalore ITAT, IT(TP)A No.2412/Bang/2019

8) Hewlett Packard India Software Operation Pvt. Ltd., AY 2014-15, Bangalore ITAT, IT(TP)A No. 3400/Bang/2018

10. Ld. D.R. submitted that Ld. D.R.P. on on perusal of the annual report of the company, noted that this company is engaged in providing IT technology services comprising Application Development services, Application Maintenance Services, Application Modernisation Services, independent validation solution, testing services, Business service management, consulting and systems integration services. All these activities fall within the gamut of 'software services'. The mere reason that these services are rendered in regard to different industries such as Financial, Manufacturing, Life Science, Energy, Retail does not make it functionally dissimilar. As per information in the stand-alone P& L account of this company (available at page 115 of the annual report), it

has reported revenue from 'software services' of Rs.53,334 crores and from 'software products' of Rs.649 crores, and thus it could be seen that the product revenue constitutes meagre 1.2% of total operating revenue. Taking into consideration, various information available in the annual report and the fact that the company is predominantly having revenue from software services, (ie. nearly 99% of its operating revenue) Ld. DRP was of the considered view that this company can be considered as functionally comparable to the assessee. The pleas that it has diversified activities, rendering services to various industries, and hence it is functionally dissimilar are rejected by Ld. DRP.

10.1 It was pleaded before Ld. DRP by the assessee that this company has a huge brand which has contributed to its growth in revenue and hence not comparable. A perusal of the annual report by the Ld. DRP shown that the growth in revenue was on account of various business initiatives taken to accelerate growth such as - internal re-organization, implementing cost effectiveness through reducing cost of operation, improving utilization percentage of employee, restricting the organization for agility by creating smaller and nimbler sales regions, redesigning supply chain functions, reducing attrition rate, increasing the offshore mix, improving delivery expertise etc., As per information in page 20 of annual report, 97.1% of revenues was from repeat business. At page 71 of the annual report, it is discussed, "clients often cite our industry expertise, comprehensive end-to-end solutions, ability to scale, superior quality and process execution, global delivery model, experienced management team, talented professionals, track record and competitive pricing as reasons for awarding contracts'. Thus, the growth in revenue is not on account of its brand or any exceptional event, and hence cannot be a reason for rejecting this company, which is otherwise found to be functionally comparable. Further, the assessee has not placed before Ld.

DRP any information to demonstrate that the brand has a material impact on the profitability of the enterprise. It was also pleaded that this company has brand building expenses, however, on verification, it was seen that these expenses refer to the expenses incurred in participation in various seminar etc; and as such constituted meagre 0.33% of total revenue to materially affect comparability or profitability. Hence, these pleas are rejected by the Ld. DRP.

10.2 A plea was raised that this company also provides data analytic services which is high end and hence, cannot be compared to the assessee. Ld. DRP did not find merit in the plea, as undoubtedly, provision of data analytic services is not functionally different from software development activity. The data analytic services also use only certain software and tools, write codes to perform certain tasks. Like any other software application, these tools also facilitate and enable business enterprises for informed management and decision. Therefore, Ld. DRP did not find merit in the plea. Further, there cannot be any distinction between high end software activity and low end activity, so long as it falls within the purview of software development services. Besides, under the TNMM, such differences are tolerable and there is no requirement that the services / activities performed are identical. It is enough that the services are similar and fall within the same domain of software development. Accordingly, the pleas raised are rejected by Ld. DRP.

10.3 Ld. D.R. stated that Ld. DRP on perusal of the details in the annual report shown that the company has incurred R & D expenditure to the tune of Rs.415 crores, which constitute meagre 0.8% of its total operating revenue, and which is much less: than the generally acceptable tolerable limit of 3% of the total revenue. It is also noted that out of this, only Rs.31 crore was capital in nature and the remaining Rs.384 crore represented revenue expenditure, which go to show that the R&D initiative are

substantially routine for immediate business purposes for developing expertise and improved process execution. It was also pleaded that by the assessee before Ld. DRP that the company has significant intangibles. However, on perusal of the information at page 109 of the annual report, Ld. DRP noted that the value of intangible assets as on 31.03.2016 was Rs 30 crore and as on 31.0.2015 was. Rs.42 crore, which is insignificant considering its turnover of Rs.53,983 crore and net Asset portfolio of Rs.8248 crore. Ld. DRP also noted that, the assessee has failed to establish that such differences, if any, on account of R&D, brand and intangibles have material effect on the margin of the above company, in terms of clause (i) of sub-rule (3) of Rule 10B. Besides, he also noted that the assessee leverages on the intangibles owned by the AEs without factoring the corresponding cost in its analysis. Further, as per the Service Agreement with the AE, the intangibles/ intellectual property generated by the assessee and the Methodology/ ideas/concepts/algorithms developed by it during the performance of the services are assigned to the AEs without compensation. Taking into account all these aspects, Ld. DRP did not find any material difference so as to affect comparability. Hence, these pleas are rejected by the Ld. DRP.

10.4 The assessee has objected that the company has reported subcontract charges/outsourcing charges and alleged that it had subcontracted its part of contracts and hence the business model is different. The objection is misplaced because the company has incurred only Rs.4417 crores on the cost of technical subcontractors who have been employed for operational activities. It is not out of place to mention that this is a regular practice in almost all the software development companies to allocate a portion of the work to some other subcontractors for a variety of reasons. This may allow the company to focus on its core activities. These expenses are incurred in a routine course of business. Therefore, this cannot be held to be a criteria to affect the functional

comparability of a company and more so in the facts of this case, wherein certain sub-contracting expenses are incurred. This objection is accordingly rejected by the Ld. DRP.

10.5 On the plea as to difference in the scale of operations and consequent abnormal profits, Ld. DRP noted that turnover does not influence the margins in the service sector. The fixed costs in the ITeS industry are insignificant when compared to the manufacturing industry. The major cost in the service sector is variable cost such as salary, travelling expenses, communication expenses, etc. In the absence of any significant fixed costs, the margins in the ITeS are not linked to the turnover of the company. This can be seen from the fact that many smaller companies also have high profits in this sector. On this issue, the ITAT Delhi in the case of Calibrated Healthcare Systems India Pvt Ltd.(ITA No.5271/Del/2012), held that 'when a company is a functionally similar to that of the assessee company, the same cannot be exclude merely because its turnover was at a higher or lower level. Here, it is important to mention that Section 92C(1) of the Act provide for computation of Arm's Length Price by one of the methods prescribed therein. First proviso to Section 92C(2) clearly provides that when more than one price are determined by the most appropriate method; then the Arm's Length Price shall be taken to be Arithmetic Mean of such prices. It does not talk of excluding companies with high or low turnover or high or low profit rate. Further, the Delhi Tribunal in Nokia India Pvt Ltd (ITA No.242/0/2010) has held that a potentially comparable company cannot be excluded for the reason of high or low turnover or high or low profit margin. In reaching this conclusion, the Delhi bench also considered a special bench order passed in the case of Maersk Global Centre India Pvt Ltd. Vs ACIT (2014) 147 1TD 83 (BOM)(SB)'. Similarly, the Mumbai Tribunal in Capgemini, took note of the ITAT,

Bangalore decision in Genisys (supra), and other Tribunal decisions to conclude (in Para 5.3.5 & 5.3.6) that there was no such correlation of profit margins with the turnover of the IT companies, which is primarily based on skilled manpower and related costs, and that the classification based on turnover made in Dun and Bradstreet study was not based on profit margins and hence not relevant. The ITAT, Bangalore, in a recent decision Societe Generale Global Solution Centre Pvt. Ltd. vs. DCIT in IT(TP) appeal No.1188(Bang) of 2011, dated: 22.04.2016, [2016] 69 Taxmann.com 336(Bangalore Trib.) has also held that turnover cannot be a criteria for selection of comparables.

10.6 In its latest judgement dated 12/04/2017, the Income Tax Appellate Tribunal 'B' Bench, Bengaluru in IT(TP)A No.502/Bang/2015 (Assessment year: 2010-11) and Cross Objn.No.139/Bang/2015 (In IT(TP)A No.502/Bang/2015) (Assessment year: 2010-11) in the case of M/s. Scancafe Digital Solutions Pvt. Ltd. Vs. Income-tax Officer, Ward 6(1)(1), Bengaluru. IT(TP)A No.450/Bang/2015 (Assessment year: 2010-11) held as under while dealing with the issue of Turnover Filter:

> *"17. Ground Nos.2 and 3 challenge the direction of the DRP applying turnover filter of Rs,1 to Rs.200 crores. Though there are decisions to the effect that the companies with the turnover filter of Rs.1 to Rs.200 cores should alone be considered as comparables, this proposition was diluted by the Mumbai bench of IT(TP)A Nos.502 & 450/Bang/2015 Page 22 of 26 the Tribunal in the case of Willis. Processing Services (I) P. Ltd. vs, DCIT [75-49-ITAT-2013(1klum)-Tel wherein it was held that the turnover band of Rs.1 to Rs.200 cores is bereft of any rationality as the application of this rule does not enable comparison of a company with Rs.200 crores with another company having a turnover of Rs.201 crores. It was further absented by the Hon'ble Tribunal that the turnover was also not a criteria prescribed under rule 105 for selection of comparables. We are also of the considered opinion that the turnover cannot be relevant criteria in a service sector where fixed overheads are nominal and the cost of service is in direct proportion to the*

services rendered. Following this reasoning we hold that the above companies cannot be excluded from the list of comparables."

10.7 In the light of rationale laid down in the above decisions, Ld. DRP rejected the plea raised by the assessee to exclude this company based on the size and level of operations. In this regard it is relevant to note that the ITAT Bangalore in the case Advice America Software Development Centre Private Limited (in ITA (TP) No. 2531/I3ang/2017 dated 23.05.2018 relating to. A.Y. 201314) rejected the plea of the assessee to exclude a company as comparable on the ground of size and level of operations. In view of the above, Ld. DRP upheld this company as comparable to the assessee.

11. We have heard the rival submissions and perused the materials available on record. This comparable has been considered as not comparable in the case of ADP Pvt. Ltd. by the coordinate bench of Hyderabad cited (supra), wherein held as under:-

9.3 We have considered the rival submissions and perused the material on record as well as gone through the orders of revenue authorities. The co-ordinate bench in assessee's own case in ADP (P.) Ltd. (supra), directed the AO/TPO to exclude this company from the list of comparables for determining ALP by observing as under:

'25. Having regard to the rival contentions and the material on record, we find that in a number of decisions including the assessee's own case, Infosys Ltd has been held to be not comparable with any other software development company such as the assessee due to its huge turnover and high profit margin and also as it is into software products and owns intangible intellectual property rights. In the case of Agnity India Technologies Ltd, 36 Taxmann.com 289 (Del), the Hon'ble Delhi High Court has held that Infosys Ltd is not comparable to other software development company. Relevant paragraphs are reproduced hereunder: "

8. It is a common case that Satyam Computer Services Ltd. should not be taken into consideration. The Tribunal for valid and good reasons has pointed out that Infosys Technologies Ltd. cannot be taken as a comparable in the present case. This leaves L&T Infotech Ltd. which gives us the figure of 11.11 %, which is less than the figure of 17% margin as declared by the

> *respondent-assessee. This is the finding recorded by the Tribunal. The Tribunal in the impugned order has also observed that the assessee had furnished details of workables in respect of 23 companies and the mean of the comparables worked out to 10%, as against the margin of 17% shown by the assessee. Details of these companies are mentioned in para 5 of the impugned order".*

26. Respectfully following the same, we direct the exclusion of this company from the final list of comparables.'

9.4 On perusal of the entire financial statements, we observe that the company is functionally not comparable and selling and marketing expenses are 5% of revenue and there were extraordinary events also noted i.e. transfer of product - financial & edge services as well as diversified activities like artificial intelligence, products services, platforms, consulting etc. Also onsite revenue was 52.7% and no segmental details like services, consulting products are available. In view of the above observations, the co-ordinate bench in assessee's own case for AY 2014-15 directed to exclude this company as comparable. Respectfully following the said decision, we direct the AO/TPO to exclude this company as comparable from the list of comparables.

11.1 In view of the above judgement of Tribunal, taking a consistent view, we direct the AO/TPO to exclude Infosys Ltd. from the list of comparables.

12. No other comparable was pressed in this ground. According not considered.

13. The assessee seeks inclusion of following comparables in ground No.1.15 which is reproduced as follows:-

The learned AO/learned TPO/Hon'ble DRP have grossly erred in rejecting following companies that ought to have been accepted as comparable:

- i. *Sasken Communication technologies Limited;*
- ii. *Minvesta Infotech Limited*
- iii. *Agilisys IT Services India Pvt. Ltd.;*
- iv. *Batchmaster Software Private Ltd.;*

v. *DCIS Dot Com Solutions India Pvt. Ltd.;*

vi. *Evoke Technologies Private Limited;*

vii. *Eluminous Technologies Private Limited;*

viii. *Sagarsoft (India) Limited;*

ix. *Ace Software Exports Limited;*

x. *Synfosys Business Solutions Limited;*

xi. *Isummation Technologies Private Limited;*

xii. *InfoMile Technologies Limited; and*

xiii. *Mudunuru Limited.*

13.1 However, the assessee pressed for inclusion of following comparables only:-

i. Sasken Communication Technologies Limited;
ii. Evoke Technologies Private Limited;
iii. Sagarsoft (India) Limited;
iv. Ace Software Exports Limited
v. Isummation Technologies Private Limited;

i. Sasken Communication Technologies Ltd.:-

14. The Ld. A.R. submitted that this is functionally different and he drew our attention to the order of the TPO wherein the TPO gave his remarks that this company is into Embedded design and programming. Sasken is engaged with several of the top 10 vendors in the semiconductor industry providing a range of IC Design and Software Services for their flagship development, integration and testing services. TPO stated that he has identified key sectors that offer growth opportunities for the assessee in ER&D services and have sharpened their focus on them. Overall, TPO believed that assessee's

company is well positioned to achieve significant revenue growth based on the portfolio of service offerings assessee have in ER&D and Digital IT. Sasken Communication Technologies Ltd. is a leader in providing Engineering R&D and Productized IT Services to global Tier-1 customers in the Communications & Devices. Retail, Insurance and independent Software space. The company offers IC Design, multi-layer analog/RF/High speed digital, mixed signal and high power PCBs boards, post-diagnostics, boot code, board support packages, device drivers, and verification and pre/post validation services for semiconductor industry. Also, TPO observed that Zinnov, a reputed and independent advisory and consulting firm, has rated Sasken as an established and niche player in their Global Service Providers Ratings – 2015 for Engineering R&D services. TPO observed the details of the company having applied 32 patents in India, out of which 8 are granted and 16 are pending. The company also derives revenue from assignment of IP rights and licensing. In view of the above, the TPO observed that the company is functionally different and hence rejected for inclusion. According to the TPO, the above activities of Sasken Communication Technologies Ltd. cannot be compared to the assessee's case. In this regard, Ld. A.R. relied on the following decisions of the coordinate benches of ITAT Bangalore & Hyderabad as mentioned below:-

1) EIT Services India Pvt. Ltd., AY 2016-17, Bangalore ITAT IT(TP)A No.210/Bang/2021

2) Infor (India) Private Limited, AY 2016-17, I.T.A-TP. No. 198/HYD/2021

3) ARM Embedded Technologies Private Limited, AY 2014-15 IT(TP)A No.3374/Bang/2018

15. The Ld. D.R. relied on the order of the lower authorities.

16. We have heard the rival submissions and perused the materials available no record. Sasken Communication Technology Ltd. has been

included in the case of Info India Pvt. Ltd. in IT(TP)A No.198/Hyd/2021 dated 6.10.2021 wherein held as under:-

> *"5. The assessee's 4th substantive ground (having sub grounds (i) to (xiii) challenges correctness of learned lower authorities' action rejecting its comparables. Both the parties are ad idem during the course of hearing that this tribunal's co-ordinate bench's order(s) for AY.2014-15 and 2015-16 (supra) have already included M/s. Evoke Technologies Private Limited and M/s. Sasken Communication Technologies Limited; respectively. The assessee's ground Nos.4(i) and 4(iv) are accepted therefore."*

16.1 In view of the above order of the coordinate bench of Hyderabad Tribunal, we direct the AO/TPO to include this company in the list of comparables.

ii. Evoke Technologies:-

17. The Ld. A.R. submitted that the final sales are unreliable as the figures from branch office outside India was included. From Note 2.29 on page 29 of the annual report of the company, it was noticed by the TPO that the standalone financials reported for the year 2015-16 include revenue and net-profit figures of one branch outside India also. The relevant portion of annual report is reproduced as below:-

> *'Note 2.29 the Balance sheet and Profit and Loss account include the unaudited financial statement of a Branch situated outside India, whose financial statements reflect liability of Rs.4,75,78,953/- as at 31st March, 2016, revenue of Rs.13,00,22,161 for the year ended as on dated 31st March 2016 and branch net loss of Rs.27,33,756/- for the year ended 31st March, 2016.'*

17.1 Ld. TPO stated in his report that since the financials include figures from an outside branch, which are unaudited and hence not reliable. Hence, the company is not acceptable as a comparable.

17.2 In this regard, Ld. A.R. relied on the following decisions of the coordinate benches of ITAT Bangalore & Hyderabad as mentioned below:-

1) Mindteck India Limited, AY 2016-17, IT(TP)A No 252/Bang/2021

2) Infor (India) Private Limited, AY 2016-17, I.T.A-TP. No. 198/HYD/2021

3) ADP Pvt. Ltd., AY 2016-17, Hyderabad ITAT, ITA Nos. 227 & 228 /H/2021

4) Goldman Sachs Services Private Limited, AY 2015-16 IT(TP)A No. 2355/Bang/2019

5) Hewlett Packard India Software Operation Pvt. Ltd., AY 2013-14, Bangalore ITAT, IT(TP)A No. 2866/Bang/2017

18. The Ld. D.R. relied on the order of lower authorities.

19. We have heard the rival submissions and perused the materials available on record. This was considered in the case of Mindtek India Limited in assessment year 2016-17 in IT(TP)A No.252/Bang/2021 dated 27.6.2022, wherein the issue was remitted back to the file of AO/TPO with the following observations:-

> *"As far as the plea of the assessee for inclusion of Evoke Technologies Pvt. Ltd. is concerned, this company was rejected by the TPO on the ground that the financials of this company include figures from outside branches which are unconnected. The DRP agreed with the view of the TPO. The learned Counsel for the assessee placed reliance on the decision of the ITAT, Hyderabad Bench in the case of Infor India Pvt. Ltd. Vs. Deputy Commissioner of Income-tax (2019) 109 taxmann.com 435 (Hyderabad Tribunal) wherein it was held that availability unaudited accounts cannot be the reason to reject the comparability of the company, which satisfies all filters. Reliance was also placed on the decision of the ITAT, Bangalore Bench in the cas of Zynga Game Network India Pvt. Ltd. Vs. Deputy Commissioner of Income-tax in IT(TP)A No.2573/Bang/2019, order dated 23.3.2021 for AY 2015-16 in which the comparability of this company was remanded to the TPO for fresh consideration. We are of the view that the comparability of this company has to be remanded to the TPO for fresh*

consideration in the light of the decision brough to our notice as above."

19.1 On the similar direction, we remit this issue to the file of AO/TPO for fresh consideration.

iii. Sagarsoft (India) Limited:-

20. The Ld. A.R. submitted that this fails SWD Services revenue filter and referred page 40 of the TPO order wherein he observed that the company fails the SWD service revenue > 75% filter. Hence, it was rejected by the TPO. In this regard, Ld. A.R. relied on the following decisions of the coordinate bench of ITAT Bangalore as mentioned below:-

1) EIT Services India Pvt. Ltd., AY 2016-17, Bangalore ITAT IT(TP)A No.210/Bang/2021

2) Mindteck India Limited, AY 2016-17, IT(TP)A No 252/Bang/2021

21. The Ld. D.R. relied on the order of lower authorities.

22. We have heard the rival submissions and perused the materials available on record. This issue came for consideration before this Tribunal in the case of EIT Services India Pvt. Ltd. cited (supra) where in it was held as under:_

"9.7 Ld. A.R. submitted that the learned TPO in in the TPO order (Page 49) has erroneously rejected Sagarsoft by stating that it fails service revenue filter. To this the Ld. A.R. stated that Sagarsoft has an IT service income to sales percentage of 100% and hence passes the aforesaid filter and must be accepted as a comparable company.

9.8 The Ld. A.R. further submitted that Sagarsoft is engaged in software development services. The relevant extract from the annual

report is provided at page 2017 of the paper book which makes it evident that the company is engaged in rendering software services. The Appellant also submits that the company qualifies the quantitative filters applied by the learned TPO. (He referred page 2017 of the paper book)

9.9 Further, the comparable has been accepted by the Ld. DRP in AY 2017-18 in Appellant's own case. (He referred Page 63 of the Case Law Compilation).

9.10 In view of the above-mentioned reasons, Ld. A.R. requested to direct the TPO to include this comparable to the final list of SWD/IT Segment.

9.11 Ld. D.R. relied on the order of Ld. DRP

9.12 We have heard the rival submissions and perused the materials available on record. It was the contention of Ld. A.R. that in the year 2017-18, the Ld. DPR itself included this comparable while determining the ALP in that assessment year. In our opinion, there is no reason to not include this company as a comparable in the A.Y. 2016-17. Accordingly, we direct the AO/TPO to include Sagar Soft (India) Ltd. in the assessment year 2016-17 also."

22.1 In view of the above order of the Tribunal, we direct the AO/TPO to include this comparable.

iv. Ace Software Exports Limited:-

23. The Ld. A.R. submitted that TPO observed in his order that this comparable fails SWD service revenue >75% filter and hence, it was rejected by him and requested to include this company in the list of comparables. The Ld. A.R. submitted that this company has been included in the case of EIT Services India Pvt. Ltd. cited (supra) in the A.Y. 2016-17 and the same may be followed.

24. The Ld. D.R. relied on the order of Ld. DRP.

25. We have heard the rival submissions and perused the materials available on record. This was considered as comparable in the case of EIT Services India Pvt. Ltd. cited (supra) in the AY 2016-17 wherein it was held as under:-

"v. Ace Software Export Ltd.

10. The Ld. A.R. submitted that the learned TPO has erroneously rejected Ace Software in the TPO order at page 50 by stating that the company fails the persistent loss filter. To this the Appellant states that Ace Software has been profitable for the FYs 2015-16, 2014-15 and 2013-14 and hence passes the filter. The relevant extracts from the financial statements of Ace Software are given at page 2019 of the paper book. The company is functionally similar as it is engaged in SWD activity which is evident from page 7 of the Annual Report.

10.1 Further, the comparable has been accepted by the Ld. DRP in AY 2017-18 in Appellant's own case. (He referred Page 66 of the Case Law Compilation)

10.2 In view of the above-mentioned reasons, Ld. A.R. requested to direct the TPO to include this comparable to the final list of SWD/IT Segment.

10.3 Ld. D.R. relied on the order of Ld. DRP.

10.4 We have heard the rival submissions and perused the materials available on record. In this case, it was excluded by Ld. DRP in assessment year 2017-18. We do not find any reason to exclude in the assessment year 2016-17. Being so, we direct the AO/TPO to include this company in the list of comparables."

25.1 In view of this, we direct the AO/TPO to include this company in the list of comparables.

Isummation Technologies Pvt. Ltd.

26. The Ld. A.R. submitted that the AO has not commented on this comparable and he submitted that this company has been included in the case of EIT Services India Pvt. Ltd. cited (supra) in the A.Y. 2016-17 and the same may be followed.

27. The Ld. D.R. relied on the order of the Ld. DRP.

28. We have heard the rival submissions and perused the materials available on record. This issue was considered by this Tribunal in the case of EIT Services India Pvt. Ltd. cited (supra), wherein it was held as under:

"7.6 It has been submitted by Ld. A.R. that this comparable has been accepted by the Ld. DRP in assessment year 2017-18 in assessee's own case. As seen from the direction in para 2.11.7.1 of the order, wherein observed as under:-

> *"2.11.7.1 Having considered the submissions, and on perusal of the annual report, it is seen that the TPO has rejected the comparable for the reason that it fails export revenue filter. However, on examination of the financials of the company as per Note 13 forming part of financial statements the company has reported Rs.2,20,11,325!- of revenue from export sales as against total sales of Rs. 220,84,825!- constituting 99.67% of the total revenue. Thus, the company satisfies the export turnover filter adopted by the TPO. In addition, the company as per the information in the annual report especially the segmental reporting the business activity of the company falls within the single primary business segment viz. Software development. As it is functionally similar and satisfies the export turnover filter, the TPO is directed to consider the company as comparable for the determination of ALP in the software development services."*

7.7 In view of the above, we do not find any reason to exclude this company viz. Isummation Technologies Ltd. from the list of comparables in the assessment year 2016-17. Directed accordingly."

28.1 In view of the above, we direct the AO/TPO to include this company in the list of comparables.

29. No other comparables were pressed in this ground.

30. Ground No.1.16 is not pressed and hence dismissed as not pressed.

31. Ground No.1.17 is with regard to treating a delay in receivables or deferred receivables as an international transaction.

31.1 The Ld. A.R. submitted that the period of credit given to the parties is only 24.5 days and as per agreement, 90 days credit has been given to the parties. Further, he submitted that the learned AO/ learned TPO/ Ld. DRP erred in not appreciating the fact that TP

adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income. The learned AO/ learned TPO/ Ld. DRP erred in disregarding the fact that the receivables are arising out of transactions that are being determined to -be at arm's length by application of Transactional Net Margin Method ("TNMM") and in separately adjusting the -receivables on account of excess credit period. They further erred in not considering the fact that the outstanding amount from the money advanced by the assessee would get adjusted in the working capital adjustment and hence no separate adjustment is required. They further erred in computing interest on the outstanding balance from the AE by evaluating on invoice by invoice basis even though the weighted average period period of receivables of the Appellant is only 24 days, which is less than 30 days as accepted by the Ld. TPO. They also erred in imputing interest on the outstanding receivables from AEs ignoring the fact that the Appellant followed the same policy of not charging any interest on trade receivables from both AEs as well as Non-AEs. Without prejudice, the learned AO/ learned TPO/ Ld. DRP erred in computing notional interest by considering entire year after providing 30 days grace period rather than limiting it to the delay beyond the average credit cycle of the comparable companies selected by the TPO while proposing the TP adjustment. Further without prejudice, the learned TPO has committed arithmetical mistakes in computation of interest. Without prejudice, the Ld. DRP has erroneously directed the learned TPO to adopt State Bank of India ("SBI") short term deposit interest rate instead of adopting London Inter-Bank Offered Rate ("LIBOR"). In this regard, the Ld. DRP have erred in law by not giving an opportunity to the assessee as per

Section 144C(11) of the Act and passing direction which is prejudicial to the interest of the assessee.

32. The Ld. D.R. relied on the order of lower authorities.

33. We have heard the rival submissions and perused the materials available on record. In this case, the main contention of the Ld. A.R. is that assessee has been granted only 24.5 days to the AE. As per agreement, it was 90 days and the payment has been received within this period and there cannot be any adjustment towards interest receivables. In our opinion, the argument of Ld. A.R. is justified. The provision for doubtful loans and advances cannot be considered for computation of interest on intra-group trade and advances as the recovery of the principal itself is doubtful. Hence, we direct the AO/TPO to consider net advances after deducting provision for doubtful loans and thereafter apply LIBOR+2% as held by Tribunal in the case of Swiss Re Global Business Solutions India Pvt. Ltd. in IT(TP)A No.397/Bang/2021 dated 21.1.2022 for the AY 2016-17, wherein it was held as under:-

> *"35. The only other issue that remains for adjudication is ground No.15 with regard to re-characterizing certain trade receivables as unsecured loans and computing notional interest on such trade receivables. The main contention of the ld. AR is that deferred receivables would not constitute a separate international transaction and need not be benchmarked while determining the ALP of the international transaction. In our opinion, this issue was considered by the Tribunal in assessee's own case for AY 2014-15 and in para 23 to 23.9 of the order dated 21.5.2020 this Tribunal held as under:-*
>
> > *"23. Ground No. 14-17 alleged by assessee against adjustment of notional interest on outstanding receivables.*
> >
> > *From TP study, it is observed that payments to assessee are not contingent upon payment received by AEs from their respective*

customers. Further Ld.AR submitted that working capital adjustment undertaken by assessee includes the adjustment regarding the receivables and thus receivables arising out of such transaction have already been accounted for. Alternatively, he submitted that working capital subsumes sundry creditors and therefore separate addition is not called for.

23.1. Ld.TPO computed interest on outstanding receivables under weighted average method using LIBOR + 300 basis points applicable for year under consideration that worked out to 3.3758% on receivables that exceeded 30 days. It has been argued by Ld.AR that authorities below disregarded business/commercial arrangement between the assessee and its AE's, by holding outstanding receivables to be an independent international transaction.

23.2. Ld.AR placed reliance on decision of Delhi Tribunal in Kusum Healthcare (P.) Ltd. v. Asstt. CIT [2015] 62 taxmann.com 79, deleted addition by considering the above principle, and subsequently Hon'ble Delhi High Court in Pr. CIT v. Kusum Health Care (P.) Ltd. [2018] 99 taxmann.com 431/[2017] 398 ITR 66, held that no interest could have been charged as it cannot be considered as international transaction. He also placed reliance upon decision of Delhi Tribunal in case of Bechtel India (P.) Ltd. v. Dy. CIT [2016] 66 taxman.com 6 which subsequently upheld by Hon'ble Delhi High Court vide order in Pr. CIT v. Bechtel India (P.) Ltd. [IT Appeal No. 379 of 2016, dated 21-7-16] also upheld by Hon'ble Supreme Court vide order, in CC No. 4956/2017.

23.3. It has been submitted by Ld.AR that outstanding receivables are closely linked to main transaction and so the same cannot be considered as separate international transaction. He also submitted that into company agreements provides for extending credit period with mutual consent and it does not provide any interest clause in case of delay. He also argued that the working capital adjustment takes into account the factors related to delayed receivables and no separate adjustment is required in such circumstances.

23.4. On the contrary Ld.CIT.DR submitted that interest on receivables is an international transaction and Ld.TPO rightly determined its ALP. In support of the contentions, he placed reliance on decision of Delhi Tribunal order in Ameriprise India (P.) Ltd. v. Asstt. CIT [2015] 62 taxmann.com 237 wherein it is held that, interest on receivables is an international transaction and the transfer pricing adjustment is warranted. He stated that Finance Act, 2012 inserted Explanation to section 92B, with retrospective

> *effect from 1.4.2002 and sub-clause (c) of clause (i) of this Explanation provides that:*
>
> *(i) the expression "international transaction" shall include—*
>
> *. . . . . (c) capital financing, including any type of longterm or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;. . . . '*

23.5. Ld.CIT.DR submitted that expression 'debt arising during the course of business' refers to trading debt arising from sale of goods or services rendered in course of carrying on business. Once any debt arising during course of business is an international transaction, he submitted that any delay in realization of same needs to be considered within transfer pricing adjustment, on account of interest income short charged or uncharged. It was argued that insertion of Explanation with retrospective effect covers assessment year under consideration and hence under/non-payment of interest by AEs on debt arising during course of business becomes international transactions, calling for computing its ALP. He referred to decision of Delhi Tribunal in Ameriprise (supra), in which this issue has been discussed at length and eventually interest on trade receivables has been held to be an international transaction. Referring to discussion in said order, it was stated that Hon'ble Delhi Bench in this case noted a decision of the Hon'ble Bombay High Court in the case of CIT v. Patni Computer Systems Ltd. [2013] 33 taxmann.com 3/215 Taxman 108 (Bom.), which dealt with question of law:

> *"(c) 'Whether on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging an interest during such credit period would not amount to international transaction whereas section 92B(1) of the Income-tax Act, 1961 refers to any other transaction having a bearing on the profits, income, losses or assets of such enterprises?"*

23.6. Ld.CIT.DR submitted that, while answering above question, Hon'ble Bombay High Court referred to amendment to section 92B by Finance Act, 2012 with retrospective effect from 1.4.2002. Setting aside view taken by Tribunal, Hon'ble Bombay High Court restored the issue to file of Tribunal for fresh decision in light of legislative amendment. It was thus argued that non/under-charging of interest on excess period of credit allowed to AEs for realization of invoices, amounts to an international transaction and ALP of such international transaction has to be determined by Ld.TPO. Insofar as charging of rate of interest is concerned, he relied on decision of the Hon'ble Delhi High Court in CIT v. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523/231 Taxman 401 holding that currency in which such

amount is to be re-paid, determines rate of interest. He, therefore, concluded by summing-up that interest on outstanding trade receivables is an international transaction and its ALP has been correctly determined.

23.7. We have perused the submissions advanced by both the sides in the light of the records placed before us. This Bench referred to decision of Special Bench of this Tribunal in case of Special Bench of ITAT in case of Instrumentation Corpn. Ltd. v. Asstt. DIT (IT) [2016] 71 taxmann.com 193/160 ITD 1 (Kol. - Trib.), held that outstanding sum of invoices is akin to loan advanced by assessee to foreign AE., hence it is an international transaction as per Explanation to section 92B of the Act. We also perused decision relied upon by Ld.AR. In our considered opinion, these are factually distinguishable and thus, we reject argument advanced by Ld.AR.

23.8. Alternatively, it has been argued that in TNMM, working capital adjustment subsumes sundry creditors. In such situation computing interest on outstanding receivables and loans and advances to associated enterprise would amount to double taxation. Hon'ble Delhi Tribunal in case of Orange Business Services India Solutions (P.) Ltd. v. Dy. CIT [2018] 91 taxmann.com 286 has observed that:

> *"There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which would have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the assessee would have to be studied. It went on to hold that, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-a-vis the receivables for the supplies made to an AE, the arrangement reflected an international transaction intended to benefit the AE in some way. Similar matter once again came up for consideration before the Hon'ble Delhi High Court in Avenue Asia Advisors Pvt. Ltd v. DCIT [2017] 398 ITR 120 (Del). Following the earlier decision in Kusum Healthcare (supra), it was observed that there are several factors which need to be considered before holding that every receivable is an international transaction and it requires an assessment on the working capital of the assessee. Applying the decision in Kusum Health Care (supra), the Hon'ble High Court directed the TPO to study the impact of the receivables appearing in the accounts of the assessee; looking into the various factors as to the reasons why the same are shown as receivables and also as to whether the said transactions can be characterised as international transactions."*

23.9. In view of the above, we deem it appropriate to set aside this issue to Ld.AO/TPO for deciding it in conformity with the above referred judgment. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in accordance with law."

36. Accordingly, we are of the opinion that deferred receivables would constitute an independent international transaction and the same is required to be benchmarked independently as held by the Hon'ble Karnataka High Court in PCIT v. AMD (India) Pl. Ltd., ITA No.274/2018 dated 31.8.2018.

37. Once we have held that the transaction between the assessee and AE was in foreign currency with regard to receivables and transaction was international transaction, then transaction would have to be looked upon by applying the commercial principles with regard to international transactions and accordingly proceeded to take into account interest rate in terms of London Inter Bank Offer Rate [LIBOR] and it would be appropriate to take the LIBOR rate + 2%. For this purpose, we place reliance on the judgment of the Bombay High Court in the case of CIT v. Aurionpro Solutions Ltd., 99 CCH 0070 (Mum HC). It is ordered accordingly."

33.1 Accordingly, this issue remitted to the file of AO/TPO for re-examine if the credit period is more than 90 days adjustment towards interest receivable to be made. Issue is accordingly remitted to AO/TPO. Ordered accordingly.

Corporate Tax:-

34. Ground No.2 is regarding Corporate Tax. In ground Nos.2.1 & 2.9, the assessee has raised following grounds:-

> *"2.1 The Learned AO and Honorable DRP has erred in law and on facts, in disallowing the expenditure on ESOP of INR 18,18,00,000 under section 37 of the Act without appreciating the submissions furnished by the Appellant.*
>
> *2.9 The learned AO has erred in law and on facts by disregarding that the ESOP expense is liable to TDS under section 192 of the Act as perquisite in the hands of the employees and appropriate taxes are deducted and remitted by the Appellant, which is evidenced by sample Form 16 copies."*

34.1 The Ld. A.R. submitted that during the assessment proceedings for the subject AY 2016-17, the Learned AO had sought certain details in respect of Employee Stock Option Plan ("ESOP") cross-charges incurred by the Company, based on the disclosures made in the financial statements (refer note 25 of the

financial statements). During the proceedings, the AO had specifically sought responses to following questions:

> *"A. Expenses incurred on remittance made to non-residents and whether section 195 of the Act, has been complied with?*
>
> *B. In respect of ESOP cross-charges incurred by the assesse company, furnish a detailed note on modus operandi of ESOP calculation and vesting period option exercised by the employees and whether section 195 is applicable"*

34.2 In response to the above the Company had furnished its response vide submission dated 06 December 2019, explaining the reasons why Tax Deduction at Source ("TDS") provisions are not applicable on the subject cross-charges, which are on cost-to-cost basis.

34.3 However, in the DAO the learned AO proceeded to make adjustments under section 37 of the Income-tax Act, 1961 ("the Act") *(without providing the Company any opportunity to explain allowability of expenditure),* while the AO also noted his observation on non-deduction of TDS under Section 195 of Act, in the DAO.

34.4 Ld. A.R. highlighted that the questions sought by the learned AO in the notice were pertaining to applicability of TDS provisions, but the AO proceeded to make adjustment under section 37 of the Act in the DAO. In view of the above, we have in the paragraphs below provided our detailed submission explaining the reasons for which the addition proposed by the learned AO needs to be dropped –

Background

34.5 Ld. A.R. submitted that the employees of the Company are eligible to participate in Share based compensation schemes of the Ultimate Holding Company, wherein the shares of Ultimate Holding Company are granted to employees of the Company on satisfying certain conditions (explained in detail in the paragraphs below).

34.6 As per the note 25 of the financial statements, the Company has two types of share based compensation scheme operational, namely - Employee Stock Purchase Plan ("ESPP") and Employee Stock Incentive Plan ("ESIP") (hereinafter collectively referred as 'ESOP schemes').

Brief note on the schemes

34.7 Ld. A.R. submitted that as explained in the notes to accounts, under the ESOP schemes the employees are eligible to purchase/get the shares of Ultimate Holding Company (through ESPP/ESIP scheme). The shares of ultimate Holding Company are issued under these schemes, as HPISO is not a listed entity and its shares are not traded in open market.

34.8 A.R's submissions on ESPP scheme :-

- The ESPP scheme provide an opportunity for Employees of HPISO to purchase share of Ultimate Holding Company at defined concessional price and thereby to have an additional incentive.

- Employees' are eligible to participate in this scheme and option is given to the employees to purchase defined

number of shares at concessional price by way of exercising the options. The difference between the purchase price and market price of shares is cross-charged by the Ultimate holding Company to HPISO.

- In this regard, Ld. A.R. has enclosed Annexure 2, copy of the cost reimbursement agreement entered by the Company with the Ultimate Holding Company. Para 2.3(b) of the agreement provides that the said expenses shall be that of HPISO as the same is incurred in respect of shares granted to the employees of HPISO. Accordingly, the same is considered as expenses relating to HPISO's employees and debited to profit and loss account of HPISO. Further, such cross charges are considered as a part of salary income of the concerned employees of HPISO, based on perquisite valuation rules and accordingly taxed in their hands.

- The stock options vest to employees and become exercisable according to the vesting schedule.

- <u>Illustration/Mechanism</u>

Particulars	Refer	Amount
Market Price	A	30
Exercise Price/Purchase price for the employee	B	20
No of shares allotted	C	1500
ESOP expenses cross-charged to HPISO		15,000 *[1500*(30-20)]*

He submitted that the cross-charges to HPISO is in respect of actual cost incurred towards options exercised and shares purchased by employees of HPISO.

<u>AR's submissions on ESIP Scheme</u>

34.9 ESIP schemes provides for various incentives. In India, employees of HPISO are eligible to receive stock awards (in the form of Restricted Stock Units, hereinafter referred to as "RSU") and stock options. The rewards under the stock options and RSU, are explained in the paragraphs below -

- RSU represents Restricted Stock Unit. As per the scheme, upon completion of vesting period, the employees will be eligible to receive reward in the form of shares. HPE grants RSUs at no cost to the employees. The value of the RSU shall be the market price of stock multiplied by the number of shares, which the employee is eligible to receive.

- Stock options represents options, which provide employees the right to purchase Shares in future at a specified price (the grant price) set on the grant date. The mechanism and illustration similar to ESPP scheme shall apply under stock option plan.

- The interest of the employee (i.e., shares) in the RSUs/stock options shall vest according to the vesting schedule (say 1/3 each year over a period of three years).

- <u>Illustration/Mechanism for RSU</u>

Particulars	Refer	Year 1	Year 2	Year 3
Market Price	A	30	32	35
Exercise Price/Purchase price for the employee	B	-	-	-
No of shares allotted	C	500	500	500
ESOP expenses cross-charged to HPISO		15,000 *[500*30]*	16,000 *[500*32]*	17,500 *[500*35]*

- The cost of such shares granted by the Ultimate Holding Company, to the eligible employees of HPISO under this scheme are cross-charged to HPISO by Ultimate Holding Company. The cross-charged amount is the expense incurred by HPISO and debited to its Profit and Loss account under the head Employee benefit expenses. The ESOP expenses in hands of HPISO is considered as a part of salary Income for the employees based on perquisite valuation rules.

- HPE global ESIP plan document along with sample RSU Grant agreement and Stock Option Award Agreement are enclosed as Annexure 3, Annexure 4A and 4B respectively. Additionally, the cross-reimbursements agreement enclosed as Annexure 2, shall apply in respect of cross charges of expenses by Ultimate Holding Company to HPISO.

ESOP schemes - Administration and Management

34.10 Ld. A.R submitted that as explained in the earlier paragraphs, the shares pertaining to Ultimate Holding Company are granted to eligible employees of HPISO under the above ESOP schemes. In this regard, Ld. A.R. submitted the following-

- The ESOP schemes are managed and administered by the Ultimate Holding Company for all the employees across HPE group entities.

- Employees of the Company are eligible to participate in these ESOP schemes, and accordingly, shares are granted based on their performance and certain other parameters.

- HPISO recommends the list of eligible employees to the ESOP Committee, based on employee performance and the other parameters.

- Ultimate Holding Company's responsibility is limited to grant of these shares to employees of HPISO as the shares are listed in stock exchange in USA. HPISO will handle all the paperwork, collection of options, providing eligible list of employees with number of shares to be granted, perquisite computation for the employees, TDS computation on perquisite and remittance thereof, etc. as the actual beneficiary of such shares are the employees of HPISO.

34.11 In connection with the above, Ld. A.R. submitted that the differential price/full price of the shares granted under

these schemes are considered as a part of 'perquisite' taxable in the hands of employees under section 17(2) of the Act. Accordingly, the Company has deducted appropriate TDS under section 192 of the Act.

<u>ESOP Cross-charges represents actual cost to</u> <u>HPISO</u>

34.12 Ld. A.R. submitted that the ESOP cross-charges incurred by the Company represents the actual expenditure incurred by the Company. The remittance made towards such cross charges are in fact in the nature of incentives/compensation paid to the employees of HPISO, who form part of its business and are involved in carrying out day-to-day business operations/management. To substantiate the above, we have enclosed the following -

- Details of shares granted to employees in respect of which cost is recovered by Ultimate Holding Company from HPISO (enclosed as Annexure 6);

- Sample debit note/invoices in respect of which remittance is made towards ESOP charges during the year (enclosed as Annexure 7);

- Copy of the cost reimbursement agreement (enclosed as Annexure 2);

- Sample Form 16 evidencing that ESOP considered as taxable perquisite in the hands of the employees and included in their taxable salary and deduction of TDS on the taxable salary including the ESOP perquisite value as granted to the employees

- ESPP scheme document, ESIP scheme document and sample RSU agreement are enclosed as Annexure 1, Annexure 3 and Annexure 4A respectively.

34.13 From the above, it is evident that the ESOP charges incurred by the Company represents actual expenditure and therefore question of the same being notional in nature, as alleged by the learned AO, does not arise in the subject case.

34.14 Ld. A.R. in the paragraphs below provided detailed submission on the deductibility of ESOP charges and the reasons for which provisions of TDS under section 195 of the Act are not applicable.

ESOP cross-charges are deductible under Section 37(1) of the Act

34.15 Ld. A.R. submitted that as indicated earlier, the ESOP cross-charges represents the actual expenditure incurred by the Company in respect of its employees, who form part of the Company's business and are involved in carrying out day-to-day business operations/management. The said expenses are incurred wholly and exclusively for the business of the Company and therefore, eligible for deduction under section 37 of the Act.

34.16 These expenses are nothing but compensation paid to employees of HPISO and accordingly, taxed in the hands of employees as 'Perquisites'. The disallowance of these expenses under section 37 of the Act would imply that the AO believes

that the compensation paid to its employees is not allowable under section 37 of the Act.

34.17 Provision of section 37(1) of the Act *inter alia* provides that "any expenditure laid out or expended wholly and exclusively for the purposes of the business or profession, not being in the nature of capital expenditure or personal expenses, shall be eligible for deduction in computation of total income".

In the subject case, we wish to submit as under:

- The ESOP schemes for stock options enables in attracting and retaining the employees of the Company, resulting in better performance of the Company's business operations. The scheme is designed primarily to incentivise and for retaining the employees and thereby earn more revenue by securing consistent and concentrated efforts of dedicated employees.
- Further, the share based compensation under the ESOP scheme is construed both by the employees and the Company as a part of employment remuneration package, which is an expenditure inextricably linked to the business of the Company.
- On similar facts, Income-tax Appellate Tribunal ("Tribunal"), Bangalore in the case of Nova Nordisk India Private Limited (ITA NO 1275/Bang/2011) (copy enclosed as Annexure 8) has held that ESOP expenditure incurred is deductible under Section 37(1) of the Act.
- In the cited case, the Tribunal was dealing with the expenditure incurred on ESOP schemes (managed by the Holding Company) and expenditure was in respect of

employees of Indian Company. The Tribunal held that the ESOP expenditure was wholly and exclusively for the purpose of the business of the Indian Company and had to be allowed as deduction as a revenue expenditure. Relevant extract of the decision is provided below -

- *"We fail to see any basis for the observation of the CIT(A) that the obligation to issue shares at a discounted price to the employees of the Assessee was that of the foreign parent company and not that of the Assessee. Admittedly, the shares were issued to employees of the Assessee and it is the Assessee who has to bear the difference in cost of the shares. The expenditure is necessary for the Assessee to retain a healthy work force. Business expediency required that the Assessee incur such costs. The parent company will be benefitted indirectly by such a motivated work force. This will be no ground to deny the deduction of a legitimate business expenditure to the Assessee as laid down by the Hon'ble Supreme Court in the case of Sassoon J.David (supra)"*

- In addition, Ld. A.R. placed reliance on the decision of the Bangalore ITAT (Special Bench) in the case of Biocon Ltd. Vs. DCIT [2013] 25 ITR(T) 602, wherein the Tribunal has held as under

- *"It follows that the discount on premium under ESOP is simply one of the modes of compensating the employees for their services and is a part of their remuneration. Thus, the contention of the Id. DR that by issuing shares to employees at a discounted premium, the company got a lower capital receipt, is bereft of an force. The sole object of issuing shares to employees at a discounted premium is to compensate them for the continuity of their services to the company. By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company. The substance of this transaction is disbursing compensation to the employees for their services, for which the form of issuing shares at a discounted premium is adopted."*

34.18 In addition to the above, various Courts have also upheld deductibility of ESOP expenses in the following cases:

ING Vysya Bank Ltd. Vs: ACIT [2014] 39 ITR(T) 250 (Bangalore ITAT) Sterlite Technologies Ltd (ITA No.4841/Mum/2013) (Mumbai ITAT) CERA Sanitaryware Ltd (ITA No.2817/Ahd/2011) (Ahmedabad ITAT) Aditya Birla Nuvo Ltd (ITA No.3178/M/2012) (Mumbai ITAT)

- HDFC Bank Ltd (ITA No.374/Mum/2012) (Mumbai ITAT)
- Inox Leisure Ltd (ITA Nos.374 & 523/AHD/2012) (Ahmedabad ITAT)
- Korn Ferry International Pvt Ltd (ITAs No.5152/Mum/2012) (Mumbai ITAT) Sandvik Asia Pvt Ltd (ITA Nos.1841 & 1842/PN/2012) (Pune ITAT)

  Religare Commodities Limited (ITA No.2283/Del/2013 and ITA No.3634/Del/2014)(Delhi ITAT)
- DCIT vs Kotak Mahindra (IT APPEAL NO. 698 (MUM.) OF 2016)(Mumbai ITAT)
- CIT v. Lemon Tree Hotels Ltd. [IT Appeal No. 107 of 2015, dated 18-8-2015]
- CIT v. PVP Ventures Ltd. [2012] 23 taxmann.com 286/211 Taxman 554 (Mad.)

34.19 Therefore, Ld. A.R. submitted that it is amply clear that cross-charges towards ESOP scheme is an expenditure incurred by the Company wholly and exclusively towards its business.

Expenditure incurred is not notional expense

34.20 As explained in the earlier paragraphs, the expenditure incurred on ESOP cross-charges represents actual expenses, evidenced from the invoices, employee listing, actual remittances made by the Company and other documentary evidences;

34.21 In fact, the Company has deducted appropriate TDS under section 192 of the Act on the ESOPs granted to the employees (as evidenced by sample Form 16 enclosed). Therefore, the question of the said expenditure being notional in nature does not arise;

34.22 Additionally, in the decisions referred above, it has been clearly emphasized that ESOP cost represents actual expenditure and not notional in nature. Therefore, the expenditure is eligible for deduction under section 37 of the Act.

34.23 Given the expenditure incurred in the subject case is towards employees of the Company, the question of the same being in nature of 'personal' does not arise.

Expenditure is not capital in nature

34.24 ESOP schemes designed are primarily to incentivize better performing employees and thereby earn more revenue by securing consistent and concentrated efforts of dedicated employees. The schemes designed are not with an intention to increase the capital needs of the Company. The shares granted to employees are the shares listed and traded in stock exchange at USA.

34.25 The compensation paid to the employees in the form of ESOPs is revenue in nature and no asset of enduring nature is coming into existence. The decisions referred above also emphasize the said fact that expenditure incurred is in the nature of revenue expenditure.

34.26 Accordingly, Ld. A.R. submitted that said expense should be deductible in the hands of the employer. Additionally, Ld. A.R. submitted that the treatment cannot be different in the hands of the employee and in the hands of employer. Share based compensation under ESOP schemes is taxable in the hands of

employees as "perquisite" under Salary income and TDS provision are applicable on such payment.

34.27 In view of the above, he submitted that the incurrence of expenditure towards ESOP for employees is a clear and explicit expenditure incurred for the employees and directly affects the performance of employees, which in-turn is critical for the Company's business and its long-term growth. Accordingly, we wish to submit that the expenditure incurred is deductible under section 37(1) of the Act.

34.28 While the learned AO failed to evaluate the facts of the case and made an unwarranted disallowance by wrongful application of section 37(1) of the Act. The learned AO had also erred in stating that the subject cross-charges were subject to withholding under Section 195 of the Act. In the paragraphs below, the Company submitted its contention against the application of section 195 of the Act.

Provisions of section 195 of the Act shall not apply

34.29 At the outset, Ld. A.R. reiterated that the Company has deducted appropriate TDS under section 192 of the Act in respect of share based compensation under ESOP schemes, as 'perquisites' under section 17 of the Act. Accordingly, it is submitted that the ESOP cross charges are subject to TDS provisions under section 192 of the Act and the same is in accordance with the Circular No. 17/2014 issued by the Central Board of Direct taxes for computation of taxable income of employees.

34.30 Without prejudice to the above, Ld. A.R. submitted the following:-

- As mentioned earlier, the cross charges from the Ultimate Holding Company represent the cost of these shares as incurred by the Ultimate Holding Company in respect of shares granted to employees of HPISO and exercised by them. Accordingly, the subject cross charges and the remittances against the same does not contain any element of income, which is taxable in the hands of the Ultimate Holding Company as the same is cross-charged to HPISO on cost-to-cost basis.

- Provisions of section 195 of the Act *inter a/ia* provides for deduction of TDS only in respect of any sum of which is chargeable to tax under the Act. In the absence of any income element in the subject remittance, there is no sum chargeable to tax to Ultimate Holding Company and hence the provisions of Section 195 of the Act would not apply.

- The above principle has been upheld by various Courts including the Hon'ble Supreme Court in the case of GE India Technology Cen.(P.). Ltd vs CIT [2010] 327 ITR 456 (SC). Relevant extract of the Supreme Court decision is reproduced below -

> *"Section 195 falls in Chapter XVII which deals with collection and recovery. Chapter XVII-B deals with deduction at source by the payer. On analysis of various provisions of Chapter XVII one finds use of different expressions, however, the expression "sum chargeable under the provisions of the Act" is used only in section 195. For example, section 194C casts an obligation to deduct TAS in respect of "any sum paid to any*

> *resident". Similarly, sections 194EE and 194F inter alia provide for deduction of tax in respect of "any amount" referred to in the specified provisions........*
> *......The Act is to be read as an integrated Code. Section 195 appears in Chapter XVII which deals with collection and recovery. As held in the case of CIT v. Eli Lilly & Co. (India) (P.) Ltd. [2009] 312 ITR 225 (SC) the provisions for deduction of TAS which is in Chapter XVII dealing with collection of taxes and the charging provisions of the Income-tax Act form one single integral, inseparable Code and, therefore, the provisions relating to TDS applies only to those sums which are "chargeable to tax" under the Income-tax Act."*

34.31 The above view has also been upheld by various other courts –

- Principal Commissioner of Income Tax vs Nova Technocast (P.) Ltd [2018] 94 taxmann.com 322 (Gujarat HC)
- Commissioner of Income-tax vs Prism Cement Unit [2015] 61 taxmann.com 273 (Madhya Pradesh HC)
- Commissioner of Income-tax -IV vs Himalya International Ltd. [2014] 51 taxmann.com 213 (Delhi HC)
- Indo Overseas Films vs Income Tax Officer, International Taxation [2017] 81 taxmann.com 378 (Chennai - Trib.)

34.32 While the AO has considered the decision of GE India Technology Cen.(P.). Ltd in the DAO but without examining the facts of the case, has proceeded to conclude that ESOP cross charge is in the nature of income and are taxable under the Act.

34.33 The learned AO has neither examined nor has given any factual finding as to how the element of income is embedded in the reimbursement of ESOP cross charges. The AO has failed

to take cognizance of the fact that the reimbursements are made on cost-to-cost basis. The AO has also made references to various other provisions of the Act without analyzing whether the ESOP cross-charges includes any income element, which is taxable under the Act.

34.34 Further, the case laws relied upon by the Learned AO are very different on facts and not applicable in the context of the Company.

34.35 The ESOP expenditure incurred is a compensation/incentive to the employee and has direct nexus with his/her employment. Such compensation to the employees in the form of ESOP are included in salary of the employees under Section 17 of the Act. Therefore, such expenses are incurred for the purposes of business and hence allowable expenditure under section 37 of the Act in the hands of the employer i.e. the Company.

34.36 The expenditure of ESOP cross-charge amounting to INR 18,18,00,000 by the Ultimate Holding Company to HPISO are actual expenses incurred and remitted by HPISO and not notional in nature.

34.37 The ESOP remittance does not contain any element of income, which is taxable in the hands of the Ultimate Holding Company as the same are cost-to-cost reimbursements. Accordingly, the provisions of Section 195 of the Act is not applicable in the subject case.

34.38 Given the above facts and the judicial precedents, the Company submitted that ESOP expense is a deductible expenditure

under section 37 of the Act and provisions of section 195 of the Act is not applicable.

35. The Ld. D.R. relied on the order of lower authorities.

36. We have heard the rival submissions and perused the materials available on record. Similar issue came for consideration before this Tribunal in the case of Novo Nordisk Inia Pvt. Ltd. in ITA No.1275/Bang/2011 dated 30.9.2013, wherein it was held as under:-

18. "We have considered the rival submissions. It is clear from the facts on record that there was an actual issue of shares of the parent company by the assessee to its employees. The difference, between the fair market value of the shares of the parent company on the date of issue of shares and the price at which those shares were issued by the assessee to its employees, was reimbursed by the assessee to its parent company. This sum so reimbursed was claimed as expenditure in the profit & loss account of the assessee as an employee cost. The law by now is well settled by the decision of the Special Bench of the ITAT Bangalore in the case of Biocon Ltd. in ITA No.248/Bang/2010, A.Y. 2004-05 and other connected appeals, by order dated 16.07.2013, wherein it was held that expenditure on account of ESOP is a revenue expenditure and had to be allowed as deduction while computing income. The Special Bench held that the sole object of issuing shares to employees at a discounted premium is to compensate them for the continuity of their services to the company. By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company. The substance of this transaction is disbursing compensation to the employees for their services, for which the form of issuing shares at a discounted premium is adopted.

19. In the present case, there is no dispute that the liability has accrued to the assessee during the previous year. The only question to be decided is as to whether it is the expenditure of the assessee or that of the parent company. We are of the view that the observations of the CIT(A) in para 5.6 of his order that these expenses are the expenses of the foreign parent company is without any basis and lie in the realm of surmises. The foreign parent company has a policy of offering ESOP to its employees to attract the best talent as its work force. In pursuance of this policy of the foreign parent company, allowed its subsidiaries/affiliates across the world to issue its shares to the employees. As far as the assessee in the present case which is an affiliate of the foreign parent company is concerned, the shares were in fact acquired by the assessee from the parent company and there was an actual outflow

of cash from the assessee to the foreign parent company. The price at which shares were issued to the employees was paid by the employee to the Assessee who in turn paid it to the parent company. The difference between the fair market value of the shares of the price at which shares were issued to the employees was met by the Assessee. This factual position is not disputed at any stage by the revenue. In such circumstances, we do not see any basis on which it could be said that the expenditure in question was a capital expenditure of the foreign parent company. As far as the assessee is concerned, the difference between the fair market value of the shares of the parent company and the price at which those shares were issued to its employees in India was paid to the employee and was an employee cost which is a revenue expenditure incurred for the purpose of the business of the company and had to be allowed as deduction. There is no reason why this expenditure should not be considered as expenditure wholly and exclusively incurred for the purpose of business of the assessee.

20. We fail to see any basis for the observation of the CIT(A) that the obligation to issue shares at a discounted price to the employees of the Assessee was that of the foreign parent company and not that of the Assessee. Admittedly, the shares were issued to employees of the Assessee and it is the Assessee who has to bear the difference in cost of the shares. The expenditure is necessary for the Assessee to retain a health work force. Business expediency required that the Assessee incur such costs. The parent company will be benefitted indirectly by such a motivated work force. This will be no ground to deny the deduction of a legitimate business expenditure to the Assessee as laid down by the Hon'ble Supreme Court in the case of Sassoon J.David (supra).

21. The reference by the CIT(A) to the provisions of Sec.40A(2)(b) of the Act is again without any basis. The price of the shares of NNAS is arrived at by applying the average market price for the period 3rd October, - 17the October, 2005 in the Copenhagen Stock Exchange. The price so arrived at and the price at which shares are issued to the employees of the Assessee is the benefit which the employees get under the ESOP. The Assessee or its parent company can never influence the stock market prices on a particular date. There is no evidence or even a suggestion made by the CIT(A) in his order. There is no basis to apply the provisions of Sec.40A(2)(b) of the Act.

22. With regard to the decision of the ITAT in the case of Accenture (supra), we find that the facts of the case of Accenture (supra) are identical. In the case of Accenture (supra), the facts were that the assessee company incurred certain expenses on account of payments made by it for the shares allotted to its employees in connection with the ESPP. The AO had disallowed Rs. 9,06,788/- incurred by the assessee on the ground that this expenditure is not the expenditure of assessee company but that expenditure is of parent company and the benefit of such expenditure accrues to the parent company and not assessee. The CIT(A) deleted the addition made by the AO. The CIT(A) found that the common shares of Accenture Ltd. the parent company, have been allotted to the employees of ASPL, the Indian

affiliate/Assessee and not to the employees of the parent company. The CIT(A) also found that though the shares of the parent company have been allotted, the same have been given to the employees of the Assessee at the behest of the Assessee. The CIT(A) thus held that it was an expense incurred by the assessee to retain, motive and award its employees for their hard work and is akin to the salary costs of the assessee. The same was therefore business expenditure and should be allowable in computing the taxable income of the assessee. The tribunal upheld the view of the CIT(A). It can be seen from the decision in the case of Accenture (supra) that the shares of the foreign company were allotted and given to the employees of affiliate in India at the behest of the affiliate in India. The CIT(Appeals), however, presumed that the facts in the instant case of the assessee was that the shares were allotted to the employees of the affiliate in India at the behest of the foreign company. This is not the factual position in the assessee's case, as the assessee had on its own framed the NNIPL ESOP Scheme, 2005, to benefit its employees. NNAS may have a global policy of rewarding employees of affiliates with its shares being given at a discount and that policy might be the basis for the Assessee to frame ESOP. That by itself will not mean that the ESOP was at the behest of the parent company. In any event the immediate beneficiary is the Assessee though the parent company may also be indirect beneficiary of a motivated work force of a subsidiary. We are of the view that the factual basis on which the CIT(Appeals) distinguished the decision of the Mumbai Bench of ITAT in the case of Accenture (supra) is erroneous.

23.With regard to the observations of the CIT(Appeals) that the ESOP actually benefits only the parent company, we are of the view that the expenditure in question is wholly and exclusively for the purpose of the business of the assessee and the fact that the parent company is also benefited by reason of a motivated work force would be no ground to deny the claim of the assessee for deduction, which otherwise satisfies all the conditions referred to in section 37(1) of the Act. The decision of the Hon'ble Supreme Court in the case of Sassoon J. David & Co. (P) Ltd. (supra) and the Hon'ble Karnataka High Court decision in the case of Mysore Kirloskar Ltd. (supra) clearly support the plea of the assessee in this regard.

24. We are of the view that in the facts and circumstances of the present case, the expenditure in question was wholly and exclusively for the purpose of the business of the assessee and had to be allowed as deduction as a revenue expenditure.

25. For the reasons given above, we direct the expenditure be allowed as deduction."

36.1. Further, the Tribunal in the case of Global e-Business Operations (P) Ltd. in IT(TP)A No.212/Bang/2021 dated 27.09.2022 has held as under:-

“20. We have heard rival submissions and perused the material on record. In assessee’s group case, namely, EIT Services India Pvt. Ltd. v. DCIT (supra), had held that the ESOP expenditure is to be allowed as a deduction u/s 37 of the I.T.Act. The Tribunal had followed the judgment of the Hon’ble jurisdictional High Court in the case of CIT v. Biocon Limited (supra). The relevant finding of the Tribunal in assessee’s group case, reads as follows:-

> *“20.27 We have heard the rival submissions and perused the materials available on record. This issue came up for consideration before the Hon’ble Karnataka High Court in the case of CIT Vs. Biocon Ltd. cited (supra) wherein it was held as under:-*
>
> > *“From a perusal of section 37(1) of the Income-tax Act, 1961 it is evident that the provision permits deduction of expenditure laid out or expended and does not contain a requirement that there has to be a payout. If an expenditure has been incurred, section 37(1) of the Act would be attracted. Section 37 does not envisage incurrence of expenditure in cash.*
> >
> > *An assessee is entitled to claim deduction under the provision if the expenditure has been incurred. It is well settled in law that if a business liability has arisen in the accounting year, it is permissible as deduction, even though, the liability may have to be quantified and discharged at a future date.*
> >
> > *Section 2(15A) of the Companies Act, 1956, defines "employees stock option" to mean option given to whole time directors, officers or the employees of the company, which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future rate to securities offered by the company at a pre-determined price. In an employees stock option plan a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at a discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. In order to be eligible for acquiring shares under the scheme, the employees are under an obligation to render their services to the company during the vesting period as provided in the scheme. On completion of the vesting period in the service of the company, the option vests with the employees.*
> >
> > *The expression "expenditure" also includes a loss and therefore, issuance of shares at a discount where the assessee*

absorbs the difference between the price at which they are issued and the market value of the shares would be expenditure incurred for the purposes of section 37(1). The primary object of the exercise is not to waste capital but to earn profits by securing consistent services of the employees and therefore, it cannot be construed as short receipt of capital.

Held, dismissing the appeal, that the deduction of the discount on the employees stock option plan over the vesting period was in accordance with the accounting in the books of account, which had been prepared in accordance with Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. For assessment year 2009-10 onwards the Assessing Officer had permitted the deduction of the employees stock option plan expenses. The Revenue could not be permitted to take a different stand with regard to the assessment year 200405. The expenses were deductible."

21. In view of the above judgement of Hon'ble Karnataka High Court in the case of Biocon Ltd., we are in agreement with the contention of assessee's counsel in principle on this issue. However, we make it clear that the AO has to verify whether the said amount has been subject to TDS in the assessment year under consideration u/s 192/195 of the Act as argued by the Ld. A.R. before us. Accordingly, this issue is remitted to AO for fresh consideration in the light of above."

21. The assessee has raised grounds with regard to the issue that the assessee is not liable for TDS u/s 195 of the I.T.Act (refer grounds 2.9 to 2.15). We are of the view that these grounds need not be adjudicated, since, on perusal of the final assessment, it is clear that the disallowance of ESOP expenses has made under the provisions of section 37 of the I.T.Act (though there was some discussion in the draft assessment order with reference to disallowance u/s 40(a)(i) of the I.T.Act). Therefore, grounds 2.1 to 2.8 are allowed and ground 2.9 to 2.15 is not adjudicated."

36.2. In view of the above order of the Tribunal, we are inclined to allow both the above grounds taken by the assessee.

37. Ground No.3 is not pressed before us. Accordingly dismissed as not pressed.

38. Ground No.4.1 which is preposterous and does not require adjudication.

39. Ground No.4.2 is with regard to levy of interest u/s 234B & 234C of the Act, which is consequential in nature. Ordered accordingly.

40. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 3rd Oct, 2022.

Sd/- **(N.V. Vasudevan)** **Vice President**	**Sd/-** **(Chandra Poojari)** **Accountant Member**

Bangalore,
Dated 3rd Oct, 2022.
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.