

Cos. engaged in sales of software can't be used as comparables for Cos. providing software development services

Summary – The Hyderabad ITAT in a recent case of United Online Software Development (India) (P.) Ltd., (the Assessee) held that where TPO made addition to assessee's ALP in respect of software development services provided to its AE located abroad, in view of fact that some of comparables selected by TPO were also engaged in sales of software products and thus they were functionally different whereas some other comparables were found inappropriate on account of related party transactions, brand value, high turnover, etc., impugned adjustment was to be set aside and, matter was to be remanded back for disposal afresh.

Facts

- The assessee was engaged in providing software development services only to its AE in USA on cost plus basis.
- In transfer pricing proceedings, assessee adopted Transaction Net Margin Method (TNMM) as the most appropriate method and selected 36 companies as comparables for bench marking its price charged for the international transaction.
- Since the average profit margin on cost of the 36 comparable companies was 12.06 per cent as against assessee's margin of 9.67 per cent, the price charged for international transaction was claimed to be within ALP.
- The TPO though agreed with the assessee so far as adoption of TNMM as most appropriate method was concerned, but, he nevertheless rejected the TP study of the assessee by pointing out various defects and deficiencies therein and primarily for the reason that the assessee had not used current year data in case of 27 companies and in respect of the rest 9 companies, assessee had considered current year data along with data relating to the preceding two years.
- After rejecting TP document furnished by the assessee, the TPO undertook a search in the data bases by adopting some of the filters applied by the assessee along with some other additional filters which yielded 20 comparables with average ALP margin at 19.9 per cent.
- Accordingly, certain adjustment was made to assessee's ALP.
- The DRP set aside objections raised by assessee.
- The assessee filed instant appeal raising objection to selection of five comparables by TPO.

Held

- The objection raised by assessee regarding selection of comparables is dealt with in following manner:

I. Accel Transmatic Ltd.

- It is the specific contention of the assessee that Accel Transmatic Ltd, has sold IP rights for the software developed by it. Further, it is also the contention of the assessee that this company fails the RPT filter of more than 25 per cent applied by the TPO himself. In case of *Huawei Technologies India Ltd. v. ITO* [IT Appeal No. 1338 (Bang.) of 2010, dated 30-4-2013], the ITAT Bangalore had held that this company could not be taken of comparable to a purely software development service provider.
- Facts being materially same and since it pertains to the same assessment year, following the view adopted by the ITAT, Bangalore Bench in the aforesaid case, it is held that this company cannot be comparable to the assessee.

II. Megasoft Ltd.

- It is quite evident from records that this company has two separate segments i.e. product and services. therefore, it at all, the Assessing Officer/TPO considers the aforesaid company to be a comparable, then, he is directed to consider software development services segment alone for comparability analysis.

III. Infosys Technologies Ltd.

- Undisputedly, the TPO has accepted the fact that the assessee is purely a software development service provider to its AE whereas Infosys is not a captive service provider like assessee. It is a fact that Infosys is engaged in diversified activities and also engaged in development of products consultancy and solution. That apart, the size, reputation and brand value of Infosys, in no way makes it comparable to a small captive service provider like assessee. Therefore, following consistent view of different benches of Tribunal, this company is excluded from the list of comparables.

IV. Tata Elxsi Ltd. (Seg.)

- In case of *Huawei Technologies India (P.) Ltd. (supra)*, ITAT Bangalore Bench excluded this company relying upon the decision of ITAT, Mumbai Bench in case of *Telcordia Technologies India (P.) Ltd. (supra)* pertaining to the same assessment year i.e. 2006-07.
- Following the view expressed by Bangalore and Mumbai Benches, of the Tribunal, which is in relation to assessment year 2006-07, it is opined that Tata Elxsi Ltd. is also to be excluded from the list of comparables while determining the ALP of the International transaction.
- In aforesaid circumstances, impugned adjustment is set aside and matter is remanded back to APO/TPO for disposal afresh.