

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

[Before Hon'ble Shri A.T.Varkey, JM & Shri M.Balaganesh, AM]

I.T.A Nos. 927 & 2400/Kol/2017

Assessment Years : 2012-13 & 2013-14

M/s Labvantage Solution Pvt. Ltd. -vs.-
Kolkata
[PAN : AAACL 5340 H]
(Appellant)

A.C.I.T., Circle-2 (1)
Kolkata

(Respondent)

For the Appellant : Shri Manoneet Dalal &

Shri Gyan Prakash Srivastava

For the Respondent : Shri G.Mallikarjuna, CIT, DR

Date of Hearing : 07.05.2018

Date of Pronouncement : 11 .05.2018

ORDER

Per Shri M.Balaganesh, AM

1. These appeals of the assessee arise out of the proceedings for the Asst Years 2012-13 and 2013-14 of the Learned Dispute Resolution Panel (DRP) dated 13.10.2016 and 8.5.2017 respectively in which directions are given to the Learned AO u/s. 144C(5) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act'). As some of the issues involved in both the appeals are identical in nature, they are taken up together and disposed off by this common order for the sake of convenience.

ITA No. 927/Kol/2017 – Asst Year 2012-13

2. At the time of hearing, the Id AR stated that the Ground Nos. 1, 3.1, 3.2, 3.3, 3.6. are not pressed before us. The same is reckoned as a statement from the Bar and accordingly the same are dismissed as not pressed.

3. The Ground No. 2 raised by the assessee is general in nature and does not require any adjudication.

4. The first ground to be decided in this appeal for the Asst Year 2012-13 is with regard to exclusion of E-Infochips Ltd as a comparable while determining the Arm's Length Price of the assessee with regard to software development services (international transaction) of the assessee. The inter connected issue to be decided in this appeal is as to whether the Id DRP was justified in treating the foreign exchange gain as non-operating income while determining the ALP of international transactions, in the facts and circumstances of the case. The other issue involved in this appeal is with regard to determination of Arm's Length Price (ALP) of Royalty payments at Rs Nil by the Id TPO. The assessee had raised the following grounds in this regard:-

3. Determination of arm's length price by the AO, TPO and DRP for the software design & development services

That on the facts and circumstances of the case and in law, , the Ld. DRP, TPO and AO erred in not accepting the arm's length price of the transaction undertaken by the Appellant with respect to software design & development services without appreciating the contentions, arguments e idences and data put forward by the Appellant during the course of the proceedings before them and in doing so have grossly erred in :

3.4. erred in rejecting comparable companies selected by the Appellant by providing adhoc reasons and accepting companies which were not comparable to the Appellant in terms of functions, assets and risk profile.

3.5. excluding the foreign exchange gain / loss while calculating the Profit Level Indicator (PLI) of the Appellant as well as of the comparable companies.

5. Erroneous disallowance of the Royalty payment

5.1 The Ld. DRP, AO, and TPO erred on facts and in law by separately determining the arm's length price of the royalty paid, by using TNMM while determining the amount of adjustment on a proportionate basis.

5.2 The Ld. DRP, AO, and TPO also erred on facts and in law in not giving cognizance to the separate benchmarking analysis done by Appellant, by virtue of which such payment of royalty by the Appellant to its AEs was determined to be at arm's length.

5.3 The Ld. DRP, AO and TPO erred on facts and in law in making an adjustment on account of payment of royalty by completely disregarding the business and pricing model of the Appellant and thereby challenging the commercial wisdom of the Appellant in making such payments while passing the order.

4.1. The brief facts of this issue is that the Labvantage Solutions Private Limited ("LVS India") and Labvantage Solutions inc. ("LVS US"/"AE") are group companies as both are directly or indirectly held by TCG Lifesciences Ltd. LVS US is a global solutions provider that helps companies optimize their laboratory productivity, and leverage the latest information management and communication technologie in order to effectively share analytical data throughout their worldwide organizations. LVS US is engaged in development, marketing of Laboratory Information Management Systems (LIMS) Software, testing and customer configuration services, provision of local sales and customers support services. The proprietary software is conceptualized and owned by LVS US. LVS India is engaged in the development and customization of LIMS for its AE. The software development and customization work is sub-contracted by LVS US to the assessee. The assessee vis a vis the group is involved in the execution of the software development i.e primarily coding of software ("software services") outsourced to it by LVS US.

4.2. Further, LVS India is also engaged in the resale of packaged software namely 'Sapphire' in the domestic market. This software caters to the laboratory requirements of process industries, pharmaceutical companies and contract laboratory organizations. With respect to the said distribution activity, the AE charges Royalty based on software packages sold by the assessee.

4.3. The assessee had following international transactions with its AE during the financial year 2011-12 relevant to Asst Year 2012-13:—

(i) Provision of software design & development services	Rs 11,60,79,838
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(ii) Payment of Royalty to LVS US (including TDS) Rs 55,80,071/-

The assessee used Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) with a Profit Level Indicator (PLI) of Net Cost Plus (NCP) Margin to demonstrate the arm's length nature of the international transaction. The assessee arrived at a set of 12 comparable companies with a NCP margin of 15.68%.

Table 9 : NCPs of the Comparable Companies

Sr.No.	Name of the Company	NCP 2009-10 (%)	NCP 2010-11 (%)	NCP 2011-12 (%)	Weighted Average
1.	Akshay Software Technologies Ltd.	(3.19)	0.66	9.87	2.93
2.	Evoke Technologies Pvt. Ltd.	18.72	8.33	NA	12.55
3.	E-Zest Solutions Ltd.	18.14	41.85	NA	29.57
4.	Goldstone Technologies Ltd.	3.01	5.92	11.01	6.62
5.	Mindtree Ltd.	22.98	9.06	14.43	14.81
6.	Persistent Systems Ltd.	30.53	25.87	27.09	27.57
7.	R S Software (India) Ltd.	9.88	16.35	15.28	14.09
8.	R Systems International Ltd.	18.62	6.50	2.60	8.90
9.	Sasken Communication Technologies Ltd.	24.71	27.03	17.00	22.79
10.	Tata Elxsi Ltd.	17.13	8.59	6.55	10.11
11.	Thirdware Solutions Ltd.	29.59	17.45	NA	22.74
12.	Vama Industries Ltd.	9.33	14.59	27.52	15.47
	Arithmetical Mean				15.68

The NCP margin of the assessee under export segment was 22.86%. Based thereon, the assessee's margin earned on software design and development services was considered

at arm's length. Further, as the transaction pertaining to 'Payment of Royalty' constituted less than 10% of the International transaction, the same was also aggregated and benchmarked under TNMM. During the course of transfer pricing assessment proceedings, the Ld. TPO rejected segmental computation furnished by the assessee wherein the aforementioned two transactions were aggregated and benchmarked. Instead, he computed the overall entity level NCP margin of the assessee at 5.27% as under:-

1. Operational Revenue		Rs 13,02,39,108/-
2. Operational Expenses as per P&L A/c	Rs 12,41,46,286/-	
Less: Interest	Rs 51,028/-	
Provision for doubtful debts	Rs 3,73,870/-	
Loss on sale of assets	Rs 11,655/-	
3. Total Cost		Rs 12,37,09,733/-
4. Operational Profit (1-3)		Rs 65,29,375/-
5. PLI = OP / TC		5.27%

4.4. The Id TPO considered the same for determination of arm's length nature of transaction pertaining to Contract Software Development Services. The Id TPO then determined the arm's length margin at 21.17% by conducting a fresh benchmarking exercise by selecting 16 companies as under:-

Sl.No.	Name of the Company	PLI-OP/TC(%)	Remarks
1	Acropetal Technologies Ltd	6.84	PLI revised
2	CTIL	11.47	
3	Datamatics Global Solutions Ltd	14.09	
4	RS Software Ltd	15.28	
5	Spry Resources (India) Pvt Ltd	35.12	
6	Lucid Software Ltd	13.42	

7	PreludeSys (India) Ltd	56.38
8	ASM Technologies Ltd	16.41
9	E-Infochips Ltd	74.97
10	Onward Technologies Ltd	13.61
11	Trigyn Technologies Ltd	7.74
12	Thirdware Solutions (P) Ltd	25.24
13	Sasken Communications Technologies Ltd	12.13
14	E-Zest Solutions Pvt Ltd	16.06
15	Akshay Software Technologies Ltd	7.84
16	Evoke Technologies Ltd	12.13
	Simple Arithmetic Mean	21.17

4.5. The assessee pleaded that some of the companies selected by the Id TPO were not functionally comparable to the activities undertaken by the assessee with respect to the international transaction. While computing the adjustment for software development services for LVS India, the Id TPO inter alia included the following in the cost base for computing the assessee's NCP margin:-

- a) Royalty expense paid by LVS India to LVS US (even though a separate adjustment for the same was done by the Id TPO)
- b) Domestic as well as the AE cost for the software segment as total cost.

It was pleaded that based on the above erroneous approach, the Id TPO made a transfer pricing (TP) adjustment of Rs 1.74 crores with respect to the margin earned by the assessee under the software development activity. Separately, the Id TPO made an adjustment of Rs 11.82 lacs with respect to payment of Royalty. The Id DRP upheld

the order of the Id TPO by granting minor relief to the assessee by directing the Id TPO to grant working capital adjustments.

5. The Id TPO passed an order giving effect to the directions of Id DRP on 24.11.2016 wherein the final list of comparables as accepted by the Id DRP were listed as under:-

<u>Sl.no.</u>	<u>Final Comparable</u>
1.	Acropetal Technologies Ltd.
2.	CTIL Ltd
3.	Spry Resources India Pvt. Ltd
4.	Lucid Software Ltd.
5.	Onward Technologies Ltd
6.	Trigyn Technologies Ltd.
7.	Thirdware Solutions Ltd
8.	Sasken Communication Technologies Ltd.
9.	E-Zest Solutions Pvt. Ltd.
10.	Akshay Software Technologies Ltd.
11.	Evoke Technologies Pvt Ltd
12.	R S Software Ltd.
13.	ASM Technologies Limited
14.	E-Infochips Limited

5.1. The Id TPO after taking into account the working capital adjustments as directed by the Id DRP, arrived at the arithmetic mean of comparables at 15.94% as under:-

Sl.No.	Name of the comparables	PLI as per order of the TPO dt. 31.12.2015(%)	Revised PLI on incorporation of working capital adjustment in compliance with DRP's direction (%)
1.	Acropetal Technologies Ltd.	4.66	4.07
2.	CTIL Ltd	11.47	(12.61)
3.	Spry Resources India Pvt. Ltd.	15.28	17.57
4.	Lucid Software Ltd.	31.87	16.10
5.	Onward Technologies Ltd	14.90	15.84
6.	Trigyn Technologies Ltd.	16.41	14.37
7.	Thirdware Solutions Ltd	74.97	72.67
8.	Sasken Communication Technologies Ltd.	13.61	16.04
9.	E-Zest Solutions Pvt. Ltd.	6.80	1.46
10.	Akshay Software Technologies Ltd.	25.24	24.34
11.	Evoke Technologies Pvt Ltd	12.13	13.77
12.	R S Software Ltd.	16.06	14.53
13.	ASM Technologies Limited	7.84	11.08
14.	e-Infochips Limited	11.60	13.97
	Simple Arithmetic Mean	18.77	15.94

5.2. The assessee submitted before the Id DRP that the Id TPO had erroneously considered royalty payment in the cost base of the assessee while computing the adjustment amount, completely ignoring the fact that a separate adjustment on account of such royalty paid had already been undertaken. In this regard, the Id DRP accepted the objections of the assessee. The Id TPO in his order dated 24.11.2016 supra noted that revised cost base to be considered post excluding the cost incurred for royalty as under:-

Operating Cost as considered by the TPO in order dt

31.12.2015	Rs 12,37,09,733/-
Less: Royalty to LVS Inc. (since adjustment has been Made for it separately)	Rs 8,01,318/-
Net Operating expense to be considered	Rs 12,29,08,415/-

The ALP after incorporating the directions of the Id DRP was arrived by the Id TPO finally as under:-

Software design and development services rendered

1. Operating Cost [OC] (as per order dated 31.12.2015)	Rs 12,37,09,733/-
2. Less: Royalty to LVS Inc. (based on revised computation)	Rs 8,01,318/-
3. Net Operating Expenses (Operating cost – adjustment on Royalty)	Rs 12,29,08,415/-
4. Arm's Length Mean Margin Post Working Capital Adj.	15.94% of OC
5. ALP @ 115.94% of Net Operating Costs	Rs 14,25,00,016/-
6. Total Operational Revenue	Rs 13,02,39,108/-
7. Sales to AE	Rs 11,60,79,838/-
8. Percentage of Sales to AE to Operational Revenue	89.13%
9. ALP of transaction with AE	Rs 12,70,10,265/-
10. 5% variation from international transactions	Rs 12,18,83,830/-
11. Upward Adjustment	Rs 12,70,10,265/-

5.3. The assessee objected before the Id DRP regarding the adjustment made on account of Royalty. However, the Id DRP relying on the remand report furnished by the Id TPO

rejected the assessee's objection. The Id TPO observed in his order dated 24.11.2016 (i.e giving effect to DRP order) that in the order dated 31.12.2015, the TPO had used TNMM as the Most Appropriate Method (MAM). Based on the various discussions, a revised PLI of 15.36% has been arrived at and thus applied on such payment of royalty and accordingly the revised adjustment on account of payment of royalty would be as under:-

Arm's length mean profit margin (%) as per DRP direction	15.94
Total Royalty Paid (as per Form 3CEB)	Rs 50,27,091/-
Total Royalty Paid (gross including TDS)	Rs 55,80,071/-
ALP of Royalty (84.64% of Rs 50,27,091/-)	Rs 42,25,772/-
Excess Paid	Rs 8,01,318/-
Downward adjustment	Rs 8,01,318/-

5.4. The Id TPO accordingly in his giving effect to DRP directions passed an order dated 24.11.2016 by making the following TP adjustments as under:-

Upward adjustment in respect of software services	Rs 12,70,10,265/-
Downward adjustment on account of royalty	Rs 8,01,318/-
Total Adjustment	Rs 12,78,11,583/-

5.5. Later the assessee filed a rectification petition u/s 154 of the Act on 23.12.2016 against the giving effect order dated 24.11.2016 pointing out various mistakes apparent from record as under:-

- a) Adoption of incorrect margin of Lucid Software Ltd at 14.90% instead of corrected working capital adjusted NCP margin of 12.04%
- b) Adoption of incorrect margin of Spry Resources India Pvt Ltd at 16.10% instead of 11.10%

Among others

5.6. The Id TPO passed the rectification order u/s 92CA(5) r.w.s. 92CA(3) and 144C(5) of the Act dated 8.3.2017 pursuant to the 154 petition of the assessee and arrived at the revised PLI of comparables after taking into account working capital adjustments as under:-

Sl.No.	Comparable companies	PLI as per order of the TPO dt. 31.12.2015(%)	Corrected PLI post directions issued by the Dispute Resolution Panel (%)	Revised PLI on incorporation of working capital adjustment in compliance with DRP's direction (%)
1.	Acropetal Technologies Ltd.	6.84	4.66	4.07
2.	CTIL Ltd	11.47	11.47	(12.61)
3.	Spry Resources India Pvt. Ltd.	35.12	31.87	11.76
4.	Lucid Software Ltd.	13.42	11.10	12.04
5.	Onward Technologies Ltd	13.61	13.61	16.04
6.	Trigyn Technologies Ltd.	7.74	6.80	1.46
7.	Thirdware Solutions Ltd	25.24	25.24	24.34
8.	Sasken Communication Technologies Ltd.	12.13	12.13	13.77
9.	E-Zest Solutions Pvt. Ltd.	16.06	16.06	14.53
10.	Akshay Software Technologies Ltd.	7.84	7.84	11.08
11.	Evoke Technologies Pvt	12.13	11.60	13.97

	Ltd			
12.	R S Software Ltd.	15.28	15.28	17.57
13.	ASM Technologies Limited	16.41	16.41	14.37
14.	E-Infochips Limited	74.97	74.97	72.67
	Simple Average	19.16	18.50	15.36

5.6.1. The revised cost base to be considered post excluding the cost incurred for royalty is as follows:-

Particulars	Amount (INR)
Operating cost as considered by TPO in order dated 31.12.15	12,37,09,733
Less: Royalty to LVS Inc.(since adjustment has been made separately)	8,57,099
Net operating expense to be considered	12,28,52,634

5.6.2. The revised adjustment to ALP was arrived as under:-

Software development services

1.	Operating Cost (as per order dated 31.12.2015)	Rs.12,37,09,733/-
2.	Less : Royalty to LVS Inc. (as above)	Rs.8,57,099/-
3.	Net operating expenses	Rs.12,28,52,634/-
4.	Arm's length mean margin post working capital adjustment	15.36% of Operating cost
5.	Arm's length price (ALP) @115.36% of net operating cost	Rs.14,17,22,799/-
6.	Total operational revenue	Rs.13,02,39,108/-

7.	Sales to AE	Rs.11,60,79,838/-
8.	Percentage of sales to AE to operational revenue	89.13%
9.	Arm's length Price of transaction with AE (89.13% of Rs.14,17,22,799/-)	Rs.12,63,15,050/-
10	+5% variation from international transaction (i.e. Sl no.7 X 105%)	Rs.12,18,83,830/-
11.	(-) 5% variation from international transaction (i.e. Sl. No.7 X 95%)	Rs.11,02,75,846/-
12.	Shortfall to be adjusted upward (i.e. Sl no.9-7)	1,02,35,212

Payment to royalty

Arm's length mean profit margin	15.36%
Total royalty paid (as per form 3 ceb)	50,27,091/-
Total royalty paid (gross including TDS)	55,80,071/-
Arm's length price of royalty (84.64% of Rs.55,80,071)	47,22,972/-
Excess paid	8,57,099/-
Downward adjustment	8,57,099/-

Thus, total adjustment would be as follows :

<u>S.No.</u>	<u>Issue</u>	<u>Amount</u>
1	Rendering of software development services	1,02,35,212
2	Payment of royalty	8,57,099/-
	Total Adjustment	1,10,92,311/-

Thus the quantum of adjustment to be made with total income is Rs.1,10,92,311/-.

6. Aggrieved, the assessee is in appeal before us on the grounds stated supra.

7. With regard to arm's length computation of software services, we find that the assessee had sought exclusion of E-Infochips Ltd from the list of final comparables for which Ground No. 3.4. is raised by the assessee. We find that during the Asst Year

2012-13, the company amalgamated one of its wholly owned subsidiary, namely E-Infochips Bangalore Ltd w.e.f. 1.4.2011 which is evident from the fact reported in their annual report for the financial year 2011-12 enclosed in page 1054 of the paper book. Pursuant to the said amalgamation, E-Infochips Bangalore Ltd's functions, assets as well as risks too got merged with that of E-Infochips Ltd with effect from 1.4.2011. We find from the nature of business mentioned in the business profile of the said comparable enclosed in page 1118 of the paper book, that the said comparable is engaged in IT, ITES and sale of products for which segmental information is not available. The assessee herein does not have ITES. Hence no comparison could be made for want of segmental data. We also find that the co-ordinate bench decision of *Delhi Tribunal in the case of Alcatel Lucent India Ltd vs DCIT reported in (2016) 74 taxmann.com 105 (Delhi-Trib) dated 24.8.2016 for the Asst Year 2011-12* had rejected this comparable for being engaged in diversified services and for want of information of segmental data. We find that this decision has been approved by the *Hon'ble Delhi High Court in the case of PCIT vs Alcatel Lucent India Ltd in ITA No. 515/2017 dated 18.7.2017*. The Id AR stated that the Id DRP in Asst Year 2013-14 (i.e succeeding assessment year) had accepted that the said comparable is not functionally comparable with the assessee's profile. We find this fact to be correct from the record of Asst Year 2013-14 which is also before us along with this appeal. Hence we have no hesitation in holding that E-Infochips Ltd is not functionally comparable to the assessee and accordingly we direct the Id TPO to exclude the same from the final list of comparables. Accordingly, the Ground No. 3.4. raised by the assessee is allowed.

8. With regard to exclusion of foreign exchange gain / loss while calculating the Profit Level Indicator (PLI) , for which assessee has raised Ground No. 3.5, we find that the Id TPO had treated forex gain as non-operating even though the assessee functionally bears forex risk. We find that this has been captured in the TP study report enclosed in page 66 of the paper book as under:-

4.3.7. Foreign Exchange Risk

Foreign exchange risk means the risk associated with the adverse fluctuation in the rate of currencies in which entity is dealing. Since LVS india's expenses are incurred in Indian Rupees and the payment is received from AE in foreign currency, LVS India bears risk of currency rate fluctuations.

We find that the exchange fluctuation risk is factored by the assessee in its FAR analysis and the same need to be treated as operating income while computing PLI. We find that the assessee had borne the foreign exchange risk as part and parcel of its trading transactions with its AE which is on revenue account and hence the ratio laid down by the Hon'ble Supreme Court in the case of CIT vs Woodward Governor India (P) Ltd reported in 312 ITR 254 (SC). We also find that the Hon'ble Delhi High Court in the case of PCIT vs M/s Rampgreen Solutions Pvt Ltd in ITA No. 340/2016 dated 27.5.2016 had held as under:-

“4. As regards the other issue concerning foreign exchange fluctuation loss. being considered as part of the operative expenses, the issue stands covered against the Revenue and in favour of the Assessee by the decision of the Supreme Court in Commissioner of Income-tax v. Woodward Governor India (P) Ltd. (2009) 312 ITR 254 (SC). Likewise, the issue concerning the rate of interest for capital adjustment is covered against the Revenue and in favour of the Assessee in terms of the decision of this Court in Cotton Natural (P) Ltd. v. CIT (2015) 276 CTR 445. Consequently no substantial question of law arises in respect of these issues as well.”

The Id AR stated that the Id DRP in Asst Year 2013-14 (i.e succeeding assessment year) had accepted that the foreign exchange fluctuation is to be treated as operating income while computing PLI in assessee's own case. We find this fact to be correct from the record of Asst Year 2013-14 which is also before us along with this appeal. Hence we have no hesitation in holding that forex gain . loss is to be treated as operating income while computing PLI and accordingly we direct the Id TPO to compute the PLI accordingly. The Ground No. 3.5. raised by the assessee is allowed.

9. The Id AR argued that with the exclusion of E-Infochips Ltd from the list of final comparables chosen by the Id TPO and the inclusion of forex gain as part of operating income for computing PLI, the assessee's margin would be clearly justified to be at ALP and hence no adjustment need to be made in the facts and circumstances of the case. In view of this, we hold that the adjudication of other grounds namely Ground Nos. 4.1. , 4.2. , 6 & 7 becomes academic in nature and hence need not be gone into.

10. With regard to disallowance of Royalty payment, we find that the Id TPO in his remand report submitted to the Id DRP had accepted the fact that the assessee had indeed been benefitted from the said transaction and the same has been captured in the DRP directions enclosed in page 46 of the appeal set. Hence there is no dispute on the veracity of the said international transaction or the benefit derived by the assessee from the said transaction. The only aspect disputed by the Id TPO is the amount paid by the assessee to its AE. The assessee had paid royalty to its AE on the license sales made by it to the third party customers as well as on the maintenance revenue generated from such licenses earlier sold to third party customers. The Id AR argued that since such payment was integral to the operations of assessee, and in the nature of operating expenses, such transaction was aggregated with the provision of software design and development services transaction and benchmarked using TNMM as the MAM. Thus, owing to closely linked and integrated nature of said transaction, TNMM is the MAM for its evaluation. The Id AR submitted that while determining the arm's length nature of the said transaction, the Id TPO has used the same set of comparable companies as those selected for the software development segment. This is contrary to the position taken by the Id TPO himself, wherein, he had on one hand segregated the said transaction for determination of the arm's length price and on the other hand, had in turn used the same margin to determine the arm's length margin. The Id AR submitted that in case the said transaction had to be benchmarked separately, then the correct approach to benchmark the said transaction would be to use comparable uncontrolled transaction which are functionally similar to the said international transaction. Based on these

arguments, the Id AR argued that the adoption of CUP search undertaken by the assessee and filed with the Id DRP vide submission dated 16.6.2016 should be accepted. The Id AR further argued that what is effectively carried out by the assessee is only trading in software as far as this transaction is concerned. The assessee bought software from its AE and sold it locally to third party customers and 40% of it is given to the AE as Royalty. This royalty admittedly is paid pursuant to the Royalty agreement entered into with AE and which was also placed before the lower authorities. But what is effectively paid is pursuant to revenue sharing arrangement between the assessee and its AE by sharing 40% of the revenue from trading of software to its AE by the assessee. The Id AR also placed reliance on the decision in assessee's own case for the Asst Year 2010-11 of this tribunal in ITA No. 617/Kol/2015 dated 19.10.2016 wherein it had been held that the assessee had complied with the benefit test in the form of increased turnover and profitability in that year pursuant to payment of royalty to its AE. However, we find that during the year under appeal, the Id TPO himself had accepted the fact that the assessee had indeed satisfied the benefit test pursuant to payment of royalty to its AE. Hence the ratio laid down by this tribunal on this aspect for the Asst Year 2010-11 cannot be made applicable for this year under appeal before us. We also find that the assessee had pleaded that the payment though nomenclatured as royalty, is not royalty as such, but is only a payment made towards revenue sharing arrangement entered into with its AE. Though this fact was also mentioned in the Asst Year 2010-11 order of this tribunal, we find that no finding with regard to this aspect was given by the tribunal and relief was granted to the assessee on the benefit test and benchmarking of royalty done by the assessee based on CUP method. We find that no finding whatsoever had been given by the lower authorities on the argument of the assessee that payment of 40% is made to AE pursuant to revenue sharing arrangement, though nomenclatured as royalty. In other words, the lower authorities had completely proceeded on the point that the payment made is only towards royalty. The Id AR also pointed out that the assessee to be on the safer side, had also subjected the payment of

40% to AE to withholding tax treating the same as royalty to avoid possible disallowance of the same u/s 40(a)(i) read with section 195 of the Act. We find that this has got no bearing on the determination of ALP of the subject mentioned payment in the scheme of transfer pricing. Since the Id AR before us had stated that what is paid is only share of AE pursuant to revenue sharing arrangement and not royalty, this aspect deserves to be remanded back to the file of the Id TPO for denovo adjudication. Accordingly, we hold that this issue of disallowance of payment of royalty is remanded to the file of Id TPO / Id AO for denovo adjudication with a direction to Id TPO to benchmark the subject mentioned payment vis a vis the comparables afresh, in order to determine the ALP of the said international transaction, in accordance with law. Accordingly, the Ground Nos. 5.1., 5.2. and 5.3. raised by the assessee are allowed for statistical purposes.

11. The Ground No. 8 raised by the assessee is with regard to initiation of penalty proceedings u/s 271(1)(c) of the Act which does not survive in view of the aforesaid decisions rendered for the quantum additions with a liberty granted to the revenue to initiate fresh penalty proceedings u/s 271(1)(c) of the Act on completion of the set aside assessment, if they so desire. Accordingly, the Ground No. 8.1. raised by the assessee is allowed.

12. In the result, the appeal of the assessee for the Asst Year 2012-13 in ITA No. 927/Kol/2017 is partly allowed for statistical purposes.

ITA No. 2400/Kol/2017 – Asst Year 2013-14 – Assessee Appeal

13. The Ground No.1 raised by the assessee for the Asst Year 2013-14 is general in nature and does not require any specific adjudication.

14. The only issue contested in this year is with regard to disallowance of Royalty payment of Rs 21,53,468/-. We find that the Id TPO had accepted the margin earned by the assessee from its software development services to be at Arm's Length by giving the benefit of (+) / (-) 5% range difference. The assessee's margin was 13.47% and the comparables margin chosen by the Id TPO was 16.50%. Accordingly, no adjustment was made by the Id TPO for the software development services. However, the Id TPO as was done by him in Asst Year 2012-13, applied the same comparables margin (i.e margin of software development services) of 16.50% to the royalty payment of Rs 21,53,468/- and made a downward adjustment of Rs 3,55,323/- in the transfer pricing assessment which was upheld by the Id DRP. Aggrieved, the assessee is in appeal before us on the following grounds :-

“2. Erroneous disallowance of the Royalty payment

2.1. The Ld. DRP, AO, and TPO erred on facts and in law by separately determining the arm's length price of the royalty paid, by using TNMM while determining the amount of adjustment on a proportionate basis.

2.2. The Ld. DRP, AO, and TPO also erred on facts and in law in not giving cognizance to the separate bench marking analysis done by Appellant, by virtue of which such payment of royalty by the Appellant to its AEs was determined to be at arm's length.

2.3. The Ld. DRP, AO and TPO erred on facts and in law in making an adjustment on account of payment of royalty by completely disregarding the business and pricing model of the Appellant and thereby challenging the commercial wisdom of the Appellant in making such payments while passing the order.”

15. We have heard the rival submissions. We find that as in Asst Year 2012-13, even in Asst Year 2013-14, the Id DRP / Id TPO had not disputed the compliance of benefit test by the assessee pursuant to payment of royalty / license fees to its AE. We have already held supra that what is paid to the AE is only the share of revenue which is nomenclatured as royalty. We find lot of force in the argument of the Id AR that the Id TPO having decided not to make any adjustment to ALP of software development

services, ought not to have applied the same comparables margin of 16.50% on the royalty payment thereby resulting in excess payment of royalty of Rs 3,55,323/- and consequentially making downward adjustment to the same. We hold that the decision rendered by us supra for Asst Year 2012-13 would apply with equal force for this Asst Year 2013-14 also except with variance in figures. Accordingly, the Ground Nos. 2.1., 2.2. and 2.3. raised by the assessee are allowed for statistical purposes.

16. The Ground No. 3 raised by the assessee is with regard to initiation of penalty proceedings u/s 271(1)(c) of the Act which does not survive in view of the aforesaid decisions rendered for the quantum addition with a liberty granted to the revenue to initiate fresh penalty proceedings u/s 271(1)(c) of the Act on completion of the set aside assessment, if they so desire. Accordingly, the Ground No. 3.1. raised by the assessee is allowed.

17. In the result, the appeal of the assessee for the Asst Year 2013-14 in ITA No. 2400/Kol/2017 is allowed for statistical purposes.

18. To sum up,

ITA No. 927/Kol/2017 – Asst Year 2012-13 – appeal of the assessee is partly allowed for statistical purposes.

ITA No. 2400/Kol/2017 – Asst Year 2013-14 – appeal of the assessee is allowed for statistical purposes.

Order pronounced in the Court on 11.05.2018

Sd/-
[A.T.Varkey]
Judicial Member

Sd/-
[M.Balaganesh]
Accountant Member

Dated : 11 .05.2018

[RG SPS]

Copy of the order forwarded to:

- 1.M/s Labvantage Solutions Private Limited, Bengal Intelligent Park Limited, Building-D, 3rd floor, Block EP & GP, Sector-V, Salt Lake Electronics Complex, Kolkata-700091.
2. Astt..C.I.T., Circle-2(1), Kolkata.
3. Dissolution Resolution Panel-2, Kolkata.
4. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Senior Private Secretary
Head of Office/D.D.O.. ITAT, Kolkata Benches

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