IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I" NEW DELHI
BEFORE SHRI R.P. TOLANI AND SHRI SHAMIM YAHYA

ITA No. 5420/Del/2011 & 6057/Del/2012
A.Yrs. 2007-08 & 2008-09

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| Hughes Systique India Pvt. Ltd.<br>1, Shivaji Marg, Westend Green,<br>NH-8, New Delhi-110038.<br>PAN: AACB 6600 N | Vs. | ACIT, Circle 12(1),<br>New Delhi. |
| ( Appellant ) | | ( Respondent ) |

| | | |
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| Appellant by | : | Shri Ajay Vohra Adv.<br>Shri Abhishek Agarwal CA<br>Shri Ramit Katyal CA |
| Respondent by | : | Shri Peeyush Jain CIT(DR) TP |

**O R D E R**

**PER R.P. TOLANI, J.M:**:

These are assessee's appeals against assessment orders dated 31.10.2011 for A.Y. 2007-08 and dated 19.10.2012 for A.Y. 2008-09.passed by the assessing officer u/s 143(3) after seeking directions from DRP u/s 144C(13) of the Income-tax Act, 1961 ("the Act"). Both the appeals are heard together and disposed of by this common order for the sake of convenience.

2. The principal grounds of appeal, common in both the years under consideration, raised by the appellant are as under; others being supplementary and argumentative grounds are not pressed hence dismissed.

> *2. That the assessing officer erred on facts and in law in making an addition of Rs. 129,356,670/- (A.Y. 2007-08) & Rs. 17,28,83,745/- (A.Y. 2008-09) on account of the alleged difference in the arm's length price of the 'international*

*transaction' of (i) provision of software services, and (ii) marketing support services, on the basis of the order passed under section 92CA(3) read with section 144C(5) of the Act by the Transfer Pricing Officer ("the TPO").*

*2.1. That the assessing officer / DRP erred on facts and in law in disregarding the internal benchmarking undertaken by the assessee for determining the arm's length price of the international transactions applying TNMM on the ground that (i) the transactions undertaken with unrelated party at 20.60% of the total revenue, is lower than the quantum of transaction undertaken with associated enterprises, hence, it does not provide a robust measure of comparability, and (ii) internal benchmarking was adopted to gloss over the entity level loss.*

*2.2. That the assessing officer/DRP erred on facts and in law in evaluating the international transactions applying TNMM at entity level by comparing the net operating profit margin of the assessee with uncontrolled net operating profit margin of comparable uncontrolled enterprises.*

*3. That the assessing officer/DRP erred on facts and in law in holding the arms length price of the international transactions of payment of market support services fees ('MSF') of Rs. 9,12,80,860/- (A.Y. 2007-08) and Rs. 7,70,11,732/- (A.Y. 2008-09) at nil allegedly concluding that no such service has been received by the and therefore there is no rationale for paying this marketing support services fees to the AE.*

*4. That the assessing officer erred on facts and in law restricting depreciation on computer peripherals @ 15% as against 60% claimed by the assessee, without appreciating that UPS could not work without computers and such machines are a part of computer system and not plant and machinery.*

> *5. That the assessing officer erred on facts and in law in levying interest under Section 234B and Section 234C of the Act.*

3. Brief facts about grounds of appeals are : The appellant has challenged before us Transfer Pricing adjustment made by the TPO and sustained by the Dispute Resolution Panel ("DRP") on account of (I) international transaction of provision of software development services; and (II) international transaction of payment of fee for marketing support services to the associated enterprise.

**(I) Transfer Pricing adjustment in respect of the international transactions of software development services:**

3.1. The appellant, Hughes Systique India Pvt. Ltd., is as subsidiary company of Hughes Systique Mauritius Private Limited and is engaged in the business of providing software engineering services in the telecom domain with areas of focus being broadband, satellite communications, wireless, multimedia applications, etc. During the previous year, relevant to assessment years 2007-08 and 2008-09 the appellant, in the course of its business, entered into international transaction of rendering of software development services with its associated enterprise, viz., Hughes Network Systems, USA.

3.2. This international transaction of rendering of software development services to the associated enterprise was reported to be at arm's length in the following manner by the appellant:

**(i) Benchmarking of international transaction of software development services applying TNMM considering internal comparables.**

3.3. Besides undertaking software development for the associated enterprise, viz., Hughes Network Systems Inc., USA, the appellant also entered into direct contracts with other unrelated party customers during the relevant previous years. Since an internal comparables were available for benchmarking the international transactions of provision of software design and development services, the appellant applied Transactional Net Margin Method ("TNMM") as the most appropriate method and considered internal comparables for applying TNMM.

The result of the benchmarking analysis, as aforesaid, is tabulated as under:

| | | |
|---|---|---|
| Onsite software development services | 7.55% | -9.29% |
| Offshore software development services | -50.81% | -56.73% |

3.4. In respect of the international transactions of rendering onsite software development services to the associated enterprise, the appellant earned operating profit margin (OP/TC) of 7.55%, the average operating profit margin of (-) 9.29% earned on similar transactions with unrelated parties, such international transactions were considered to be at arm's length.

3.5. While rendering offshore software development services to the AE, the appellant earned operating profit margin (OP/TC) of (-) 50.81% as against average operating profit margin of (-) 56.37% on similar transactions with unrelated third parties. Accordingly, the international transaction of provision of software design and development services onsite and also offshore was considered to be at arm's length price.

**(ii) Benchmarking of international transaction of software development services applying TNMM with external comparables**

3.6. For the purpose of applying TNMM, the appellant by written submissions filed with the TPO, external comparables and the operating profit margin (Operating Profit/Operating Cost ratio) of the appellant on international transactions entered into with AE (i.e. on controlled transaction) was alternatively benchmarked with the operating profit margin (Operating Profit/Operating Cost ratio) of the comparable companies. After considering the various selection criteria, 17 comparable companies were identified as functionally comparable to the operations of the appellant.

3.7. The operating profit ratio of the appellant from controlled transactions, i.e., 13.26% (after considering adjustment on account of idle capacity) being higher than the average of operating profit margin of the comparable companies at 6.48%, the international transaction was even otherwise demonstrated to be at arm's length and no adjustment was required to be made.

**(iii) Benchmarking of international transaction of software development services applying internal CUP method.**

3.8. The assessee also justified the international transaction of onsite software development services rendered to associated enterprise being at arm's length, applying CUP. It was contended that while providing onsite services, the appellant has charged $11,000 per month from its associated enterprise, viz, Hughes Network Systems as against $8000 - $9,000 per

month charged from unrelated party, namely, Nokia Siemens Networks, Oy. Since the price charged from associated enterprise for providing onsite software development services was higher than the price charged from unrelated party, such international transaction of rendering of onsite software development services were to be considered being at arms length price

**TPO's/DRP's orders**:

3.9. The TPO in his report disregarded the internal benchmarking analysis undertaken by the appellant applying Transactional Net Margin Method ("TNMM"), holding that transactions with unrelated party constituted minor share of 20.30% of the total transactions and, therefore, did not provide a robust measure of comparability and further, internal benchmarking was adopted by the appellant to gloss over entity level loss.

3.10. The Dispute Resolution Panel (DRP), affirming the conclusions of the TPO, held that "*in view of DRP, internal comparables can be used but only if they provide a correct measure of comparability. If the transaction with non AEs constitutes a minor share of 20.60% of total transaction it cannot provide a robust measure of comparability as considerations other than market factors can be embedded in it.*"

3.11. The TPO has, instead, undertaken the benchmarking analysis applying TNMM considering external comparables. The TPO, for application of TNMM, carried out a fresh search of comparables and applied additional filters, e.g., wages/ sales ratio, persistent losses,

declining operating profit and onsite revenue filter for selection or rejection of external comparable companies.

3.12. The TPO, considering average operating profit margin (OP/OC%) of 25 external comparable companies at 24.31% (after working capital adjustment) as against a loss of 6.53% of the appellant, computed an adjustment of Rs. 3,80,75,810 allegedly on account of difference in international transactions of rendering of software development services.

4. After mentioning these brief facts, ld. Counsel for the assessee adverted to application under rule 29 of the ITAT Rules dated 18-01-2013 for admission of additional evidence. For the justification and admissibility of the evidence it is pleaded that: :

(i) Copy of software development agreement entered in to between the associate enterprise of the appellant, i.e. Hughes Network Systems Inc. and unrelated third party, i.e. Hughes Software System Limited (now known as Aricent Technologies Holdings Limited).

(ii) Sample copy of invoice raised by Hughes Software System Limited (now known as Aricent Technologies Holdings Limited) on Hughes Network Systems Inc. against provision of software development services.

4.1. It is emphasized that this is practically the first appeal before the Tribunal against the impugned assessment order. The appellant had placed before the TPO comparable uncontrolled transactions for application of CUP method in respect of onsite software development services. However, at that time, the appellant did not have in its

possession similar comparable uncontrolled transactions in respect of offshore software development services rendered to the associated enterprise.

4.2. The TPO, in his order, did not consider the aforesaid comparable uncontrolled transactions for benchmarking of international transactions onsite software services, placed before him not appreciating that CUP method is the most direct method which provides a reliable measure for determining arm's length result for the controlled transaction. The DRP, too, in its orders did not deal with the comparable uncontrolled transactions, placed on record by the appellant as part of the Transfer Pricing documentation. Consequently DRP's order also becomes non speaking in nature.

4.3. Consequent to such non speaking rejection of its comparable, the assessee has collected the aforesaid additional evidence from its associated enterprise. The same becomes necessary for consideration by way of additional evidence. Without the consideration of this evidence the T.P. adjustment will remain lopsided based on surmises.

4.4. The prices of comparable uncontrolled transactions of software development services on offshore basis received by the associated enterprise, viz., Hughes Network Systems Inc. and from unrelated party, viz. Aricent Technologies India Limited, which are lower than what is charged by the appellant, as under:

| **Nature of service** | **Per Man Month rate paid to appellant** | **Per Man Month rate paid to unrelated party** |
|---|---|---|
| Software Development | USD 3834 3700 (till 31.12.2007)<br>USD 4000 (01.01.2008 | USD 3700 (Up to December, 2010) |

| | onwards) | |
|---|---|---|

4.5. Since price paid by Hughes Network Systems Inc. to the appellant (USD 3700-4000) is higher than the price paid to unrelated parties, i.e. Aricent Technologies India Limited (USD 3700) for the offshore software development services, the international transaction of provision of offshore software development services undertaken by the appellant with its associated enterprise too are to be regarded as at arm's length applying CUP method.

Transfer Pricing adjustment of Rs. 9,12,80,860 in respect of international transactions of payment of marketing and management support services:

4.6. In order to rebut the conclusion arrived at by the TPO, the appellant by way of additional evidence in terms of application dated 18-01-2013 under rule 29 of the ITAT Rules, has placed on record, the following:

(i) Affidavit of Mr. Ajay Gupta, Vice President (Sales & Marketing) of Hughes Sytique Corporation, USA ('HSC, USA') declaring the work performed by him during the year 2006-07 for the appellant

(ii) Affidavit of Mr. Anil Sharma, Vice president (Operations) of Hughes Sytique Corporation, USA ('HSC, USA') declaring the work performed by him during the year 2006-07 for the appellant

(iii) Affidavit of Mr. Pradeep Prithvinath Kaul, President and Chief Executive Officer Hughes Sytique Corporation, USA ('HSC,

USA') declaring the work performed by him during the year 2006-07 for the appellant

4.7. In the affidavits of the officials of Hughes Corporation, USA, namely Mr. Pradeep Prithvinath Kaul, Mr. Anil Sharms and Mr. Ajay Gupta, affirms and records the work done by them pursuant to the marketing support services agreement entered into between the appellant and the associated enterprise. In the aforesaid affidavit of the key managerial personnel, on the pay roll of HSC, USA, clearly stated that the entire activities of such individuals based in US, were solely devoted to business operation of the appellant in India, in as much as, these key personnel were only interfacing the customers and soliciting business for the appellant in India.

4.8. It would be appreciated that the associated enterprise has provided wide spectrum of marketing support services and has been working only for the appellant. The allegation of the TPO that there was no evidence of receipt of such services by the appellant, is also contrary to the fact on record.

4.9. This evidence could not be produced by assessee before TPO and DRP as it was procured subsequently and assessee was prevented by sufficient reasons in not filing the same before lower authorities. This being first appeal, in order to correctly decide the ALP these documents are very relevant.

5. Ld. CIT(DR) is heard on admission of additional evidence, who opposed the admission of additional evidence.

6. On merits, it is pleaded by the ld. Counsel that the international transactions of rendering of offshore software development services as

well as onsite software development services, therefore, have been validly demonstrated to be at arm's length applying CUP method. Therefore, such adjustment calls for being deleted in respect of prices of such international transactions on following contentions:

6.1. Regarding international transactions of software development services, ld.Counsel contends that:

**(i) Re: CUP method being the most direct method is to be applied.**

6.2. Rule 10B(1)(a) of the Income-tax Rules ("the Rules") provides that for application of CUP, the price charged or paid for services provided in a comparables uncontrolled transaction or a number of such transactions are to be compared with price charged from international transaction undertaken by the enterprise (tested party) from the international transaction undertaken with an associated enterprise. Rule 10B(1)(a) of the Rules reads as follows:

> "*10B. (1) For the purposes of sub-section (2) of section 92C, the arms length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:*
>
> *(a) comparable uncontrolled price method, by which,*
>
> *(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;*
>
> *(ii) such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into*

*such transactions, which could materially affect the price in the open market;*

*(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arms length price in respect of the property transferred or services provided in the international transaction;"*

6.3. CUP method evaluates whether the amount charged in a controlled transaction is at arm's length with reference to the amount charged in a comparable uncontrolled transaction. The CUP seeks to provide a direct estimate of the price the parties would have agreed to, had they resorted directly to an open market alternative to the controlled transaction. The results derived from applying CUP method generally will be the most direct and reliable measure of an arm's length result for the controlled transaction.

6.4. The OECD guidelines also provide in paragraph 2.7 that **"…….***Where it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm's length principle. Consequently, in such cases the CUP Method is preferable over all other methods***."**

6.5. The CUP method provides the most direct comparison for the purpose of determining the arm's length price of international transactions and is to be preferred over the other profit based methods. Reliance is placed in this regard on the following decisions:

- Aztec Software Technologies Services Ltd. vs. ACIT 107 ITR 141
- UCB India Pvt. Ltd. vs ACIT (2009) 30 SOT 95(Mum)
- Gharda Chemicals vs DCIT (2009) 35 SOT 406 (Mum)

- Intervet India Pvt. Ltd. Vs. ACIT :130 TTJ 301(Mum)
- ACIT vs Dufon Laboratories: (2010) 39 SOT 59 (Mum)

6.6. Reliance is also placed on the decision of the Hon'ble Pune Bench of the Tribunal in the case of *ACIT vs. MSS India (P) Ltd.: 123 TTJ 657*, wherein, the appellant had determined the arm's length price of the international transactions with associated enterprise applying CUP/ Cost Plus method. The TPO, however, rejecting the application of CUP/ Cost Plus method by the appellant, made adjustment applying TNMM. The Tribunal, while holding that the TPO was not justified in rejecting the CUP/ Cost Plus method, which was transactional based method, and instead making adjustment applying TNMM even if the assessee has suffered loss in those transactions with its associated enterprise, observed as under.

> *"However, whenever necessary inputs for applying one of these methods are available and there is no dispute about comparability of those inputs, there is no good reason to resort to transactional profit methods. It would thus follow that in a situation in which the assessee has followed one of the standard methods of determining ALP, such a method cannot be discarded in preference over transactional profit methods unless the revenue authorities are able to demonstrate the fallacies in application of standard methods. In any event, any preference of one method over the other method must be justified by the Transfer Pricing Officer on the basis of cogent material and sound reasoning. Let us, in the light of this factual position, revert to the facts of this case."*

6.7. Reliance in this regard is also placed on the decision of Mumbai Bench of Tribunal in the case of Serdia Pharmaceuticals (India) Private Limited vs. ACIT (ITA No. 2469/3032/2531 of Mum), wherein the

Hon'ble Tribunal while dealing with the priority of application of methods, has held as under:

> "*64……… as long as CUP method can be reasonably applied in determining the arm's length price of an international transaction in a particular fact situation, and unless another method is proven to be more reliable a method vis-à-vis the fact situation of that particular case, the CUP method is to be preferred. The reason is simple. When associated enterprises enter into a transaction at such conditions in commercial and financial terms, which are different from commercial and financial terms imposed in comparable transaction between independent enterprises, the differences in these two sets of conditions in financial and commercial terms are attributed to inter relationship between the associated enterprises, and it is this impact of interrelationship between the associated enterprises that is sought to be neutralized by the transfer pricing regulations. As long as CUP method can be reliably applied on the facts of a case, it does offer most direct method of neutralizing the impact of interrelationship between AEs on the price at which the transactions have been entered into by such AEs"*

6.8. Relying on the decision of Serdia Pharma *(supra)*, the Delhi bench of Tribunal too, in the case of M/s Clear Plus India Pvt Ltd vs. DCIT (ITA No.3944/D/2010), held that:

> *"7. ………In the case of Serdia Pharmaceuticals India (P) Limited, it has been held that CUP method is a preferred method and it leads to more reliable results visa- vis the results obtained by applying transaction profit method. In the case of SNF (Australia) Pty. Limited, it has been held that the focus is on the market in which products are acquired. The ratio of this case is applicable mutatis-mutandis to the facts of the case as the focus is on the market in which products are sold."*

6.9. In the case of Gharda Chemicals Limited Vs DCIT, 130 TTJ 556, the Hon'ble Income Tax Appellate Tribunal ("ITAT"), too, held that internal comparable should be preferred over external comparables. The relevant extract of the judgment is reproduced below:

> *"Internal CUP method envisages comparing the uncontrolled transactions of the appellant itself with other unrelated parties so as to determine the ALP with the AE. However the External CUP method disregards the price charged or paid by the appellant to or from its unrelated parties and contemplates the comparison of the price so charged from or paid to its AE with some external independent reliable price data under similar circumstances of transactions with AE. Ordinarily the Internal CUP method should be preferred over the External CUP method as it neutralizes several distinguishing factors, such as the local factors and the economies available or unavailable to the appellant in particular, having bearing over the comparison of price charged from unrelated parties and AE."*

6.10. In case of the appellant, it would be appreciated, the most direct comparison has been provided by way of comparable uncontrolled transactions entered into by the associated enterprise with unrelated parties, in India, for rendering similar software development services. The aforesaid internal comparison undisputedly provides the most reliable and direct benchmark for establishing the arm's length price of such international transactions of rendering software development services entered into by the appellant. Therefore, in the case of the appellant, CUP could appropriately be applied considering internal comparable uncontrolled transactions entered into by the appellant with unrelated parties.

6.11. The TPO was not justified in ignoring the aforesaid comparable uncontrolled transactions placed on record and instead embarking upon a less direct benchmarking exercise by resorting to comparison of profits of external comparables.

**Without prejudice rejection of internal TNMM by the TPO:**

6.12. Rule 10B(1)(e) of the Income-tax Rules ("the Rules") provides that for application of TNMM, the profit margin realized by an enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions are to be compared with net profit margin realized by the enterprise (tested party) from the international transactions entered into with an associated enterprise. Rule 10B(1)(e) of the Rules reads as follows:

> *"Transactional net margin method, by which,—*
>
> *(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;*
>
> *(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;*
>
> *(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which*

*could materially affect the amount of net profit margin in the open market;*

*(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);*

*(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction."*

6.13. The internal comparables available in case of an assessee are to be preferred for the purpose of benchmarking of international transactions even in the case where TNMM is applied, instead of relying on external comparables, as provided in Paragraph 3.26 of the OECD Guidelines which reads as under:

*"3.26. The transactional net margin method examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction or transactions that are appropriate to aggregate under the principles of Chapter I). Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied. This means in particular that the net margin of the taxpayer from the controlled transaction (or transactions that are appropriate to aggregate under the principles of Chapter I) should ideally be established by reference to the net margin that the same taxpayer earns in comparable uncontrolled transactions. Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise may serve as a guide. A functional analysis of the associated enterprise and, in the latter case, the independent enterprise is required to determine whether the transactions are comparable*

*and what adjustments may be necessary to obtain reliable results". (emphasis supplied)*

6.14. The revised OECD Transfer Pricing Guidelines issued on 22nd July, 2010, too, recommended the use of internal comparable data for benchmarking analysis, as under:

*"C.3.4.4 Reliance on data from the taxpayer's own operations ("internal data"):*

*2.141 "Where comparable uncontrolled transactions of sufficient reliability are lacking to support the division of the combined profits, consideration should be given to internal data, which may provide a reliable means of establishing or testing the arm's length nature of the division of profits……….."*

*A.4.2 Internal comparables:*

*3.27 "Step 4 of the typical process described at paragraph 3.4 is a review of existing internal comparables, if any. Internal comparables may have a more direct and closer relationship to the transaction under review than external comparables. The financial analysis may be easier and more reliable as it will presumably rely on identical accounting standards and practices for the internal comparable and for the controlled transaction. In addition, access to information on internal comparables may be both more complete and less costly."*

*A.4.3 External comparables and sources of information:*

*Para 3.29 "There are various sources of information that can be used to identify potential external comparables. This sub-section discusses particular issues that arise with respect to commercial databases, foreign comparables and information undisclosed to taxpayers. Additionally, whenever reliable internal comparables exist, it may be unnecessary to search for external ones, see paragraphs 3.27-3.28."*

*3.32 "It may be unnecessary to use a commercial database if reliable information is available from other sources, e.g. internal comparables......."*

6.15. Reliance is placed in this regard on the following decisions:

(i) The Third Member Bench of the Mumbai Tribunal, in the case of Technimount ICB Pvt. Ltd. vs. ACIT (ITA No. 4608 & 5085/Mum/2010), while explaining the import of clause (i) of Rule 10B(e) of the Act, held that the rule itself provides that preference shall be given to internal comparable uncontrolled transactions vis-à-vis externally comparable uncontrolled transactions.

(ii) The Hon'ble Tribunal in the case of Birlasoft (India) Ltd. vs. ACIT 136 TTJ 505, too, upheld the internal benchmarking analysis undertaken by the appellant while justifying the international transactions of provision for software development services as at arm's length applying TNMM as against external benchmarking referred by the TPO. Further, the revenue is not before the High Court on the issue of internal comparability.

(iii) On the same lines, the co-ordinate bench of Delhi Tribunal in the case of Destination of the World vs. DCIT [ITA No 5534/Del/2010] and Interra Information Technologies India (P) Ltd. Vs. DCIT (ITA No. 5568&5680/Del/2011), too, held that transfer pricing analysis should be done by taking recourse to internal uncontrolled transactions.

(iv) Reliance is also placed on the decision of Hon'ble Mumbai Bench of the Tribunal in the case of UCB India (P) Ltd. v ACIT 30 SOT 95 (Mumbai).

6.16. The TPO rejected the internal benchmarking carried out by the appellant disputing the comparison in relation to volume/quantum of transactions with related and unrelated parties, holding that such unrelated party transactions constituted minor share of 20.30% of the total revenues and, therefore, did not provide robust benchmark.

6.17. In the case of the appellant, the revenue derived from unrelated party transactions at 20.30% of the aggregate revenue of the appellant, cannot be the reason for disregarding internal comparability analysis undertaken by the appellant. It would be appreciated that the appellant in the course of its business enters into several software development contracts of small volume. In other words, aggregate turnover of the appellant comprises of several transactions / contracts for rendering of software development services of smaller volume.

6.18. Further, it is not the case of the TPO that software development contracts undertaken with unrelated parties are not similar to software development contracts undertaken with associated enterprises, which constitute international transactions. It is also the position taken by the Revenue that the magnitude of turnover is not the test of comparability for identifying the comparable companies.

6.19. In any case, the Delhi Bench of Tribunal in the case of Interra Information Technologies India (P) Ltd. Vs. DCIT (ITA No. 5568&5680/Del/2011) held that, transaction undertaken with unrelated

third parties, in excess of 15% of the total transactions (revenue) is sufficient to undertake benchmarking applying TNMM considering internal comparables.

6.20. It is also pertinent to note that the TPO in his order, while conducting fresh search has selected companies with turnover in excess of 1 crore. However, the TPO himself has rejected the internal comparable with a turnover of 2.97 crores used by the appellant for benchmarking analysis, holding is to be very small as against the sales made to associated enterprise. Since the TPO himself has accepted companies with turnover more than 1 crore, this argument of the TPO seems inconsistent with his own approach

6.21. The internal benchmarking analysis undertaken by the appellant, therefore, has wrongly been rejected by the TPO and the Transfer Pricing adjustment made in respect of the international transaction of software development services rendered to the associated enterprise, calls for being deleted.

6.22. The international transactions of rendering software development services having been established to be at arm's length, the Transfer Pricing adjustment of Rs.3,80,75,810 made by the TPO, is, therefore, liable to be deleted.

**II. Transfer Pricing adjustment of Rs. 9,12,80,860 in respect of international transactions of payment of marketing and management support services:**

6.23. The appellant has entered into an agreement dated 1st April, 2006 with the US associated enterprise, viz., Hughes Systique Corporation

("HSC USA") for availing the following marketing and management support services:

(a) assisting the appellant with sales promotion of the products/ services.

(b) obtains customers and solicit orders and sell the appellant's products/ services, its licenses and services.

(c) Rendering of strategic and leadership services to the appellant, i.e. performing regular reviews of operations of the appellant and including reviewing of financial statements, staffing status, cash flow requirement, facilities management, etc.

(d) Formulation of business strategies for the appellant and supporting the appellant in the execution of the business strategy.

(e) Assisting appellant in maintaining the goodwill of customers, keeping customers informed on contract progress, identifying and resolving customers concerns about products/ services, monitoring and reporting on customer satisfaction to the appellant.

(f) Monitoring and expediting the receipt, customs clearance, transportation and installation of products.

(g) Notifying the appellant of any claim/ litigation involving products/ services

6.24. In terms of the arrangement with the appellant, the aforementioned costs are charged out on cost plus 7% basis to the appellant. The benefit of entire cost incurred by the AE, viz., HSC USA, is to be derived by the appellant. The appellant, accordingly, during the financial year 2006-07 made payment of a sum of Rs. 9,12,80,860 to HSC USA, towards marketing support service fee.

6.25. For benchmarking the aforesaid transaction, the appellant conducted a search of comparable companies on 'Onesource' database considering its associated enterprise, i.e. HSC, USA as the tested party applying TNMM method. The average Return on Total Cost for comparable companies in the United States of America region was found to be at 15.80%, which was higher than the Return on Total Cost earned by HSC, USA at 11.30%, and accordingly, the international transaction of payment of marketing support fees was considered to be at arms length price.

**TPO's/DRP's order**:

7. The TPO, however, ignoring the benchmarking analysis undertaken as above, held that there was no evidence for rendering of the marketing support services by the associated enterprises to the appellant and an independent party would not have made such a payment in an arm's length situation. Further, it has been observed by the TPO that evidence of market price for availing such services from a third party was not available. The TPO, accordingly, applying CUP method determined the arm's length price of marketing support service as NIL and accordingly the income of the appellant was adjusted by a sum of Rs.9,12,80,860.

7.1. The DRP affirming the order of the TPO, held as under:

> *"DRP finds that the TPO has examined the issue in detail in his order from paras 24 to 26. DRP has also examined the nature of services as tabulated above rendered by the AE to querist i.e. client solicited in the US. Except for c & d the other services can be rendered directly from India in view of instant communication facilities at the most a liaison office is required.*

*So to have an AE exclusively for such services seems inappropriate and if AE is surviving only on mark up for its income, no wonder it is in losses. The losses in the circumstances appear to be contrived. As far as c & d is concerned how effectively can such services be rendered is also a moot point. These services are needed to be performed locally either inhouse or by a local party which knows local business environment. Services at d are being rendered for the querist in US and can perhaps be considered as being actually provided actually. But there is no way of quantifying them and establishing their veracity. So, on the whole after considering TPO's reasons and our own analysis, DRP concurs with the disallowance made by the TPO."*

**Assessee's contentions on AO & DRP order:**

8. There is no bar under the Act to have transactions with the group companies and the querist is free to conduct business in the manner most suitable to it and the commercial or business expediency of incurring any expenditure is to be seen from the assessee's point of view. It is also a settled law that it is the prerogative of the businessman to organize its affairs in a manner best suited to it and the revenue authority cannot step into the shoes of the businessman.

8.1. It is further submitted, that the assessee is free to conduct business in the manner that assessee deems fit and the commercial or business expediency of incurring any expenditure is to be seen from the assessee's point of view. Attention in this regard is invited to the following decisions:

- CIT vs. Malayalam Plantations Limited: 53 ITR 140 (SC)
- CIT v. Walchand & Co. etc. (1967) 65 ITR 381
- J K Woollen Manufacturers v. CIT: 72 ITR 612(SC)
- CIT v. Birla Cotton Spg. And Wvg. Mills Ltd.: 82 ITR 166 (SC)
- Madhav Prasad Jatia v. CIT U.P.: 118 ITR 200 (SC)

- S.A. Builders Ltd. vs. CIT : 288 ITR 1 (SC)
- CIT V. Bharti Televentures Ltd: 331 ITR 502 (Del)
- CIT vs. Padmani Packaging (P) Ltd. : 155 Taxmann 268 (Del)
- CIT v. Rockman Cycle Industries Ltd.: 331 ITR 401 (P&H) (FB)
- CIT vs. EKL Appliances Ltd. : ITA No. 1068/2011 & 1070/2011 (Del HC)

CIT v. Dalmia Cement (P.) Ltd: 254 ITR 377 (Del)
CIT vs. Dalmia Cement (B) Ltd. (supra), (Del)

8.2. As long as an item of expenditure has been incurred wholly and exclusively for the purpose of business of the assessee, whether or not such expenditure actually benefits the assessee is an irrelevant consideration for the purpose of determination of ALP.

8.3. Reliance is placed on the decision of DCIT vs Ekla Appliances: (2011-TII-37-ITAT-Del-TP) Wherein the Hon'ble Tribunal held that the TPO cannot challenge the judgment of the assessee as to the source from which the technology is to be obtained and at what cost etc. The Hon'ble Delhi High Court while upholding the decision of the Hon'ble Tribunal held that as long as an expense is incurred wholly and exclusively for the purpose of business, it is irrelevant as to whether such expenditure actually results in profit or not. The Hon'ble High Court held as under:

> "*21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.*

> ……
> *So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised."*

8.4. The Tribunal in the case of M/s. Ericsson India Pvt. Ltd. vs. DCIT (ITA No. 5141/Del/2011), too, following the law laid down by the Hon'ble jurisdictional High Court, held that *"….. it would be wrong to hold that the expenditure should be disallowed only on the ground that these expenses were not required to be incurred by the assessee……."*

8.5. In the case of Dresser Rand India Pvt. Ltd. vs. Addl. CIT (ITA No 8753/Mum/2010) the Hon'ble Mumbai bench of the Tribunal, while dealing with similar management fee paid to the associated enterprise held that benefits derived by the assessee is not a relevant criteria for determination of arm's length of an expenditure incurred by the assessee.

8.6. Further, in the case of LG Polymers India Pvt. Ltd vs Addl. CIT (ITA No 524/Vizag/2010), the Hon'ble Visakhapatnam Bench of the Tribunal held as under

> *"13. We agree with the views of the Learned A.R on this issue. As submitted by him, it is the prerogative of the assessee to regulate its business affairs and it is not open for the department to question the same. Similar views have been expressed by the Hon'ble Supreme Court in the case of Dhanrajgiriji Raja Narasingirji, referred (Supra)"*

8.7. Recently in the case of SC Enviro Agro India Ltd vs DCIT (ITA No 2057 & 2058/Mum/2009) the Mumbai Bench of the Tribunal held that *"The TPO has to examine whether the price paid or amount paid was at arms length or not under the provisions of Transfer Pricing and its rules. The rule does not authorize the TPO to disallow any expenditure on the ground that it was not necessary or prudent for assessee to have incurred the same."*

8.8. The Hon'ble Delhi Bench of the Tribunal in the case of AWB India Pvt Ltd vs Addl. CIT (ITA No 4454/Del/2011) held as under:

> *"As also settled by judicial decisions (supra), the revenue authorities are not empowered to question the commercial wisdom of the assessee and it is entirely for the assessee to take such decisions as favour the advancement of the assessee's business."*

8.9. Attention is also invited to paragraph 7.5 of the OECD Transfer Pricing Guidelines, which provides that whether or not payment for intra group services is justified, depends upon the following two questions:

*(i) whether intra-group services have been rendered*
*(ii) Whether the price paid for such services satisfies the arm's length test.*

**(i) Whether intra-group services have been rendered:**

9. The OECD Transfer Pricing Guidelines provide that whether or not a service has been rendered depends on whether the service provides the recipient with some commercial or economic value to enhance its commercial position. Para 7.6 of the guidelines reads as under:

> *"7.6 Under the arm's length principle, the question whether an intragroup service has been rendered when an activity is*

> *performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance its commercial position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself."*

9.1. The assessee does not conduct any sales or marketing activity for promotion of its products and services outside India. Further, the appellant does not have any marketing or sales office outside India for selling its services to independent third parties. HSC, USA on behalf of the appellant is inter-facing the customers and soliciting the software development business. The associated enterprise has the necessary contacts and network to reach the customers to get the business for the appellant. The appellant on the other hand does not have any other person or network and therefore depends solely on HSC USA for selling the products and services of the appellant.

9.2. Assessee does not have any sales or marketing office outside India and therefore the entire third party business of the appellant is generated as a result of the market support services provided by HSC, USA. During the relevant financial year the business of the appellant from unrelated third parties has increased to almost Rs. 10 cr from Rs 2.97 cr. The increase in revenue of more than 3 times of the revenue of immediately preceding year is pursuant to the significant marketing activity undertaken by HSC, USA.

**(ii) Whether the price paid for such services satisfies the arm's length test:**

10. The associated enterprise, HSC USA, does not undertake any business activity of its own and was created solely for the purpose of rendering marketing and aforesaid management support services to the appellant. The operating costs incurred by the HSC USA relate entirely to the operations of the appellant in India and there is no other revenue reflected in the profit and loss account of the associated enterprise. Nature of costs being incurred by HSC USA for the aforesaid services, are, payroll, insurance, general office running expenses, etc.

10.1. The TPOdid not appreciate that the arrangement with the AE, viz. HSC USA, is one of charging of actual cost incurred by the AE for the purpose of the business of the appellant. It would also be appreciated that only the cost incurred by the AE for rendering the marketing and management support services is allocated to the appellant. Further, the various expenses, e.g., salary, rent and other establishment cost are incurred by the AE by way of making payment to unrelated parties. Such expenses, therefore, it would be appreciated, provide an independent third party benchmark of the market price for availing such services.

10.2. The international transactions of rendering of marketing and management support services by the associated enterprise has independently been demonstrated to be at arm's length applying TNMM, taking associated enterprise as the tested party. Such international transactions undertaken in the Transfer Pricing study, has otherwise not been disputed by the TPO.

10.3. It is submitted that the appellant derived significant benefits from the management services provided by the associated enterprise and

therefore, the services provided by the associated enterprise satisfies the tests as laid down by the OECD Guidelines.

10.4. The Transfer Pricing adjustment made by the TPO in respect of international transactions of payment of marketing and management support services amounting to Rs.9,12,80,860, therefore, is not sustainable and is liable to be deleted.

**Re: Ground of appeal Nos. 4:**

11. The appellant in the relevant previous year claimed depreciation @60% on the purchases of computer accessories and peripherals amounting to Rs. 4,329,055.

11.1. The assessing officer restricted the claim of depreciation on computer peripherals at 15% as against 60% claimed by the appellant stating it to be a part of plant and machinery and accordingly made the disallowance of Rs. 1,495,560.

11.2. It is a settled proposition that a 'computer system' comprises of not only the central processing unit (CPU) but also all input / output devices including printer, monitor and other devices, etc. Reference is made to CIT vs. IBM World Trade Corporation : 130 ITR 739 (Mum).

11.3. Further, the issue stands covered by the decision of Special Bench of Mumbai Tribunal in the case of DCIT vs. Datacraft India Ltd. (2010) 6 Taxman.com 85 and Delhi High Court in the case of CIT v. BSES Rajdhani Powers LLD.: ITA 1266/2010, wherein, depreciation at a higher rate of 60% on computer accessories and peripherals were allowed.

11.4. Therefore, UPS and other computer accessories should not be termed as plant and machinery and should be allowed depreciation

@60% i.e. at the computer equipment rates. Accordingly, the disallowance of Rs. 14,95,560 calls for being deleted.

12. Ground of appeal Nos. 5 is **c**onsequential

13. Ld. CIT(DR) Shri Piyush Jain supported the orders of AO and DRP on all these issues. Alternatively it is pleaded that if additional evidence is sought to be admitted, in that case it will be desirable that TPO also considers the same. Thus, the matter may be set aside.

14. We have heard rival contentions and perused the material available on record. Firstly, we should adjudicate whether the additional evidence should be admitted or not. The claim of the assessee is that these documents came in its possession after the assessment. In our view, the aspect of applicability of CUP method has not been properly dealt with by DRP and TPO also did not consider CUP method for bench marking of international transaction. As the facts emerge, the order of DRP does not throw effective light to reject the assessee's CUP method. The plea of the assessee is that the documents have been subsequently procured and are necessary for proper ascertainment of T.P. adjustment. Under these circumstances, we are of the view that assessee's application for admission of additional evidence deserves to be admitted. The assessee was prevented by sufficient cause as these documents could not be procured before the assessment proceedings. After having admitted the additional evidence, the question before us is whether to consider the additional evidence at our level or send it back to TPO for consideration of this material and decide the issue afresh. On this score, we find merit in the alternate plea raised by ld. CIT(DR) that in this eventuality the issue about T.P. adjustments should be restored back to the file of TPO. Assessee has no objection on that. In view thereof, we set aside ground

nos. 2 & 3 above in respect of T.P. adjustments for both the years back to the file of TPO to decide the issues afresh after giving the assessee an opportunity of being heard and give proper reasons if the CUP method is proposed to be not considered.

14.1. That leaves ground no. 4 regarding depreciation on computers peripherals. Respectfully following Hon'ble Delhi High Court judgment in the case of BSES Rajdhani Powers Ltd. (supra), we hold that assessee is eligible for depreciation @ 60%. This ground of the assessee is allowed.

14.2. Ground no. 5 i.e. charging of interest u/s 234B & 234C is consequential.

15. In the result, assessee's appeals are partly allowed for statistical purposes.

Order pronounced in open court on 05-07-2013.

| Sd/- | Sd/- |
|---|---|
| ( SHAMIM YAHYA ) | ( R.P. TOLANI ) |
| ACCOUNTANT MEMBER | JUDICIAL MEMBER |

Dated: 05-07-2013.

**MP**

Copy to :

1. Assessee
2. AO
3. CIT
4. CIT(A)
5. DR