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IN THE HIGH COURT OF DELHI AT NEW DELHI

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ITA 959/2011

STMICROELECTRONICS PVT LTD Appellant
 Through: Mr M.S. Syali, Senior Advocate with
 Mr Taran Deep Singh and Mr Mayank Negi,
 Advocate.

versus

COMMISSIONER OF INCOME TAX Respondent
 Through: Mr Ashok Kr Manchanda, Senior
 Standing Counsel.

WITH

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ITA 960/2011

STMICROELECTRONICS PRIVATE
 LIMITED Appellant
 Through: Mr M.S. Syali, Senior Advocate with
 Mr Taran Deep Singh and Mr Mayank Negi,
 Advocate.

versus

COMMISSIONER OF INCOME TAX Respondent
 Through: Mr Ashok Kr Manchanda, Senior
 Standing Counsel.

AND

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ITA 961/2011

STMICROELECTRONICS PVT LTD Appellant
 Through: Mr M.S. Syali, Senior Advocate with
 Mr Taran Deep Singh and Mr Mayank Negi,
 Advocate.

versus



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COMMISSIONER OF INCOME TAX

..... Respondent

Through: Mr Ashok Kr Manchanda, Senior

Standing Counsel.

CORAM:**JUSTICE S.MURALIDHAR****JUSTICE VIBHU BAKHRU****ORDER**

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29.02.2016

1. The Assessee has filed these Appeals under Section 260A of the Income Tax Act, 1961 (hereafter 'the Act') impugning a common order dated 3rd June, 2011 passed by the Income Tax Appellate Tribunal (hereafter 'the ITAT') in ITA Nos. 1806/Del/2008, 1807/Del/2008 and 5058/Del/2010 in respect of Assessment Years (hereafter 'AY') 2003-04, 2004-05 & 2006-07 respectively.

2. In so far as the AYs 2003-04 and 2004-05 are concerned, the Assessing Officer (hereafter 'AO') had made a reference to the TPO and on the basis of his reports had made transfer pricing adjustments in respect of international transactions disclosed by the Assessee. The Assessee had appealed against the said orders before the Commissioner of Income Tax (Appeals) (hereafter 'the CIT(A)') who upheld the transfer pricing adjustments but by separate orders dated 28th February, 2008 in respect of



the two AYs reduced its quantum by reducing the profit margins as determined by the TPO. Both, the Assessee and the Revenue, were aggrieved by these decisions made by the CIT (A) and, accordingly, preferred appeals before the ITAT. In so far as AY 2006-07 is concerned, the Assessee had objected to the draft assessment order proposing a transfer pricing adjustment. The Assessee's objections were rejected by the Dispute Resolution Panel (hereafter 'the DRP') by an order dated 29th September, 2010 passed under Section 144C of the Act. The Assessee being aggrieved filed an appeal before the ITAT. All the aforesaid appeals were disposed of by the common order impugned herein.

3. The present appeals were admitted on 12nd March, 2013 and the following questions of law were framed:-

“1. Whether in view of the provisions of Section 92C read with Section 92CA of the Income Tax Act, 1961 read with Rule 10B of the Income Tax Rules, 1962, the Tribunal was right in law in upholding the adjustment made to the declared value of the international transaction to arrive at the arm's length price thereof?

2. Whether the Tribunal had taken into account all the relevant parameters for arriving at the arm's length price?”

4. The Assessee is a wholly owned subsidiary of STMicroelectronics Pvt.



Ltd, Singapore which in turn is wholly owned by STMicroelectronics NV, Netherlands. The Assessee is a captive contract service provider and is engaged in providing Software Development services to its parent/group companies (hereafter referred to as 'the ST Group'). The Assessee had entered into two types of international transactions which were described as:

- i) The provision of Integrated Circuit design, CAD Tools and software development services; and
- ii) provision of Marketing Support Services.

The Assessee considered Transactional Net Margin Method ('TNMM') as the most appropriate method for benchmarking the international transactions and filed a transfer pricing report on that basis. The Assessee is remunerated on cost plus basis and, accordingly, had used Operating Profit to Cost as the Profit Level Indicator (PLI). For the year 2003-04, the Assessee had declared a margin (PLI) of 9.87% over cost. For the purposes of benchmarking the international transactions, the Assessee had found a set of 14 companies that it considered as comparables. The arithmetic mean of the PLI of these companies was computed at 11.88%. The Assessee contended that the same fell within acceptable tolerance limit of +/- 5%. The TPO did not accept the benchmarking study submitted by the Assessee. The TPO was



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of the view that the comparables chosen by the Assessee were relatively smaller companies whose average turnover was a small fraction of the Assessee's turn over. Further, he held that the said companies were not involved in "high-end software development or chip design" but were engaged only in "routine low end software work". The TPO found a set of 23 companies that it considered comparable and computed the arithmetic mean of their PLI - OP/TC (Operating Profit Margin over Total Costs) - at 17.86%. He, accordingly, directed enhancement of 'Arm's Length Price' of the international transactions as disclosed by the Assessee. Accordingly, the AO passed an assessment order dated 30th March, 2006 giving effect to the TPO's report.

5. Aggrieved by the aforesaid order, the Assessee filed an appeal before the CIT (A). The CIT (A) observed that a meaningful FAR (Functions Performed, Assets deployed and Risks assumed) analysis of a tested party's international transactions is the foundation for an objective Arm's Length Price determination. The CIT (A) thereafter examined the functional profile of the Assessee and also took note of an article captioned "embedded systems" by Deepak Bagai, Assistant Professor, Department of Electronics, Punjab Engineering College, Chandigarh in which the embedded system



design was described as a 'sunshine' area in the Indian IT Boom. The said article also made a mention of the Assessee as being one of the companies involved in this emerging technology. Based on the abovesaid, the CIT (A) upheld the TPO's finding that the Assessee was performing 'high-end activity' in the software industry and was positioned fairly high in the value chain as compared to a large number of companies operating in the software industry. The CIT (A) thereafter examined the quantitative and qualitative filters applied by the TPO for finding the comparables and found that some of the filters applied were not appropriate. The CIT (A) thereafter, narrowed down the list to four entities which according to him were comparable to the Assessee. The arithmetic mean of the PLI of these comparables was computed at 16.16%. Accordingly, the quantum of Transfer Pricing adjustment made by the AO was reduced.

6. The facts in respect of AY 2004-05 are somewhat similar. In that year, the Assessee's PLI was declared at 8.93%. The TPO determined the arithmetic mean of PLI of comparables at 17.50%, which was reduced to 16.33% by the CIT(A). In AY 2006-07 the Assessee's PLI was computed at 11.6% and the AO/DRP computed the average mean of PLI of comparables at 18.30%.



7. On Appeal before the ITAT, the Assessee contended that the companies chosen as comparables were not functionally similar as the Assessee. The Assessee also contended that the AO/TPO as well as the CIT(A) had grossly erred in categorising the business profile of the Assessee as 'high-end software developer'. It is the Assessee's case that the Assessee rendered services in accordance with the guidelines provided by the ST Group and all technical specifications were provided to the Assessee. It was further contended that the risks assumed by the Assessee were minimal as the Assessee was a captive service provider.

8. Mr Syali, learned Senior Counsel appearing for the Assessee has limited his arguments to seeking a remand to the ITAT. He contended that the ITAT had failed to consider/adjudicate some of the vital issues argued before it. He submitted that the ITAT had not examined the Assessee's contention that the comparables chosen were not functionally similar to the Assessee. He submitted that first and foremost, TPO was required to conclude that the functions performed by entities chosen as comparables for benchmarking the international transaction were performing similar functions. He also referred to two recent decisions of this Court in *Chryscapital Investment Advisors (India) Pvt. Ltd. v. Deputy Commissioner of Income Tax: ITA No.*



417/2014, decided on 27th April, 2015 and Rampgreen Solutions Pvt Limited v. Deputy Commissioner of Income Tax: ITA 102/2015, decided on 10th August, 2015 in support of his contention. He further submitted that the law relating to transfer pricing adjustment had not developed at the material time when the ITAT considered the present controversy. However, thereafter there had been several decisions which provide valuable guidelines to the authorities for approaching the contentious issues relating to transfer pricing adjustments. Mr Syali then also referred to a table providing a comparison between the Assessee and Visual Soft Technologies Limited (a company chosen as comparable for AY 2003-04 and AY 2004-05) and Infosys Technologies Ltd. (chosen as a comparable for AY 2006-07). He pointed out that whereas both the aforesaid entities are carrying on research and development functions and during the relevant period had also earned revenue from the same, no such function are performed by the Assessee. In addition, he also submitted that the Visual Soft Technologies Limited is a product company and is a technology solution provider. Similarly, Infosys Technologies Ltd. is involved into providing end to end solutions. Further, both the aforesaid companies also had earned revenues from on-site operations which was absent in the case of the Assessee.



9. Mr Syali, referred to para 26 of the impugned order passed by the ITAT wherein it had noted the Assessee's arguments that the risk profile of the entities chosen as comparables was materially different from the risk profile of the Assessee. The Assessee had contended that the companies chosen were full-fledged entrepreneurs and assumed higher risk as compared to the Assessee and consequentially, their rewards would also be higher. He further submitted that the ITAT had dismissed the said objections by holding that the Assessee's objections were peripheral and a suitable adjustment could be made while selecting the comparables which would take care of their objections. He argued that although the ITAT had so observed, it had not issued any directions for making any suitable adjustments.

10. Mr Manchanda, learned Senior Standing Counsel contended that the Assessee was a 'high-end service provider' and, therefore, the comparables chosen by the Assessee were inappropriate. He supported the orders passed by the ITAT by contending that the comparables chosen were of 'high -end service provider' and, therefore, the Assessee could have no grievance in that regard.

11. We have heard the learned counsel for the parties and we feel that there



is much merit in the grievance voiced by Mr Syali that the ITAT has not considered the principal contention that the functional profile of the comparables chosen are different from that of the Assessee. Merely, classifying software developments as 'high-end' and 'low-end' may not be sufficient. The ITAT ought to have considered the Assessee's contention as regard to the specific features pointed out by the Assessee in respect of some of the comparables and taken an informed view whether the same was merited or not. It was also necessary for the ITAT to consider the Assessee's contention with regard to the dissimilarities as to the risk profile of the Assessee and the comparables used for determining the Arm's Length PLI. Having stated the above, we also feel that the transfer pricing report/study submitted by the Assessee is also deficient as the Assessee's itself had not made a functional comparison as is now sought to be canvassed on its behalf before us.

12. In the aforesaid circumstances, we do not consider it appropriate to answer the questions framed and are of the view that it necessary for the ITAT to reconsider contentions advanced by the Assessee and decide afresh. It would be open to the Assessee to produce before the ITAT further material/study in support of its contention and in such an event the Revenue



would be also afforded an opportunity of a response thereto.

13. The impugned common order dated 3rd June, 2011 passed by the ITAT in ITA Nos. 1806/Del/2008, 1807/Del/2008 and 5058/Del/2010 is set aside and the said appeals are restored to the file of the ITAT for a fresh disposal in accordance with the above directions. The appeals are disposed of accordingly.

A handwritten signature in black ink, appearing to be 'S. Muralidhar'.

S.MURALIDHAR, J

A handwritten signature in black ink, appearing to be 'Vibhu Bakhru'.

VIBHU BAKHRU, J

FEBRUARY 29, 2016

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