

IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD “I” BENCH AHMEDABAD

BEFORE SHRI PRAMOD KUMAR, ACCOUNTANT MEMBER,
AND SHRI S. S. GODARA, JUDICIAL MEMBER.

ITA Nos. 3298/Ahd/2011 & 2880/Ahd/2012
(Assessment Years: 2007-08 & 2008-09)

Erhardt+Leimer (India) Private Limited,
Survey No. 252/1, 252/2, Sarkhej-Bavla
Highway, Sanand, Ahmedabad - 382220

Appellant

Vs.

Asst. Commissioner of Income Tax,
Circle-4, Ahmedabad

Respondent

PAN: AAACE2657G

आवेदक की ओर से / By Assessee : Shri Sanjay R. Shah, A.R.
राजस्व की ओर से / By Revenue : Shri M. P. Singh, CIT. D.R.
सुनवाई की तारीख/Date of Hearing : 29.09.2016
घोषणा की तारीख/Date of
Pronouncement : 27.12.2016

ORDER

PER S. S. GODARA, JUDICIAL MEMBER

These two assessee's appeals for assessment years 2007-08 & 2008-09, arise against ACIT, Circle-4, Ahmedabad's assessment orders dated 28.10.2011 & 25.10.2012; respectively, in proceedings under section 143(3) r.w.s. 144(C) of the Income Tax Act, 1961; in short "the Act".

We proceed assessment year-wise for the sake of convenience and brevity.

2. We come to former assessment year 2007-08 involving ITA No.3298/Ahd/2011. Assessee's first substantive ground pleaded therein assails correctness of transfer pricing adjustment of Rs.23,542,136/- in respect of import of components as proposed by the Transfer Pricing Officer and upheld before the Dispute Resolution Panel. Learned counsel submits that the above adjustment amount involved has also been subjected to Section 154 rectification proceedings on 14.12.2010 and 09.03.2012. We appreciate this fair submission and observe that our adjudication in the succeeding paragraph are confined to both the parties' arguments in principle only.

3. We advert to the relevant facts now. The assessee company manufactures web feeding guiding equipments along with electrical/electronic control panel. It purchased components worth Rs.4,18,92,723/- from its associate enterprises. The assessee would adopt the transaction net margin method (TNMM) to benchmark its above import transactions to be having PLI of 4.22% (as per the Transfer Pricing Officer's order dated 19.10.2008). It had chosen fifteen comparable companies i.e. M/s. Ahmedabad Victoria Iron Works Ltd., Nichrome India, Rollatiner, Schrader Duncan Ltd., Seasons Textiles Ltd., Lippy Systems Ltd., Austin Engineering, EPC Industries, Forbes Aquamall Ltd., JBM Industries Ltd., Jai Bharat Exhaust Systems Ltd., Krypton Industries Ltd., Mivin Engineering Technologies Pvt. Ltd. and M/s. Ultra Dytech Ltd.. The Transfer Pricing Officer excluded two of them i.e. M/s. Rollatiner and M/s. EPC Industries only on the ground that they had been making losses since 2002 and past

three years; respectively after declining assessee's very strong objections against the said exclusion.

4. We proceed further to notice that the Transfer Pricing Officer thereafter adopted profit level indicator of PBIT (Profits before interest and tax)/sales after rejecting assessee's plea to rather take its profit level indicator as PBDIT (profits before depreciation, interest and tax)/sales since it had made additions in fixed assets of Rs.1435.98 lacs in its new plant over and above the written down value of Rs.341.51 lacs of the assets already shown in the balance sheet as pertaining to Odhav plant. The Transfer Pricing Officer declined assessee's instant objection as well. He quoted Rule 10B(1)(e) to observe that it was never stipulated in the above said rule to adopt such a course of action. He accordingly adopted average PLI of the remaining thirteen comparables @ 9.98% as against 4.22% to propose consequential adjustment of Rs.2,07,60,681/-. The Assessing Officer framed draft assessment on 20.12.2010 making consequential adjustment. The assessee filed objection before the Dispute Resolution Panel inter alia pleading therein that the Transfer Pricing Officer had erred in rejecting the above two loss making entities from the array of comparables and also that he had wrongly adopted profit level indicator of PBIT / sales instead of PBDIT/sales (supra). The assessee would further file a fresh list of comparables. The Dispute Resolution Panel issued its directions on 29.08.2012 upholding Transfer Pricing Officer's action on the first two issues. It would however direct the Transfer Pricing Officer to work out average PLI in view of fourteen comparables i.e. twelve already given in Transfer Pricing Officer's order followed by four new entities included before the DRP proceedings. We deem it appropriate to reproduce DRP's following directions as under:

- “1. *The assessee’s objections against rejection of loss making comparables are rejected.*
2. *Out of the 13 comparables accepted by the TPO M/s Krypton Industries Ltd. should be deleted, the assessee’s objections against the rest of the comparables are rejected.*
3. *Out of the new comparables proposed by the assessee the above mentioned four comparables be included in the final set of comparables.*
4. *The TPO should work out average PLI adopting PBIT of the 16 comparables (12 from the set in the draft assessment order and 4 as mentioned above from assesee's new set).*
5. *The assessee's arguments for adopting PBDIT as PLI are rejected.*
6. *The assesee's objections regarding 5% standard deduction are also rejected.*
7. *The assessee's objections regarding adjustment in respect of the commission income are rejected.”*

The Assessing Officer has accordingly framed the impugned assessment making the above transfer pricing adjustment forming subject matter of adjudication before us.

5. We have heard both sides. Case file perused. The assessee’s arguments are two folded. First one is that the authorities below have erred in excluding the above two loss making entities from the array of comparables. The Revenue strongly supports the impugned exclusion. We find that neither the Transfer Pricing Officer nor the Dispute Resolution Panel have looked into the FAR analysis of the above two entities M/s. Rollatiner and EPC Industries as the same have been summarily rejected in view of their consistent losses since 2002 and last three assessment years. We repeat that the impugned assessment year is 2007-08. We quote Rule 10B(4) herein to observe that the data relevant for a time period of not more than two years prior to the financial year involved may be considered only if it reveals any influence thereof in such financial year involved. The authorities

below have nowhere under taken such an exercise. We also find that this tribunal's special bench decision in DCIT vs. Quark Systems Pvt. Ltd. (2010) 132 TJJ 001 (SB) has already rejected such an approach after concluding that consistent loss making entities cannot be per se excluded merely in view of the negative income figures thereof. We draw support therefrom to direct the Transfer Pricing Officer to redo the entire exercise afresh regarding these two entities as per law after affording adequate opportunity of hearing to the assessee.

6. Learned counsel's second argument seeks to reject the lower authorities' action taking profit level indicator of PBIT / sales instead of PBDIT/sales (supra). There is no dispute that the assessee has in fact increased its fixed assets/plant and machinery to the tune of Rs.1435.98 lacs in the impugned assessment year held eligible for depreciation. Its endeavor in the instant case is to exclude corresponding depreciation for the purpose of determining the profit level indicator which admittedly has not found favour from the lower authorities. We reiterate first of all that the relevant method used herein is the transactional net margin method which is an indirect method wherein the profit level indicator is taken after stating net figure of profits. We observe in the above stated facts that there can hardly be any dispute about assessee's net profits to have seen a decline in view of its depreciation claim arising from the above fixed assets of Rs.1435.98 lacs pertaining to the impugned assessment year. We notice in these facts that this tribunal in M/s. BA Continuum India Pvt. Ltd. vs. ACIT ITA No.1154/Hyd/2011 dated 24.10.2013 holds that such a depreciation has to be excluded before computing the corresponding profit level indicator. We accordingly direct the Transfer Pricing Officer in these peculiar facts to exclude assessee's corresponding depreciation claim for the purpose of the

profit level indicator in question. This assessee's argument also succeeds. We accordingly remit this former issue of transfer pricing adjustment addition in respect of import of components back to the file of the Transfer Pricing Officer for afresh adjudication as per law as indicated hereinabove.

7. The assessee's next substantive ground challenges correctness of transfer pricing adjustment of Rs.6,52,435/- in respect of its commission income. It had derived commission income from its german and italian associate enterprises having profit level indicators @ 12.45% and 8.52% after adopting the comparable uncontrolled price (CUP) method. The Transfer Pricing Officer noticed the assessee to have earned similar commission income from a german enterprise involving PLI @ 12.13%. He accordingly rejected assessee's explanation stating various key factors of volume of business transactions, market presence and geographical factors to make the impugned adjustment after taking PLI @ 12.13% resulting in the addition in question. The Dispute Resolution Panel upholds the same.

8. Heard both sides. The assessee is unable to dispute the fact that it had already adopted CUP method wherein the german non associate enterprise had paid it commission income of 12.13% as against 8.52% obtained from its italian associate enterprise. Learned counsel raises a technical plea that the DRP's findings at page 16 observe that assessee's german associate enterprise could not be taken as a comparable in CUP method. He however fails to dispute that the other german entity who is not assessee's associate enterprise is a valid comparable under CUP method having PLI @ 12.13%. We thus find no reason to interfere with the impugned transfer pricing adjustment pertaining to assessee's commission income.

9. The assessee's third substantive ground seeks benefit of $\pm 5\%$ tolerance margin in the above transfer pricing adjustments. Ld. Departmental Representative submits that it is essentially a computation issue. He invites our attention to the fact that we have already remitted the above substantive issues back to the file of the Transfer Pricing Officer. We accordingly direct that this assessee's plea seeking $\pm 5\%$ tolerance margin would be considered at the time of final computation. This assessee's appeal ITA No.3298/Ahd/2011 is partly accepted for statistical purposes.

10. We now come to assessment year 2008-09 involving ITA No.2880/Ahd/2012. The assessee's first substantive ground seeks to delete transfer pricing adjustment of Rs.75,33,672/- in respect of import of components as made by the lower authorities.

11. The assessee's only substantive argument raised in the course of hearing is that the authorities below have not granted it capacity underutilization benefit in respect of the above import of component transactions. We notice at this stage that the relevant facts pertaining to the instant issue are in a narrow compass. The assessee pleaded before the Transfer Pricing Officer that it had set up new installed capacity of manufacturing of 11520 machines as against the consequential production of 4133 sets thereof only. It sought to seek underutilization adjustment since it could manufacture only 35% of the installed capacity leaving behind 65% as unutilized. The Transfer Pricing Officer as well as the Dispute Resolution Panel declined this relief on the ground that such a course of action of making adjustment in the hands of comparable entities is nowhere provided in the Act or the Rules framed thereunder. All this resulted in the impugned transfer pricing adjustment addition being made in assessee's hands.

12. We have given our thoughtful consideration to rival contentions. There is admittedly no dispute about the fact that assessee's 65% manufacturing capacity has remained idle in the impugned assessment year. It adopted the transaction net margin method (TNMM) to benchmark its above purchased transaction. There is further no issue between the parties that the above term capacity utilization is a factor affecting net profit margins since it results in higher per unit cost qua the utilized capacity which in turn lowers down the profits in question at a transactional or unit level. Ld. Departmental Representative at this stage vehemently argued that such an adjustment in the hands of comparable entities is nowhere provided either in the Act or Rules. This argument fails to impress us. We find that a co-ordinate bench decision in DCIT vs. EDAG Engineers & Design India Pvt. Ltd. ITA No.549/Del/2011 decided on 13.10.2014 quotes Rule 10B (1)(e)(3) to be providing for adjustments for variation which could materially affect the net profit margins in case of comparable uncontrolled transactions. Ld. Departmental Representative seeks to draw a distinction that the said case law deals with CUP method as against TNMM employed in the instant case. We find that Rule 10B(e)(iii) hereinabove is regarding TNMM method only providing for various adjustments on account of the contemporaneous factors materially affecting the net profits. The above co-ordinate bench thereafter concludes that such capacity under utilization adjustments have to be made only in the hands of comparable entities instead of that in case of tested party itself. We thus accept assessee's instant argument in principle and direct the Transfer Pricing Officer to proceed afresh as indicated hereinabove after affording adequate opportunity of hearing to the assessee.

13. Learned counsel's next plea is that the assessee has purchased the component in question from its associate enterprises amounting to

Rs.4,64,91,857/- as per pages nos. 5 to 7 of the assessment order as against its total purchases of Rs.19,22,49,647/-. The assessee's contention accordingly is that hon'ble Bombay high court in [2016] 65 taxmann.com 155 (Bom.) CIT vs. Ratilal Becharlal holds that a transfer pricing adjustment as per provisions of the Act is to be restricted to the extent of international transactions with associate enterprises instead of the entire turn over. Shri Shah accordingly seeks necessary directions to the Transfer Pricing Officer to restrict the impugned adjustment qua assessee's international transactional only. Ld. Departmental Representative fails to dispute this legal proposition. We thus direct the Transfer Pricing authority to confine the impugned adjustments to the extent of assessee's international transactions only in consequential proceedings. The assessee's first substantive ground is accordingly accepted for statistical purposes.

14. The assessee's second substantive ground seeks to believe the lower authorities action making transfer pricing adjustment in respect of sale of cloth guiders for Rs.26.97lacs to its associate enterprises. There is no dispute that it had sold cloth guiders no. KF 2020 and KF 2060 numbering 600 & 35 involving adjusted per unit price of Rs.26180/- and Rs.57849/- as against those numbering 30 & 3 sold to third parties involving adjusted per unit price of Rs.26071/- & Rs.56762/-; respectively. It had used CUP method in benchmarking the above transactions. The Transfer Pricing Officer proceeded to make the impugned adjustment after noticing the above difference in the sale price involving assessee's associate enterprises and third party customers. The DRP upholds the same as indicated in the instant ground.

15. Ld. counsel representing assessee invites our attention to the fact that it had sold 600 & 35 units of cloth guiders to associate enterprise as against 30

& 3 units to the third parties. His submission is that the impugned difference between sale price as indicated in preceding paragraph has arisen because of huge difference in volume of business which does not include written contracts all the time. The assessee further seeks to highlight the fact that it has to offer special discounted prices to associate enterprises who happen to be purchaser of huge quantity as per annexure 4 attached with Form 35A.

16. The assessee's next argument is that it has to provide warranties to local purchasers as calculated at the rate of Rs.608/- which is not the case with respect to its associate enterprises. Learned counsel accordingly submits that the lower authorities ought to have included the above two factors for the purpose of making adjustments before arriving at the ALP adjustment in question.

17. Ld. Departmental Representative strongly supported the lower authorities' action. He however fails to rebut the fact that the assessee's bulk sales to its associate enterprises are much voluminous as compared to third parties. The said gap is to the tune of 1/20th in case of former variety of cloth guider and almost 1/10th in latter category (supra). The Revenue further is unable to dispute the fact that assessee has been providing warranty cost to its local purchasers which has further shrunk its profit margins in question. We thus prima facie agree with assessee's above two arguments in principle and leave it open for the Id. Transfer Pricing Officer to make appropriate adjustments as per law after affording adequate opportunity of hearing in consequential proceedings. The assessee's latter substantive ground is remitted back to the Transfer Pricing Officer accordingly.

18. Both the learned representatives point out that assessee's third substantive ground seeking $\pm 5\%$ tolerance margin in ALP determination is

identical to that raised in preceding assessment year forming part of this order itself. We find that we have already held the same to be consequential in nature to be decided at the time of final computation. This substantive ground also follows suit accordingly. ITA No.2880/Ahd/2012 is accepted for statistical purposes.

19. The assessee's former appeal ITA No.3298/Ahd/2011 is partly accepted for statistical purposes and latter appeal ITA No.2880/Ahd/2012 is accepted for statistical purposes.

[Pronounced in the open Court on this the 27th day of December, 2016.]

Sd/-
(PRAMOD KUMAR)
ACCOUNTANT MEMBER
Ahmedabad: Dated 27/12/2016

Sd/-
(S. S. GODARA)
JUDICIAL MEMBER

True Copy

S.K.SINHA

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. राजस्व / Revenue
2. आवेदक / Assessee
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त- अपील / CIT (A)
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद /
DR, ITAT, Ahmedabad
6. गार्ड फाइल / Guard file.

By order/आदेश से,

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण, अहमदाबाद ।