IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-1 : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI LALIET KUMAR, JUDICIAL MEMBER

ITA No.444/Del/2015
Assessment Year : 2008-09

DCIT (LTU-1), NBCC Plaza, Pushp Vihar, New Delhi.	Vs.	Caparo Engineering India Pvt. Ltd., 5th Floor, Rajendra Bhawan, 210, DDU Marg, New Delhi. PAN: AABCC7862N
(Appellant)		(Respondent)

Assessee By	:	None
Department By	:	Shri Kumar Pranav, Sr. DR

Date of Hearing	:	01.05.2018
Date of Pronouncement	:	02.05.2018

ORDER

PER R.S. SYAL, VP:

This appeal filed by the Revenue arises out of the order passed by the CIT(A) on 12.09.2014 in relation to the assessment year 2008-09.

2. The first ground is against allowing relief of Rs.83,79,551/- in respect of addition on account of transfer pricing adjustment.

3. Briefly stated, the facts of this ground are that the assessee company is engaged in the business of manufacturing of sheet metal components and weld assemblies, metal fasteners, aluminum foundry, forging and tool room. International transactions of Purchase of capital goods, Sale of finished goods, Commission on sales and Reimbursement of expenses, all totaling, Rs.5.26 crore, were declared in Form No.3CEB. The Assessing Officer (A.O.) made reference to the Transfer Pricing Officer (TPO) for determining the arm's length price (ALP) of the international transactions. The TPO did not dispute the ALP of any transaction except Commission payment of Rs.1,11,72,735/-. In support of payment of commission to M/s Bull Moose Tube, its associated enterprise (AE), at the ALP, the assessee stated that it entered into an agreement for availing expert services of its AE and commission was paid as per the terms of the Agreement. In order to demonstrate that this international transaction was at ALP, the assessee applied Profit Split Method (PSM) as the most appropriate method. In the absence of any substantiation of the ALP of the international transaction of

payment of commission under this method, the TPO observed that no sales were made through the AE for which the alleged commission was paid. The assessee was found to have made fixed payment of US $ 31,500 per month in performance of its Agreement. The TPO opined that no tangible and concrete benefit was reaped by the assessee. In his opinion, no independent party would get into such an agreement where it would incur cost on provision of no services. He, therefore, held that the assessee made payment of Rs.1.11 crore for no intra-group services. The ALP of this international transaction was taken at Nil on application of Comparable Uncontrolled Price (CUP) Method. That is how, the transfer pricing adjustment of Rs.1.11 crore was proposed. The Assessing Officer made this addition.

4. The assessee challenged such addition before the ld. CIT(A). Placing before the ld. CIT(A), a copy of the Agreement with the AE, it was argued that as per the terms of the Agreement, the AE was to create market for the assessee in the United States, for which it was to be paid commission @ 2% of the FOB value of the sales made to the customers in the US. If the AE did not succeed in its efforts, the assessee was to pay US $31,500 per

month, being, the estimated expenditure incurred by the AE in performance of the services performed. The assessee also furnished before the ld. first appellate authority the details of expenditure incurred by the AE; and copy of bills of expenditure incurred by the AE. It was argued that its AE hired three marketing professionals, i.e., Mr. Dhananjay Maslekar, Mr. Richard Cramb and Mr. Navjot Singh exclusively for the assessee's operations. Copies of appointment letters of these professionals were also filed. The ld. CIT(A), after noting all the relevant facts, held that 75% of the payment made to the AE for intra-group services should be allowed as deduction. As a result of that, disallowance on account of intra-group services was restricted to Rs.27,93,184/-, thereby allowing relief of Rs.83,79,551/-. The Revenue is aggrieved before the Tribunal against such relief.

5. We have heard the ld. DR and perused the relevant material on record. There is no appearance from the side of the assessee despite notice. As such, we are proceeding to dispose off the appeal *ex parte qua* the assessee. It is observed that the TPO determined Nil ALP of the international transaction of `Payment of commission' on the premise that no services were received. The ld. CIT(A), on appreciation of certain

evidence filed before him, came to hold that 75% of the commission paid should be allowed as deduction. No basis, worth the name, can be traced from the impugned order for allowing deduction at 75% of the total commission payment. How this percentage has been determined is anybody's guess.

6. In so far as the use by the TPO of the `Benefit test' for determining the ALP of such services at Nil is concerned, it is found that the Hon'ble Punjab & Haryana High Court in *Knorr-Bremse India P. Ltd. vs. ACIT (2016)380 ITR 307 (P&H)* has held that the question whether a transaction is at an arm's length price or not is not dependent on whether the transaction results in an increase in the assessee's profit. A view to the contrary would then raise a question as to the extent of profitability necessary for an assessee to establish that the transaction was at an arm's length price. A further question that may arise is whether the arm's length price is to be determined in proportion to the extent of profit. Thus, while profit may reflect upon the genuineness of an assessee's claim, it is not determinative of the same. It went on to hold that business decisions are at times good and profitable and at times bad and unprofitable. Business

decisions may and, in fact, often do, result in a loss. The question whether the decision was commercially sound or not is not relevant. The only question is whether the transaction was entered into *bona fide* or not or whether it was sham and only for the purpose of diverting the profits.

7. Reverting to the facts of the extant case, it is established beyond doubt that three employees were found to have been specifically deployed by the AE for the business operations of the assessee, which deciphers that the international transaction entered into by the assessee with its AE was genuine and *bona fide*.

8. It is manifest that the TPO applied the CUP method for determining the ALP of the international transaction. While applying the CUP method, it was obligatory upon him to bring on record some comparable uncontrolled instance as per the mandate of rule 10B(1)(a)(i). Not even a single comparable instance has been brought on record to facilitate a comparison between the price for the services by the assessee *vis-à-vis* that paid by other comparables in similar uncontrolled circumstances. It is further found that the assessee has also not substantiated the ALP under the

PSM as claimed by it, as has been recorded by the authorities below. We, therefore, also disapprove the benchmarking by the assessee of the international transaction of payment of Commission.

9. That apart, it is noticed that the action of the TPO in determining Nil ALP of the international transaction on the ground that no benefit accrued to the assessee and then the AO making addition simply on the basis of recommendation of the TPO, is not in accordance with the judgment of the Hon'ble jurisdictional High Court in *CIT v. Cushman & Wakefield (India) (P.) Ltd. (2014) 367 ITR 730 (Del*), in which it has been held that the authority of the TPO is limited to conducting transfer pricing analysis for determining the ALP of an international transaction and not to decide if such service exists or benefits did accrue to the assessee. Such later aspects have been held to be falling in the exclusive domain of the AO. In that case, it was observed that the e-mails considered by tribunal from Mr. Braganza and Mr. Choudhary dealt with specific interaction and related to benefits obtained by assessee, providing a sufficient basis to hold that benefit accrued to assessee. As the details of specific activities for which cost was incurred by both AEs (for activities of Mr. Braganza and Mr. Choudhary),

and attendant benefits to assessee were not considered, the Hon'ble High Court remanded the matter to file of concerned AO for an ALP assessment by TPO, followed by AO's assessment order in accordance with law considering the deductibility or otherwise as per section 37(1) of the Act.

10. When we come back to the facts of the instant case, it turns out that the TPO proposed the transfer pricing adjustment equal to the stated value of the international transaction at Rs.1.11 crore and odd, *inter alia*, by holding that no benefit was received by the assessee and hence no payment on this score was warranted. The AO in his order has taken the ALP of the international transaction at Nil on the basis of such recommendation of the TPO without carrying out any independent investigation for the deductibility or otherwise of such payment in terms of section 37(1) of the Act. This addition has been made by the AO in his order without invoking section 37(1) of the Act. As per the *ratio decidendi* of *Cushman & Wakefield India (P.) Ltd. (supra)*, the TPO was required to simply determine the ALP of the international transaction, unconcerned with the fact, if any benefit accrued to the assessee and thereafter, it was for the AO to decide the deductibility of this amount u/s 37(1) of the Act. As the TPO

in the instant case initially determined Nil ALP by holding that no benefit accrued to the assessee etc. and the AO made the addition without examining the applicability of section 37(1) of the Act, we find the actions of the AO/TPO running in contradiction with the *ratio* laid down in *Cushman & Wakefield (supra)*. In these circumstances, we set aside the impugned order on this score and send the matter to the file of AO/TPO for deciding it in conformity with the above discussion and the law laid down by the Hon'ble jurisdictional High Court in the aforenoted case. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such proceedings.

11. The next ground raised by the Revenue in its appeal is against restricting the disallowance u/s 14A to Rs.5,60,984/-.

12. The facts apropos this issue are that the assessee earned exempt dividend income of Rs.20,11,752/-. No disallowance was offered u/s 14A. On being called upon to explain the reasons, the assessee submitted that the dividend income was earned from mutual funds. A request was made that Rs.20,000/- may be disallowed u/s 14A. After recording satisfaction, the

Assessing Officer invoked the provisions of Rule 8D to make disallowance of Rs.51,47,448/-, comprising of interest component under Rule 8D(2)(ii) at Rs.45,86,464/- and ½% of the average value of investments as per Rule 8D(2)(iii) at Rs.5,60,984/-. The ld. CIT(A) sustained the addition of Rs.5,60,984/- and deleted the remaining amount of Rs.45,86,464/-. The Revenue is aggrieved against the relief allowed in the first appeal.

13. We have heard the ld. DR and perused the relevant material on record. Before dealing with this contention, it is worthwhile to mention that as per page 8 of the impugned order, the value of Investments made by the assessee at the end of the year stood at Rs. 18.59 crore. Further, the assessee's paid up Share capital at the end of the year was to the tune of Rs.399.71 crore, which is many times higher than the amount of Investment yielding exempt income.

14. Section 36(1)(iii) provides for deduction of interest of the amount of interest paid in respect of capital borrowed for the purpose of business or profession. The essence of this provision is that the interest should be allowed so long as the capital borrowed, on which such interest is paid, is

used for the purpose of business or profession. If, however, an assessee is having its own interest free surplus funds and such funds are utilised as interest free advances even for a non-business purpose, there cannot be any disallowance of interest paid on interest bearing loans. The Hon'ble Bombay High Court in *CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bom)*, has held that where an assessee possessed sufficient interest free funds of its own which were generated in the course of relevant financial year, apart from substantial shareholders' funds, presumption stands established that the investments in sister concerns were made by the assessee out of interest free funds and, therefore, no part of interest on borrowings can be disallowed on the basis that the investments were made out of interest bearing funds. In that case, the AO recorded a finding that a sum of Rs.213 crore was invested by the assessee out of its own funds and Rs.1.74 crore out of borrowed funds. Accordingly, disallowance of interest was made to the tune of Rs.2.40 crore. The assessee argued that no part of interest bearing funds had gone into investment in those two companies in respect of which the AO made disallowance of interest. It was also argued that income from operations of the company was Rs.418.04 crore and the

assessee had also raised capital of Rs.7.90 crore, apart from receiving interest free deposit of Rs.10.03 crore. The assessee submitted before the first appellate authority that the balance-sheet of the assessee adequately depicted that there were enough interest free funds at its disposal for making investment. The ld. CIT(A) got convinced with the assessee's submissions and deleted the addition. Before the Tribunal, it was contended on behalf of the Revenue that the shareholders' fund was utilized for the purchase of its assets and hence the assessee was left with no reserve or own funds for making investment in the sister concern. Thus, it was argued that the borrowed funds had been utilized for the purpose of making investment in the sister concern and the disallowance of interest was rightly called for. The Tribunal, on appreciation of facts, recorded a finding that the assessee had sufficient funds of its own for making investment without using the interest bearing funds. Accordingly, the order of CIT(A) was upheld. When the matter came up before the Hon'ble High Court, it was contended by the Department that the shareholders' funds stood utilized in the purchase of fixed assets and hence could not be construed as available for investment in sister concern. Repelling this contention, the Hon'ble

High Court observed that : "*In our opinion, the very basis on which the Revenue had sought to contend or argue their case that the shareholders' fund to the tune of over Rs.172 crore was utilized for the purpose of fixed assets in terms of the balance-sheet as on March 31, 1999, is fallacious.*" In upholding the order of the Tribunal, the Hon'ble High Court held that: "*If there be interest free funds available to an assessee sufficient to meet its investment and at the same time the assessee had raised a loan, it can be presumed that the investments were from the interest free funds available*". Thereafter, the judgment of the Hon'ble Supreme Court in the case of *East India Pharmaceutical Works Ltd. Vs. CIT (1997) 224 ITR 627 (SC)* and also the judgment of the Hon'ble Calcutta High Court in *Woolcombers of India Ltd. Vs. CIT (1981) 134 ITR 219 (Cal)* were considered. It was finally concluded that: *"The principle, therefore, would be that if there are funds available both interest free and overdraft and/or loans taken, then a presumption would arise that the investments would be out of interest free funds generated or available with the company, if the interest free funds were sufficient to meet the investment"*. Consequently the interest was held to be deductible in full.

15. From the above judgment, it is manifest that there can be no presumption that the shareholders' fund of a company was utilized for purchase of fixed assets. If an assessee has interest free funds as well as interest bearing funds at its disposal, then the presumption would be that investments were made from interest free funds at its disposal. Similar view has been taken by the Hon'ble Dehi High Court in *CIT vs. Tin Box Company (2003) 260 ITR 637 (Del)*, holding that when the capital and interest free unsecured loan with the assessee far exceeded the interest free loan advanced to the sister concern, disallowance of part of interest out of total interest paid by the assessee to the bank, was not justified.

16. Applying the above proposition in the context of section 14A, the Hon'ble Karnataka High Court in *CIT & Anr vs. Microlabs (2016) 383 ITR 490 (Kar)* has held that when investments are made from common pool and non-interest bearing funds are more than the investment in tax free securities, no disallowance of interest expenditure u/s 14A can be made. This view has been taken by following the judgment of the Hon'ble Bombay High Court in *CIT vs. HDFC Bank Ltd. (2014) 366 ITR 515 (Bom)*. It is further observed that this issue is no more *res integra* in view

of the recent judgment delivered by the Hon'ble Supreme Court in *Godrej & Boyce Manufacturing Company Ltd. vs. DCIT (2017) 394 ITR 449 (SC),* in which it has been held that when interest free funds in the form of share capital and reserves are more than investment, then no disallowance of interest can be made u/s 14A.

17. When we turn to the facts of the instant case, we find that investments in the Units at the end of the year stood at Rs.18.59 crore with the corresponding opening figure at Rs.3.84 crore as against the amount of shareholders' fund at Rs.399.71 crore at the close of the year and Rs.161.91 crore at the beginning of the year. This proves that the amount of investment in the Units etc., yielding exempt income, is much less than the amount of shareholders' funds. Respectfully following the above precedent, we uphold the impugned order in deleting the disallowance of interest u/s 14A at Rs.45,86,464/-, against which the Revenue has preferred this grievance before the Tribunal. This ground is not allowed.

18. The only other issue raised in this appeal is against the deletion of addition of Rs.48,460/- made by the Assessing Officer on account of disallowance of claim of depreciation @ 60% on UPS as against 15%.

19. Briefly stated, the facts of this ground are that the assessee purchased UPS worth Rs.1,39,428/- and claimed depreciation at 60% amounting to Rs.68,358/-. The Assessing Officer restricted the rate of depreciation to 15%, thereby making disallowance of Rs.48,460/-. The ld. CIT(A) deleted the addition on this score.

20. We have heard the ld. DR and perused the material on record. We find that the issue of allowing depreciation at higher rate on computer peripherals is no more *res integra* in view of the judgment of the Hon'ble Delhi High Court in *CIT vs. BSES Yamuna Powers Ltd. 2010 –TIOL-636-HC-DEL-IT* and the Special Bench order of the ITAT in *DCIT vs. Data Craft India Ltd. (2010) 133 TTJ (Mum) (SB) 37.* In these decisions, the entitlement to the higher rate of depreciation on computer peripherals has been laid down by deciding the issue in favour of the assessee. We, therefore, uphold the impugned order in holding that depreciation on the

computer UPS be allowed at the higher rate as claimed by the assessee.

21. In the result, the appeal is partly allowed for statistical purpose.

The order pronounced in the open court on 02.05.2018.

Sd/-	Sd/-
[LALIET KUMAR] JUDICIAL MEMBER	[R.S. SYAL] VICE PRESIDENT

Dated, 02nd May, 2018.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.