

IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE
BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A No.628/Bang/2017
Assessment Year : 2012-13

M/s A.O Simth India Water Products Pvt. Ltd., No.300, Phase II, KIADB Indl. Area, Harohalli, Kanakapura (TQ), Ramanagar Dist, Bengaluru-562 112. PAN - AAFCA 8954 R	Vs.	The Dy. Commissioner of Income-Tax, Circle-1(1)(2), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri K.R Vasudevan, Advocate
Revenue by	:	Shri Pradeep Kumar, CIT (DR)

Date of Hearing	:	27-01-2021
Date of Pronouncement	:	10-02-2021

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal has been filed by assessee against the final assessment order passed by Ld. DCIT circle 1 (1) (2), Bangalore for assessment year 2012-13 on following grounds of appeal:

“The grounds mentioned hereinafter are without prejudice to one another.

Transfer Pricing

The learned Assessing Officer ("learned AU"), learned Transfer Pricing Officer ("learned TPO") and the Honourable Dispute Resolution Panel ("Hon'ble DRP") grossly erred in adjusting the transfer price by INR 21,17,82,872/- of the Appellant's international transactions with its Associated Enterprises ("AEs") u/s 92CA of the Income-tax Act, 1961 ("the Act").

2. The learned AU/learned TPO/Hon'ble DRP erred in rejecting the TP documentation maintained by the Appellant by invoking provisions of sub-section (3) of 92C of the Act.

3. The learned AU/learned TPO/Hon'ble DRP erred in disregarding the economic analysis performed by the Appellant in the Transfer Pricing documentation to justify the arm's length nature of the international transaction pertaining to purchase of raw materials.

IN The learned AU/learned TPO/Hon'ble DPP erred in not applying Cost Plus Method ("CPM") as the most appropriate method with respect to the manufacturing activity of the Appellant.

5 The learned AO/learned TPO/Hon'ble DRP ought to have appreciated the fact the Appellant was in its startup phase with respect to the manufacturing activity of the Appellant.

The learned AU/learned TPO/Hon'ble DRP erred in not appreciating the fact that the losses incurred during the year were due to economic and business reasons such as:

- i. Market penetration strategies;*
- ii. Price competitiveness;*
- iii. Under-utilization of capacity; and*
- iv. Impact of foreign exchange fluctuation*

7. Without prejudice to the abovementioned grounds that no transfer pricing adjustment ought to be made, the learned AO/learned TPO/Hon'ble DRP erred in not restricting the transfer pricing adjustment to the value of the international transactions of the Appellant.

8. Without prejudice to the above, the learned AO/learned TPO/Hon'ble DRP erred in not analyzing the impact of the proposed transfer pricing adjustment on the gross margin of the Appellant.

9. Without prejudice to the argument that CPM is the most appropriate method, the learned AO/learned TPO/Hon'ble DRP erred in not providing appropriate adjustment towards

customs duty incurred by the Appellant vis-à-vis comparable companies.

10. The learned AO/learned TPO/Hon'ble DRP erred in not considering the previous two years financial data of the comparable companies while determining the ALP.

Corporate Tax

11. Disallowance of provision created for sales/advertisement - Rs.73,37,974

a. The learned AO/ Hon'ble DRP has erred in considering provision for annual sales schemes or advertisement expenses amounting to Rs.73,37,974 as contingent liability not crystalized as on 31 March 2012.

b. The learned AO/ Hon'ble DRP has erred in disallowing the provision for annual sales schemes or advertisement expenses amounting to Rs.73,37,974 under section 37 of the Income-tax Act, 1961 ('the Act').

c. The learned AO/ Hon'ble DRP ought to have appreciated that if a business liability arises in an accounting year, the deduction should be allowed in that year although the liability may be discharged at a future date.

d. The learned AO/ Hon'ble DRP ought to have appreciated that the liability towards provision for annual sales schemes or advertisement has been determined based on the actual sales made during financial year 2011-12 and hence the same cannot be considered as an unascertained liability.

12. Disallowance of expenditure on advertisement- Rs.93,02,790

a. The learned AO/ Hon'ble DRP has erred in disallowing a portion of expenditure incurred on advertisement amounting to Rs.93,02,790 by considering the same as an unexplained expenditure.

b. The learned AO/ Hon'ble DRP ought to have observed that the said advertisement expenditure has been incurred with an intent to promote sale of Company's products.

c. The learned AO/ Hon'ble DRP ought to have appreciated that the above expenses have been incurred for the purpose of business and hence allowable under the provisions of section 37(1) of the Act.

13. Disallowance of warranty provision - Rs.94,95,260

a. The learned AO/ Hon'ble DRP has erred in disallowing the warranty provision of Rs.94,95,260

b. The learned AO/ Hon'ble DRP has erred in observing that the Company does not have enough data to carry out a trend analysis in a scientific manner as AY 2012-13 is the fourth year of operation of the Company and third year of utilisation of warranty provisions.

c. The learned AO/ Hon'ble DRP has erred in holding that the Company has been creating provisions on an ad-hoc basis ignoring the basis on which the provision was determined.

d. The learned AO/ Hon'ble DRP has erred in observing that warranty provision is contingent in nature and hence, not allowable as a business expenditure.

e. The learned AO/ Hon'ble DRP ought to have observed that warranty provision is calculated based on historical trend and is created on a scientific basis and hence is not contingent in nature.

The appellant craves leave to add, alter, rescind and modify the grounds herein above or produce further documents, facts and evidence before or at the time of hearing of this appeal.

For the above and any other grounds which may be raised at the time of hearing, it is prayed that necessary relief may be provided.”

Brief facts of the case are as under:

2. The assessee is a company and filed its return of income for year under consideration on 29/11/2012 declaring current year loss of Rs.29,98,71,723/-. Subsequently, the assessee filed revised return on 31/03/2014, declaring loss of Rs.21,15,18,062/-. Book profit was shown to be at 'nil' by assessee. The case was selected for scrutiny and notice under section 143(2) of the Act was issued, in response to which, representatives of the assessee appeared before the Ld. AO and filed requisite details as called for.

3. The Ld.AO observed that, the assessee was engaged in the business of manufacture and sale of water heaters. During the year it was observed that, the assessee had international transaction exceeding Rs.50 crores. Therefore with prior approval, the issue reference was made to the transfer pricing officer to determine arm's length price as per provisions of section 92CA of the Act.

4. Upon receipt of reference, the Ld.TPO called upon assessee to file requisite details in Form 3CD regarding the international transaction between the assessee and its AE. The Ld. TPO noted that assessee had following international transaction during the year under consideration:

Category	Amount (in Rs)
Purchase of Water Heaters	4,669,014
Purchase of raw materials	303,487,860
Payment towards support services	27,501,012
Payables	138,448,606
Payment of Royalty	17,424,633

4. Assessee for the year under consideration applied CPM as the most appropriate method in manufacturing segment. The Ld.TPO rejected the MAM adopted by the assessee for the reason that functions performed by the assessee before reselling the products of its AE and costs for performing such functions were not available. The Ld.TPO adopted TNMM as the MAM and determined the ALP of the transaction of trading. It is relevant to point out that in respect of manufacturing segment, the Ld.TPO accepted following comparables chosen by the assessee:

S.NO	Company Name	Sales	OP	OP/SA LES
1	Genus Power Infrastructures Ltd.	717.77	86.0 4	11.99%
2	Incap Ltd.	17.61	0.76	4.32%
3	Salzer Electronics Ltd.	249.12	21.8	8.75%
4	Penguin Electronics Ltd.	86.94	5.92	6.81%

5	Kirloskar Electric Co. Ltd.	949.5	21,3 1	2.24%
AVERAGE				6.82%

5. The Ld.TPO computed assessee's margin to be (-) 18.28% on sales and average margin of comparables at 6.28%, and thus proposed an adjustment at Rs.21,17,82,872/-by determining in the margin of assessee using PLI as OP/OC.

6. The Ld.AO while passing the draft assessment order further disallowed:

- The provision created for sales/advertisement amounting to Rs.73,37,974/-
- Unexplained expenditure on advertisement amounting to Rs.93,02,790/-
- Provision created for warranty amounting to Rs.94,95,260/-

7. Aggrieved by the additions made by the Ld.AO, assessee filed objections before DRP.

8. Before DRP the assessee submitted that it is in the start-up phase and operates in the capital intensive industry and hence despite having held the gross margin, it failed to recover the other operational costs at net level and hence reports loss, as compared to the comparable companies, who were early entrants in the specified industry.

9. The DRP observed that assessee has not brought any argument or facts in favour of application of CPM in the instant case when it is a full-fledged manufacturer. The DRP observed

that replies and submissions were general and vague without making out any case in its favour. The DRP thus confirmed the action of the Ld.TPO and application of TNMM as most appropriate method.

10. In respect of disallowance of provision created for sales/advertisement, DRP held as under:

Having considered the submissions, we have perused the record to find that _ has examined this issue in para 6 of the Draft Asst Order (DAO), wherein he has brought out clearly, that the liability is crystallised in the next financial year and the obligation to pay is also in the next financial year based on the 'sales numbers' of the current year. Everything is happening in the next financial year and only statistics of sales of the previous year are used to quantify the incentives. Therefore, it is allowable only in the next financial year. The expenses are not doubted at all and it is said that the liability to pay gets crystallised and arises in the next financial year, therefore, it is allowable only in the next Year. Considering the same, we are in complete agreement with the AO to confirm his action and accordingly reject this ground of objection."

11. In respect of disallowance of advertisement expenditure as unexplained, the DRP upheld the AO's action by observing as under:

"Having considered the submissions, we are of the view that the AO has disallowed the claim on the ground that the assessee has not proved the said expenditure with any documentary proof/evidence. Instead of leading the basic evidence as required by the AO, assessee has submitted before us that the increase in sales should be considered as a valid justification for establishing that it had incurred this expenditure. Before us, the assessee has referred to Annex 1.7A and upon careful examination, we found that it has only one page (page 80 of the PB) containing the statement of TDS made and it is not, in any sense, any evidence This failure on the part of the assessee cannot be redeemed in any way except by way of producing the proper documentary evidence, least by saying that increase in turnover justifies this. The increase in turnover this year over last year, could be due to several factors including the factors pertinent to the previous year, to cite one; that the company had full scale manufacturing for complete 12 months during the year in contrast to the 6 months of manufacturing last year.

Thus, we are of the view that the assessee has to discharge the initial onus to establish the genuineness of the transaction, which it failed to do so. Both the cited judicial precedents are not helpful to the assessee, as the facts are totally different and in the present case the assessee has completely failed to establish the fact that it had genuinely incurred any such expenses claimed in the Books.

In view of the above, we uphold the action of the AO and reject the objection of assessee.”

12. In regards to disallowance of warranty provision, the DRP upheld the action of Ld. AO by observing as under:

“Having considered the submissions, we have examined para 7 of the TP order this issue was discussed while concluding in para 7.5-7.6 that:

7.5 Even going by the warranty provision workings, it is seen that for the past three years, the actual utilization of warranty varies from 17% to 43%. Further, the returns under warranty also vary from 0.15% to 0.40% of production.

7.6 Going by all the above, it is inferred that the warranty provisions not been made in a scientific manner as laid out by the ratio supra) of the Apex Court. Therefore, the unused warranty provisions of 94,95,260/- is being disallowed and added to the taxable income.

Considering these facts, we are of the view that the assessee has no valid and scientific basis in creating the said warranty provision @1.85% of sales, as laid by the Hon'ble SC in the case of Rotork India. Only upon proving that the assessee has a scientific basis behind the said calculation of the provision, then comes the overall limit of 3%. Hence, we are of the view that the said claim is not allowable and accordingly, reject the objection.

However, it is observed from the Balance Sheet, P &L account and Computation of income filed along with the ROI that the said provision of warranty is found not debited/claimed as expenditure for the year. The AO is accordingly directed to verify this fact to ensure that the assessee has debited this expenditure, as the disallowance is valid only when the said amount is indeed claimed as expenditure for the Year.”

13. Based upon the above directions, Ld.AO passed final assessment order by making addition in the hands of assessee.

14. Aggrieved by order of the Ld.AO, assessee is in appeal before us now.

15. At the outset, the Ld.AR submitted that, **Ground No. 1-3** are general in nature and therefore do not require any adjudication.

16. It has been submitted that, **Ground No.4-10** are in respect of transfer Pricing addition made by the Ld.AO. He submitted that, these issue have been addressed by coordinate bench of this *Tribunal* in the assessee's own case for assessment year 2011-12, reported in [2018] 98 *taxmann.com* 295, wherein the issue has been remanded to the Ld.TPO.

17. The Ld.CIT.DR did not have any objection for the issue being remanded to the Ld.TPO, to be dealt with in accordance with directions by this *Tribunal* in assessee's own case for assessment year 2011-12.

18. We note that, this *Tribunal* for assessment year 2011-12 (supra) decided the issue as under:

“16. Aggrieved by the order of the DRP as aforesaid, the revenue has preferred the present appeal before the Tribunal.

17. We have heard the rival submissions. The ld. DR submitted that the basis on which the DRP deleted the TP adjustment made by the AO was not correct. In this regard, the ld. DR submitted that the requirement of section 92(1) of the Act for determination of ALP in respect of an international transaction has to be followed and merely for the reason that on such determination, the profit margin of the assessee will be exorbitant cannot be the basis to delete the addition made on account of determination of ALP. His submission that if the DRP finds that the MAM is CPM for international transaction for purchase of raw materials and RPM for international transaction for trading in water heaters is appropriate, then the DRP ought to have embarked upon an enquiry as to whether the ALP computed by the assessee in accordance with those methods was correct. It was submitted by him that by default price paid in international transaction cannot be considered as at arm's length. It was therefore submitted by him that determination of MAM and determination of ALP based on the MAM should be directed to be carried out.

18. *The ld. counsel for the assessee, on the other hand, pointed out that as far as international transaction of trading in heaters is concerned, in assessee's own case, this Tribunal has held that RPM is the MAM for determining the ALP. The decision of ITAT in Dy. CIT v. A.O. Smith India Water Heating (P.) Ltd.[2018] 97 taxmann.com 218 (Bang. - Trib.) was sought to be relied upon by the ld. counsel for the assessee. With regard to the international transaction of purchase of raw materials, the ld. counsel for the assessee brought to our notice that the only reason given by the TPO for rejecting the CPM as MAM is the absence of details regarding computation of gross profit of the assessee. In this regard, our attention was drawn to the TP study where the gross margins earned by the assessee have been clearly given. These details have already been extracted while dealing with the contentions of the assessee before the DRP in the earlier part of this order. It was therefore submitted by the ld. counsel for the assessee that the conclusions of the TPO that CPM is not the MAM in respect of international transaction for purchase of raw materials is not correct. The ld. counsel for the assessee therefore prayed that the order of the DRP should be upheld.*

19. *We have given a careful consideration to the rival submissions. As far as international transactions for purchase of raw materials is concerned, the only reason given by the TPO in rejecting CPM as MAM is the absence of gross margins of the assessee and the manner in which it was computed. In this regard, we find that in a letter dated 14.10.2014 filed by the assessee before the TPO in Annexure-2, the assessee has given cost of sales and other indirect cost. The same is at page 525 of assessee's PB. In these circumstances, we are of the view that the reasons given by the TPO for rejecting CPM as MAM cannot be sustained.*

20. *As far as international transaction of trading in water heaters is concerned, this Tribunal has already taken a view in assessee's own case for AY 2010-11 that RPM is the MAM. Following the aforesaid order, we hold that the TPO is not correct in rejecting the RPM as MAM.*

21. *As far as determination of ALP for both international transactions are concerned, we are of the view that the provisions of section 92 mandate determination of ALP. The fact that after carrying out such exercise, the profit margins of the assessee would be abnormal cannot be the basis to accept the price paid in the international transactions as at arm's length. In other words, it is mandatory to determine the ALP in the manner contemplated by the Act and the Rules. In our view, the DRP fell into an error in accepting the price received by the assessee in international transactions as at arm's length without carrying out such an exercise. We therefore feel it proper to set aside the order of DRP and remand to the AO/TPO for fresh consideration the*

determination of ALP on the basis of MAM as adopted by the assessee in its TP study.

22. *The ld. counsel for the assessee submitted before us that the comparables chosen by the assessee in its TP study were also chosen by the TPO, when he adopted TNMM. His prayer was that pursuant to the remand by the Tribunal, the TPO should be directed to restrict himself from choosing any fresh comparables. In our view, the TPO has to carry out the exercise in accordance with the law and no restriction can be placed on his powers to bring any relevant and appropriate data on record in the matter of determination of ALP.*

23. *In the result, the appeal by the revenue is allowed for statistical purposes.”*

19. We note that, for assessment year 2011-12, it was the revenue who was aggrieved by the directions of DRP in considering CPM as the most appropriate method for determining ALP of the international transaction under trading segment. For assessment year 2011-12, the Ld.TPO had adopted RPM as against CPM considered by assessee, with same set of comparables as considered by assessee therein.

20. In the present facts the Ld.TPO adopted TNMM as against CPM adopted by assessee with the same set of comparables as considered by assessee for determining the arm's length price of the transaction under trading segment.

Admittedly, no difference has been pointed out in facts and circumstances for assessment year under consideration vis-a-vis assessment year 2011-12. Respectfully following the directions of this *Tribunal* for assessment year 2011-12 in assessee's own case, we direct the Ld.TPO to determine the arm's length price of the transaction under trading segment by using CPM as the most appropriate method and to carry out the exercise of

determining the arm's length price of the transaction in accordance with law.

21. Needless to say that proper opportunity of being heard shall be granted to assessee in accordance with law.

Accordingly these grounds stands allowed for statistical purposes.

22. Ground No. 11 is raised by assessee against disallowance of provision created for sales/advertisement amounting to Rs.73,37,974/-.

23. We have considered the submissions advanced by both sides in the light of records placed before us.

We note that DRP upheld the action of the Ld.AO as the liability was not crystallised during the year under consideration. DRP referred to the categorical observation in the draft assessment order wherein the said fact has been noted by the Ld.AO. The DRP also noted that the said expenses would be allowable only when it is crystallised which falls in the next year. This has not been controverted by any documents/evidences by the Ld.AR even before us. Under such circumstances we do not find any infirmity with the observations of DRP in upholding the action of the Ld.AO.

Accordingly this ground raised by assessee stands dismissed.

24. Ground No. 12 is against disallowance of expenditure on advertisement amounting to Rs.93,02,790/-.

25. The Ld.AO confirmed the addition, as no supporting evidence documents could be filed by assessee.

26. The Ld.AR prayed for one more opportunity to be granted to assessee to support its claim.

27. Ld.CIT.DR did not object the issue being remanded to the Ld.AO.

28. Accordingly, we remand this issue to the Ld.AO for assessee to provide necessary documents in support of its claim. The Ld.AO shall verify the details/evidences filed by assessee and consider the claim in accordance with law.

Needless to say that proper opportunity of being heard may be granted to assessee.

Accordingly this ground raised by assessee stands allowed for statistical purposes.

29. Ground No. 13 has been raised by assessee against disallowance of warranty provision of Rs.94,95,260/-.

It has been submitted that the DRP directed Ld. AO to verify the fact to ensure that assessee debited the said expenditure as the disallowance is valid only when the said amount is indeed claimed as expenditure for the year. It has been submitted that no verification has been carried out by Ld. AO as directed by DRP.

30. The Ld.AR prayed for one more opportunity to be granted to assessee to support its claim.

31. The Ld.CIT.DR did not object the issue being remanded to the Ld.AO.

32. Accordingly, we remand this issue to the Ld.AO for assessee to provide necessary documents in support of its claim. The

Ld.AO shall verify the details/evidences filed by assessee and consider the claim in accordance with law.

Needless to say that proper opportunity of being heard may be granted to assessee.

Accordingly this ground raised by assessee stands allowed for statistical purposes.

In the result appeal filed by assessee stands partly allowed as indicated hereinabove.

Order pronounced in the open court on 10th February, 2021

Sd/-
(CHANDRA POOJARI)
Accountant Member
Bangalore,
Dated, the 10th February, 2021.
/Vms/

Sd/-
(BEENA PILLAI)
Judicial Member

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar, ITAT, Bangalore

		Date	Initial	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	-2-2021		Sr.PS
3.	Draft proposed & placed before the second member	-2-2021		JM/AM
4.	Draft discussed approved by Second Member.	-2-2021		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	-2-2021		Sr.PS/PS
6.	Kept for pronouncement on	-2-2021		Sr.PS
7.	Date of uploading the order on Website	-2-2021		Sr.PS
8.	If not uploaded, furnish the reason	--		Sr.PS
9.	File sent to the Bench Clerk	-2-2021		Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS