

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई।
IN THE INCOME TAX APPELLATE TRIBUNAL
'D' BENCH: CHENNAI

श्री यस यस विश्वनेत्र रवि, न्यायिक सदस्य एवं श्री जगदीश, लेखक सदस्य के समक्ष
BEFORE SHRI SS VISWANETHRA RAVI, JUDICIAL MEMBER AND
SHRI JAGADISH, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.501/Chny/2017
निर्धारण वर्ष /Assessment Year: 2009-10

The Dy. Commissioner of
Income Tax,
Corporate Circle-1(1),
Chennai.

(अपीलार्थी/Appellant)

Vs. M/s. AVO Carbon India Pvt. Ltd.,
25/A2, Diary Plant Road,
SIDCO Industrial Estate,
Ambattur, Chennai -600 098.
[PAN: AABCM 8697F]

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Assessee by
प्रत्यर्थी की ओर से /Revenue by

: Shri SP Chidambaram, Advocate
: Shri A Sasikumar, CIT

सुनवाई की तारीख/Date of Hearing

: 20.05.2024

घोषणा की तारीख /Date of Pronouncement

: 14.08.2024

आदेश / O R D E R

PER JAGADISH, A.M. :

Aforesaid appeal filed by the Revenue for Assessment Year (AY) 2009-10 arises out of the order of Learned Commissioner of Income Tax (Appeals)-1, Chennai [hereinafter "CIT(A)"] dated 18.11.2016 in the matter of assessment framed by Ld. Assessing Officer [AO] u/s. 143(3) r.w.s 92CA of the Income-tax Act, 1961 (hereinafter "the Act") on 07.05.2013. The revenue has raised the following grounds of appeal:

"1. The order of the learned CIT(A) is contrary to law, facts and circumstances of the case.

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2.1 The learned CIT(A) erred in deleting the T.P adjustment made on account of purchases from the Associated Enterprises and adjustment to income towards material cost attributable to the AE to the tune of Rs. 15.71 crores without appreciating the fact that the losses incurred by the assessee are on account of purchase of - defective machinery and poor quality of raw materials from the A.E, which is evident from the assessee's own letter dated 25.10.2012, as the transaction is between the poor quality assessee and its AE involving defective machinery and raw materials, thereby requiring T.P adjustment?

2.2 The learned CIT(A) erred in not appreciating the fact that, had transaction involving defective machinery/ low quality raw the materials etc., been with a third party, the assessee Company would have been definitely compensated by the third party, and same principle shall apply in the case of transaction with the A.E also and therefore the losses suffered by the assessee company needs to be adjusted/compensated, which shall only partake the character of "income" of the assessee, for that financial year.

2.3 The learned CIT(A) erred in not appreciating the fact that, income towards material the transaction involving adjustment to adjustment attributable to A.E is based on clear facts, and cost re-characterization of income, or abnormal cannot be termed as Cost".

4. For these and other grounds that may be adduced at the time of hearing, it is prayed that the order of the learned CIT(A) may be set aside and that of the Assessing Officer restored."

2. The brief facts of the case are that the assessee-company formerly known as Carbon Lorraine Madras Pvt. Ltd. is engaged in the business of manufacture and supply and export of carbon brushes which are used in automotive, power tool and home appliances. The company was established as 49:51 joint venture between M/s. Carbon Lorraine India Pvt. Ltd. and Le Carbon Lorraine S.A, France. M/s. Carbon Lorraine India Pvt. Ltd. is a 100% subsidiary of Le Carbon Lorraine SA, France. During A.Y 2009-10, the assessee has entered into various international transactions with its Associated Enterprises

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(AEs) like import of raw-material, export of finished goods, import of fixed assets, sorting charges and ERP charges as under :

| Sl. No. | Type of Service | Name of the AE | Amount (in Rs.) |
|---------|---|---|-----------------|
| 1 | Import of raw material | Carbone Lorriane Applications Electriques Segment Biens De Consomations | 7,42,57,363 |
| | | Deutsche Carbone AG | 3,81,57,283 |
| | | Carbone Kirkwood LLC | 13,05,27,595 |
| | | Carbone of America | 12,28,282 |
| 2. | Export of Finished goods (EOU Segment) | Carbone Lorriane Applications Electriques Segment Biens De Consomations | 3,990 |
| | | Carbone Kirkwood LLC | 25,688 |
| | | Carbone of America | 10,88,06,822 |
| | | Carbone Lorraine Mexico | 27,697 |
| 3. | Import of fixed assets | Carbone Kirkwood LLC | 66,49,975 |
| 4. | Sorting charges | Carbone Lorraine Korea | 2,94,272 |
| | | Carbone of America | 2,22,79,940 |
| 5. | Network charges | Carbone Lorraine Corporate services | 14,29,729 |
| 6. | ERP Charges | Le Carbone Lorraine France | 12,74,104 |
| | Total | | 38,49,92,740 |

3. The assessee has adopted TNMM method as MAM to determine arm's length price of its transactions with its AE. The assessee-company has shown a profit of 8.98% in DTA segment and a loss of - 30.11% are in EOU segment. The assessee in its TP study selected six broadly independent comparable companies and arithmetic mean of net profit margin earned owned by the Indian comparable company was at 6.82%. The assessee prepared segmental financials for DTA and EOU segments and compared the adjusted NMP earned in the DTA segment i.e., 8.98% with that of the margins of comparables.

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Thus, arm's length pricing of the international transactions was established. As regards to EOU segment, no benchmarking was done on the basis that it would be inappropriate to compare a start up segment with established company and being the first year of operations, the EOU segment incurred huge losses on account of heavy start up costs. However during proceeding before TPO, the assessee recomputed Net Profit Margin(NMP) after adjusting for abnormal material and other extraordinary items at 10.24% which was stated to be higher than NMP of comparable companies i.e., 7.25%. The TPO has rejected the assessee's computation and computed the adjustment of Rs. 3.76 Crores on account of profit margin towards purchases from AE. The TPO has also made adjustment of Rs. 11.95 Crore as reimbursement by its AE on account of defective material supply.

4. The Ld. CIT(A) allowed the benefit of material cost adjustment and other abnormal cost and deleted the TPO adjustment. The Department has filed appeal against deleting the TP adjustments.

5. The Ld. DR has submitted that the assessee-company while computing the arm's length price by adopting TNMM method has reduced material cost of Rs. 11.95 Crores and sorting, freight, spares

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and tool costs while computing the PLI. As per the Ld. DR, the Ld. CIT(A) was not justified to allow these expenses to be reduced from cost in computing the PLI only to match the PLI of comparable companies.

6. The Ld. AR has relied upon order of Ld CIT(A) deleting addition made by AO on TP adjustments . The Ld AR has submitted that AVO Carbon India Pvt. Ltd. was operating in domestic segments DTA and EOU segment was established during this year. The Ld AR submitted that there was a loss in the current year due to extraordinary business circumstances resulting to abnormal material consumption , and significant change , therefore assessee was justified to compute the margin after claiming material cost adjustment. The Ld. AR has relied on the decision of Co-ordinate Bench of this Tribunal in the case of *Igarshi Motors India Vs. ACIT in ITA No.2257/Mda/2011* and *Hanil Tube India Pvt. Ltd. in ITA No.1037/Mds/2014* in support of adjustment.

7. We have heard the rival submissions, and perused the materials available on record. The AO/TPO has made adjustment of Rs. 3.76 Crores for difference in margin and Rs. 11.95 Crore on adjustment to income towards material cost adjustment attributable to AE. The

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A.O/TPO has re-characterized the raw-material cost adjustment claimed by the assessee as income on the ground that such cost is attributable to AE and to be reimbursed by the AE. The Ld. CIT(A) has deleted the transfer pricing adjustment of Rs. 3.76 Crore for difference in margin accepting the assessee's claim that material cost of Rs. 11.95 Crore, other cost of Rs. 4.05 Crore and foreign exchange loss of Rs. 3.47 Crore are extraordinary cost and therefore, should be reduced from the cost to arrive at net profit margin computed by TPO. As per Ld. CIT(A), the profit margin after above adjustment would be 10.42% which would be in the range profit margin of comparable company at 10.59% taken by the TPO. On adjustment by re-characterization of abnormal cost of Rs. 11.95 Crore attributable to AE. The Ld. CIT(A) has held that the entire expenditure categorized as extraordinary cost relates to bringing into existence and stabilizing a property being Carbon brushes and hence, the extraordinary cost would constitute a capital cost input in development of the property and cannot be charged to the Revenue as operative expenses.

8. It is seen that the assessee has sales of Rs. 39.08 Crore and cost of raw material consumption at Rs. 32.77 Crores. The assessee while computing the profit margin is claiming reduction of Rs. 11.95 Crores (Rs. 4.09 Crores from DTA unit and Rs. 7.85 Crore from EOU

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unit) out of total raw-material purchases from AE as economic adjustment. The assessee is claiming the above adjustment on the ground that it was first year of EOU unit and due to structural changes there was significant deficiency in manufacturing process consequently high raw-material consumption. We do not find any basis for reducing the cost of Rs. 10.95 Crores from total cost to make profit margin comparable to the profit margin of comparable companies. The assessee is claiming adjustment of raw-material of Rs.4.08 Crores from DTA unit which was an old unit and already in existence. The Co-ordinate Bench in the case of *DCIT vs. M/s. Yazaki Wiring Technologies India Pvt. Ltd. in IT(TP)A No.51/Chny/2019 order dated 19.10.2022* has rejected the claim of abnormal consumption adjustment observing as under:

“7. The abnormal third-party consumption adjustment has been granted by Ld. CIT(A) on the ground that had the assessee not undertaken any international transactions, it would have still incurred losses and therefore, comparing the margin of the assessee with that of comparable companies and undertaking TP adjustment is not warranted. The same, in our opinion, is not a correct reasoning. The Ld. CIT(A), in para-4, has noted that as per assessee’s submissions also, this is not an abnormal item. The objective of Transfer Pricing mechanism is to arrive at ALP of the international transactions and this reasoning applied by Ld. CIT(A) to grant this adjustment could not be upheld. Therefore, this adjustment has rightly been denied to the assessee by Ld. TPO. We order so.”

9. The similar is the case of adjustment on other cost as these are also relating to the abnormal raw-material consumption . As regards to

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foreign exchange, the Co-ordinate Bench in the case of *DCIT vs. M/s. Yazaki Wiring Technologies India Pvt. Ltd.*, supra, has rejected the claim of adjustment on foreign exchange fluctuation as under:

“8. Similar is the situation with foreign exchange losses. In a global environment, the assessee would be exposed to such risks and the same could not be termed as abnormal or non-operating item in nature. The foreign exchange fluctuations arise due to exchange differences during the year since the assessee would be dealing in multiple currencies. Such risks are normal in any business. Further, this adjustment could not be granted unless it was shown that similar data was available for comparable entities and the same was excluded to compute their respective PLI. Nevertheless, this item, in our opinion, is still an operating item. The definition as provided under safe harbour provisions apply in a specific situation only which is not the case here. Therefore, this adjustment is not to be granted. No other ground has been urged before us. The appeal stands partly allowed in terms of our above order. The Ld. AO / TPO is directed to re-compute the TP adjustment in terms of our above order.”

10. We therefore, reverse the finding of Ld CIT(A) and uphold the TPO adjustment of Rs. 3.76 Crores on purchases from its AE rejecting the claim of adjustments sought by the assessee in computing the profit margin by adopting TNMM methods.

11. As regards to re-characterization and adjustment of Rs. 11.95 Crores, the Ld. DR has submitted that, had the transactions involving defective machinery/low quality raw-material being third party, the assessee company would have been definitely compensate by the third party and same principle should apply in the case of transaction with its AE also and therefore, losses suffered by the assessee-company needs to be compensate which shall partake the character of

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income. The AO/TPO has characterized the adjustment on abnormal cost sought by the assessee to determine PLI as loss recoverable from AE and therefore, treated it as income and termed it adjustment to income towards material cost adjustment attributable to AE. It is seen that the TPO has already made adjustment on purchase of raw-material from its AE by determining the arm's length price at Rs. 20.66 Crore against the actual price paid by the assessee to its AE of Rs.24.40 Crores. The abnormal cost of Rs. 11.95 Crore is included in the actual cost of Rs. 24.40 Crores for which TPO has already made adjustment of Rs. 3.76 Crores by applying TNMM method by taking PLI of 10.59% against the assessee's PLI of -8.06%. In our opinion, further adjustment of cost by re-categorization as income and making adjustment under transfer pricing is not as per the principle of transfer pricing. We therefore, delete the TP adjustment of Rs. 11.95 Crores.

12. In the result, the appeal filed by the Revenue is partly allowed.

Order pronounced on 14th August, 2024.

Sd/-

(यस यस विश्वनेत्र रवि)

(SS Viswanethra Ravi)

न्यायिक सदस्य / Judicial Member

Sd/-

(जगदीश)

(Jagadish)

लेखा सदस्य /Accountant Member

चेन्नई/Chennai, दिनांक/Dated: 14th August, 2024.

EDN/-

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आदेश की प्रतिलिपि अग्रेषित/**Copy to:**

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त/CIT, Chennai
4. विभागीय प्रतिनिधि/DR
5. गार्ड फाईल/GF