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THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES 'C': NEW DELHI

BEFORE SHRI G.E. VEERABHADRAPPA, VICE PRESIDENT
AND
SHRI I.P. BANSAL, JUDICIAL MEMBER

ITA No.5341/Del/2010
Assessment Year: 2006-07

Haworth (India) Pvt. Ltd., Raisoni Industrial Park, Site No.276, Village Maan, Taluka Mulshi, Pune. AAACH8417K	Vs.	DCIT, (OSD) CIT-IV, Room No. 151, C.R. Bldg., New Delhi.
(Appellant)		(Respondent)

Appellant by : Shri Kunj Vaidya, CA & Sh. K.M. Gupta, Adv.
Respondent by : Sh. Narender K. Chand, Sr. DR & Sh. A.D. Mehrotra, CIT(DR)

ORDER

PER I.P. BANSAL, J.M.

This is an appeal filed by the assessee under the provisions of sec. 253(1)(d) of Income Tax Act, 1961 (Act) against the order passed by Assessing Officer dated 25th October, 2010 u/s 143(3) read with section 144C of the Act. The main addition agitated in the present appeal is an amount of Rs. 5,45,54,363/- on account of variation in income as a consequence of the order of Transfer Pricing of the Officer (TPO) u/s 92C(iii) of the Act. The other disallowances made are Rs. 40,94,915/- in respect of provisions made for certain expenses. Initially the provision was found to be made in respect of various expenses at an aggregated sum of Rs. 1,01,91,619/- and on query raised by the AO a sum of Rs.

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60,96,704/- was suo motu disallowed by the assessee, hence, net addition of Rs. 40,94,915/- was made. The other disallowance is a sum of Rs. 13,73,781/- which is with respect to disallowance of excess depreciation on computer peripherals, UPS and printers. The assessee had claimed depreciation @ 60%. As against that AO has allowed the claim @ 15% and in the circumstances a net addition of Rs. 13,73,781/- is made on that account. All these additions are agitated by the assessee in the present appeal. The grounds of appeal read as under: -

Transfer Pricing Matters

On the facts and circumstances of the case, and in law;

1. The ld. AO pursuant to the directions of the ld. Dispute Resolution Panel ('Ld. DRP') erred in rejecting the approach adopted for Transfer Pricing analysis / contemporaneous documentation maintained by the appellant and thereby making a transfer pricing adjustment of RSs. 54,554,363/- to the income of the appellant by holding that the international transactions of the "manufacturing segment" and the "marketing support services segment" of the appellant do not satisfy the arm's length principle envisaged under the Income Tax Act, 1961 ('the Act').

Marketing support services business

2. The ld. DRP/AO erred in considering commission expenses of Rs. 13,209,105 as operating expenses for the purpose of transfer pricing analysis, despite accepting the same as not being wholly and exclusively for the purpose of business u/s 37of the Act for computing taxable income, resulting in double taxation of the same income.

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3. Without prejudice to the above grounds, if the above expenses of Rs. 13,209,105 are considered as operating expenses for transfer pricing purposes, then the ld. AO should have allowed the same as deduction u/s 37 as business expenditure for corporate tax assessment and reduce the appellant's taxable income by Rs. 13,209,105.

4. The ld. DRP/AO erred in disregarding the detailed factual analysis and functional comparability presented by the appellant in respect of the comparables selected by the appellant and determining the arm's length nature of the transactions using only a single comparable. The ld. DRP did not attempt to find a larger set of comparables and also ignored the fresh set of comparables submitted by the appellant without providing any reasons.

Manufacturing business

5. The ld. DRP/AO erred in considering expenses incurred prior to commencement of the manufacturing operations, as operating expenses for the purpose of computation of operating profit for application of Transactional Net Margin Method ('TNMM').

6. The ld. DRP/AO erred in rejecting the adjustments made on account of underutilized capacity, disregarding the fact that unlike the comparables, the manufacturing business of the appellant was in a start up stage, and also disregarding the authentic information submitted by the appellant to enable the computation of such an adjustment.

7. Without prejudice to the other grounds, the ld. DRP/AO erred in computing the quantum of adjustment to be made to the profit of the manufacturing segment of the assessee by applying the profit level indicator of Operating Profit/Sales to the value of international transaction

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pertaining to import of raw material instead of sales figure of the manufacturing segment which resulted in an increase in the adjustment by Rs. 2,691,806/-.

General grounds

8. The ld. DRP/AO erred in not granting the benefit of +/- 5% range as envisaged by the Proviso to Sec. 92C(2) of the Act.

9. On the facts and in the circumstances of the case, the ld. AO erred in not appreciating the fact that additions made to the total income of the appellant are merely due to difference of opinion and not due to any mala fide intent on the part of the appellant, thereby initiating penalty proceedings u/s 271(1)(c) of the Act on the premise that the appellant has concealed/ furnished inaccurate particulars of income.

10. The ld. DRP erred in issuing directions which are incomplete with respect to:

- *Discussion on reasons for rejection of the appellant's contentions, evidences and factual and technical analyses;*
- *Discussion for distinguishing the case on hand from the various judicial precedents submitted in its support by the appellant and;*
- *Discussion on the additional evidence submitted by the appellant in the form of a fresh search and recent judicial precedents.*

11. The ld. DRP/TPO erred in using data which was not available to the appellant at the time if conducting the transfer pricing analysis for computing the transfer pricing adjustment, not allowing the use of multiple year data as prescribed under Rule 10B(4) of the Rules thereby unfairly

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penalizing the appellant for an act that was impossible to perform on the part of the appellant.

CORPORATE TAX MATTERS

12. Provision for expenses

The ld. DRP/AO erred in disallowing a sum of Rs. 40,94,915 towards provision for certain expenses by considering the same as contingent liability.

The appellant had made provision of certain expenses of Rs. 1,01,91,619. Out of the same the Company suo motu disallowed under the provisions o. DRP/AO erred in disallowing a sum of Rs. 40,94,915 towards provision for certain expenses by considering the same as contingent liability.

The appellant had made provision of certain expenses of Rs. 1,01,91,619. Out of the same the Company suo motu disallowed under the provisions of section 40(a)(ia), a sum of Rs. 60,96,704 on account of non deduction/payment of TDS within the due date. The ld. DRP, while giving credence to the appellant's contention that certain expenses that were suo motu disallowed under the provisions of section 40(a)(ia), erred factually in considering the entire provisions for these cost of Rs. 1,01,91,619 as contingent liabilities.

13. Disallowance of excess depreciation

The ld. DRP/AO erred in classifying computer peripherals, viz. Printers, UPS and other computer peripherals in the block of "Plant and Machinery", being eligible for depreciation at 15%, as against the block of 'Computers' eligible for depreciation at 60%.

The above grounds are without prejudice to each other.

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Your appellant craves leave to add, amend, alter, withdraw, modify and/or substitute, and to withdraw the above grounds of appeal."

2. Draft order came to be passed by the AO on 2.12.09 which was forwarded to the assessee. Against draft order, the assessee opted to refer the matter to Dispute Resolution Panel (DRP), who vide its order dated 30.9.10 has passed order u/s 144C(5) of the Act.

3. Transfer pricing study has been conducted by Price Water House Coopers and copy of such study has been placed by the assessee in the paper book at pages 101 to 170.

4. The return of income has been filed by the assessee on 27.11.06 declaring a loss of Rs. 52,33,133/-. Subsequently, a revise return was filed on 31.3.08 in which an income of Rs. 79,75,972/- was declared and assessment has finally came to be passed at an assessed income of Rs. 6,79,99,031/- after making the aforementioned three additions.

5. The assessee is engaged in the business of manufacturing, whole sale trading and installation of furniture and is also providing marketing services. It was incorporated in the year 1997 as a wholly owned subsidiary of Haworth Inc. to promote the sale of "Haworth" branded furniture to the Indian clients of "Haworth" group. It also provides marketing and related support services to "Haworth", Singapore. From

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December, 2005 the company has also commenced its manufacturing activities for assembly of chairs, at its newly set up plants in Hinjewadi, Pune. During the year the assessee has undertaken the following International transactions: -

Table 1

S.No.	***Description Of transaction***	***Method***	***PLI***	***Received (in Rs.)***	***Paid (in Rs.)***
1	*Purchase Of raw material*	*TNMM*	*OP/Sales*		*5,93,36,409*
2	*Import of modular furniture*	*TNMM*	*OP/TC*		*59,78,072*
3	*Import of display items and mock-ups*	*TNMM*	*OP/TC*		*24,40,429*
4	*Purchase of fixed assets*	*TNMM*	*OP/TC*		*1,40,82,083*
5	*Marketing & installation services*	*TNMM*	*OP/TC*	*15,39,33,769*	
6	*Purchase of catalogues*	*TNMM*	*OP/TC*		*7,89,028*
7	*Reimbursement of expenses paid*	*CUP*	*--------*		*31,76,157*
8	*Reimbursement of expenses received*	*CUP*	*-------*	*12,64,269*	

6. In order to benchmark the International transactions, two segments have been created namely: (1) import of raw material for manufacturing and (2) marketing support services. The transactions relating to import of raw material for manufacturing are benchmarked using TNMM as the most appropriate method with OP/Sales as Profit Level Indicator (PLI). For this segment the assessee has computed net profit margin of 13.50% (by making certain adjustment on account of capacity utilization etc.) in its TP study as against mean margin of five comparables at 9.17% (as per table 3 given in order of TPO and reproduced below at the end of this

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para) and in this manner as per TP study, the transaction has been considered as transaction at an arm length price.

Table 3

Manufacturing Segment	
Company Name	***OP/Sales***
BP Ergo Ltd.	*9.46%*
Gunnebo India Ltd. (Steelage Industies Ltd.)	*-13.86%*
Shakti Met-Dor Ltd.	*28.62%*
Supreme Industries Ltd.	*4.28%*
APW President Systems Ltd.	*13.73%*
Count	***5***
Average	***8.45%***

7. With regard to other segment relating to market and installation support services, the benchmark used by the assessee is also TNMM being most appropriate method with OP/TC as PLI. For this segment the net profit margin has been computed in the TP report at 1.35% against net profit margin of comparables at 3.15%. For this segment the margin of comparable data for multiple years has been used in the TP report.

8. The segment wise international transactions, as described in the order of TPO in table 2 are as under: -

Table 2

S.No.	***Particulars***	***Manufacturing Segment***	***Marketing Segment***	***Total***
1.	*Import of raw materials*	*5,93,36,409*		*5,93,36,409*
2.	*Import of modular furniture*		*59,78,072*	*59,78,072*
3.	*Import of display items and mock-ups*		*24,40,070*	*24,40,070*
4.	*Import of fixed assets*		*1,40,82,082*	*1,40,82,082*
5.	*Marketing & Installation services*		*15,39,33,769*	*15,39,33,769*

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6.	*Purchase of catalogues*		*7,89,028*	*7,89,028*
7.	*Reimbursement of expenses (Paid)*	*31,76,157*		*31,76,157*
8.	*Reimbursement of expenses (Received)*	*12,64,269*		*12,64,269*
	Total	***5,93,36,409***	***17,72,23,021***	***24,09,99,856***
	Common	***44,40,426***		

9. It was noticed by the TPO that assessee has for manufacturing segment computed its margin after claiming an adjustment on account of capacity utilization and preoperative expenses. He noticed that these adjustments were claimed by the assessee while computing the margin at 13.50%. Adjustment on account of idle capacity has been made on the ground that manufacturing activity of the assessee had commenced in December, 2005. It is the case of the assessee that it had achieved a capacity utilization of 30.58% as against average capacity utilization in the cases of comparable at 70%. The cost pertaining to abnormal under utilization of capacity amounting to Rs. 44,38,709/- was ignored for the purpose of computing operating profits from the manufacturing operations during the year under consideration. Further it was noticed that excessive overhead cost amounting to Rs. 1,28,04,653/- was incurred during pre-commencement period i.e. upto December, 2005 and the same was not considered for the purpose of computing operating profits from the manufacturing operations. Such position has been described in the order of TPO in table 5 & 6 which for the sake of convenience are being reproduced below: -

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Table 5

	Particulars	Manufacturing segment	
		After Capacity Adjustment	Before Capacity Adjustment
	A	D	E
INCOME			
	Sales of Goods (Gross)	5,01,43,814	5,01,43,814
	Less: Excise duty		
	Sales of Goods (Net)	5,01,43,814	5,01,43,814
	Total Income	5,01,43,814	5,01,43,814
EXPENDITURE			
	Raw material consumed	4,10,37,556	4,10,37,556
	Excise Duty	16,85,845	16,85,845
	(Increase)/Decrease in inventories	(61,69,246)	(61,69,246)
	Subtotal - Variable Costs	**3,65,54,155**	**3,65,54,155**
	Depreciation		20,65,181
	Personal expenses		76,42,445
	Administration & Other expenses		1,43,57,069
	Non-operating expenses		(1,28,04,653)
	Sub total - Fixed Costs	**68,21,333`**	**1,12,60,042**
	Financial charges	-	-
	Total expenditure	**4,33,75,488**	**4,78,14,197**
	Operating Cost	**4,33,75,488**	
	Operating Profit	**67,68,326**	
	Operating Profit/Sales	**13.50%**	

Table 6

Note 1:		
Particulars	**Reference**	**Percentage**
Capacity utilization of comparables	A	70%
Normal idle capacity	B = 100% - A	30%
Actual Capacity utilization of Haworth India	C	30.58%
Normal capacity for Haworth India	D=B+C	60.58%
Capacity adjustment made considering normal capacity of Haworth India		
Operating expenses from fixed costs = (Rs. 1126042 * 60.58%) i.e. Rs. 6,821,333		

10. The details of pre-operative expenses are described in table 7 as below: -

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Table 7

Particulars	***Amount (Rs.)***
Salaries & Wages	*31,44,719*
Fringe Benefits	*19,93,198*
Consulting	*21,06,241*
Maintenance	*1,86,049*
Supplies	*1,64,571*
Travelling costs	*26,63,272*
Telephone	*5,46,689*
Postage	*81,438*
Lease Rents	*3,32,655*
Training/Education	*2,56,264*
Legal Accounting	*10,63,150*
Advertising Fairs	*91,060*
Insurance	*1,64,226*
Other selling and general administration expenses	*11,120*
Total	***1,28,04,653***

11. Thus, it was found by the TPO that assessee has based its calculation of margin which varied from the audited annual accounts of the asessee. For the following reasons, ld. TPO has rejected the claim of the assessee regarding the adjustments to be granted to the assessee on account of capacity utilization and pre-operative expenses: -

> *"(a) It is seen that no preoperative expenditure has been shown in the profit and loss account. It is amply clear from this fact that the statutory auditors have not considered any expenditure as preoperative expenditure and the claim of preoperative expenses was made only for the purpose of Transfer Pricing.*
>
> *(b) Adjustment has been claimed in depreciation which has already been charged only for part of the year since the manufacturing activities started in December, 2005. When the depreciation has already been charged for part of the year there is no reason for claiming the*

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adjustment on account of capacity utilization on the same.

(c) Similarly the other expenditure in the nature of Personnel and other administrative expenses has already been incurred for only a part of the year particularly only after the production started.

(d) In the transfer pricing report no evidence were available to examine the capacity utilization of the comparables."

12. For manufacturing segment, after rejecting such adjustments claimed by the assessee, ld. TPO has arrived at operating profit/sales ratio at (-) 20.88% as per account of the assessee as per table 9 which is as below: -

Tables 9

	Particulars	***Amount***
INCOME		
	Sales of Goods (Gross)	*5,01,43,814*
	Less: Excise duty	*-*
	Sales of Goods (Net)	*5,01,43,814*
	Total Income	***5,01,43,814***
EXPENDITURE		
	Raw material consumed	*4,10,37,556*
	Excise Duty	*16,85,845*
	(Increase)/Decrease in inventories	*(61,69,246)*
	Depreciation	*20,65,181*
	Personnel expenses	*76,42,445*
	Administration & Other expenses	*1,43,57,069*
	Total expenditure	***6,06,18,850***
	Operating cost	
	Operating Profit	***-1,04,75,036***
	Operating Profit/Sales	***-20.88%***

13. ld. TPO has thus, worked out difference in the arm length price of manufacturing segment at Rs. 1,74,03,994/- as per table 10: -

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Table 10

Details	*Amount*
Value of International Transactions	*5,93,36,409*
Arm's Length OP/Sale @ 8.45%	*39,521,183*
Arm's Length Margin	*50,13,926*
Margin shown by the assessee @ (-) 20.88%	*1,23,90,068*
Difference	*1,74,03,994*
% of difference with the value at which the international transaction has taken place	*29.33%*

14. Since the variation exceeded 5% no adjustment has been given to the assessee on account of variation up to 5%.

15. So as it relates to market support service segment, it is noticed by the TPO that as per revised return filed for the year under consideration the earlier margin computed at 1.13% was revised and recomputed at 9.63% by taking into consideration the disallowed expenditures. He further found that out of 5 comparables submitted by the assessee current year data was available only with regard to two parties whose mean was worked out at (-) 3.58%. The names of the two companies in respect of whom current year data was available are Alfred Herbert India Limited & Priya International Limited. The TPO noticed that Alfred Herbert India Limited is deriving income from sales, commission, current and profit on sale of investment. It was observed that no segmental information was available and, therefore, ld. TPO rejected the said comparable and he utilized only one comparable which is Priya International Limited whose mean margin on the basis of current financial year data is calculated at

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22.58% and thus, it has been found by the TPO that there was a difference in arm length price of Rs. 3,71,50,369/-, which has been computed in table 11 which is described as below: -

Table 11

Details	*Amount*
Total Cost as shown in Appendix H of the Transfer Pricing Report	*175,027,383*
Arm's Length OP/TC @ 22.58%	*39,521,183*
Arm's length price	*214,548,566*
Operative Income shown by the assessee	*177,398,197*
Difference	*37,150,369*
% of difference with the value at which the international transaction has taken place	*20.96%*

16. Ld. TPO has rejected the claim of the assessee regarding the grant of 5% adjustment on the ground that the difference in arm length price exceeded 5%. In the above manner, total adjustment in arm length price is made by the ld. TPO at Rs. 5,45,54,363/- which is described in following table: -

Details	*Reference*	*Amount*
Adjustment in Manufacturing Segment	*Para 4.17*	*1,74,03,994*
Adjustment in Market Support Service Segment	*Para 5.9*	*3,71,50,369*
Total Adjustment		*5,45,54,363*

17. The findings of DRP on the objections raised by the assessee are as under: -

<u>Findings on legal issues: -</u>

1. Data of only the relevant financial year of the comparable entities is to be used as assessee did not establish that the data of the

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preceding two years demonstrated settled facts which have influenced the result of the financial year under consideration.

2. Adjustment of 5% as provided under the second proviso to sec. 92C(2) of the Act cannot be granted as the difference computed by the TPO in the arm length price (ALP) is more than 5% of the ALP determined by the TPO.
3. The AO is not under an obligation to demonstrate the existence of tax avoidance for invocation of transfer pricing provisions according to the decision of Spl. Bench in the case of Aztech Software and Technology Ltd. Vs. DCIT 107 ITD 141 (Banglore) (SB).

Findings on manufacturing segment: -

1. Assessee's claim for considering a sum of Rs. 1,28,04,653/- as pre-commencement expenses cannot be accepted as no preoperative expenditures are shown in the profit and loss account and statutory auditors have not considered any expenditure as preoperative expenses and such claim is made only for the purpose of transfer pricing.
2. Adjustment regarding capacity utilization cannot be granted in absence of evidence being made available in the transfer pricing report from where fact regarding capacity utilization of comparables could be examined. Before TPO only the assessee has submitted information in the case of M/s Steel Age Industries Ltd. for which the capacity utilization was taken at 50.72% by the assessee and as against that annual report had shown that the

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installed capacity of that company was much higher than the licensed capacity and the annual production was also higher than the licensed capacity. In this manner the data relating to that company was unreliable/not correct.

3. According to settled law as per transfer pricing provisions contained in the Act, only a reasonable accurate adjustment from accurate and reliable data can only be made and as assessee could not produced the details regarding accurate and reliable data from where reasonable accurate adjustment could be suggested and thus, assessee cannot claim adjustment as it relates to capacity utilization.

Market support service segment: -

1. Assessee's claim regarding suo muto disallowance of expenditures of Rs. 60,96,704/- in the revised return cannot be considered for working out net profit margin of the assessee as TPO has not discussed such issue in his order and once the assessee has given up a claim of certain expenditure from such segment, the same is reasonably require to be excluded from the cost of the assessee. It is also not established that the expenditure which have been suo muto disallowed in the revised return was relating to operating profit of the assessee. Unless it is established that such expenditure was the operating expenditure, no benefit can be given to the assessee in the transfer pricing analyses. The expenditure are in the nature of procurement, legal and accounting,

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consultancy and professional fees and on the face of it these expenditures are non-operational expenses.

2. The rejection of comparable M/s Alfred Herbert India Limited is correct for the reasons discussed by TPO in his order as the functions of that company were not similar to the functions of the assessee. The directors annual report of that company indicated that the company was carrying on business activity of the reality and business service division which has contributed to the increased profitability of the said company and that the efforts continue by the company to improve the sale of market division and thus, it can be seen that the said company was having difference kind of business. There was no segmental report in the annual report of the company. Therefore, the results of the said company cannot be compared with the assessee.
3. The TPO was correct in rejecting three out of five comparables selected by the assessee as the financial data of relevant financial year for those companies was not available. The TPO was justified in taking into consideration only the remaining comparable namely M/s Priya International Limited.

<u>Corporate Issues</u>: -

1. AO has rightly disallowed a sum of Rs. 40,94,950/- on account of provision for expenses being pro-type cost, promotional material, display material, promotional programs and public relation as assessee has not furnished anything to show that the expenditure

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in question was crystallized in the financial year. The only argument advanced was that the amount of expenses booked is closely proximate to the provision made, therefore, it was not a contingent liability.

2. The claim of the assessee regarding depreciation @ 60% in respect of printers, UPS, network routers is rightly restricted by the AO @ 15% as those equipments are not a necessary pre-requisite for running the computer.

18. In the aforementioned manner, DRP has upheld the draft assessment order except deleting a disallowance of Rs. 11,440/- made by the AO on account of capital expenditure in respect of software. In pursuance of the directions of DRP ld. AO has framed the impugned assessment at an income of Rs. 6,79,99,031/- against return loss of Rs. 52,33,133/- which was revised by a subsequent return declaring income at Rs. 79,75,972/-. Aggrieved by such order assessee has filed the aforementioned grounds of appeal contesting all the additions made by the AO in pursuance of directions of the DR.

19. Both the parties have argued the appeal at length and after conclusion of the hearing they have submitted the synopsis of their arguments and in this manner this appeal was heard.

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20. After narrating the facts, first and foremost objection raised by ld. AR is in respect of ground nos. 2 & 3 which is regarding a sum of Rs. 1.32 crore which pertained to the commission expenditure and is suo muto disallowed by the assessee in the revised return and the same was required to be excluded from the operating cost as the income to that extent was offered by the assessee in the return of income and the income of the assessee was assessed on the basis of the said disallowance and hence, DRP was wrong in not granting the relief to that extent on the ground that assessee had given up its claim regarding those expenditures. To substantiate the argument that such disallowance has to be taken out of operating cost, ld. AR has placed reliance upon the decision of Tribunal in the case of M/s SAP India Limited Vs. ACIT, copy of which is placed at page 43 of the compendium. It was submitted that in any case if the said expenditure is not allowed for the purpose of TP analysis then the same should be allowed as deduction u/s 37 for corporate tax assessment and reduce the assessed income to that extent to avoid double taxation.

21. Touching to ground no. 4 the objection of ld. Counsel is that according to search process conducted for TP study to identify a set of broadly functional comparable the assessee had arrived at a set of five broadly comparable companies/entities with a mean margin of 3.15%. As per table 13 below: -

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Table 13: Arm's Length Results

S.No.	Name of the Company	Data Source	OP/TC
1.	Fortune Communications Ltd.	Prowess	4.11%
2.	Shanthi Sales Ltd.	Prowess	1.61%
3.	Ujjwal Ltd.	Capitaline	3.78%
4.	Priya International Ltd.	Prowess Segmental	17.15%
5.	Alfred Herbet (India) Ltd.	Capitaline Segmental	-10.91%
	Mean		**3.15%**
	Median		3.78%
	Lower Quartile		1.61%
	Upper Quartile		4.11%

22. He submitted that out of aforementioned five comparables three were rejected by the TPO on the ground that current year data was not available. He submitted that Alfred Herbert India Limited has been rejected from the list of comparables on the ground that current year data of the said comparable was available on consolidated basis and the overall business of the said company was not functionally comparable with the assessee. It was submitted that before DRP it was the case of the asessee that while computing the arm length price, the assessee has taken into consideration only the segmental data of Alfred Herbert India Limited (sales and marketing operation) and, therefore, the said result was functionally comparable with the assessee and should have been considered for comparability analysis. With respect to consolidated segment, it was submitted that the subsidiaries are Indian Companies and though the subsidiaries may be engaged in the manufacturing but the segment pertained to sales and marketing services was comparable despite being reported on a consolidated basis. He in this regard has

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relied upon the submissions made before DRP vide letter dated 7.1.10, copy of which is placed at pages 172 to 232 of the paper book and reference in this regard was made to the submissions contained at pages 208 to 210.

23. It was further submitted that only one comparable cannot be considered for application of TNMM and in that circumstances fresh search was submitted to DRP with a larger set of six comparables and reference in this regard was made to page 234 to 236 of the paper book, whereby the fresh search was submitted. He submitted that such objections have wrongly been rejected by DRP. At first, it was submitted that if the old search is taken into consideration then TPO could have considered multi year data of the three rejected comparables which was available at the time of preparing the TP study. So far as it relates to exclusion of Alfred Herbert India Private Limited the submission of ld. AR as under: -

"6.52 Alfred Herbet India Ltd.:

- *As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subjects to risks and returns that are different from those of other business segments." The fact that the consolidated annual report of Alfred India Limited has shown the sales and marketing segment as a separate proves that this is a separate service provided by the Company.*

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- *The consolidated segment i.e. sales and marketing operations is functionally comparable to the MSS segment of the appellant.*
- *As Priya International Ltd. (Indenting segment) has been accepted as a comparable, Alfred Herbert India Ltd. (Sales & Marketing Operations segment) should also be considered as comparable as the said segment is engaged in providing similar services and has relatively low volume as is the case for Priya International Limited (Indenting segment).*
- *If Alfred Hebert India Limited (Sales & Marketing segment) is rejected as it has incurred an significant loss of, then on the same lines Priya International Limited (Indenting segment) should also be rejected as it has a significant high profit. It can be observed that both the comparables were outliers in respect of their margins even in the set selected as per the TP study report (Refer **Table 13 on page 153** of the paper book).*

  *Also Refer detailed submission dated **February 24, 2011** as directed by the Hon'ble Bench."*

24. It was further submitted that under TNMM, ALP should not be computed using only one comparable and a broader set of comparable should be looked at and for this purpose reliance was placed on following decisions of the Tribunal: -

1. *M/s SAP Labs India Pvt. Ltd. Vs. ACIT [ITA No. 398/Bang/2008 and ITA No. 418/Bang/2008].*
2. *Aztec Software and Technology Vs. ACIT [294 ITR 32].*
3. *Mentor Graphics (P) Ltd. Vs. DCIT [112 TTJ 408].*

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4. Sony India (P) Ltd. Vs. DCIT [ITA Nos. 1181/D/2005, 1656/Del/2007].

25. Coming to ground no. 5, it was submitted by ld. Counsel that the commencement of the manufacturing operation was an extension of an ongoing business and thus, they were not required to be identified for reporting separately even as per requirements as per Companies Act, 1956. These costs have been excluded merely for the purpose of comparability to obtained margins earned from international transactions and thus, they will not loose the character of pre-commencement expenses for the purpose of computing the operating margin for comparability purposes. Referring to Rule 10B(1)(e)(i) it was submitted by ld. AR that for the purpose of computing net operating margin the cost which can be considered are pertaining to such transactions, therefore, the cost incurred prior to the commencement of commercial operations have no nexus with the international transactions and thus, required to be excluded while computing the operating margins. The assessee has identified these expenses totaling to Rs. 1.28 crore the details of which is filed at page 263 of the paper book. He submitted that if the matter is considered from the view point of law as described in Rule 10B(1)(e)(i) the assessee has computed the profit margin as follow: -

a) "The revenue earned from the raw material during the accounting period (i.e. sales effected using the imported raw material) to be considered - Rs. 50,143,814.

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b) The value of imported raw material to be reduced from the sales.

c) The change in stock (both raw material and finished goods) during the period be added to (in case of increase in stock) or reduced from (in case of decrease in stock) from the sales are the case may be.

d) The other costs (direct and overheads) pertaining to these sales to be reduced from the sales.

*e) The resultant net profit would represent **"profit earned from the international transaction"** during the year.*

f) The operating margin to be computed by dividing the sales from the profit so arrived at it may be noted that the profit level indicator OP/Sales is not disputed in the case."

26. Thus, it was pleaded that by adopting the above mentioned steps the expenses incurred prior to commencement of operations are not required to be considered while computing the operating margins for the international transactions. It was submitted that the margin of manufacturing segment after excluding pre-commencement cost is 4.65% reference in this regard was made to Annexure 'C' enclosed with the written submissions which described the net profit margin as under: -

Annexure C - Computation of operating margin of manufacturing segment for 4 month period of operations

Particulars	***Amounts (Rs.)***
Sales	*50,143,814*
Operating expenses	
Cost of materials consumed	*41,037,556*
Increase in inventory	*-6,169,246*
Excise duty	*1,685,845*
Personnel costs	*7,642,445*
Admin and other costs	*14,357,069*
Depreciation	*2,065,181*
Less: Pre-commencement expenses	*-12,804,653*

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Operating expenses	*47,814,197*
Operating Profit	
Operating Profit/Sales	***2,329,617***
Margin of comparables as per TPO	***4.65%***
Within +/-5% range	*8.45%*

27. The margin as computed by TPO in respect of comparable is 8.45% and thus, the difference being less than 5% the benefit of proviso to sec. 92C(2) is available to the assessee and thus, it was pleaded that international transaction relating to manufacturing segment should be considered to be at arm length price.

28. Coming to ground no. 6 which relates to adjustment on account of capacity utilization, it was submitted that all the details were submitted by the assessee regarding the startup stage of operations and capacity utilization details viz-a-viz the details with regard to comparables and also the legal pronouncement in favour of the assessee and reference in this regard was made to page 264 to 298 and pages 245 to 247 of the paper book. He submitted that neither TPO nor DRP has contested difference between the stage of operations of the assessee and the comparable. They have rejected the entire adjustment based only on account of the presumed inconsistency which has been observed only in one out of five comparables which is also proved to be incorrect as the licensed capacity does not have any relevance in the computation of capacity utilization as at the prevailing time there was no statutory restrictions to exceed the production from licensed capacity. Reference in this regard was made to

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page 200 to 201 of the paper book. He submitted that licensed capacity is disclosed in the annual accounts merely to comply with the disclosure requirements which are more relevant to licensing era i.e. pre 1991. It was submitted that if ld. DRP/TPO were not in agreement with the reliability of the data of the one comparable used by the assessee, they should have considered the data for balance comparables to make adjustment. Alternatively, it was pleaded that onus would be on Department to make adjustments for differences in the stage of operations of the comparables and the assessee for an appropriate comparability analyses. For this purpose ld. AR relied upon the following decisions: -

1. *ACIT Vs. Flat India Pvt. Ltd. [Hon'ble Mumbai Tribunal (ITA No. 1848/Mum/2009)].*
2. *Skoda Auto India (P) Ltd. Vs. ACIT [Hon'ble Pune Tribunal (122 TTJ 699)].*
3. *E-Gain Communication (P) Ltd. Vs. ITO [Hon'ble Pune Tribunal (118 TTJ 354)].*
4. *Global Vantedge Pvt. Ltd. Vs. DCIT [Hon'ble Delhi Tribunal (ITA Nos. 2763 & 2764/Del/2009)].*

29. He submitted that in the case of E-Gain Communication (P) Ltd. vs. ITO (supra), the Tribunal has held that depending upon the facts and circumstances of the case, it will be appropriate to adjust operative profit of the tested party and comparable parties. Thus, it was pleaded that if an adjustment cannot be made to comparables to eliminate material differences, appropriate adjustment can be made to the margins of the

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tested party as has been done by the assessee. In the alternative, it was submitted that if the department is not in favour of making an adjustment to the tested party to account for the difference in the stage of operations, the onus was on the department to make suitable adjustments to the comparables in that regard. It was further submitted that the assessee is placing on record an alternative working prepared after making the capacity utilization adjustment to the comparable which is enclosed as Annexure 'D'. It was submitted that arithmetic mean OP/Sales of the comparables after such adjustment is (-) 7%, vis-a-vis the margin of the assessee from the international transaction of 4.65% which clearly demonstrate that the arm's length nature of the transaction relating to manufacturing segment, which stands thus irrespective of the approach.

30. Coming to Ground No.7, it was argued that TPO has applied the PLI of OP/Sales to the value of the international transaction (which is import of raw material) rather than to sales of the manufacturing segment of the assessee and, thus, learned TPO has computed the operating margin of the comparables on sales and applied the operating margin on the assessee's purchases. Thus, it was submitted that there is a fundamental difference in the calculation of mean margin. He submitted that the correct computation in this respect, if the same criteria is adopted, will be as under:-

Sr. No.	Particulars	Amount (Rs.)
1.	Sales	50,143,814

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2.	OP/Sales as calculated by the Ld. TPO	8.45%
3.	OP considering the above OP/Sales	4,237,152
4.	OP as calculated by the Ld. TPO	(10,475,036)
5.	Difference – being the adjustment required	14,712,188

31. Thus, it was pleaded that an adjustment of ` 1,47,12,188/- is required to be made in this regard.

32. It was further submitted that TNMM is an indirect method for testing the arm's length nature of the pricing of a transaction. The arm's length nature is tested by comparison of the margins derived from controlled and uncontrolled transactions. It was further submitted that the closing stock is reflected in the subsequent years provided as opening stock, which is considered for computing profit for that year. If the TPO's approach were to be followed, then, the erroneous computation for current year would also affect the subsequent years, creating a chain of errors. Rectifying these errors spanning different period is impracticable and effectively the results of such analysis would be absurd. It was submitted that it is also arithmetically incorrect to apply the ratio of OP/Sales on any other base, but sales. The TPO has applied this ratio on the imports, which is a cost-diametrically opposite in the profitability statement from the denominator i.e., sales. Thus, it was submitted that the incorrect adjustment amount of ` 1,74,03,994/- was computed by the Ld. TPO instead of ` 1,47,12,188/- and without prejudice to other

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grounds, learned Assessing Officer may be directed to rectify this erroneous computation.

33. Referring to ground No.8, it was argued that 5% benefit should be allowed in the determination of arm's length price as this position has been made clear by various decisions of ITAT and it is also clear from the memorandum to Finance Bill, 2009 and reference was made to the following decisions:-

a. M/s SAP Labs India Pvt. Ltd. vs. ACIT (ITA No.398/Bang/2008 and ITA No.418/Bang/2008). The relevant portion of Para 62 was extracted as below:-

> ".......the amended proviso as explained above are not applicable to the present case in hand. The proviso applicable to the present case is the one which stood before the substitution brought in by the Finance (No.2) Act, 2009 w.e.f. 1.10.2009."

b. Development Consultants (P) Ltd. vs. DCIT [115 TTJ 577]:

Para 22

> "The assessee computed the arm's length price considering the 5% tolerance range. The results of such computation are given below."

Para 25

> "..........we conclude DCIL should retain the gross margins as determined through the benchmarking exercise by the assessee discussed earlier in this order."

c. Sony India (P) Ltd. vs. DCIT [ITA Nos.1181/Del/2005, 1257/Del/2007 & 1656/Del/2007].

<u>Para 163</u>

> "Option is given to the tax payer as in some cases, variation not exceeding 5% of arithmetic mean might not suit the tax payer, and, therefore, taxpayer in such cases should not be put to a prejudice. Otherwise, there is no difference between the first and the second limb of the

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provision as far as right of the taxpayer to challenge the determined price is concerned. The second limb only allows marginal relief to the tax payer at his option to take ALP not exceeding 5% of the arithmetic mean. Therefore, in line with the view taken by Kolkata Bench of the Tribunal, we are of the view that benefit of the second limb is available to all taxpayers irrespective of the fact that price of international transaction disclosed by them exceeds the margin provided in the provision."

d. Skoda Auto India (P) Ltd. vs. ACIT 122 TTJ 699.

Para 20

"The only other issue that is argued before us is the adjustment for +/- 5%. Learned representatives agree that this issue is now covered in favour of the assessee by a series of Tribunal decisions including decision in the case of Sony India Limited (supra) even as learned Departmental Representative vehemently supported the stand of the authorities and justified the same. We, therefore, uphold assessee's grievance in this respect."

e. ACIT vs. UE Trade Corporation (India) (P) Ltd. (ITA No.4460 (Del)/2009).

Para 5.4

"The proviso, which is applicable to the proceedings of this year, contemplates an option to the assessee to choose a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean…….

A substantive provision can be amended retrospectively by the legislature. However, such amendment is taken retrospectively only if it has been so specifically provided by the legislature itself. The proviso was substituted with effect from 01.10.2009 and not retrospectively. Therefore, it comes into operation from assessment year 2009-10 and applies to subsequent years."

f. Memorandum to the Finance Bill 2009. Clause 40 of the Finance Bill 2009:-

Clause 40 of the Finance Bill 2009

"40. In section 92C of the Income-tax Act, in sub-section (2) for the proviso, the following provisos shall be substituted with effect from the 1st day of October, 2009, namely :-"

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Notes to the clause 40 of the Finance Bill 2009

"This amendment will take effect from 1st October, 2009."

34. In respect of ground No.9, 10 and 11, it was submitted that these are general grounds raising various objections against the order framed by the Assessing Officer, TPO and DRP and it is the contention of the assessee that while deciding the various issues, they did not appreciate the arguments, documents and evidences submitted by the assessee and the issues touched upon in these grounds is regarding initiation of penalty u/s 271(1)(c) and in respect of DRP order that DRP failed to consider or appreciate various submissions, evidences and documents placed before it and finally regarding the user of current year financial data as against multiple year data prescribed under Rule 10B(4) of the IT Rules, 1962. He submitted that at appropriate places the discussion on these issues have already been made, hence, these grounds may be decided accordingly.

35. Coming to ground No.12, it was submitted by learned AR that the assessee made provisions of ` 40,94,915/-. The assessee had booked the actual expenditure of ` 33,24,274/- in the next financial year i.e., financial year 2006-07. Such provision to the extent not booked against the actual expenditure in financial year 2006-07 was reversed in the next year and, in this manner, excess provision was offered to tax in the next year. He submitted that the provision as on March 31, 2006 was actually a

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sum of ` 47,40,969/- and, on the basis of actual expenditure, an amount of ` 14,16,695/- was reversed in financial year 2006-07 and he described the following table:-

Provision as on March 31, 2006 (disallowed amount	4,740,969
Less : Booked against actual expenses in FY 2006-07	3,324,274
Less : Reversed (Written back) in FY 2006-07	1,416,695
Balance as on March 31, 2007	0

36. To describe the factual aspect he submitted that according to principles of mercantile system, these expenses had accrued in the year ending 31st March, 2006 and these expenses have accrued and are incurred by the company for the purpose of its business and are not in the nature of contingent liability and these are allowable as per the following decisions:-

1. Bharat Earth Movers vs. CIT (245 ITR 428)
2. Metal Box Company of India Ltd. vs. their workmen 73 ITR 53
3. Calcutta Co. Ltd. vs. CIT 37 ITR 1.

37. Thus, it was submitted that these expenses are allowable. In the alternative, it was submitted that if these expenses are considered as contingent liability and the disallowance is sustained, then, the same should be adjusted while computing TP margins and arm's length prices.

38. So as it relates to ground No.13, learned AR submitted that the depreciation @ 60% was claimed by the assessee on computer peripherals

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viz., printers, UPS and other computer peripherals and against the claim of the assessee learned Assessing Officer has allowed only 15% and, accordingly, an addition of ` 13,73,781/- was made to the total income of the assessee. He submitted that the Assessing Officer has classified the computer peripherals, printers and UPS of ` 16,16,213/- as plant & machinery and not computers and, thus, the disallowance should be deleted in view of the following decisions:-

a. Decision of the Mumbai ITAT Special Bench in the case of DCIT vs. Datacraft India Limited (2010-040-SOTS-0295)

b. Calcutta ITAT ruling in the case of ITO vs. Samiran Majumdar 280 ITR 74.

39. Concluding his arguments, he submitted that appropriate relief should be granted to the assessee.

40. On the other hand, apropos ground no. 2, it was submitted by learned DR that though if an expenditure has been disallowed for tax computation purposes and if it is not removed while computing the transfer pricing adjustment, it would result in double taxation, but in the present case the assessee has not demonstrated that commission expenditure disallowed in the return of income was considered as part of operating expenses in the TP analysis. Therefore, he pleaded that to verify such fact, the matter may be sent back to the file of Assessing Officer/TPO.

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41. In respect of ground No.3, he submitted that this ground is interrelated to ground No.2 and the said amount has already been surrendered for taxation and, therefore, it does not call for adjudication.

42. In respect of ground No.4, he submitted that this issue has been discussed by TPO in para 5. He submitted that the assessee has considered five companies as comparables in the TP study report considering multiple year data. The TPO adopted current year data on the basis of which he rejected three out of five comparables. He submitted that the current year data for the said three comparables was not even available before DRP and the said data is not available even as on date. He submitted that TPO has not disturbed assessee's approach or method or PLI and they have been accepted as such. He submitted that the current year data was available only with respect to two comparables. He submitted that one of two filtered comparable Alfred Herbert is rejected by the TPO for the valid reasons recorded by him. He submitted that assessee cannot be permitted to rely on so called fresh search simply for the reason that only one comparable is left on the basis of which ALP is computed. He submitted that the assessee may not be permitted to use the process of new or fresh search only to obtain biased result. He submitted that there should be some finality at some stage, otherwise such process can continue at later stage of litigation also.

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43. He further submitted that in respect of two comparables of whom the current year data was available, TPO has rejected one comparable, namely, Alfred Herbert India Limited for the detailed reasons mentioned in his order. He submitted that the said comparable cannot be taken into account for the following reasons:-

a. The company is involved in completely different business activities.

ii) Sales and marketing operations form an insignificant part of the overall operations of the company.

iii) The turnover of the segment is very low (just Rs.18 lakhs).

iv) The segment has incurred losses.

v) The segmented accounts are available only on consolidated basis.

44. Thus, he submitted that according to remaining one comparable, the arm's length margin was 22.58%. The turnover of the comparable is ` 151 lac which is good enough and the said comparable cannot be rejected by saying that the turnover was similar to one rejected by the TPO. He submitted that the very comparable was selected by the assessee company being a valid comparable and now it is not open to the assessee to go back from its stand. He submitted that there is nothing in law which says that one comparable cannot be considered for application of TNMM. He submitted that the assessee did not submit fresh search during the TP audit proceeding and it was submitted only in front of DRP. Unless DRP passes a speaking order about admission of such fresh search, the said fresh search cannot be considered. He submitted that following case laws

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support the case of the revenue that even one comparable is good enough to compute arm's length price:-

i) In the case of Vedaris Technology (P) Ltd. vs. ACIT [ITA No.4372 (Del)/2009] reported as 131 TTJ 309 (Delhi), the arm's length price had been determined considering only one comparable. This case is on TNMM. The para relied upon by the AR is of no help to the assessee as the decision is taken by the Tribunal on merits and not on concession.

ii) In the case of Petro Systems TSI India Ltd. vs. DCIT [ITA No.2320, 2321 and 2322/Del/2008) (reported as 2010-TIOL-51-ITAT-DEL-TP) wherein the arm's length price had been determined considering only one comparable. This decision was further relied upon by ITAT in the case of U E TRADE available in the case law compilation submitted by AR of the assessee at pages 302-317 of compendium of case laws (reported at 2011-TII-04-ITAT-Del-TP).

45. He submitted that the decision of co-ordinate Bench is binding upon the Tribunal and, for this purpose, he relied upon the decision of Hon'ble Delhi High Court in the case of CIT vs. ESC Ltd. 231 ITR 255. Thus, he submitted that approach of the TPO should be upheld.

46. Coming to ground No.5 he submitted that the issue regarding setting up of business or date of commencement has not been brought out clearly in the submission/argument. It was submitted that if assessee claims that the expenses incurred prior to commencement of manufacturing portion are to be excluded while calculating the operating margins of manufacturing segment, then, the onus is on the assessee to

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prove that these expenditures were actually incurred prior to commencement of manufacturing activities and, thus, do not relate to international transaction of this segment. He submitted that the assessee has not discharged the initial onus by furnishing credible evidence in the shape of auditor's or accountant's certificate. Therefore, the assessee is not entitled to claim such benefit and reference in this case is made to the Special Bench decision in the case of Aztec Software and Technology Ltd. vs. ACIT 107 ITR 141. It was submitted that the assessee did not classify the said expenses as pre-operative in nature and if the assessee wants to contend so, then, the onus will be on the assessee and it cannot be shifted to the department. Unless the assessee discharge such onus, the claim of the assessee cannot be allowed.

47. Coming to ground No.6, it was submitted that so as it relates to adjustment on account of capacity utilization in the cases of comparables, it is observed by the TPO that it was not possible to make adjustment to the comparables as sufficient data to make capacity adjustment in the case of comparables was not made available and making such adjustment to the account of the tested party is not in accordance with the rule 10B (1)(e)(iii) read with rule 10B (3). Reference was made to the decision of ITAT in the case of Global Vantedge Pvt. Ltd. 37 SOT 1 and also of 2010 TIOL-24-ITAT-Delhi-TP (copy of which is filed at pages 318 to 341 of the assessee's compilation case laws). He submitted that the assessee has relied upon para 14 of the ITAT's order. He submitted that whole of the

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para should be read and it will show that adjustments are to be made to the comparables and not to the tested party and such position was upheld by ITAT. Distinguishing the decisions in the case of Fiat India Pvt. Ltd. and Skoda Auto India (P) Ltd. he submitted that they were given in the context of capital intensive industries, hence, could not be applied to the case of the assessee.

48. It was further submitted that one can visit to OECD guidelines only when the provisions of IT Act or Rules are not clear and, in the present case, the law being clear and the adjustment being not in accordance with the law, the claim of the assessee should be rejected. He submitted that as pointed out by the DRP and TPO, the data considered for capacity utilization of one of the comparables, namely M/s Steel Age Industries Ltd. was not reliable, hence, adjustment on that account was rightly rejected. He submitted that since the assessee bears the capacity utilization risk as mentioned in the TP study report, the cost relating to such risk should be operating cost of the assessee and the same should be considered in the cost base while computing the net profit margins of the assessee.

49. He further submitted that according to the calculation submitted by the assessee the total cost is bifurcated into fixed cost and variable cost. The fixed cost represent the cost which does not vary due to change in volume of production. Variable costs are those which vary on increase

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or decrease in the volume of production and such bifurcation is largely theoretical in nature and in reality and practice fixed costs are never fixed and variable costs are never variable. They some how move in step direction. The assessee did not submit the basis of classification and evidence to substantiate that the movement of cost is in accordance with the claim of the assessee. In the absence of history, the assessee has also not demonstrated the movement taking figures of subsequent period and, thus, the assessee has failed to substantiate the movement of fixed and variable cost in a particular way, therefore, the claim should not be entertained even when the adjustment was to be made in the data of the tested party though the claim of the department is that adjustments are only to be made in the data of the comparables.

50. Apropos ground No.7, it was pleaded that the assessee has reported the value of international transaction of import of raw material at ` 5,93,36,409/-, therefore, the arm's length price has to be computed on the entire transaction even if a part of the raw material is left as inventory and is not part of the operating cost for the relevant year. It was submitted that it is not necessary that the transactions should be routed through P & L Account. For example, in the case of transaction relating to purchase of capital goods, the entire value of purchase is tested through the principle of ALP in the year of purchase irrespective of the fact that only a part of the value will affect the Profit & Loss Account in the form of depreciation for that particular year. In the similar

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manner, even if some of the imports are in the inventory, an adjustment should be made to the entire purchases during the year under consideration. Thus, it was submitted that TPO has rightly computed the adjustment in the manufacturing segment taking the value of international transactions reported in Form 3CEB and it is for the assessee to argue that this could possibly lead to anomaly in the subsequent year when the unused inventory enters the profit and loss statement and TNMM is used for determining ALP. This may require suitable adjustment when ALP is determined in the next year. This would be a matter of details and can be left to be decided in the next year if such a situation arise.

51. Apropos ground No.8, it was submitted by Ld. DR that in the case of Global Vantedge Pvt. Ltd. Ltd. 37 SOT 1, it has been held that it is not a standard deduction. He submitted that for marketing support segment only one comparable was selected, therefore, since only one arm's length price was selected, there is no question of analyzing the variation from the transfer price of the international transaction as the proviso clearly mentions "where more than one price is determined by the most appropriate method" and such position of law has been upheld by the Tribunal in the following cases:-

i) ACIT vs. UE Trade Corporation (India) (P) Ltd. ITA No.4405/Del/2009.
ii) Global Vantedge Pvt. Ltd. vs. DCIT (ITA Nos.1432 & 2321/Del/2009)

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iii) Perot Systems TSI India ltd. vs. DCIT (ITA No.2320, 2321 and 2322/Del/2008)

52. Thus, it was submitted that the assessee's claim is not sustainable.

53. It was further submitted that the amendment brought into the provisions of Section 92C(2) was clarificatory in nature, hence, applicable retrospectively. This amendment has been brought to undo the unintended consequences and, for this purpose, ld. DR relied upon the decision of Hon'ble Supreme Court in the case of M/s Allied Motors 224 ITR 677 (SC). He submitted that the proviso to Section 92C(2) states as follows:-

> *"Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:*
>
> *Provided further that if the variation between the arm's length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price."*

54. He submitted that the position of circular No.5 dated 03.06.2010and its corrigendum issued on 30.09.2010 has already been placed on record. The proviso was inserted by Finance Act, 2009 w.e.f. 1st October, 2009. Accordingly it will be applicable to all the cases pending before TPO on or after 1st October, 2009. He submitted that the corrigendum dated 30th September, 2010 read as under:-

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> "the above amendment has been made applicable with effect from 1st October, 2009 and shall accordingly apply in relation to all cases in which proceedings are pending before the Transfer Pricing Officer (TPO) on or after such date."

55. Therefore, he pleaded that it is clear that the benefit of +/- 5% range granted by the Proviso to Section 92C(2) is available only if the variation between the arm's length price and transfer price does not exceed 5% of the transfer price. He submitted that for the reason aforesaid, the claim of the assessee regarding +/- 5% as standard deduction has rightly been denied by TPO.

56. Apropos ground No.11, it was submitted that current year data is only the relevant data as per Rule 10B(4) and such issue has been set at rest by the decision of Appellate Tribunal in the case of Customer Services India Pvt. Ltd. 30 SOT486 wherein it has been held as under:-

> "It was mandatory on the part of the TPO to use the assessee data relating to financial year 2002-03 in which the international transactions were admittedly entered into by the assessee company with its associated enterprises."

57. He submitted that as per well settled law, single year data has to be considered unless the assessee demonstrates that prior years' data has had an influence on the setting of transfer price of international transaction either at the time of setting them or by way of adjusting them subsequent to entering into the international transaction to align them to the arm's length price. This is a condition precedent for user of the

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multiple year financial data. For such contention, he also placed reliance on the following decisions:-

i) AZTEC Software 107 ITD (AT) 141 (SB) (Bang).
ii) Mentor Graphic 109 ITD 101 (Del)
iii) Honeywell Ltd. 209-TIOL-104 (AT) (Pune)

58. Apropos Ground No.12, it was submitted that the assessee has not provided evidence for a sum of ` 40,94,915/- for making provision for certain expenses which have been considered as contingent liability and in the absence of such evidence, the claim of the assessee has rightly been rejected. So as it relates to ground No.13, he submitted that the items which can work independently on computer should not be treated as part and parcel of computer and, hence, depreciation claimed by the assessee @ 60% should not be allowed.

59. In the rejoinder, it was submitted by learned AR that it was impossible for the assessee to envisage that whether current year data for the comparable selected would be available in the public domain or not at the time of TP assessment which was 2-3 years later. Therefore, he pleaded that there was no basis for the assessee to predict the action of the learned TPO for rejecting one of the remaining two comparables. The selection of the assessee regarding comparable was in good faith and was at the time of preparing contemporaneous documentation. The assessee had selected a set of five comparables with the bona fide belief that the entire set would be accepted and it was never intended by the assessee to

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use only one of the comparables to establish arm's length test. He submitted that it has never been the contention of the assessee that a set of two comparables will be sufficient. On the contrary, it was submitted that a set of two comparables would also be insufficient and the TPO should consider a larger set of comparables if single year data of three out of five comparables is not available. Reference in this regard was made to para 4.10.6 at page 259 of the paper book. He submitted that mostly current year data for comparable companies in the public domain is not available upto the date of filing the returns and such fact is established by the statistics placed as Annexure-A. He submitted that as per Annexure-B, the set of comparables selected by the TPO for financial year 2006-07 during assessments, current year data was not available for any of the comparable companies in the public domain at the time of statutory time line to file the returns and such fact prove that it is impossible for the tax payer to use current year data while preparing the contemporaneous documents. He submitted that while deciding the issue regarding user of multiple year data the submissions of the assessee made before the DRP vide pages 211-215 of the paper book should be considered.

60. So as it relates to the contention of learned DR that one comparable is sufficient to determine arm's length price, he submitted that it has never been the case of the assessee that any of the comparables selected by it should be rejected. In fact, the assessee has selected and all throughout distinguished the set of comparables selected

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in its TP study report and it is the request of the assessee that whole set of comparables should be accepted and rejection criteria should be consistent. Therefore, the data regarding Alfred Herbert India could not be rejected on the ground of low turnover. If the said criteria is adopted, then, the data regarding Priya International Ltd. would also be liable for rejection on the ground of consistency. Conversely, if the data regarding Priya International ltd. is applied, then, obviously, the data relating to Alfred Herbert India should also be applied.

61. So as it relates to arguments of learned DR that the assessee bears the capacity utilization risk and the cost relating to this risk should be operating cost of the assessee and the same should be considered in the cost base while computing the net profit margin of the assessee, it was submitted that if the capacity utilization risk was not borne by the assessee, then, it would not have any extraneous cost due to capacity under utilization as they would not have accrued to the assessee in any manner. The question of capacity under utilization and adjustment, therefore, arises because the assessee bears the capacity utilization risk in the first place. Furthermore, the risk analysis as per TP study is intended for holding inappropriate characterization of the assessee vis-a-vis associated enterprises. It has nothing to do with the capacity utilized by the assessee or by the uncontrolled comparables. Accordingly, the capacity risk is borne by the assessee vis-a-vis its associated enterprises and the adjustment for under utilized capacity is done vis-a-vis

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uncontrolled comparables which are two distinct aspects altogether. It was submitted that the manner of computation of adjustment for capacity under utilization already allows for idle capacity risk at comparable levels which further demonstrates that the capacity risk borne by the assessee is duly factored in the computation of adjustment. He submitted that in short capacity adjustment was essential irrespective of the fact that whether capacity was borne by the assessee or not as the comparable companies and the tested party were operating at significantly different capacities. Any comparison without adjustments for these differences would provide inappropriate results.

62. In this manner, both the parties had concluded their arguments on the present appeal.

63. We have carefully considered the rival submissions in the light of material placed before us. Firstly we take the grievance of the assessee as represented in ground no. 2 to 4 relating to adjustment made with regard to marketing support services segment. First and foremost objection of the assessee is regarding non-reduction of suomoto disallowance of commission expenses of Rs. 1,32,09,105/- from operating expenses for the purpose of TP analysis. It has been the case of the assessee that on 31.3.08 it has electronically filed the revise return vide which a sum of Rs. 1,32,09,105/- was added to the earlier returned income on account of "commission paid to DSF added back". Copy of such

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revise return is placed at pages 1 to 5 of the paper book according to which taxable income of the assessee has been computed at Rs. 79,75,972/- as against earlier returned loss of Rs. 52,33,133/-. Copy of original return file is placed at pages 6 to 30 of the paper book. It has also been the submission of the assessee before DRP that TPO has erroneously computed the arm length price pertaining to market support services of the assessee as he did not take into consideration the suomoto disallowance made by the assessee in the revise return of income. The submission of the assessee before DRP as contained in para 6.4.1 and 6.4.2 are as under (copy of these submissions made by the assessee before DRP vide letter dated 7.1.10 are filed at pages 172 to 232 of the paper book): -

> *6.4.1 "The assessee submits that the commission expense incurred by the assessee is towards payments to local dealers for assisting in procuring orders for products of its associated enterprise from the Indian customers. The assessee filed a revised return where the assessee suo moto disallowed the excessive commission paid to dealers during the year ended March 31, 2006. This expenditure was unauthorized and was discovered as a result of internal investigation. The assessee disallowed the same considering that the reliable evidence of such expenditure may not be readily available.*
>
> *6.4.2 Accordingly, the revised margins of the assessee's marketing support services for the purposes of transfer pricing analysis were computed which worked out to 9.63%."*

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64. If the aforementioned submission of the assessee is taken into consideration it will be clear that according to the submission of the assessee the commission expenditures which have been disallowed were payments claimed to be made to local dealers for assistance in procuring orders for the products of assessee's associated enterprises from the Indian Customers. It was, in the earlier computation of arm length price, it consists of operating expenses which was later on suomoto disallowed. The assessee has also paid tax upon that. This contention of the assessee has been rejected by DRP on the ground that TPO has not discussed this issue in his order and once the assessee has given up a claim of certain expenditures from the segment therefore, it was reasonably be required to be excluded from the cost of the assessee. It is also observed by DRP that assessee did not establish that the expenditure which is disallowed in the revise return of income was operating profit and unless it is established so, no benefit can be granted to the assessee in the TP analysis. Here it will be pertinent to mention that DRP while considering this issue has mistakenly written the amount as 60,96,704/- and this position has been clarified by the ld. AR in his written submissions in para 5.3.2 as the said sum of Rs. 60,96,704/- relates to ground no. 12 in connection with a corporate tax ground. So the sum as stated in DRP's order at page 2 in para 1(b) is relating to the claim of the assessee of Rs. 1,32,09,105/- instead of Rs. 60,96,704/-.

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65. Thus, it can be seen that the contention of the assessee has been rejected by the DRP without properly appreciating the case of the assessee. It is the case of the assessee that TPO has wrongly computed the margin of the assessee at 1.35% and if the said sum of Rs. 1,32,09,105/- is taken into consideration then the profit margin will be 9.63% and such computation has been shown in the following table no. 1 annexed with the written arguments:

Table 1: Computation of operating margins for marketing support services segment

Amount in Rs.

Particulars	***Reference***	***Without disallowance as per TPO***	***Considering disallowance as per revised computation by appellant***
Commission income		*153,933,769*	*153,933,769*
Installation revenue		*14,455,751*	*14,455,751*
Revenue from incidental sale of traded goods		*9,008,677*	*9,008,677*
Total Operating Income	*A*	***177,398,197***	***177,398,197***
Operating expenses			
Personnel costs		*31,881,328*	*31,881,328*
Admin & other costs			
- Commission paid (Others)		*18,613,265*	*18,613,265*
-Other admin expenses		*110,377,761*	*110,377,761*
Cost of procurement of traded goods		*11,204,766*	*11,204,766*
Depreciation		*2,950,263*	*2,950,263*
Less: Commission expenses offered as disallowance in the revised return		*-*	*(13,209,105)*
Operating expenses ("TC")	***B***	***175,027,383***	***161,818,278***
*Operating Profit ("OP")_*	*C=A-B*	*2,370,814*	*15,579,919*
OP/TC		*1.35%*	*9.63%*

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66. It can be seen from the above table that the major component of receipt of International transaction of the assessee is commission income as it constitute Rs. 15,39,33,769/- of the total operating income of Rs. 17,73,98,197/-. Therefore, it cannot be said that commission expenses which have been suomoto disallowed by the assessee were not claimed as operating expenses while computing the arm length price. If they are subsequently disallowed suomoto by the assessee in the revise return, they are required to be excluded from the operating cost and the calculation of the assessee should have been accepted that its profit margin should have been taken according to the income computed in the revise return for which the assessee has also paid the due taxes. In this manner, finding force in the contentions of ld. AR, we are of the opinion that ground no. 2 of the assessee is to be allowed and accordingly allowed. Ground no. 3 is the alternative argument and as the main argument of the assessee is accepted we need not required to go in the alternative claim made by the assessee.

67. The second objection of the assessee relating to marketing support service business is conveyed in ground no. 4. First issue relates to rejection of three comparables out of five comparables selected by the assessee. Three comparables have been rejected on the ground of non-availability of current years financial data. The current year financial data of those three comparables has not been available even before Tribunal. According to well settled law, as explained in various decisions

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of Tribunal, only current year financial data is relevant for determination of arm length price and this position of law is well settled by the following decisions of the Tribunal : -

1. Aztec Software and Technology Services Ltd. 294 ITR (AT) 32
2. Mental Graphics Pvt. Ltd. 109 ITD 101
3. Customer Service India Pvt. Ltd. Vs. ACIT 30 SOT 486.

68. Moreover, Rule 10(4) regulates such position of law which read as under: -

> *"10(4) The data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into:*
>
> ***Provided** that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relating to the transactions being compared."*

Thus, sub-rule (4) of Rule 10B clearly state that the data to be used in analyzing the comparability of uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. The proviso carves out an exception that the data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer price in relating to transactions being compared. Thus, according to the law, the data relating to relevant financial year is only the

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contemporaneous data and the proviso is applicable only in some specified conditions. No material has been brought on record by the assessee to suggest that there were circumstances prevailing for application of proviso. Therefore, we uphold the action of AO/DRP/TPO for rejection of three comparables in respect of whom current year data was not available.

69. Now the objection of the assessee is against rejection of other comparable namely Alfred Haworth India Ltd. The said comparable was rejected by the TPO on the ground that the financial data of the said concern was available on a consolidated basis and overall business of the said company was not functionally comparable with the assessee. It is the submission of ld. AR that while considering Alfred Haworth India Ltd. as comparable, only the segmental data relating to sales and marketing operation was considered as comparable and not entire business of that concern, therefore, the said comparable could not be rejected. The relevant submission of the assessee before DRP are placed at pages 208 to 210 of the paper book. In para 6.5.6 assessee has admitted that the said comparable and its subsidiaries were also engaged in businesses not comparable to the marketing support service segment of the assessee but assessee has considered the data only on a segment level and not on a company wide level. This issue has been discussed by TPO in para 5.6 and after going through the report of the directors with regard to financial performance of the said concern, it is observed by the TPO that the said

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concern was having different kind of businesses. The financial report of the said concern is filed by the assessee in the paper book at pages 345 to 397 and at page 375 the following functions of the said concern are described as primary segment: -

1. Manufacturing operations
2. Sales and marketing operations
3. Reality business services
4. Others.

The revenue earned by the said concern from these activities as described in the report is 1,670.13 lakh, 18.78 lakh, 42.79 lakh & 917.15 lakh, respectfully for the financial year ending on 31.03.2006. Thus, it can be seen that the revenue of the said concern from sales and marketing operations is only a sum of 18.78 against gross revenue of 2,648.85. To select a comparable, according to well recognize principle, it should also be functionally comparable. A company which is majorly dealing in other segments cannot be accepted as functionally comparable. It can be seen from the above figures that the said concern had dealt in the segment of sales and marketing operations at a very minimum level of total revenue and on a simple turnover of 18.78 it has shown loss of 7.59 which means that it has incurred loss of 40.41% from the relevant segment. Therefore, going through the business of the said concern, it is held that the said concern is not functionally comparable with the assessee and hence has rightly been rejected by the TPO and DRP. The rejection of the said comparable is upheld.

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70. It is also the case of the ld. AR that on the basis of one comparable only, the arm length price of the assessee cannot be determined and in such a situation, it is admissible that a fresh search of comparables should take place and in fact such fresh search was placed before DRP and DRP has failed to take into consideration said search and, therefore, the adjustment made to arrive at arm length price is to be set aside. To support the argument that on the basis of one comparable only the arm length price could not be determined. Ld. AR has placed reliance upon following decisions: -

1. *M/s SAP Labs India Pvt. Ltd. Vs. ACIT [ITA No. 398/Bang/2008 and ITA No. 418/Bang/2008].*
2. *Aztec Software and Technology Vs. ACIT [294 ITR 32].*
3. *Mentor Graphics (P) Ltd. Vs. DCIT [112 TTJ 408]*
4. *Sony India (P) Ltd. Vs. DCIT [I.T.A. Nos. 1181/Del/2005, 1257/Del/2007 & 1656/Del/2007]*

71. On the other hand, it is the case of ld. DR that the arm length price can be computed even on the basis of one comparable and to support such contention he has relied upon:

1. Vedaric Technology Pvt. Ltd. Vs. ACIT (supra)
2. Parrot Systems TSI India Ltd. Vs. DCIT (supra)

72. In none of the cases relied upon by ld. AR, it has been categorically held that if only one comparable is left, the entire exercise should be

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carried out freshly. In the case of M/s SAP Labs India Pvt. Ltd. Vs. CIT (supra) 22 comparables were selected by the assessee in its TP report. As against that the TPO had selected 8 comparables and out of all these parties the Tribunal has selected 12 comparables for computing the arm length price. The main observation of the Tribunal upon which the assessee has placed reliance read as follow: -

> *81. "The argument of the assessee company cannot be accepted as such, for various reasons. First of all, the comparables available in the revised list of TPO/AO is only three. Three comparables are not a reliable sample size."*

From the above observations it does not appear that a principle of law has been laid down that in case one comparable remains, the entire exercise would fail.

73. Similarly in the case of Aztec Software and Technology Services Ltd. Vs. ACIT (supra) it was observed that the sample size of data taken by the tax payer, to support the arm length price was too small to come to any general conclusion.

74. In the case of Mentor Graphics (Noida Pvt. Ltd. Vs. DCIT) also it has not been laid down that if only one comparable is left, the entire exercise was to be done again.

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75. In the case of SAP Labs India Pvt. Ltd. Vs. DCIT (supra), it was observed that even as per OECD guide lines large number of similar entity should be taken to make comparison broad based.

76. In none of these cases it has been held that, if one comparable is left, the same cannot be adopted to work out the mean margin to arrive at arm length price.

77. Now coming to the case law relied upon by ld. DR which convey that only one comparable is sufficient and it has been held by the Tribunal in other cases that arm length price can be worked out even on the basis of one comparable. In the case of Vedaris Technology Pvt. Ltd. Vs. ACIT (supra) 20 comparables were short listed and mean margin was worked out at 16.585% and out of those only one comparable was left namely Sophia Software Ltd. on the basis of which the arm length price was determined. Here, it is the case of ld. AR that the said case is not applicable to assessee's case as in that case both the parties had accepted one comparable only. But that is not the only basis on which the Tribunal has rested its decision. The other case of similar nature is Parrot Systems TSI India Ltd. vs. DCIT (supra). Moreover, the comparable which has been left was selected by the assessee itself in its TP study and no reason whatsoever is given that how the said comparable could not be taken to compute arm length price of the assessee. Therefore, we reject the submission of the assessee that on the basis of one comparable, the arm

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length price could not be determined and fresh search was required to be taken as per submissions made before DRP. The facts of the present case do not warrant the fresh search to be taken into consideration as there is no valid reason to do so.

78. In view of above discussion ground no. 4 of the assessee is rejected.

79. Apropos ground no. 5 it is the case of the assessee that the following expenses should be considered as expenses incurred prior to the commencement of manufacturing activity hence should be excluded from operating expenses: -

Table 7
Preoperative Expenses

Particulars	***Amount (in Rs.)***
Salaries & Wages	*31,44,719*
Fringe benefits	*19,93198*
Consulting	*21,06,241*
Maintenance	*1,86,049*
Supplies	*1,64,571*
Travelling costs	*26,63,272*
Telephone	*5,46,689*
Postage	*81,438*
Lease Rents	*3,32,655*
Training/Education	*2,56,264*
Legal Accounting	*10,63,150*
Advertising Fairs	*91,060*
Insurance	*1,64,226*
Other selling and general administration expenses	*11,120*
Total	***1,28,04,653***

80. To support the contention that manufacturing operation was started only in the month of December, 2005 the assessee has placed reliance on the certificate issued by Central Excise Authorities dated 30th May, 2005 vide which the assessee had sought registration as

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manufacturer of excisable goods at Hinjewadi, Pune and the related returns which were filed in the month of December, 2005 and copies of these documents are filed at pages 263 to 298 of the paper book. It may not be a matter of doubt that assessee has commenced its manufacturing operation in December, 2005 but the question is that whether or not assessee is entitle to exclude the aforementioned expenses from operational expenses on the ground that manufacturing activities were started only in December, 2005 despite the fact that those very expenses were relating to manufacturing activity of the assessee.

81. The assessee to support its contention that those expenses are required to be excluded from operational expenses has mainly relied upon the provisions of Rule 10B(1)(e)(i). Taking support from the above argument it is the case of the assessee that according to the stipulation in the aforementioned provision, the expenses incurred prior to commencement of operation should not be considered while computing the operating margins from the International transaction. It is the submission of the assessee that if the aforementioned expenses are excluded from operational expenses then the margin of the assessee would be within the permissible range of 5% as described in proviso to sec. 92C(2).

82. We have carefully considered the rival submissions on this issue. We find no force in the contention of ld. AR that such expenses were

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required to be excluded. The reason for not accepting such argument is that what is operational expenses is the expenses which are incurred to earn that income. It is not even the case of the assessee that those expenses did not relate to manufacturing segment of the assessee out of which the revenue was earned by the assessee. If the expenses have nexus with the revenue then they are to be considered as operational expenses and they cannot be excluded simply for the reason that the date of occurrence of the revenue is later and expenses have been incurred prior to that. Therefore, ground no. 5 of the assessee is rejected.

83. Apropos ground no. 6, it is already observed that assessee has computed its margin after claiming adjustment on capacity utilization. Therefore, the first issue to be decided is that whether assessee can deviate from the net profit shown in its books of account for the purpose of computing arm length price. The method adopted by the assessee is TNMM for the purpose of computing arm length price. Provisions of Rule 10B(1)(e)(i) regulates such method and read as under: -

> *"10B(1)(e) transactional net margin method, by which, -*
>
> *(i) the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base,"*

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84. The expression "net profit margin realized" means the net profit margin actually realized and actual cost incurred and sale affected and thus, there is no room for any assumption for taking the profit margin which has been realized. In the case of the tested party (assessee), it is not permissible to deviate from the book results on the ground of capacity utilization. The adjustment on account of capacity utilization, if any, is permissible by Rule 10B(3)(ii) Rule 10B(3) read as under: -

> *"(3) An uncontrolled transaction shall be comparable to an international transaction if -*
> *(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or*
> *(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences."*

85. Therefore, it is clear that in the case of tested party (assessee), there cannot be any deviation in the net profit shown in the books of account and the adjustment, if any, can be made to the same to eliminate the material affects to such differences to the extent of these adjustments are reasonably accurate. Therefore, the position emerges is that adjustment can be granted to the assessee in computation of mean margin only to the extent of these being reasonably accurate. In the light of these provisions we have to examine that whether or not department is right in rejecting the claim of assessee regarding capacity utilization.

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86. It has been the submission of the assessee that it had assumed the capacity utilization of comparables to be 70% in accordance with Rule 10D(1)(k) in its TP study report due to unavailability of required details at that point of time and has also made appropriate disclosure therein.

87. Rule 10D(1)(k) as described under the head "Information and documents" to be kept and maintained u/s 92D -

10D(1) every person who is entered into an international transaction shall keep and maintain the following information and documents namely: -

(a) to (j).......

(k) the assumptions, policies and price negotiations, if any which have critically affected the determination of the arms length price;

88. The perusal of the above provision will reveal that every person who is entered into an international transaction is under an obligation to keep and maintain the information and document with respect to the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arms length price. TPO in its report has observed that assessee did not submit any evidence for assuming the capacity utilization of the comparables and whatever data relied upon by the assessee for seeking capacity utilization adjustment was either unreliable or incorrect. When fixed cost itself is incurred only for a part

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of the year the same cannot be adjusted for differential capacity utilization.

89. According to submissions made before DRP it was submitted by the assessee that assumption has been made regarding capacity utilization of the comparables at 70% in accordance with Rule 10D(1)(k) in the TP study due to the unavailability of the required details at that point of time and appropriate disclosures were made. It was submitted that detailed working in connection with the capacity utilization in the comparables (i.e. 70%) which showed similar results as mentioned in TP study was furnished and reference in this regard is made to pages 200 and 335 of the paper book. It was submitted that adjustments are needed to be made to the cost considered for arriving at the profitability of the transaction as expenditure incurred for pre-commencement period was needed to be adjusted. Under utilized capacity has been computed considering only the relevant part of the year i.e. after the commencement of the business. DRP has observed that no evidence has been made available in the TP report to examine the capacity utilization of the comparables and the data relied upon by the assessee for seeking such adjustment is unreliable and incorrect. Before us it was submitted that all the details regarding start up stage of operations and capacity utilization details of the assessee viz-a-viz the comparables were filed and reference in this regard is made to pages 264 to 298 and submissions at pages 245 to 247 of the paper book. It was submitted that TPO/DRP have nowhere contested difference

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between the stage of the operation of the assessee and the comparables reference in this regard is made to page 405 to 408 and 414 to 436. It was submitted that TPO and DRP have rejected the entire adjustment based only on account of the presumed inconsistency which has been observed in one out of the five comparables which has been proved incorrect as licensed capacity does not have any role to play in computing the capacity utilization. There was no provision to restrict the production only upto capacity as such restriction was applicable only to license era i.e. pre 1991. Finally it was submitted that if there was any inconsistency with regard to data of one comparable than data regarding remaining comparables should have been considered and reference in this regard was made to page 203 of the paper book.

90. For proper appreciation of the submission of the assessee it has to be seen that what evidence has been filed by the assessee with regard to assumption made by it with regard to capacity utilization of 70% of the comparables. It has already been described that it is the legal obligation of the assessee to keep and maintain the information and documents in respect of any assumption made by it which according to assessee has critically affected the determination of arms length price. In the written submissions the assessee has made reference to evidence being placed at pages 264 to 298 and submissions placed on 245 to 247 of the paper book in para 8.41. Pages 264 to 298 have been described as Annexure 'H' in the index of paper book and the narration is "copy of application and

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submission made before the ld. TPO dated October 9, 2009. Page 264 is the Central Excise Registration Certificate of the assessee dated 30th May, 2005. Page 265 to 269 is the copy of formation E.R.-1 being return of excisable goods and availment of CENVAT credit for the month of June, 2005. Similarly from pages 270 to 274. 275 to 279, 280 to 284, 285 to 289, 290 to 294, 295 to 297 are the similar returns from the month of July, 2005 to the month of December, 2005. Page 298 is the extract from "Business Line" financial daily from the Hindu group of publication dated 18.3.06 which is a news item under the head "Haworth Inc. Inaugurates Facility in Pune". None of these documents have described the capacity utilization by the comparables. Thus, it has been wrongly claimed by the assessee that it has furnished sufficient evidence with regard to capacity utilization in the cases of comparables. No credible information has been submitted by the assessee to seek adjustment on account of capacity utilization and we hold that the case law relied upon by ld. AR in this regard have no relevance as on facts of this case and it is held that assessee has not been able to furnish credible and accurate information with regard to capacity utilization and such adjustment can be allowed only in a case where assessee is able to furnish accurate and credible evidence in this regard. Therefore, the decisions in the following cases cannot be relied upon to give relief to the assessee.

*1. **ACIT Vs. Fiat India Pvt. Ltd.** [Hon'ble Mumbai Tribunal (ITA No. 1848/Mum/2009)].*

*2. **Skoda Auto India (P) Ltd. Vs. ACIT** [Hon'ble Pune Tribunal (122 TTJ 699)].*

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*3. **E-Gain Communication (P) Ltd. Vs. ITO** [Hon'ble Pune Tribunal (118 TTJ 354)].*

*4. **Global Vatedge Pvt. Ltd. Vs. DCIT** [Hon'ble Delhi Tribunal (ITA Nos. 2763 & 2764/Del/2009)].*

Accordingly, Ground No. 6 is dismissed.

91. Now coming to ground no. 7, it is the case of the assessee that the TPO/DRP has erred in computing the quantum of adjustment to be made to the profit of the manufacturing segment of the assessee by applying the profit level indicator of operating profit/sales to the value of International transaction pertaining to import of raw material instead of sales figure of manufacturing segment which has resulted in an increase of adjustment by a sum of Rs. 26,91,806/-. It is observed that these submissions were made by the assessee before DRP as per copy of submissions placed at pages 205 and 206 of the paper book and it is observed that ld. DRP has not passed any speaking order on such submission of the assessee. If such submission of the assessee were to be rejected then reasons must should have been given for the same. There being no discussion on this issue in the order passed by DRP, we consider it just and proper to restore this issue to the file of DRP with a direction to consider the submissions of the assessee and to decide this issue by way of speaking order after providing the assessee a reasonable opportunity of hearing. This ground is allowed for statistical purposes in the manner aforesaid.

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92. Coming to ground no. 8 the assessee is claiming +/- 5% range as per proviso to section 92C(2) of the Act. Proviso as applicable for the year under consideration read as under: -

> *"Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the taxpayer, a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean."*

93. This proviso is applicable in a case where more than one price determined by the most appropriate method. In a case where only one price determined by most appropriate method than benefit of 5% is not available to the assessee. Therefore, so as it relates to marketing support service segment, only one price is determined by the most appropriate method as only one comparable namely Priya International Ltd. has been left on the basis of which arm length price of the assessee has been determined. Hence, the benefit of proviso is not available to the assessee with respect to marketing support service segment. In respect of manufacturing segment more than one prices is determined by most appropriate method by taking into account five comparables which have been accepted by the TPO and they have been listed in table 3 of his order. Therefore, for the said segment the adjustment of 5% is available at the option of the assessee irrespective of the fact that the arm length price determined by the TPO exceeds 5% or not and so has been held by

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the coordinate bench in the cases of Sony India Private Limited Vs. DCIT (supra) and in the case of M/s SAP Labs India Pvt. Ltd. Vs. ACIT (supra). This issue has been discussed in detail in the decision of Sony India Pvt. Ltd. (supra) in paras 157 to 163.4 and it has been categorically held that benefit of 5% is available at the option of the assessee, even in a case where arm length price has been determined exceeding %5 and assessee does not give up its right to contest the remaining addition which is in excess of 5% margin and it will be relevant to reproduce para 163.4 from the said decision: -

> *"**163.3** The controversy is relating to the second limb/portion of the provision where "an option" is given to the taxpayer to take Arm's Length Price which may vary from the arithmetic mean by an amount not exceeding 5 per cent of such arithmetic mean. Here again, there is no controversy that taxpayer can take Arm's Length Price which is not exceeding 5 per cent of the arithmetic mean. The "option", as is clear from the language is to take Arm's Length Price which is not in excess of 5 per cent of the said mean. The word "option" as per The Law Lexicon is synonymous with "choice" or "preference". Therefore, it is the choice of the taxpayer to take Arm's Length Price with a marginal benefit and not the arithmetical mean determined as the Most Appropriate Method. The controversy is in cases where the International Price shown in related party transaction exceeds 5 per cent of the Arithmetic mean envisaged by the provision and such Arm's Length Price is contested by the taxpayer. According to the revenue, in such a situation, the second limb of the provision is not applicable. The reasons put forth in support*

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of such a view by the revenue have already been noted. It is their contention that the second part/limb of the provision is meant to cover marginal cases only where the price shown by the taxpayer does not exceed 5 per cent of the Arm's Length Price representing arithmetic mean by the Most Appropriate Method. Where the difference is much more than 5 per cent, then taxpayer cannot have the benefit of the said provision, particularly where the taxpayer has not accepted such arithmetic mean.

163.4 *The other view is the one accepted by Kolkata 'A' Bench of the Tribunal in the case of Development Consultants (P.) Ltd. (supra). As per the said decision, the benefit of second limb of the proviso was allowed to the taxpayers although the price disclosed by it was more than 5 per cent of arithmetic mean. The decision of the Co-ordinate Bench is binding on us and we are inclined to follow the same. That apart, we are of the view that Kolkata Bench of the Tribunal has taken a right view of the provision. We are to go by the language of the provision and when we do so, we do not see anything in the language to restrict the application of the provision only to marginal cases where price disclosed by the taxpayer does not exceed 5 per cent of the arithmetic mean. In our considered opinion, the Arm's Length Price determined on application of Most Appropriate Method is only an approximation and is not a scientific evaluation. Therefore, the Legislature thought it proper to allow marginal benefit to cases who opt for such benefit. In the case of a taxpayer who exercises the option and accepts Arm's Length Price as per the second limb of the proviso or in other words, he accepts the Arm's Length Price even*

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exceeding 5 per cent of Arithmetic mean determined by the tax authority as correct and is ready to pay tax on the difference between price disclosed by him and the above Arm's Length Price. We do not see any valid objection on the part of the revenue to the application of above provision to such a case. The taxpayer has exercised the option and took Arm's Length Price as per the second limb as the final price without raising any dispute. Therefore, the parameters laid down as per the second limb are fully satisfied. In our opinion, the legal position cannot be different in a case where minor variation of 5 per cent is not accepted and Arm's Length Price is further challenged in appeal. Mere fact of acceptance or non-acceptance of arithmetic mean can be taken to be the determining factor relating to right to contest Arm's Length Price in appeal. Such inference has no support of language of the provision. In our view, both in the first as also in the second limb, implications of determined Arm's Length Price are the same except for the marginal benefit allowed to the taxpayer under the second limb. Hence, we are of the view that second limb is applicable even to cases where the taxpayer intends to challenge Arm's Length Price taken as arithmetic mean and determined through the Most Appropriate Method. As stated above, the second proviso is intended to give marginal relief to all taxpayers as determination of Arm's Length Price is not an exact science but is an approximation. Option is given to the taxpayer as in some cases, variation not exceeding 5 per cent of arithmetic mean might not suit the taxpayer, and, therefore, taxpayer in such cases should not be put to a prejudice. Otherwise, there is no difference between the first and

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the second limb of the provision as far as right of the taxpayer to challenge the determined price is concerned. The second limb only allows marginal relief to the taxpayer at his option to take ALP not exceeding 5 per cent of the arithmetic mean. Therefore, in line with the view taken by Kolkata Bench of the Tribunal, we are of the view that benefit of the second limb is available to all taxpayers irrespective of the fact that price of international transaction disclosed by them exceeds the margin provided in the provision."

94. In this view of the situation, we hold that benefit of 5% is not available to the assessee with respect to marketing support service segment and it is available to the assessee with regard to manufacturing segment. The AO will compute the arm length price accordingly. This ground is partly allowed for statistical purposes in the manner aforesaid.

95. Ground no. 9 is pre-mature vide which the assessee has contested the initiation of concealment penalty, therefore, it is dismissed.

96. Ground no. 10 relates to objection raised with respect to finding given by DRP which according to assessee are incomplete as the contentions of the assessee have been rejected without appropriate reasons. We have discussed each and every issue in detail and wherever we found that the issue has not been property dealt with by the

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departmental authorities, we have directed them to re-consider the same. Therefore, this ground does not need to be adjudicated separately.

97. Ground no. 11 has already been discussed and it has been held that only data of relevant financial year is relevant and hence this ground of the assessee is dismissed.

98. Apropos ground no. 12 – the assessee in its original return had claimed provision for certain expenses at a sum of Rs. 1,01,91,619/- the details of which are as under: -

The assessee has made provisions for the expenses as follows:

(a) Prototype cost	*Rs. 3,39,072*
(b) Promotional material	*Rs. 4,501*
(c) Display Material	*Rs. 20,27,746*
(d) Promotional Programmes	*Rs. 20,75,024*
(e) Public relation	*Rs. 2,94,626*
(f) Member procurement	*Rs. 2,20,023*
(g) Legal & Accounting	*Rs. 16,26,520*
(h) Professional fee	*Rs. 24,89,733*
(i) Consultancy	*Rs. 16,09,000*
Total	*Rs.1,01,91,619*

99. Later on, on account of applicability of 40(a)(ia) inter-alia legal and accounting, professional fees and consultancy fees were suo moto disallowed by the assessee in the revised return and the balance sum remained at Rs. 40,94,915/-. It has been observed by the AO in the

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assessment order that assessee was given specific opportunity to explain the allowability or otherwise of these expenditures and in reply assessee has submitted that according to consistently followed mercantile system of accounting these expenses were debited to Profit & Loss account on account of provision of accrued expenses. It was submitted that it was not in the nature of contingent liability. The AO has found that such explanation of the assessee is not acceptable and he has disallowed the remaining amount of Rs. 40,94,915/-. Before DRP also, argument of the assessee was that these expenses were closely approximate to the provisions made which cannot be termed to be a contingent liability. In the written submissions filed before us it is submitted that the auditors of the assessee company had not identified these expenditures as inadmissible. It is submitted that correct amount is not a sum of Rs. 40,94,915/- but it is 47,40,969/- and against those expenditure the expenses booked by the assessee company are 33,24,274/- and thus, actual incurrence of these expenditure is in the near proximity of the provision of these expenditure. He submitted that excess provision was written back in financial year 2006-07 and, therefore, to that extent these expenditure were offered for taxation and to that extent they should not have been disallowed.

100. We have carefully gone through the argument submitted by both the parties. It has not been shown by the assessee that how these expenditures, which are claimed as provision, had accrued in the year

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under consideration. No details whatsoever have been filed in the paper book as no reference in the written submission regarding evidence has been made. Only on the basis of certain decisions namely Bharat Earthmover (supra), Metal Box Company of India Ltd. (supra) and Calcutta Company Ltd. (supra) it is claimed that these expenditures are not in the nature of contingent liability and are allowable. However, no evidence/detail whatsoever is submitted by the assessee to prove that these expenditure were actually accrued during the year under consideration. There being no evidence on record to prove that these provisions were not in the nature of contingent liability, we find no infirmity in the disallowance being upheld. Whenever such claim is made, the onus is on the assessee to prove that these expenses have actually been accrued during the year under consideration. The assessee was provided with many opportunities including hearing before DRP and evidence having not been furnished in this regard, we confirm the disallowance. However, the assessee can seek relief in subsequent years as per provisions of law, if it is permissible to do so. With these observations this ground of assessee is rejected.

101. Apropos ground no.13 – Printers and UPS of the value of Rs. 16,16,213/- are considered to be eligible for depreciation under the head "plant and machinery" and depreciation of 15% has been granted. It is the claim of the assessee that these items are eligible for depreciation @ 16% being computer peripherals and reliance has been placed on the

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decisions of DCIT Vs. Data Craft India Ltd. (supra) and ITO Vs. Samiran Mazumda (supra).

102. After hearing both the parties, we are of the opinion that UPS and Printers fall within the computer peripheral hence eligible for depreciation @ 16% the AO is directed to compute the depreciation accordingly and this ground of the assessee is allowed.

103. In the result, the appeal is partly allowed in the manner aforesaid.

Order was pronounced in the Open Court on 29.4.11

Sd/-
(G.E. VEERABHADRAPPA)
VICE PRESIDENT

Sd/-
(I.P. BANSAL)
JUDICIAL MEMBER

*Kavita
Dated:

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

TRUE COPY

By Order

DEPUTY REGISTRAR
ITAT