IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH 'A', PUNE

BEFORE SHRI I C SUDHIR, JM AND
SHRI D. KARUNAKARA RAO, AM

ITA No.1296/PN/10 (Asstt. Year 2006-07)

Brintons Carpets Asia P Ltd. **Appellant**
Ghat No 414/415/416, A/P Urawade Tal
Mulshi, Dt
Pune – 411 012
PAN AAACB7059H

Vs.

Dy.CIT Circle 1(1) Pune **....** **Respondent**

Appellants by : Shri Rahul Mitra
Respondent by : Shri Hareshwar Sharma, CIT DR

ORDER

Per D. Karunakara Rao, AM

This is the appeal filed by the assessee against the order dt 27.09.10 for the AY 2006-07, which was passed under section 143(3) read with section 144C of the Income Tax Act, 1961 of the Act after considering the guidelines of the Dispute Resolution Panel, pune dated 30.7.10. Initially, the appeal was filed in Form no 36 inadvertently. Subsequently, considering the fact of Rule 14 of the Income tax Dispute Resolution Panel Rules 2009, the assessee filed a letter dated December 28, 2010 enclosing the correct Form no 36B and the grounds and the same are accepted for the proceedings under consideration.

2. The grounds raised by the assessee read as under:-

1. The ld. assessing officer (AO) pursuant to the directions of the Ld Dispute Resolution Panel (DRP) erred in rejecting the benchmarking approach adopted by the appellant in the transfer pricing study and thereby making a transfer pricing adjustment of Rs.161,98,390 to the income of the appellant by holding that the international transaction of "Export of carpets" of the appellant does not satisfy the arm's length principle envisaged under the Income tax Act, 1961 (the Act).

2. The Ld.DRP/AO erred in considering the domestic segment of carpets business (domestic segment) as compared to the export

segment of carpets business (export segment) for benchmarking, without appreciating the fact that the domestic segment is a controlled segment as it entails international transaction pertaining to import of raw materials from the associated enterprises and hence, non-comparable. Ld.DRP/AO ought to have considered the external uncontrolled comparables and not the internal controlled comparable for determining the arm's length price of the impugned international transaction.

3. The ld.DRP/AO erred in not granting an ***economic adjustment*** *on account of labour unrest while conducting the comparability analysis. The Ld.DRP/AO erred in not considering the impact of labour unrest on the appellant's profitability from its international transactions and thereby not comparing the adjusted profitability with the external comparables.*

4. On a without prejudice basis, the Ld.DRP/AO erred in disregarding the differences in the functional, asset and risk (FAR) profile of the appellant's export segment and the domestic segment while undertaking the benchmarking analysis. Also, the Ld.DRP/AO erred in disregarding the adjustments made by the appellant in connection with certain FAR differences between the aforesaid segments while the onus is on the Ld. AO to make reasonably accurate adjustments to eliminate the above differences.

5. The Ld.DRP/AO erred in upholding the TPO's stance of adjustment of 44.54% being granted, for the differences in FAR profile between the export and domestic segment, when in fact no such adjustment has been granted.

6. The Ld.DRP/AO erred in making a transfer pricing adjustment of Rs.161,983,90, without appreciating the fact that the appellant is availing tax holiday ***benefits u/s 10B*** *of the Act and hence, there would not have been any untoward motive of desiring a tax advantage by manipulating transfer prices of it international transactions.*

7. The Ld.DRP/AO erred in not giving cognizance to the explanatory circular issued by the CBDT which clarifies that the ***amendment to the proviso to sec 92C(2)*** *is applicable in respect of assessment year 2009-10 and onwards. Thus, the Ld.DRP/AO erred in not granting the benefit of +/- 5% range as per the proviso to sec. 92C(2) as it stood before the amendment.*

8. On the facts and in the circumstances of the case, the Ld.AO erred in initiating the penalty proceedings u/s 271(1)(c)of the Act on the premise that the appellant has furnished inaccurate particulars of income without appreciating the fact that the transfer pricing adjustment so made is not in accordance with law.

3. A. Briefly stated relevant facts of the case are that the assessee Brintons Carpets Asia P Ltd (in short 'BRASIA') is a 100% subsidiary of Brintons Ltd, UK (in short " BLK") and BRASIA claimed benefits u/s 10B of the Act. BRASIA is a contract manufacturer in India for BLK and export the same as per the agreement. BRASIA also made domestic sale of the carpets. BRASIA's actual figures vis a vis BLK is 459,217 sq mts against the target of 758,032 sq meters and its domestic figures are 44,589 sq mts against the target of 42,525 sq meters. BRASIA could not meet the export commitments to the BLK and shortage in this regard is just above 3 lakhs sq meters of carpet. There was labour unrest in the company resulting in the go-slow approach of the labourers, labour strike and lock outs, which effect adversely the budgeted production.

B. Assessee filed the return of income reporting the international transactions. During the year, the assessee imported raw materials, spares and consumables as well as the capital goods. At the same time, the assessee exported the yarn and carpets too. Although there are four of such international transactions, the disputed transactions relates to the 'export of the carpets' and the export sales amount involved works out to 34,33,26,376/-. It includes the scrape sales of Rs. 35.20 lakhs (rounded off) too. Corresponding unadjusted total cost is Rs 39,83,86,412/-. Thus, ***net effect is the export loss to the assessee during the year to the tune of -13.57% without adjustments***. Per contra, on the domestic segment front, the margin is 27.09%. While filing the return, in view of the applicability of the 'transfer pricing' provisions to the international transactions, the assessee adopted the 'transactional net margin method - "TNMM" and made adjustments to the said total cost relatable to the 'unabsorbed overheads' and such adjustments as per the assessee works out to Rs 7,31,73,120/-. In other words, the said total cost of Rs 38,93,86,412/- was under absorbed by the assessee during the year due to the undisputed labour unrest and therefore, it calls for adjustments as per the transfer pricing guidelines - arm's length principles. Accordingly, assessee made the said economic adjustment of Rs 7,31,73,120/- to the total cost relatable to the exports to the BRASIA. Thus, as per the assessee, the adjusted operating margin of the 'export segment' is 5.88%. Assessee compared the same with operating margin of the average of the external comparables with 7.12% and opined that in view of the 'below 5% variation' (7.17-5.88), the same is proper after exercising the +/- 5% range provided in the amended provisions of the proviso

to section 92C(2) of the Act. This is the position as per the assessee as reported in the return of income.

C. In accordance with the set guidelines, AO referred the matter to the TPO and the TPO invoked the provisions of section 92C of the Act. In effect, the TPO rejected the not only the assessee's claim relating to the adjusted operating margin at 5.88% but also rejected the economic adjustments to the total cost at Rs 7,31,73,120/-. In the process, the TPO **summarily** rejected the external comparable without any discussion or reasoning. Instead, the TPO proceeded to compare the unadjusted operating margin of the export segment with -13.57% with that of the domestic segment with 27.09%. Thus, TPO compared the international transactions with the domestic transactions. At the end of the proceedings, u/s 92CA(3) of the Act, TPO proposed the addition of Rs 16,19,83,910/- equalent of the difference of nearly 40% ie (from -13.57% to 27.09%). The AO adopted the said order of the TPO in his order and proposed addition of Rs 16.20 crores (rounded off). In response, as per the options available to the assessee, the BRASIA approached the Dispute Resolution Panel (DRP). On hearing the assessee and its objections and submissions, the DRP confirmed the draft order passed by the AO and confirmed the proposed addition of Rs 16.20 crores to the export segment. Finally, the AO passed the impugned order dt 27.09.2010 for the At 2006-07 under section 143(3) read with section 144C of the I T Act 1961 of the Act in the light of the guidelines of the DRP, Pune dated 30.7.2010.

4. Aggrieved with the same, the assessee filed the present appeal before us.

During the proceedings before us, Shri Rahul Mitra, Ld Counsel for the assessee narrated the facts of the case and submitted that the AO/TPO/DRP erred in not upholding the decisions of the assessee and confirming the additions made by the revenue. As per Mr Mitra, a couple of keys issues for adjudication by the Tribunal are as under:

(i) export segment cannot be compared with the domestic segment; and external comparables would be more appropriate; and

(ii) economic adjustment on account of labour unrest is warranted to arrive at correct profitabalility of the international transaction pertaining to export of carpets.

In this regard, the learned Counsel explained the grounds raised in the appeal and proceeded to make various arguments. Some of them are as follows:

(i) When the external comparables of the available for making the transfer pricing adjustments to the export segment of the carpet, the decision of the AO/TPO combine in resorting to the internal comparables is not proper. This is for the reason in the instant case domestic comparable cases are controlled ones which cannot be compared with the uncontrolled transactions. Demonstration the incorrectness of picking up the domestic comparable, Mr Mitra referred to 4 of the reasons given in the written synopsis filed before us and they are:

A. Domestic segment entails controlled transactions and use of a controlled transaction to benchmark an international transaction is not in accordance with the law.

B. There are significant differences in the **f**unctional, **a**ssets and **r**isk employed ('FAR profile) between the domestic and export segment for which reasonably accurate adjustments cannot be made.

C. Significant volume difference between the two segments – Export segment constitutes 91.14% of carpets manufactured while domestic segment constitutes 8.86% of carpets manufactured.

D. The TPO, on similar facts, has accepted that export segment cannot be compared with the domestic segment in subsequent A.Y i.e. AY 2007-08.

Further also, Mr Mitra argued to sum up stating that while the argument at 'A' above relates to the technicalities, 'B' relates to the functional aspect, whereas 'C' refers to the quantitative and argument at 'D' questions departmental approach of lack of inconsistency.

(ii) Later, Ld Counsel mentioned that the AO/TPO completed the assessment for AY 2007-08, the subsequent AY and the AO/TPO relied upon the six (6) external comparable prices. As per the Counsel, the AO/TPO did not repeat the picking up of the domestic comparable cases but instead relied on the six external comparable prices supplied by the assessee. In this regard, the ld Counsel mentioned that the AO/TPO cannot be allowed to pick up the domestic comparable cases while there exists external comparable cases, which the department considered valid ones in the subsequent year.

(iii) Sri Mitra Ld Counsel for the assessee demonstrated the erroneous nature of the decisions/ guidelines of the AO/TPO/DRP in resorting/sustaining of the decision of the TPO/AO in picking up the controlled domestic comparable for

making the transfer pricing adjustments and filed various written submission and citations to support his arguments. More particularly, Ld Counsel filed a copy of a recent order of the Tribunal, Mumbai Benches in the case of NGC Network (India) P Ltd. ITA No 5307/M/2008 dated 23.02.2011 and took us through the contents of paragraph15 for the proposition that the AO has to maintain the **rule of consistency** unless there is change facts materially. Comparable cases accepted by the department in the **subsequent assessment year should be adopted** for the purpose of computing the transfer pricing adjustments for the current year also. Ld Counsel also narrated the facts of that case and stated that the AO/TPO initially picked up the domestic comparable cases in that case too as in the case of the present assessee and such a decision was not accepted by the Tribunal vide the cited order dated 23.2.2011. Finally, Ld Counsel summed up stating that the AO/TPO's picked up of the domestic comparable cases in place of the 6 external comparables picked up in the subsequent assessment year erroneously and it is contrary to the established binding decisions of the Tribunal in the matter. Further, the Counsel mentioned that the matter maybe set aside for the AO/TPO to reject the domestic comparables and adopt the external comparables which were adopted in the subsequent year or any other external comparable cases. In this regard, Ld Counsel prayed for setting aside the impugned order with the direction to the AO to decide the issue afresh honoring the coordinate bench decision of the Mumbai Tribunal cited above.

5. Drawing out attention to the requirement and essentiality of making economic adjustments to the export segments in view of the labour unrest and other factors, Ld Counsel mentioned that the order of the AO is deficient in this regard and similarly the guidelines of the DRP is also not speaking order on the topic. Referring to the contents of para 6 of the DRP's guidelines dated 30/7/2010, Ld Counsel mentioned that the DRP merely travelled on the commonality of the manufacture and administrative infrastructure for both domestic and export segments. Further, he was critical of the finding in para 6.4 of the said guidelines that the lock out of the company is only for the period of 19 days in the previous year. In the process, the DRP summarily adjudicated the undisputed fact of labour's decision to go for the 'go-slow' approach for nearly for more than 6 months (April to August/September) in the PY. As per the counsel, the company took further time to come to the normal production levels. As per the Counsel, all the relevant objections raised by the assessee were not adjudicated by the DRP. According to him, DRP has not analysed the problems of the unrest faced by the assessee and its ill-effects on the production capacity of the assessee. Further, he reasoned that the assessee kept plant and

machinery in place and employed the skilled and unskilled employees were employed keeping in view the contracts on hand both domestic and the export orders from the BLK, UK and related production targets and the said targets were completely disturbed and in fact, the export production targets went haywire completely due the disloyalty of the employees by way of their unrest, lock out and their go-slow attitudes. As per the counsel, such abnormal events were directly evidenced by way of the resolutions, which are placed in the files before us and they certainly have the effects on the profits margins and therefore, they require economic adjustments. The revenue authorities have failed to consider the arguments of the assessee in proper perspective. In this regard, the counsel relied on various documents and citations. In fact, Ld Counsel prayed for setting aside the relevant grounds to the files of the AO for considering the reality of the unrest and requirement of the making economic adjustments to these facts of the unrest.

6. Per contra, Sri Hareshwar Sharma, Ld DR dutifully relied on the orders/ guidelines of the Revenue. Further, on this issue relating to domestic comparable vs. external comparable and the rule of consistency, the ld DR argued vehemently stating that the principle of *res judicata* does not apply to the Income-tax matters and mentioned that every assessment year is independent. On the comparable, Ld DR is of opinion, the onus is on the assessee to bring correct comparable to justify its claim and the non requirement of the transfer pricing adjustments. Consequently, as per the Ld DR, the six external comparables used by the AO/TPO in subsequent years need not be adopted for the current assessment year.

TRIBUNAL's FINDING

7. We have heard the parties and perused the draft order/orders/guidelines of the DRT of the Revenue as well as the cited decision before us. Correct operating margin of the export segment and the need for the adjustments based the correct comparables in accordance with the transfer pricing guidelines are the broad area of disputes. In this regard, the rival stands are as follows. Assessee's case is that the unadjusted operating margin of the export segments with 91.14% of the total annual sales of the assessee is -13.57%. This lower operating margin is due to labour unrest and therefore, the **capacity** of the company was under-utilized ie the **overheads** expended as per the original targets fixed were not absorbed by the company to its full extent due to go slow approach and lock out of the labour. Therefore, the unadjusted operating margin of 13.57% (-ve) needs to be adjusted by adjusting the 'total cost' of the export

segment. Such adjustments, which are attributable to the under absorbed overheads, work out to Rs 7.32 cr (rounded off). In effect, the adjusted operating margin works out to 5.88% as against the operating margin of 7.12% of the external comparable. The difference being only below 2%, the same has to be ignored in view of the proviso to section 92C(2) of the Act. Further, the as per the assessee, the domestic comparables is improper here as the AO rejected the external comparable prices summarily and honoured the same in the subsequent year and therefore, there is inconsistency in AO's approach, which is improper. Further, in these matters of such inconsistency, the assessee relied on decisions of the Tribunal in the cases of Fiat India P Ltd (supra) and E-gain Communication P Ltd (supra).

8. *Per contra,* the case of the revenue is that the principle of *res judicata* is inapplicable to the income tax matters and AO/TPO/DRP is free to decide the issue AY-wise depending on the facts of the case of that year. The unanswered queries of the revenue are as to how there can be two different operating margins ie -13.57% and 27.09% for export and domestic segments respectively of the same product in the same year. Further, how the labour unrest effected the export segment of the carpet manufacture and not the domestic. Therefore, these two operating margins are justly compared and different being above 40% ie -13.57% to 27.09%, the addition of Rs 16,20 crores is justified and consequently, there is no need for economic adjustments to the labour's pressure tactics to get their demands met ie go-slow approach,lock out etc.

9. The above rival stands are considered and we now proceed to adjudicate the two focal issues underlined by the Ld Counsel for the assessee. We shall take up the **first issue** first and the same is whether the export segment can be compared with the domestic segment when the AO accepted the external comparables were accepted as appropriate in the subsequent AY. This issue has various facets and they are: (i) what is wrong with the external comparable adopted by the assessee; (ii) whether, it is justified to adopt the domestic comparable where the domestic segment consists of only 8.86% against the 91.14% of the export segment in terms of volume; (iii) rule of consistency; and (iv) the existing decision on this issue etc.

10. To discuss the above, on the issue of 'external comparable' versus the 'domestic comparable', the revenue authorities or the DRP deliberated on the acceptability of the six comparable furnished by the assessee. We find they have summarily dismissed the assessee's submissions in this regard. In our opinion,

the same is not proper that the AO/TPO have not find mistake with the six external comparable filed by the assessee. They merely held that the domestic comparables are to be relied as the labour related problems are common to both export and domestic segments. In fact, considering the facts relevant to the subsequent AY where the AO/TPO accepted the six external comparable for the purpose of the TNMM, the Ld Counsel for the assessee conveyed no objection for going to the files of the AO/TPO in this regard. Para 6.4 of the DRP explains the depth of the travel by the panel on the issue. For the sake of the completeness of the order, relevant paragraph is reproduced as under.

> *"6.4. The assessee's submission has been considered. Since the same resources, the same labour, the same machines are being used for export as well as domestic segments, it is difficult to accept the contention of the assessee that the labour unrest affected only export and not a domestic segment. In fact, initially the asessee had denied having two separate segments. The assessee has given the break up on estimate basis. Since the same set up of facilities are being used the same man power, the same machines and same labour employed for manufacturing carpets for export and for domestic sale, it cannot be accepted that the labour strike or under utilization of capacity affected export segment only and the profitability went down because of the labour strike. Moreover, it was for a limited period and the loc out, admittedly has been for* ***19 days*** *only. In these circumstances, we do not consider it necessary to interfere with the decision of AO/TPO.*

11. Regarding the 'rule of consistency' and the relevant decisions on the topic, we have examined the facts for the AY 2006-07 and 2007-08. So far as the external comparables, turn over details of export and domestic segments and other relevant facts are concerned, we find similarity of the facts between both the years. The argument of the assessee is that the external comparable prices for the impugned AY 2006-07 supplied by the assessee, when accepted by the AO for the AY 2007-08, must be accepted for that year in view of the absence of material facts and also in view of the rule of consistency. We have considered this argument and in our opinion, it is a settled law that the principle of *res judicate* is inapplicable to income tax matters. However, the same is true as long as the facts of different in different AYs. Otherwise, the rule of consistency is relevant to income tax matters and AO cannot be ignore the same. There ought to be uniformity in treatment and consistency when the facts and circumstances are identical as held by the Mumbai Tribunal reported in 122 TTJ 87. Recent judgment of the Mumbai High court in the case of Gopal Purohit (228 CTR 582)

(Mum), of course, in connection with the issue of proper head of income for taxing the gains on sale of the shares is relevant for the conclusion and it read as follows.

> "..... ***there ought to be uniformity in treatment and consistency in various years when the facts and circumstances are identical*** *no substantial question of law arises.*

12. Further, we have perused the decision of the Mumbai Benches in the case of NGC Network (India) P Ltd. ITA No 5307/M/2008 dated 23.02.2011 relied upon by the assessee on the of rule of consistency and need for not taking the domestic comparables and the need for taking up the external comparable in matters of the 'transfer pricing' adjustments. The perusal of paragraph 15 which is reproduced as under underlines the principle that the uncontrolled transactions and the external comparables which was adopted by the officer in subsequent year holds relevant for the current assessment year as well. For the sake of completeness, paragraph 15 is reproduced as under:

> *"15. We have considered the various aspects. The AO had accepted the license fees for the month of February and March 2003 to be at arm's length. However the steep increase given from the beginning of the year with retrospective effect has not been accepted. The reasons given by the AO is that over the year there has been decline in rate of hiring transponders/satellite due to availability of higher capacity digital transponders and higher competition amongst various transporters. There would have been no difficulty if retrospective increase was with respect to an unrelated party because these are commercial decisions which the assessee may take according to its business needs and cannot be questioned unless they are found not genuine. The position is however different in case of transactions with a related party as in the present case, which has to be compared to unrelated party transactions to fine out the arm's length price. In this case arm's length price has been computed by the assessee with respect to certain comparables as mentioned in para 4 using TNMM.* ***These comparables and the method of computation of arm's length price has been accepted by the department in the subsequent assessment year i.e. 2004-05. Therefore in our view comparables selected by the assessee*** **have to be adopted** ***for the purpose of computation of transfer pricing adjustments this year also.*** *However, it is noted that the assessee has worked out the arm's length price on the basis of transactions relating to the comparable for A.Y 002-03 as at the relevant point of time complete details in respect of A.Y 2003-04 were not available.* ***In our view when the facts and figures in relation to the relevant assessment year i.e. AY 2003-04 are now available then the transfer pricing adjustments have to be computed based on the said facts and figures.*** *In case working is to be made on the basis of figures for AY 2002-03, then in our view the transactions in assessee's own case for the said year which have been found to be at*

arm's length in that year should be adopted as basis as the business being same, it will give better results. Merely because the transaction is with an associate enterprise cannot be the ground to reject it as a comparable when the transaction is at arm's length. ***However as we have held earlier, in our view it will be most appropriate to compare the transactions for the same year i.e. AY 2003-04 for which the figures are available in respect of comparables which have already been accepted by the department.*** *We therefore* ***set aside*** *the order of CIT(A) and restore the matter to the file of AO for reworking of the transfer pricing adjustments using TNMM on the basis of facts and figures available for AY 2003-04 in respect of the comparable selected by the assessee and pass fresh order after allowing opportunity of hearing to the assessee."*

13. From the above, it is evident that '*…* ***comparables and the method of computation of arm's length price has been accepted by the department in the subsequent assessment year i.e. 2004-05. Therefore in our view comparables selected by the assessee*** *have to be adopted* ***for the purpose of computation of transfer pricing adjustments this year also. We find no reason to not accept the above proposition considering the commonality of the facts in the instant case.*** Therefore, we are of the considered opinion in the instant case that for making the transfer pricing adjustments, the AO cannot resort to the domestic comparable in the instant AY. Here, the AO/TPO entertained the external comparable in the subsequent AY 2007-08 for the said purpose of determining the transfer pricing adjustments to the export segments. In our opinion, considering the comparability of the relevant facts in both the AYs and the rule consistency is required to be honored by the revenue. Consequently, in this case and for this year, the revenue needs to resist from adopting the domestic comparable and proceed to adopt the external comparables as supplied by the assessee or any other external comparables for the purpose of making transfer pricing adjustments to the export segments or the international transactions involving the AE. If the external comparables are available, AO/TPO may even attempt the compute the operating profits as per the TNMM considering the external comprables that fall in the periods of labour unrest and unrest-free period of the same AYs too. In any case, admittedly and undisputedly, the AO/TPO have not reckoned and adopted the external comparable cases cited by the assessee for making the transfer pricing adjustments and the orders are free of any reasoning by the AO/TPO/DRP. Therefore, we are of the opinion that the matter should be set aside for examining the issue de novo after granting the reasonable opportunity of being heard to the assessee. Accordingly, all the relevant grounds raised in this regard are **set aside**.

14. The other key issue raised by the Counsel relates to economic adjustments on account of labour unrest warranted to arrive at the correct profitability of the international transaction pertaining to export of carpets. As discussed in the other paragraphs of the order, assessee made adjustment to the total cost and the said adjustment works out to Rs 7,31,73,120/- on account of unabsorbed overheads and underutilization of the capacity. AO/TPO rejected the claim as they resorted to consider the domestic comparable as proper in this case stating that the said labour unrest is common to both export and domestic segment. In this regard, the counsel relied upon the decision of the Mumbai Bench in the case of Fiat India P Ltd (2010-TII-30-ITAT-Mum-TP) for the proposition that in cases of adoption of TNMM, the assessee are entitled to adjustments on account of under utilization of capacity. We have examined the issue in depth and find there is no dispute on the facts relating to the labour unrest. Nevertheless, there is some confusion on the length/period of the labour unrest or agitations. The revenue holds the company was closed for 19 days and on the contrary the assessee holds that the said period run into more than 5/6 months in the year under consideration. Thus, considering our decision that the need for the AO/TPO to adopt the external comparable for the reasons given above, there is need for setting aside this key issue also to the files of the AO for examining the issue of economic adjustments. Philosophically, in matters of TNMM cases, the AO is empowered to make the adjustments and the relevant rules are reproduced as under.

Sec.10B(a)-(d)…..

……

(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 asset employed o to be employed by the enterprise or having regard to any other relevant base;*
>
> *(ii) the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;*
>
> *(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is* ***adjusted to taking into account the differences, if any,*** *between the international transaction and the comparable uncontrolled*

transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realized by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction……."

15. From the above, it is clear the AO has authority vide clause (iii) above to make the adjustments. Such adjustments are necessary only to remove or minimize the differences in the comparable or anomaly in the said comparable. Such adjustments are authenticated by the OECD guidelines too. In this regard, we have perused the important findings of the Tribunal in the case of the Fiat India P Ltd (supra) placed at page 191 of the paper book. For the sake completeness, the same is reproduced as under.

"……

……

++ as regards the adjustments made by the assessee to work out its operating margin for comparing the same with the profit margin of comparable cases, it was held that there was a material difference in the facts of the assessee's case and that of the ***comparable cases in terms of capacity utilization*** *as well as in other terms.* ***Appropriate adjustments thus were required to be made to eliminate such differences****. Further, the TPO himself has allowed similar adjustments made by the assessee in the immediate preceding years i.e. AY 2002-03, 2003-04 as well as in the immediate succeeding years i.e. 005-06 and 2006-07 wherein the facts involved were similar to that of the year under consideration i.e. AY 2004-05;*

+ accordingly, no infirmity is found in the impugned order of the CIT(A) as the adjustments made by the assessee in TNMM analysis were reasonable and accurate and as reflected in the said analysis, international transactions made by the assessee company with its associated concerns during the year under consideration were at arms length requiring no adjustment/addition on this issue."

16. From the above, it is evident that the assessee is entitled to economic adjustments in the circumstances of under capacity utilization of the company. Of course, such adjustments must be restricted to fixed cost/overheads only. In the

instant case, the AO/TPO did not have the occasion to go into the period or the extent of the labour unrest, break up of the claimed adjustments amounting Rs 7.32 crores (rounded off), fixed cost versus the variable cost etc as they summarily rejected the external comparables in view of their preference to the operating profits of the domestic segment of the carpets. Therefore and consequently, this key issue also has to be set aside to the files of the TPO/AO for fresh examination of the issue. Prima facie, we see the need for such economic adjustments to the total cost of the carpet of the export segments. We refuse to comment on the facts relating to the figures as none of the authorities has gone into the details of such economic adjustments and they summarily rejected the claims. As such, the requisite adjustments are borne out of the relevant rules/provisions and therefore, the claim is *bona fide* and has support of the law. For this, the assessee prefers to go to the files of the AO for want of a speaking order on this issue. In our opinion, the request of the assessee deserves to be considered favourable.

17. In the set aside proceedings, the AO/TPO needs to examine (i) total cost amounting to Rs 39.84 cr by analyzing the same considering the fixed cost and the others; (ii) needs to determine the exact period of unrest of the labour; (iii) needs to determine balkanization of the said unrest period ie the period of go slow approach of the labour and its adverse effect on the production of the carpets for the export and the period of nil production of the carpets for the export, etc. (iv) compare the economic activity of the company during these disturbed periods with that of the normal period of the year; (v) if fact the authorities may compare the operating profits of the company considering the external comparables ie prices that fall in the labour unrest and that fall in the normal period of the previous year as the AY registers both the periods; (vi) regarding the variable cost segment of the claimed overheads, there is need for examining the essentiality of the incurring of such expenditure considering the prudence of the management and the factors relating to the commercial expediency of the conducting of the business. TPO/AP shall pass a speaking order in this regard. AO/TPO is required to grant reasonable opportunity of being heard to the assessee in the set aside proceedings. Accordingly, the relevant grounds are **set aside**.

18. There are other grounds raised in the appeal relating to applicability of the provisions of section 10B of the Act, the applicability of the provisions of the proviso to section 93C(2) of the Act etc. On hearing the parties, we find these issues should go to the files of the AO as they are dependent on the outcome of

the key issues set aside above. AO is directed to pass a speaking in this regard too depending on the outcome in the set aside proceedings and also considering the plethora of judgments on the said proviso. Accordingly, the said grounds are **set aside** too.

19. In the result, the appeal of the assessee is allowed *pro tanto* for statistical purpose

Order pronounced in the court on 15th day of June, 2011.

Sd/-	**Sd/-**
(I C SUDHIR)	**(D.KARUNAKARA RAO)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Pune,
dated the 15th June, 2011
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Copy of the order is forwarded to:

1. Assessees as mentioned in the cause title
2. Dy.CIT, Cir 1(1), Pune.
3. DRP, Pune.
4. CIT concerned,
5. D.R. ITAT 'A' Bench, Pune.
6. Guard File

By order

Assistant Registrar
I.T.A.T Pune