IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES " F ", MUMBAI

BEFORE SHIRI R. S. PADVEKAR, J.M. AND
SHRI RAJENDRA SINGH, A.M.

ITA No. : 7646/Mum/2011
Assessment Year : 2007-08

M/s. Phoenix Mecano (India) Limited 306, Marol Bhavan, Makwana Road, Andheri(E), Mumbai-400 059. **PAN NO: AAACP 2452 L**	Vs.	Office of the D.C.I.T. Range 8(2), Aayakar Bhavan, Room no.216(A), M.K. Marg, Mumbai-400 020
(Appellant)		(Respondent)

Appellant by	:	Shri Sunil M. Lala, Shri Devang Shah & Shri Zeel Jambuwala
Respondent by	:	Shri Subachan Ram
Date of hearing	:	07.12.2011
Date of Pronouncement	:	23.12.2011

ORDER

Per RAJENDRA SINGH (AM) :

This appeal by the assessee is directed against the order dated 12.12.2010 of the AO passed in pursuance of direction of DRP. The dispute raised by the assessee relates to the additions on account of GP rate and transfer pricing adjustment.

2. The facts in brief are that the AO during the assessment proceedings noted that the assessee had done international

transactions with associated enterprises. The matter was, therefore, referred to the Transfer Pricing Officer (TPO), who following the TNMM method, computed the transfer pricing adjustment of ₹.8,52,70,976/-. The assessee raised objection before the DRP regarding the TP adjustments, but the same was rejected and the adjustment proposed by the AO on the basis of order of TPO was upheld. The AO, therefore, in the final order dated 21.02.2010 made addition of ₹.8,52,70,976/-, on account of TP adjustments. The AO also noted that the assessee for the relevant year had declared GP rate of 21.33% compared to 26.63% in the immediate preceding year. The assessee gave the following explanation for the fall in GP rate :-

> *"a) Phoenix Mecano India Limited had set up die casting plant in 2006 which resulted into increase in export sale by 133% over previous year which in turn resulted in increase in expenses mainly in material cost/manufacturing/ administrative/financial expenses.*
>
> *b) The gross profit ratio of the assessee has reduced in A.Y. 2007-08 as compared to A.Y. 2006-07 by approximately 5% was due to change in the proportion of trading and manufacturing activity.*
>
> *c) The gross profit ratio has reduced due to increase in material cost by approx 2% and manufacturing expenses by approx 3%.*
>
> *d) The increase in the material cost is due to fluctuation in exchange rate of EUROs.*
>
> *e) The major head contributing to increase in manufacturing cost is power and fuel, labour and wages, consumables. The assessee has taken a new connection from the Electricity Board, power and fuel had increased due to low capacity utilization and fixed cost remaining the same. The above factors have resulted in increase in expenses and low capacity utilization."*

3. The AO, however, observed that the explanation given by the assessee was not supported by concrete evidence. It was also observed by him that because of increase in sales, profit should have been higher. He did not accept the plea that fall in GP rate was due to the manufacturing activity. The plea of increase in material cost, manufacturing expenses as well as foreign exchange fluctuations was also not accepted. It was also observed by him that assessee had reduced the profits by manipulating transactions with the associate enterprises (AE). The AO, therefore, rejected the books of accounts and adopted the G.P. rate as that of the preceding year, which resulted into an addition of ₹.81,13,911/- to the total income. Aggrieved by the decision of the AO, the assessee is in appeal before the Tribunal.

4. Before us, the Ld. AR for the assessee argued that rejection of accounts by the AO was not justified, as there were no defects pointed out in the books of accounts. The AO had also not provided specific opportunity to substantiate the claim of increase in material cost and manufacturing expenses and the effect of foreign exchange fluctuation on the material cost. In any case, it was submitted that there being no defects in the books of accounts, no addition could be made on account of GP rate. As regards, the TP adjustments, the Ld. AR did not dispute the TNMM method followed by the AO. He, however, objected to the TP adjustment in respect of the entire sales, whereas it should have been only with respect to the international transactions with the AE. He placed reliance on the decision of Mumbai Bench of the Tribunal in the case of DCIT vs. M/s. Starlite (40 SOT 421) and several other decisions of Tribunal in support of the said proposition. The Ld. AR, referring to the decision of Mumbai Bench of the Tribunal in case of Emersons Process Management India Pvt. Ltd. vs. Add CIT

(2011-TII-102-ItAT-MUM-TP) also argued that in the pre 01.10.2009 position, the adjustment of 5% was to be allowed to the assessee, even in the cases where differences in value of international transactions and its ALP was more than 5%. It was also submitted that making addition to it on account of GP rate and TP adjustment, has resulted into double addition. It was, accordingly, requested that the addition made by the AO should be deleted and the matter may be referred back to the AO for fresh computation of income, in the light of decisions of Tribunal mentioned above. The Ld. DR on the other hand, placed reliance on the order of the AO.

5. We have perused the records and considered the rival contentions carefully. The dispute is regarding the addition on account of GP rate and TP adjustment made by the AO. In making TP adjustment, the AO has followed the TNMM method, about which there is no dispute. The dispute raised is only about not giving the benefit of 5% adjustment and making the adjustments in relation to the entire sales and not limiting to the transactions with the AE. The adjustments on account of transfer pricing are to be restricted only to the international transactions with the AE, and not to the entire turnover of the assessee as held by the Mumbai Bench of the Tribunal in case of DCIT vs. M/s. Starlite (supra) and in several other cases. Similarly, in the pre 01.10.2009 position, the benefit of 5% is to be allowed to the assessee, even in cases where difference in value of international transactions and its ALP is more than 5% as held by the Tribunal in case of Emersons Process Management India Pvt. Ltd. vs. Add CIT (supra) and in other cases. The computation made by the AO is, therefore, required to be reworked. As regards the GP rate, the AO made the addition only on the ground that the GP rate had fallen compared to the previous year and that the explanation given by the

assessee was not substantiated by evidence. The AO has not pointed out any defects in the books of accounts. In our view, in the absence of any defects, books of accounts cannot be rejected. In relation to international transactions with the AE, there is provision for separate TP adjustments, and merely because there is TP adjustment, entire books cannot be rejected in the absence of any defects. We also note that the assessee had explained the fall in GP rate due to increase in material cost and in manufacturing expenses and due to impact of foreign exchange fluctuations. The AO has written that the assessee could not file supporting evidences. However, we find that it is not clear from the assessment order, whether the AO called for any evidence in support of increase in material cost and manufacturing expenses. Further, while computing the GP rate for the year, for the purpose of comparison with the earlier year, the AO had not made any allowance for TP adjustments, which would also have impact on the GP rate and, therefore, making the additions on both the counts would result in double addition. The matter, in our view, requires fresh examination. We, therefore, set aside the order of the AO and restore the matter back to him for passing a fresh order after necessary examination in the light of observations made above and after allowing opportunity of hearing to the assessee.

6. In the result, the appeal of the assessee is allowed for statistical purpose.

Order pronounced on this 23rd day of December, 2011.

Sd/- Sd/-

(R. S. PADVEKAR)
JUDICIAL MEMBER

(RAJENDRA SINGH)
ACCOUNTANT MEMBER

MUMBAI, Dt: 23.12.2011

Copy forwarded to :

1. The Appellant,
2. The Respondent,
3. The C.I.T.
4. CIT (A)
5. The DR, F - Bench, ITAT, Mumbai

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BY ORDER

ASSISTANT REGISTRAR
ITAT, Mumbai Benches, Mumbai

Roshani