

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "K" MUMBAI**

BEFORE SHRI I.P. BANSAL, JUDICIAL MEMBER

AND

SHRI RAJENDRA SINGH, ACCOUNTANT MEMBER

ITA No. 6839/Mum/2012
Assessment Year 2008-09

M/s. S. Narendra, 403, Mehta Bhavan, 311, Charni Road, Mumbai – 400 004. PAN: AAAPS 2994 P	Vs.	Addl. Commissioner of Income Tax – 16(3), Matru Mandir, Tardeo, Mumbai.
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(Appellant)

(Respondent)

Appellant by : Mrs. Aarti Visanji
Respondent by : Shri Ajeet Kumar Jain

Date of hearing : 05-02-2013
Date of pronouncement : 08-02-2013

ORDER

PER I.P. BANSAL, J.M.

This appeal is filed by this assessee. It is directed against the Assessment Order dt. 5th October 2012 passed u/s. 143(3) r.w.s. 144C of the Income Tax Act, 1961 (Act). Assessment Order has been passed in pursuance of directions of Dispute Resolution Panel (DRP) given vide its order dt. 13th August, 2012. A copy of which has been placed on record.

2. This is a stay granted matter. The stay was granted by the Tribunal vide its order on 14th day of December 2012 on the condition for making total payment of Rs. 25 Lakhs in two installments. The assessee has complied with the conditions of the stay and has

furnished the proof regarding the payments. Accordingly, we proceed to decide the present appeal after hearing both the parties.

3. The assessee has entered into the following international transactions with its Associate Enterprise (AE).

S.No.	Name and Address of AE	Nature of Transaction	Qty (In Cts)	Amount in Rs.
1.	M/s. Sauraj Diamonds NV 348, 2-Hovenierstraat B-2018, Antwerp, Belgium	Import of Rough Diamonds	1,32,564.76	53,91,66,956
2.	M/s. Sauraj Diamonds NV 348, 2-Hovenierstraat B-2018, Antwerp, Belgium	Import of Polished Diamonds	1,608.21	1,74,25,842
3.	M/s. Sauraj Diamonds NV 348, 2-Hovenierstraat B-2018, Antwerp, Belgium	Export of Polished Diamonds	11,725.22	23,10,55,520

The matter was referred to Transfer Pricing Officer (TPO) who has computed the adjustment of Rs. 3,19,55,004/- vide his order dt. 25th October 2011. It was the case of the assessee that its margin should be determined after taking into consideration the gain on foreign exchange amounting to Rs. 3,36,36,765/-. However, TPO did not accept such contention of the assessee and has computed the transaction profit of the assessee at Rs. 75,71,025/- as per the following table:

Operating Income:		Rs.
Net Sales as per P&L A/c		65,87,67,157
COGS (O.S. + Purchases – C.S)		58,73,57,330
Other direct & indirect costs	65440750	6,38,38,802
Less non op exp:		
Donations	-1525001	
Other provisions and write offs	-76947	
Transaction exp.		65,11,96,132
Transaction Profit		75,71,025
TP/NS		1.15%
TP/TE		1.16%
O.S. = opening stock, C.S. = cls. stock		

The assessee in the TP study had bench marked its international transactions with AE on TNMM basis for which assessee had selected 5 comparables and had worked out mean average margin at 1.62% as against net margin of assessee at 3.36% and thus it was contended that international transactions of the assessee with his AE are at arm's length. However, Ld. AO did not accept such submission of the assessee and searched out 11 comparables which are listed in para 4.3 of the order of the TPO. However, after considering the submissions of the assessee, Ld. TPO has short-listed 7 comparables whose mean margin on OP/OC and OP/Net Sales is computed at 6% and 5.58% respectively. While computing the mean margin of comparables under sale price, the short-fall in profit was computed by TPO at Rs. 2,87,65,719/- and while computing mean margin of purchase price, difference is computed at Rs. 3,19,55,004/-. Sum of Rs. 3,19,55,004/- being the higher one and favourable to Revenue has been taken for the purpose of the making impugned adjustment.

4. It may also be mentioned here that assessee is engaged in the business of cutting and polishing of diamonds and selling the manufactured products in India and abroad. Ld. TPO has rejected the contention of the assessee that gain on account of exchange fluctuation amounting to Rs. 3.36 Crores should be included and considered as part of 'Operating Income', on the ground that the same is not realised value of the transaction but only the recognized value and the gain is arising out of hedging transaction, therefore, speculative in nature. Despite these observations which are made in respect of submission of the assessee vide letter dt. 20th September 2011, the assessee again submitted before him vide letter dt. 10th October 2011 that in some of the comparable used by the department, foreign exchange gain was considered but that was not explicitly mentioned and it was submitted that to bring parity the foreign exchange gain in the case of assessee should also be included in the

profit. Ld. TPO has accepted such contention of the assessee that can be seen from the following observations of the TPO.

Further on 10-10-2011, the assessee submitted detailed working and explained that some of the comparables used by the Department actually had foreign exchange gain but these gains were not explicitly mentioned but were included in sales or purchase. **The assessee asked for parity. The assessee asked that since it was not possible to ascertain foreign exchange gain/loss on all the comparables, the same should be included in assessee as well as comparables. This submission of the assessee was found factually correct and therefore was accepted and comparables were re-drawn including foreign exchange gain/loss which is as under:** (emphasis ours)

Company Long Name	OP/OC %	OP/Net Sales %
1.C Mahendra Exports Ltd	6.79%	6.36%
2.Dimexon Diamonds Ltd	8.89%	8.17%
3.Goenka Diamonds & Jewels Ltd	9.64%	8.79%
4.Mohit Diamonds Pvt Ltd	4.45%	4.26%
5.SB&T International Ltd	7.08%	6.61%
6.Suashish Diamonds Ltd	-0.57%	-0.57%
7.Zodiac-JRD-MKJ Ltd	5.75%	5.44%
	6.00%	5.58%

The assessee requested invoking + / -5% in its favour. The same is analysed as under:

Assessee's sale price	231,055,520
ALP profit for assessee on cost	36,336,744
Actual profit of assessee	7,571,025
Shortfall in profit	28,765,719
ALP sale price	259,821,239
95% of assessee's sale price	246,830,177
Conclusion: No benefit of 92C(2)	
Assessee's purchase price	556,592,798
ALP profit for assessee on sale	39,526,029
Actual profit of assessee	7,571,025
Shortfall in profit	31,955,004
ALP purchase price	524,637,794
105% of purchase price	550,869,683
Conclusion: No benefit of 92C(2)	

Conclusion: Thus, transfer of profit is evidenced from both sale transaction and purchase transaction. Adjustment worked out in case of sale transaction is Rs. 28,765,719/-. Adjustment worked out in case of purchase transaction is Rs. 31,955,004/-. In the interest of revenue higher figure of adjustment is taken. Total adjustment is therefore Rs. 31,955,004/-.

In view of this, an adjustment of Rs. 31,955,004/- is made to the international transaction of the assessee.

5. It can be seen from the afore-mentioned two tables on the basis of which adjustment has been made by the TPO that he has taken the actual profit of the assessee at Rs. 75,71,025/- which is excluding the foreign exchange of Rs. 3,36,36,765/-. If the said sum is included in computing the margin of the assessee then no addition would remain and the international transactions of the assessee with his associate enterprises will be at arm's length even according to the version of the TPO which has already been reproduced. In case foreign exchange is included in the Operating profit then the actual profit of the assessee will be a sum of Rs. 4,12,07,790/- (Rs. 75,71,025 taken by TPO + 3,36,36,765/- foreign exchange gain). Thus, operating profit of Rs. 4,12,07,790/- is greater than the Arm Length Profit computed by the TPO either on sale price at Rs. 3,63,36,744/- or on Purchase Price at Rs. 3,95,26,029/-.

Therefore, the pertinent question to decide in the present appeal is that whether or not foreign exchange gain should be included in the profits for computing the margin of the assessee to compare the same with the margin of comparable parities. If it is held that foreign exchange gain is to be included for the purpose of computing Operating Profit of the assessee then the other issues raised and discussed will become infructuous and academic.

6. To bring more clarity on facts, it may also be mentioned here that though initially the assessee in his TP Report has computed his margin at 3.36% but later on the margin of the assessee has been computed at 6.26 and 6.67% on OP/Sales and OP/OCs. The margin computed by the TPO of the assessee and the margin re-computed by the assessee are stated in the following table:

Operating Profit as Computed by the learned TPO

Name of Company	OP/OC	OP/SALES (As per TPO)
C Mahendra Exports Ltd	6.79%	6.36%
Dimexon Diamonds Ltd	8.89%	8.17%
Goenka diamond & Jewel Ltd	9.64%	8.79%
Mohit Diamonds Pvt Ltd	4.45%	4.26%
SB&T International Ltd	7.08%	6.61%
Suashish Diamonds Ltd	-0.57%	-0.57%
Zodiac-JRD-MKJ Ltd	5.75%	5.44%

6.00%**5.58%**

Assessee

1.16%**1.15%****Operating Profit of the assessee (Including Exchange Difference)**

Net Sales		658,767,157
Operating Profit as per TPO	7,571,025	
Add: Exchange Gain	33,636,765	

Operating Profit – Including Exchange Gain		41,207,790
Operating Cost		617,559,367
OP/Sales (in %)		6.26%
OP/OC (in %)		6.67%

Initially, the assessee had reduced interest and depreciation from operating profits, therefore, the margin was computed at 3.36%. During the course of hearing it was also observed that while taking the cases of the comparables, interest and depreciation were reduced from the Operating Cost and, therefore, computation of margin in the case of assessee by excluding interest and appreciation is in accordance with the treatment given to the comparables.

7. It may also be mentioned here with though the assessee had filed the detailed objections before DRP regarding the adjustment computed by TPO, however, Ld. DRP has confirmed the findings of AO without any variation. The assessee is aggrieved by such order of DRP

in pursuance of which impugned assessment has been framed and has raised the following Grounds of Appeal:

1.The learned Addl. Commissioner of Income tax 16(3) has erred in making an addition of Rs. 3,19,55,004/- in Assessment Order passed u/s. 143(3) r.w.s. 144C of the Income tax Act, 1961 based on order passed by the Additional Commissioner of Income tax Transfer Pricing II (4) proposing addition of Rs. 3,19,55,004/- u/s. 92C(4) r.w.s. 92CA(4) which has been confirmed by order passed by Hon'ble Dispute Resolution Panel II (Mumbai); inter alia dismissing the following grounds of objections;

-Not considering exchange difference on import and export as a part of operating profit.

-Not considering miscellaneous expenses as operating items for computing operating profit of comparable selected for comparison.

-Not considering following factors for selection of comparables;

- o Turnover*
- o Assets Employed*
- o Risk Undertaken*
- o Functions performed*
- o Source of Purchase of Rough Diamonds*

-Making adjustment on total turnover of the appellant instead of AE transactions only

After narrating the facts, it was submitted by the Ld. Authorised Representative (AR) that the issue that whether or not gain on foreign exchange should be considered as part of profit for computing Arm Length Price (ALP) is no more res-integra as this proposition is well settled by the following decisions of the Tribunal:

Sap Labs India Vs. ACIT (44 SOT 156)

Where in vide para 42 of the order it has been held that foreign exchange fluctuation gain is nothing but an integral part of the sale proceeds of an assessee. Following observations of the Tribunal from the said decision are re-produced below:

We considered the issue carefully. The foreign exchange fluctuation gains is nothing but an integral part of the sales proceeds of an assessee carrying on export business. This proposition has been time and again considered in cases arising in the context of s. 80HHC. The Court and the Tribunals have held that foreign exchange fluctuation

gains from part of the sale proceeds of exporter-assessee. Useful reference may be made to the decisions of the Bombay High Court in the case of Shah Brothers vs. CIT (2003) 180 CTR (Bom) 287; (2003) 259 ITR 741 (Bom); that of the Gujarat High Court in the case of CIT vs. Amba Impex (2006) 201 CTR vs. Prakash I. Shah (2008) 118 TTJ (Mumbai) (SB) 577; (2008) 13 DTR (Mumbai) (SB)(Trib) 353; (2008) 306 ITR 1 (Mumbai)(SB)(AT). In all the above cases, the dominant question considered was the year of deduction on the accepted proposition that the foreign exchange fluctuation gains computed by an assessee in a relevant previous year should be treated as part of the operating income and thereby it would contribute to the operating margin of the assessee-company. The foreign exchange fluctuations income cannot be excluded from the computation of the operating margin of the assessee-company. This contention of the assessee is accepted.

She submitted that aforesaid decision has been consistently followed by the Tribunal in the following decisions:

1. M/s. Four Soft Ltd. Vs. Dy.CIT order dt. 9th September 2011 (ITA No. 1495/HYD/10) copy of the order placed at 270-292 of the Paper Book wherein by following the observations, such proposition was accepted.

With regard to the exclusion of gain on account of foreign exchange fluctuation while computing the net margin, as claimed by the assessee, we find that the exchange fluctuation gains arise out of several factors, for instance, realization of export proceeds at higher rate, import dues payable at lower rate. Since the gain or loss on account of exchange rate fluctuation arises in the normal course of business transaction, the same should be considered while computing the net margin for the international transactions with the associated enterprises of the assessee. Our view in this behalf is fortified by the decisions of the Bangalore Bench of the Tribunal in the case of SAP Labs India Ltd., (supra) and Bombay bench of the Tribunal in the case of Deutsche Bank A.G. Vs. Dy.CIT reported in 86 ITD 431. If the gain on account of foreign exchange rate fluctuations is to be taken as operating gain in nature, the net margin declared by the assessee for the international transactions with the associated enterprises, goes up still further. Hence, considering both the above two factors, there is no justification for any adjustment to the price declared by the assessee, since the assessee's margin would fall within the Arms Length range. We therefore, hold that no adjustment is required to be made on the margin declared by the assessee for the international transaction of the associated enterprises in relation to software development services. We direct accordingly.

2. Trilogy E Business Software India P. Ltd., Vs. Dy.CIT (47 SOT 45) (Bangalore) URO

Wherein similar proposition was accepted with the following observations. Copy placed on record and given to the Ld. DR

With regard to computation of margins of the assessee under 'Foreign Exchange Gain' we find that an identical issue had cropped up before the earlier Bench wherein the Hon'ble Bench in the case of SAP LABS INDIA PVT. LTD., Vs. ACIT referred supra had held that the foreign exchange gain needs to be considered as being operating in nature while determining arm's length price. In conformity with the said finding, we decide the issue in favour of the assessee

3. Order dt. 23-01-2013 in ITA No. 7148/Mum/2012 Sumit Diamond India P. Ltd., Vs. Addl. CIT.

The issue was considered as per the following observations:

16. According to the AR, gains on foreign exchange fluctuation is purely incidental to the business of the assessee, therefore, its exclusion was uncalled for. According to the AR, if this item is included, for the purposes of computing operating margin/adjustment, as proposed and done by the TPO, adjustment shall become inconsequential. He referred to the case of Saps Labs India Pvt. Ltd., ITA no. 398/Bang/2008, wherein the coordinate Bench held that the foreign exchange fluctuation gain is nothing but an integral part of the sale proceeds of an assessee carrying on export business.

17. The AR also submitted that the finance charges were rightly excluded by the TPO from operating cost. He, however, emphasized on non exclusion of discounting charges from the total operating cost, as it was emphasized that discounting charges are not part and parcel of overall finance charges. The AR, therefore, concluded that no adjustment for required for arriving at the ALP.

18. The DR on the other hand objected to the arguments taken by the AR with regard to inclusion of foreign exchange fluctuation gains towards revenues and exclusion of discount charges for the purposes of computing OP/OC. He referred to the case of coordinate Bench in the cases of DA Jhaveri, ITA no. 5161/Mum/2007 and DHL Express (India) Pvt. Ltd. ITA no. 7360/Mum/2010, wherein the Mumbai Bench of the ITAT had held that profit/loss on foreign exchange fluctuation does not form part of the operational income. In DA Jhaveri (supra), it was held that exchange difference loss was required to be reduced and to be taken as non operating expenses. The DR explained the rationale behind the observations made by the Mumbai Benches for exclusion was, that there could be the possibilities that the gain or loss on foreign exchange may be due to hedging transactions or other receipts, which are incapable of being taken for the purposes of computing operating income. The DR, therefore, concluded that exclusion of foreign exchange fluctuation gains for computing the correct ALP was very much in line with the decisions of the coordinate benches at Mumbai. He also vehemently argued with respect to the exclusion of discount charges

from the total financial charges for the purposes of reduction from the operating cost.

19. We have heard the arguments from either side and after referring to the details as placed in the APB, we are of the considered opinion that the AO/TPO were not justified in excluding gain on foreign exchange fluctuation from the total revenues, as held by the decision of Saps Labs (supra). The Special Bench in the case of ACIT Vs Prakash I Shah, ITA No. 6349/Mum/2004 (where one of us a party), reported in 115ITD 167, it was held, "Foreign exchange fluctuation gain is a part and parcel of export turnover for the purposes of section 80HHC....". Since the issue of foreign exchange fluctuation being part of operations has been laid at rest and since there are neither any contrary decision nor any reference to the High Court, we are inclined to accept the arguments of the assessee on this issue and observe that we cannot take into consideration the decisions referred to by the DR.

8. Copy of all these decisions were placed on record and also was given to Ld. DR. Ld.AR further submitted that though TPO has accepted that to bring the case of the assessee at parity with the comparables on inclusion of gain on foreign exchange in the Operative Profit, but while computing the profit margin of the assessee, he has excluded the gain on foreign exchange. Thus, she pointed out that there is a contradiction in the stand taken by TPO. She submitted that assessment made by the TPO is contrary to facts and law and addition made on this account should be deleted. She submitted that the second issue raised by the assessee is regarding 'Miscellaneous Expenditure' for the purpose of computing the margin and if main issue is decided in favour of the assessee, then the second issue will have no impact as the assessee's profit will be in accordance with ALP profit determined by the TPO.

9. On the other hand, Ld. DR submitted that TPO has specifically excluded gain on foreign exchange to compute the margin of the assessee. The gain on foreign exchange is with respect to hedging transactions and therefore speculative in nature. To contradict the contention of the Ld. AR regarding inclusion of gain on foreign exchange, Ld. DR relied upon the submissions made by the Department in the case of Smit Diamonds Vs. Addl. CIT (Supra) which

have already been re-produced while re-producing the observations of ITAT in the above order. Thus, it was submitted by the Ld. DR that the main issue to be decided in the present appeal is that whether or not the foreign exchange gain of the assessee should be included in the profits for the purpose of computing margin of the assessee.

10. In the re-joinder, Ld. AR submitted that the details regarding foreign exchange gain were submitted and summary of which as submitted before DRP is as under:

	Amount in Rs.	Page Nos.
Exchange difference (hedging transaction)	14,56,345	241 & 245
Exchange difference (other than hedging transaction)	3,21,80,420	--
Total:	3,36,36,765	90

Referring to the above table, it was submitted by her that major exchange difference is on account of non-hedging transactions. She contended that even hedging transactions cannot be treated as speculative as they are just to cover the anticipated loss which may be suffered by the assessee on account of fluctuation in foreign exchange. These transactions are also with regard to the sale and purchases conducted by the assessee and is thus in the nature of trade.

11. We have carefully considered the rival submissions in the light of material placed before us. The proposition that gain on foreign exchange if it relates to the business of the assessee is part and parcel of operating income is well established by the afore-mentioned decisions of the coordinate benches. In the present case, nothing has been brought on record to suggest that the gain made by the assessee on fluctuation of foreign exchange was not on account of business transactions of the assessee. In absence of any such material, following the afore-mentioned decisions of the Tribunal, it has to be held that the foreign exchange gain of the assessee is to be considered as part and parcel of the profit of the assessee and therefore should be

included for the purpose of computing the profit margin of the assessee. Moreover, Ld. TPO has clearly observed that to bring parity of the comparables with the assessee, foreign exchange gain is included as well in the case of comparables and after including such gain of the comparables, he has re-worked the margin of the comparable entities. However, while computing the margin of the assessee, TPO ignored the gain of the assessee on foreign exchange. Therefore, the adjustment computed by the TPO is contrary to his observations. If the gain on foreign exchange is included, then there is no short-fall in the arm length price determined by the TPO. The computation has already been made after including such gain and it has been seen that there is no short-fall in the profits of the assessee as compared to the arm length price profit determined by the TPO.

12. In view of the above discussion, we found that the adjustment made by the TPO and upheld by DRP deserves to be deleted. As the addition itself is deleted, the other issues raised by the assessee in his appeal have become academic and need no adjudication.

Appeal filed by the assessee is allowed in the manner aforesaid.

Order pronounced in the open court on 8th February, 2013

Sd/-
(RAJENDRA SINGH)
ACCOUNTANT MEMBER

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

Mumbai,
Date: 08-02-2013

Copy to:

1. Appellant
2. Respondent
3. The concerned CIT (A)
4. The concerned CIT
5. DR "K" Bench, ITAT, Mumbai
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(True copy)

By Order

Asst. Registrar,
Income Tax Appellate Tribunal,
Mumbai Benches, Mumbai