

IN THE INCOME TAX APPELLATE TRIBUNAL "K" BENCH, MUMBAI

**BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND
SHRI N.K.BILLAIYA, ACCOUNTANT MEMBER**

ITA NO.6570/Mum/2012
Assessment year: - 2008-09

M/s Goldstar Jewellery Limited. Unit No. IIIA, I Goldstar House, Block C, Plot No. 16(P), 17, 28, SEEPZ-SEZ, Andheri (East) Mumbai – 400 096.	Vs. `	Joint Commissioner of Income Tax (OSD) 8(1), Mumbai.
PAN:- AAACG3264B		
Appellant		Respondent

Assessee By	Shri Alok Saksena
Revenue By	Shri. N.K. Chand

Date of hearing	26.11.2014
Date of pronouncement	14.01.2015

ORDER

Per Vijay Pal Rao, JM

This appeal by the assessee is directed against the assessment order passed u/s 143(3) r.w.s 144C(13) of the Income Tax Act in pursuant to the directions of DRP dated 4.9.2012 passed u/s 144C(5) of the Income Tax Act for A.Y. 2008-09. The assessee has raised following grounds in this appeal:-

- 1) *The Ld. Assessing Officer/TPO/DRP erred in law, facts and circumstances of the cases by considering "Continuing debit balance" with associate enterprise as an "international transactions".*
- 2) *The Ld. Assessing Officer/TPO/DRP erred in law, facts and circumstances of the cases by holding that the extended credit period*

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allowed to the AE amounted to the short term funding granted to them without interest which is to be considered as an international transaction.

- 3) *The Id. Assessing Officer/TPO/DRP erred in law, facts and circumstances of the case by adopting the rate of interest @ 18.816% (ultimately considered @7%) on outstanding amounts from Associate Enterprises.*
- 4) *The Ld. Assessing Officer erred in the facts and in law in levying of interest u/s 234B & 234C of the Income Tax Act 1961."*

2. Ground nos. 1 to 3 are regarding adjustment of notional interest on account of extended credit period allowed to the AE.

3. The Transfer Pricing Officer (TPO) noted that average collection period of the assessee from its AE is 351 days and 332 days in case of manufacturing of Jewellery unit and Diamond Trading unit respectively. The assessee also furnished the details of average credit realization period from the Non-AEs. The TPO noted that the average realization period from non -AE is 125 days and 209 days in case of Manufacturing of Jewellery unit and Diamond trading unit respectively. Thus the TPO found that there is a delay of 226 days and 123 days in case of Manufacturing of Jewellery unit and Diamond Trading unit respectively in realization of dues from AE in comparison to non-AEs. The TPO observed that the AE of the assessee is getting the benefit of making the late payment to the assessee and the benefit is given to the AE. Assessee has borrowed funds from from the financial institution on which it is bearing the interest cost for which no remuneration is being charged to the AE. Accordingly, the TPO proposed the adjustment of Rs. 2,49,95,139/- on account of delay in realization from AE by applying interest at the rate of 18.816% as arm's length interest .

4. Before the DRP, the assessee has contended that a continuing debit balance or amount outstanding from the AE on account of delayed realization does not amount to an international transaction but it is infact the result of another international transaction, namely, export that has been entered into by the assessee. The assessee relied upon the decision of this Tribunal in the case of Nimbus Commuincations Ltd. (43 SOT 695). The delay in realization occurred due to the bad economic condition of US market in those days where the AE of the assessee was located, no financial or another benefit was made available to the AE. Alternatively, the assessee contended that the assessee obtained the loan in the form of packing credit which is a pre-shipment loan for exports and post-shipment finance. The loans are sanctioned in Indian rupee but are mainly availed of in equivalent foreign exchange. The interest on these loans by the bank is on the basis of six months LIBOR varies between LIBOR plus 1% to LIBOR plus 2%. Thus the assessee submitted that the working of six month LIBOR was 4.701%. The DRP did not accept the contention of the assessee and held that due to the retrospective amendment in section 92B by the Finance Act 2012 w.e.f A.Y. 2002-03 makes it clear that such a receivable will amount to an international transaction. However, the DRP has modified the adjustment by reducing the interest rate to 7% instead of 18.816% applied by the TPO.

5. Before us, the Ld. Authorized Representative of the assessee has reiterated its contention as before the authorities below and submitted that the extension of credit period to the AE on realization of sale proceeds is not a separate international transaction but it is arising from

the international transaction of sale to the AE. He has further contended that the assessee does not charge interest either from the AE or from non- AE for the credit period in realization of sale proceeds, therefore, the outstanding amount from the AE on account of continuing debit balance for the goods supplied in normal course of business is not an international transaction. When the revenue is recognized only on the basis of mercantile method of accounting then it is not necessary that the payment is to be made as soon as it becomes due. It is not a loan or borrowing which is an independent transaction and can be examined for the purpose of arm's length price on stand alone basis. The transaction is only the result of the main international transaction. Thus he has submitted that it is the policy of the assessee not to charge the interest on the credit period or delay in realization of the sale proceeds. In support of his contention he has relied upon the decision of Hon'ble Jurisdictional High Court in the case of **CIT Vs. Indo American Jewellery Ltd. (2014) 4 taxmann.com 310** and submitted that the Hon'ble High Court upheld the finding of the Tribunal holding that interest income is associated only with the lending or borrowing of money and not in case of sale and there is a complete uniformity in the act of the assessee in not charging interest from both the AE and non AE debtors. The Ld. Authorized Representative has also filed the details of sales to the AE and non AE as well as the average collection period from AE and non AE. He has submitted that the sale to the AE is 18% of the total sale of the assessee, therefore, the average collection period is more in case of the AE than non AE, the same would not affect any benefit to the AE because the 82% of the sale is to non AE. Alternatively the Ld. Authorized Representative has submitted that the arm's length interest

rate in respect of the average period allowed for realization from the AE should not be more than the cost of fund of the assessee. He has submitted that the assessee is charged interest on foreign debts at the LIBOR plus 2.5%.

6. On the other hand, the Ld. DR has contended that there is no contention of the assessee before the TPO that it is an uniform policy of the assessee not charging interest from AE as well as non AE in respect of realization of sales proceeds. He has referred the amendment in explanation to section 92B and submitted that the deferred payment/receivable falls under the definition of international transaction. He has also referred the memorandum of Finance Bill 2012, whereby the explanation to section 92B has been inserted and submitted that definition of term international transaction has been extended and includes the capital financing long term or short term borrowing, lending or guarantee, purchase or sale of mercantile securities or any type of advance or deferred bills or receivables any other debts arising during the course of business. Thus the Ld. DR has submitted that the deferred payment or receivable of debt arising during the course of business is covered under the expression international transaction as per clause C of explanation to section 92B. In support of his contention he has relied upon the decision of Bangalore benches of this Tribunal in the case of **Logix Micro Systems Ltd Vs. ACIT (42 SOT 525)**. Thus the Ld. DR has submitted that after insertion of explanation to section 92B, the decision relied upon by the assessee in the case of *Nimbus Communications Ltd.* (Supra) as well as *Indo American Jewellery Ltd.* (supra) become irrelevant. In support of his contention he has relied upon the decision

of Hon'ble High Court in the case **CIT Vs. Patni Computers System Ltd. (33 taxmann.com 3)** and submitted that the Hon'ble High Court has remitted an identical issue to the Tribunal by taking into consideration the amendment to section 92B(1) by the Finance Act 2012 w.r.e.f. 01.04.2002. The Ld. DR has further contended that as per the terms of agreement between the parties, the credit period is allowed only for 150 days but the TPO has allowed 180 days which is more than the period agreed between the parties.

7. In rebuttal, the Ld. Authorized Representative has submitted that only 13% of the total outstanding was realizable from the AE whereas the 87% from the non AE. Further the assessee is availing the credit from the creditors which in turn allowed to the debtors.

8. We have considered the rival submissions and relevant material on record. The assessee has reported international transaction in its TP report regarding sale to its AE from manufacture of jewellery units and diamond trading unit. The TPO accepted the price charged by the assessee from AE at arm's length. However, the TPO has made the adjustment on account of notional interest for the excess period allowed by the assessee to AE for realization of dues. The TPO applied 18.816% per annum as arm's length on the over due amounts of AE and proposed adjustment of Rs. 2,49,95,139/-. The DRP though concurred with the view of the Assessing Officer/TPO on the issue of international transaction, however, the adjustment was reduced by applying the interest rate of 7% instead of 18.816% applied by the TPO. The first issue raised by the assessee is whether the aggregate period extended by

the assessee to the AE which is more than the average credit period extended to the non-AE would constitute international transaction. We are of the view that after the insertion of explanation to section 92B(1), the payment or deferred payment or receivable or any debt arising during the course of business fall under the expression international transaction as per explanation. Therefore, in view of the expanded meaning of the international transaction as contemplated under clause (i) (e) of explanation to section 92B(1), the delay in realization of dues from the AE in comparison to non-AE would certainly falls in the ambit of international transaction. However, this transaction of allowing the credit period to AE on realization of sale proceeds is not an independent international transaction but it is a closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the party depends upon various factors which also includes the price charged by the assessee from purchaser. Therefore, the credit period extended by the assessee to the AE cannot be examined independently but has to be considered along with the main international transaction being sale to the AE. As per Rule 10A(d) if a number of transactions are closely linked or continuous in nature and arising from a continuous transactions of supply of amenity or services the transactions is treated as closely linked transactions for the purpose of transfer pricing and, therefore, the aggregate and clubbing of closely linked transaction are permitted under said rule. This concept of aggregation of the transaction which is closely linked is also supported by OECD transfer pricing guidelines. In order to examine whether the number of transactions are closely linked or continuous so as to aggregate for the purpose of evaluation what is to be considered is that

one transaction is follow-on of the earlier transaction and then the subsequent transaction is carried out and dependent wholly or substantially on the earlier transaction. In other words, if two transactions are so closely linked that determination of price of one transaction is dependent on the other transaction then for the purpose of determining the ALP, the closely linked transaction should be aggregated and clubbed together. When the transaction are influenced by each other and particularly in determining the price and profit involved in the transactions then those transactions can safely be regarded as closely linked transactions. In the case in hand the credit period extended to the AE is a direct result of sale transaction. Therefore no question of credit period allowed to the AE for realization of sale proceeds without having sale to AE. The credit period extended to the AE cannot be treated as a transaction stand alone without considering the main transaction of sale. The sale price of the product or service determined between the parties is always influenced by the credit period allowed by the seller. Therefore, the transaction of sale to the AE and credit period allowed in realization of sale proceeds are closely linked as they are inter linked and the terms and conditions of sale as well as the price are determined based on the totality of the transaction and not on individual and separate transaction. The approach of the TPO and DRP in analyzing the credit period allowed by the assessee to the AE without considering the main international transaction being sale to the AE will give distorted result by disregarding the price charged by the assessee from AE. Though extra period allowed for realization of sale proceeds from the AE is an international transaction, however, for the purpose of determining the ALP, the same has to be clubbed or aggregated with the sale

transactions with the AE. Even by considering it as an independent transaction the same has to be compared with the internal CUP available in the shape of the credit allowed by the assessee to non AE. When the assessee is not making any difference for not charging the interest from AE as well as non-AE then the only difference between the two can be considered is the average period allowed along with outstanding amount. If the average period multiplied by the outstanding amount of the AE is at arm's length in comparison to the average period of realization and multiplied by the outstanding from non AEs then no adjustment can be made being the transaction is at arm's length. The third aspect of the issue is that the arm's length interest for making the adjustment. Both the TPO and DRP has taken into consideration the lending rates, however, this is not a transaction of loan or advance to the AE but it is only an excess period allowed for realization of sales proceeds from the AE. Therefore, the arm's length interest in any case would be the average cost of the total fund available to the assessee and not the rate at which a loan is available. Accordingly, we direct the Assessing Officer/TPO to re-do the exercise of determination of ALP in terms of above observation.

9. Ground No. 4 is regarding levy of interest u/s 234B and 234C.
10. This ground is consequential in nature and, therefore, no separate finding is required on this issue.

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11. Ground no. 5 is regarding initiation of penalty proceedings u/s 271(1)(c). This ground is premature and not arising from the impugned orders of the authorities below. Accordingly the same is dismissed.

12. In the result appeal of the assessee is partly allowed for statistical purpose.

Order pronounced in the open court on this 14.01.2015

Sd/-

Sd/-

(N.K. Billaiya)
(Accountant Member)

(Vijay Pal Rao)
(Judicial Member)

Mumbai dated
SKS Sr. P.S,

Copy to:

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

By Order

Assistant Registrar
Income Tax Appellate Tribunal,
Mumbai Benches, MUMBAI