

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I' NEW DELHI

BEFORE SHRI S.V. MEHROTRA, ACCOUNTANT MEMBER
AND
SHRI CHANDRA MOHAN GARG, JUDICIAL MEMBER

I.T.A.No.882/Del/2014
Assessment Year : 2009-10

Bechtel India Pvt. Ltd., vs DCIT,
418, Naurang House, Circle-2(1),
21, K.G. Marg, New Delhi.

(PAN: AAACB0298A)

(Appellant)

(Respondent)

Appellant by: S/Shri S.D. Kalipa, R.R.Maurya, Praveen Sharma,
Sanjay Kumar, Advocates

Respondent by : S/Shri Ravi Jain, CIT DR, Subhakant Sahoo, Sr. DR

Date of last hearing: 12.10.2015

Date of pronouncement: 14.10.2015

ORDER

PER CHANDRAMOHAN GARG, J.M.

This appeal by the assessee has been preferred against the order of DCIT, Circle 2(1), New Delhi dated 6.1.2014 passed u/s 143(3) r/w section 144C of the Income Tax Act, 1961 (for short the Act) in pursuance to the directions of the Dispute Resolution Panel-I (DRP), New Delhi dated 26.11.2013 u/s 144C(5) of the Act for AY 2009-10.

2. In the beginning of the argument, Id. Counsel appearing for the assessee submitted that the assessee does not want to press ground no. 1, 2, 3.6, 3.7, 3.8

and 4, therefore, we dismiss the same as not pressed. Remaining grounds for adjudication read as under:-

“3. That on facts and circumstances of the case and in law, the Ld. AO/Ld. TPO/Ld. Dispute Resolution Panel ("DRP") erred in making an addition of Rs. 57,46,70,024/- to the returned income of the Appellant by re-computing the arm's length price of the international transactions under section 92 of the Act. Thus, in passing the order, the Ld. AO/Ld. TPO/Ld. DRP erred in:

3.1 Rejecting the comparable companies set adopted by the Appellant in its transfer pricing documentation on the basis of additional/modified quantitative filters which lacked valid and sufficient reasoning.

3.2 Ignoring the comparable set proposed by Appellant as a result of fresh benchmarking study without assigning any reasoning.

3.3 Accepting companies which were functionally not comparable to the Appellant in terms of Functions, Assets and Risk profile.

3.4 Including companies with high/supernormal margins in the comparable set adopted.

3.5. Including government held enterprises in the final comparable set adopted.

3.6 Not providing the benefit of economic adjustment on account of difference in working capital profile and thus not following the binding directions of Hon'ble DRP.

3.7 Denied the benefit of economic adjustments on account of difference in risk profile in arriving at the arm's length mean margin.

3.8 Considered reimbursements as part of the operating cost and recomputed the profit margin of the Appellant. Further, the Ld. TPO did not follow a consistent approach by not considering reimbursement received as part of operating revenue on the same principle. Further, the Ld. DRP has not given its directions against the specific plea raised by the Appellant on the said issue.

5. That in the facts and circumstances of the case and in law, the Ld. AO erred in disallowing the loss of INR 21,80,46,325/- incurred by the assessee on re-measuring the foreign exchange forward contract i.e. 'Mark to Market Losses' as on balance sheet date.

5.1 That the Ld. AO erred in holding that the Mark to Market losses in respect of re-measuring the foreign exchange forward contract as on balance sheet date are notional and contingent in nature.

5.2 That the Ld. AO erred in placing reliance on Instruction No. 3/2010 dated 23 March 2010 issued by the Central Board of Direct Taxes, as this instruction is issued with respect to assessee trading in forex-derivatives. Also, the instruction is issued after the year under consideration. Thus, accordingly the same is not applicable to the assessee. Further, the said this Instruction is ultra vires to the scope of section 119 of the Income-tax Act, 1961 being prejudicial to the interest of the assessee.

5.3 That the Ld. AO erred in holding that Mark to Market losses in respect of re-measuring the foreign exchange forward contract as on balance sheet date is not allowable as the forward contracts have not been taken for the purpose of business on raising of export invoice but taken without due exposure.

5.4 That the Ld. AO erred in disregarding the order passed by the Hon'ble Delhi Bench of the Income Tax Appellate Tribunal in the Appellant's own case for the assessment year 2008-09 reported as *Bechtel India (P.) Ltd. vs. ACIT [2013] 33 taxmann.com 213* wherein the mark to market losses in respect of foreign exchange forward contracts as on the balance sheet date was allowed to the Appellant.

6. That the Ld. AO has erred in charging interest under section 234B, 2340 and 244A of the Act amounting to INR 13,40,39,006.

7. That on the facts and in the circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act.”

Ground no. 3 to 3.5 of the assessee

3. Apropos these grounds, we have heard arguments of both the sides and carefully perused the relevant material placed on record.

4. Ld. Counsel of the assessee submitted that the ld. DRP and the AO erred in making an addition of Rs. 57,46,70,024 to the returned income of the

assessee by recomputing ALP of the international transaction u/s 92 of the Act. Ld. Counsel further contended that the TPO was not justified in rejecting the comparable companies set adopted by the Appellant in its transfer pricing documentation on the basis of additional/modified quantitative filters which lacked valid and sufficient reasoning. Ld. Counsel further contended that the TPO was not correct in ignoring the comparable set proposed by Appellant as a result of fresh benchmarking study without assigning any reasoning and accepting companies which were functionally not comparable to the Appellant in terms of Functions, Assets and Risk profile. Ld. counsel vehemently contended that TPO/DRP and the AO were incorrect on facts and in law in including companies with high/supernormal margins in the comparable set adopted for benchmarking impugned transaction of the assessee and in including government held enterprise in the final comparable set adopted for benchmarking international transaction of the assessee and for making impugned said addition to the returned income of the assessee by recomputing the ALP of the alleged international transaction u/s 92 of the Act.

5. Ld. Counsel further elaborated the background and factum of the case and submitted that the assessee company is a captive service provider, providing engineering design and related services to its Associated Enterprises (AEs) to support the overseas office's turnkey project execution. Referring to Paper Book pages 382-481, ld. Counsel submitted that as per brief overview of the academic analysis conducted in the TP study, a provision of engineering design

related service revenue was Rs.43.46 crore and by applying Transactional Net Margin Method (TNMM), the appellant's PLI was 12.57% by taking OP/OR as PLI after undertaking adjustment for ideal capacity and foreign exchange fluctuation and after considering the margin of comparable in TP study i.e. - 4.49%, the final adjustment was captured as Rs.6,22,45,957/-, whereby the TPO proposed margin of 32.47% without providing adjustment towards working capital, risk and ideal capacity. Ld. Counsel further pointed out that after Id. DRP ruling, the margin after providing working capital adjustment was 15.34% wherein risk and ideal capacity adjustment was not provided by DRP/TPO for making impugned addition.

6. Ld. Counsel of the assessee reiterating its written submissions dated 17.6.2015 spread over 7 pages submitted that in the Transfer Pricing study, the assessee selected 7 comparables while the TPO accepted that the assessee is in the business of providing engineering support services and accepted TNMM as MAM and OP/TC as PLI the assessee as a tested party. Ld counsel submitted that the assessee mainly disputes selection of Certification Engineers International Ltd. (CEIL) and NTPC Electrical Supply CO. Ltd. (NTPCES) without any basis and the DRP has considered the issue of Related Party Transaction (RPT) even though specific objections were raised by the assessee. Ld. counsel further pointed out that the TPO applied this filter mechanically by taking into account monetary transaction between the holding company and CEIL by ignoring various non-monetary benefits like free or level-basis of

office facilities and secondments of employees by the holding company. Ld. Counsel contended that in the case of NTPCES, ld. DRP failed to note that this company does not even discuss RPT in its relevant annual report and it is pertinent to note that Schedule 9 of annual report clearly states that the amount payable to NTPC under the head current liability as on 31.3.2009 was Rs.12.87 crores which alone is 18% of its operating revenue.

7. Ld. Counsel further pointed out that while evaluating comparables of these two impugned companies, the DRP has ignored the material difference in functional, geographical location of party and related party transaction (RPT) and the sole criteria adopted by the ld. DRP for treating NTPCES and CEIL as suitable comparables is only with Bechtel India Private Ltd. These two companies employ high-end technological and engineering resources and personnel. Ld. Counsel vehemently contended that the DRP erred in analyzing the function of these entities in terms of resources employed and failed to consider the wide variation in skills and qualification of employees. In the light of broad functional profile of these companies which cannot be held as comparable for benchmarking international transaction of the present assessee company for the year under consideration, ld. Counsel pointed out that if these companies viz. CEIL and NTPCES are deleted from the final set of comparables, then the international transaction of the assessee would fall within the ambit of zero adjustment and, therefore, the same may kindly be deleted from the final set of comparables adopted by the ld. TPO/DRP and AO. Ld.

counsel in the written submissions submitted a table highlighting the difference between the assessee company and the impugned comparable i.e. NTPCES and CEIL which is being reproduced below for the sake of clarity and transparency in our findings:-

Sr. No.		Bechtel India	NTPCES Pg. 810/Vol.IV	CEIL Pg. 765/Vol.-IV
1.	Operating Revenue	Rs. 178.36 Cr.	Rs.71.72 Cr.	Rs. 24.75 Cr.
2.	Status	Private company- incorporated in 1994 as 100% subsidiary of Bechtel Corporation, USA.	Government company 100% subsidiary of National Thermal Power Corporation (NTPC), which is a Government company.	Government Company. Till 1994, it was a division of Engineers India Ltd. (EIL), (a government company) from which it was demerged as a 100% subsidiary company.
3.	Function	Rendering Engineering a support service including related design and drawings as per specifications of foreign AEs.	As per website NTPC. Com: The company was formed on August 21, 2002. It is a wholly owned subsidiary company of NTPC with the objective of making a foray into the business of distribution and supply of electrical power, as a sequel to reforms initiated in the power sector. The company was also mandated to take up consultancy and other assignments in the area of Electrical Distribution Management System. (Copy of screenshot at Annexure 1A) As per Schedule 17 of AR (pg. 843 of Vol.-IV/AR) The company is operating in a single segment, that is, providing consultancy, project management and supervision services.” <u>Extracts from AR:</u> It executes turnkey contracts for XIth Plan electricity supply projects entrusted/awarded to	Third Party Inspection (TPI), & Certification of equipment supplied by vendors and fabrication or installation work of Contractors of ONGC under a MOU between EIL & ONGC dt. 11/4/1985 on nomination basis. (Ref. Pg. 765-773, 803-805/Vol.-IV). Terms of MOU are not known. Also carries on similar TPI & Certification work independently for other PSUs.

			it by government companies and Departments. Has JV for retain distribution of power in Kerala. It is "Entrusted the work of rural electrification of 4107 villages" Pan India Rural electrification under Rajiv Gandhi Grameen Vidyutikarna Yojana (RGGVY)-Achieved electrification of 4107villages execution of Turn Key Projects, providing third party inspection services. JV for retail distribution of power & Project Management Consultancy to Discoms and Power generating companies. Its functional profile is similar to Bechtel USA, holding company (Pg.1/DRP order). The contracts/projects 'entrusted' (Pg. 811/Vol.- IV). (Ref. Pg. 810-812, 835-838, 843/Vol.-IV.)	
4.	Geographical Market	International-100% exporter of service.	Domestic customers- Nil export	Domestic customers- Insignificant export of service.
5.	Forex Fluctuation Risk	Yes	Nil	Insignificant Forex earning 3.75% of operating revenue. (Schd. 3(3) at pg. 803/Vol.-IV
6.	RPT (DRP has failed to consider objection)	100%	1)RPT not reported in A.R Transactions mainly with related parties (other Government Company/Govt. Departments) Schd. 9 of A.R current Liability i)"Amount payable to NTPC Ltd. Rs. 12.87 crores (Pg. 835/IV.) ii) Schd. 17, Notes on Accounts: "5) All the employees of the company are on secondment from the Holding Company, "9) The common services being utilized by the Company for it's office at NOIDA are provided without any charges	1)RPT declared are only monetary transactions with Holding Co. only (19.60%) Transactions with other AEs like ONGC, IOCL etc. not quantified, (Pg. 215/Vol-II/DRP submission) SCHEDULE J (Notes on accounts) "5) The jobs awarded by ONGC on nomination basis are being governed by the MOU signed between EIL & ONGC

			by the Holding Company. “(Pg. 844/Vol-IV) All employees on secondment from NTPC at cost. Benefits received from Holding company not monetised in the A.R. Revenues are from Government companies/ Departments, which must be considered as related parties. Reliance placed on ITAT order in Thyssen Krupp Pg. 678 at 694/Vol-III. Note: Contracts/projects for rural electrification schemes ‘entrusted’/ sanctioned to NTPCES under Rajiv Gandhi Vidyutidaran Yojana are not awarded under open tender as per CVC Circular dt. 3/3/2007.	dated 11/4/1985. 6) The company has a Memorandum of Understanding with Engineers India Ltd. (The Holding Company) for providing manpower services, office space and facilities etc. The MOU provides level based fixed man hour/man-day rates for EIL employees, inclusive of overheads and fixed annual cost towards space, infrastructure and facilities etc. provided by EIL. The company also has a Memorandum of Understanding with Engineers India Limited for providing manpower services to EIL at actual cost plus 10% margin.” CEO’s salary paid by EIL. Ref. (804/Vol-IV) Note: Contracts awarded to CEIL by ONGC on ‘nomination basis’ under MOU with EIL are not entered into open tender as per CVC Circular dated 3/3/2007.
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8. First of all, we find it appropriate to consider the comparability of NTPCES and CEIL with the assessee company i.e. Bechtel India Pvt. Ltd. As per aforesaid contention of the assessee, both these companies are not a suitable comparable for benchmarking international transaction of the assessee Bechtel

India Pvt. Ltd., therefore, the AO/TPO may be directed to delete the same from the final set of comparables. Ld. Counsel also pointed out that after deletion of these impugned comparables, the international transaction of the assessee company would fall within 5% + - limit and there would be no requirement of making any transfer pricing adjustment to the returned income of the assessee.

9. Replying to the above, ld. DR contended that for AY 2009-10, the TPO/AO rightly held that impugned two companies are suitable comparable for benchmarking international transaction of the assessee company as functional profile of these companies are similar to the assessee company and mere pointing out some micro differences do not lose the title of comparability with the assessee company. Ld. AR also contended that the assessee company rendering engineering design, project support including design as per specification of foreign AE and impugned two companies NTPCES and CEIL are also rendering services in the similar field, therefore their suitability and comparability cannot be challenged on the frivolous and petty grounds.

Adjudication of comparability of NTPCES with the assessee company

10. On careful consideration of above submissions of both the sides, we find it appropriate to consider the issue of comparability of NTPCES and CEIL one by one with the assessee company Bechtel India Pvt. Ltd. Ld. Counsel reiterating its written submissions and comparability table therein submitted that the assessee company is a private company incorporated in 1994 as 100% subsidiary of Bechtel Corp USA. Elaborating the functional profile of the

assessee company, ld. Counsel submitted that the main function of the assessee company is rendering engineering support services by way of preparing and supplying designs and drawings as per the specifications of the foreign AEs i.e. Bechtel Corporation USA. Ld. Counsel further pointed out that the assessee company is securing operating revenue of Rs.178.36 crore from its 100% export of services to its AE having forex fluctuation risk and 100% related party transactions (RPT) and DRP has failed to consider these important factual aspects while rejecting the objections of the assessee company to the comparability of NTPCES.

11. Ld. Counsel further pointed out that NTPCES is a 100% government owned company subsidiary to the National Thermal Power Corporation (NTPC). Ld. Counsel further pointed out that NTPCES was formed on 21.8.2002 is wholly owned subsidiary of NTPC with the objective of making a foray into the business of distribution and supply of electric power as a sequel to reforms initiated in the power sector. Ld. Counsel also submitted that NTPCES was also mandated to take up consultancy and other assignments in the area of electric distribution management system and the company is also operating in a single segment of providing consultancy, project management and supervision services.

12. Ld. Counsel further pointed out that NTPCES executed turnkey contracts for XIth Plan electricity supply projects entrusted/awarded to it by government companies and departments under joint venture for retaining distribution of

power in Kerala. Ld. counsel further pointed out that this company was also entrusted the work of rural electrification of 4107 villages under Rajiv Gandhi Grameen Vidutikarana Yojana (RGGVY) for achieving electrification of these villages and execution of Turn Key Projects providing third party inspection service. Ld. Counsel also pointed out as per page observations in the DRP order, NTPCES also got joint venture assignment for retail distribution of power management consultancy to DISCOMs and power generating company. Ld. counsel also pointed out that NTPCES has all domestic customers specially government companies and department having no export services and the same cannot be held as comparable with the assessee company having 100% export of services outside India to its AE only.

13. Ld. Counsel also pointed out that the assessee company is having 100% RPT with its AE whereas RPT of NTPCES has not been reported in the annual report and this company has undertaken transaction mainly with the related parties such as government companies and government departments. Ld. Counsel also pointed out that as per annual report of the NTPCES during the financial period under consideration the amount of Rs.12.87 crore was payable to the NTPC Ltd. and as per notes on account, all the employees of NTPCES are on settlement from the holding company and the NTPCES was utilising common services for its office at Noida provided without any charges by the holding company. Ld. Counsel vehemently contended that all the employees of NTPCES are on secondment from the holding company at cost and benefits

received from holding NTPCES are not monetised in the annual report. Placing reliance on the judgment of ITAT in the case of **Thyseen Krupps India (Pvt.) Ltd. vs ACIT (2013) 33 Taxman.com 107 (Mumbai Tribunal)**. Ld. Counsel submitted that when a comparable has two segments and its revenue from comparable segment is complete in itself and is not influenced by inter-segment revenue, comparability in such a case has to be examined at segmental level and not entity level. Ld. counsel also pointed out para 12.8.1 and 12.8.2 of the order of the ITAT in the case of Thyseen Krupps (supra) and submitted that if related party transactions are much more, then the filter of 25%, is not a suitable comparable and therefore, the order for the exclusion of the same would be appropriate.

14. Ld. counsel of the assessee pointed out that TPO was not correct in applying the filters by taking companies whose income is less than Rs.5 crore as the analysis would not lead to a proper comparability and moreover their low cost/sales base makes their result unreliable. Ld. counsel also pointed out that companies whose revenue from engineering support services is less than 75% of the total operative revenue should be excluded. The ld. Counsel also pointed out that the ld. DRP in its order dated 16.12.2014 for AY 2005-06 has concluded that NTPCES is not functionally comparable with the assessee Bechtel India. He took us through operative para at pages 5-6 of the DRP order (supra).

15. Replying to the above, Id. DR pointed out that business profile of the assessee company as taxpayer recorded by the DRP in para 3 page 2 of the DRP order and submitted that the assessee company has less complex o NTPCES and CEIL operations and was accordingly selected as a tested party for the TP analysis. Ld. DR supporting the observations of the DRP submitted that NTPCES is into services requiring high end technology and engineering advances, therefore, this company is functionally quite similar to the assessee Bechtel. Ld. DR also pointed out that as per annual report of the NTPCES the assessee company also has similar functional profile, therefore, the DRP was right in upholding the conclusion of the TPO in this regard wherein NTPCES was included in the final set of comparables.

16. On careful consideration of above submissions of both the sides, we note that the business and functional profile of assessee company as tax payer, as noted by the DRP reads as under:-

“Business Profile of Bechtel India as per taxpayer:

- *Bechtel Corporation, USA ('hereinafter referred to as Bechtel USA') set up a subsidiary company in India viz BIPL in April 1994 to render engineering support service in respect of engineering designs and drawings, BIPL executes engineering designs and drawings for various overseas group entities to support the overseas offices' turnkey project execution. Presently, BIPL undertakes engineering design and related services for its overseas group companies. '*
- *The development of the Arm's length Price ('ALP') by the taxpayer recognizes that BIPL performs contract engineering design services for its group companies. BIPL leverages on all the valuable intellectual Property ('IP') Right*

('IPRs') [know-how, copyrights, etc] and other commercial processes, methodologies, etc. belonging to its AEs. Further, the Group is involved in complex operations of marketing, bidding for projects, providing turnkey solutions, project management and adhering to delivery timelines. BIPL provides engineering design services exclusively to its overseas AEs. Based on above, BIPL has less complex operations, bears lesser share of risks and was accordingly selected as the tested party for the analysis .”

In view of rival submissions of both the sides, at the very outset, we note that the assessee Betchell India (BIPL) is a private company incorporated in India in April 1994 as Bechtell Corporation, USA. Admittedly and undisputedly, as per business and functional profile of the assessee company, the assessee company is rendering support services of engineering design and drawing, execution of engineering designs and drawing for various overseas group entities to support the overseas offices in turnkey project execution. The assessee company also undertakes engineering design and relates services for its overseas group companies. From the aforesaid business and functional profile it is amply clear that the assessee company performs contract engineering design services for its group companies. BIPL leverages on all the valuable intellectual Property ('IP') Right ('IPRs') and other commercial processes, methodologies, etc. belonging to its AE i.e. Bechtell Corporation USA. The DRP has also recorded that the entire Group is involved in complex operations of marketing, bidding for projects, providing turnkey solutions, project management and adhering to delivery timelines. The assessee company only provides engineering design services exclusively to its overseas AEs and the assessee has less complex operations, bears lesser share of risk.

Ld. DR has not disputed and could not demolish this fact that as per website of NTPC.com the NTPCES is a wholly owned subsidiary company of NTPC with the objective of making a foray into the business distribution and supply of electrical power as a sequel to reform initiated in the power sector. We further note that undisputedly NTPCES was also mandated to take up consultancy and other assignments in the area of electrical distribution management system. From page 843 of volume 4 of assessee's paper book, NTPCES is operating in a

single segment i.e. providing consultancy, project management and supervision services.

However, ld. DR has pointed out that except micro dissimilarities the main business and functional profile of the assessee company is quite similar to NTPCES but he could not demolish this factum that the NTPCES executed turnkey contracts for 11th plan electricity supply projects awarded to it by the Government companies and electrical departments which also includes activity of distribution of power in Kerala. Undisputedly, the NTPCES was also provided work contract of rural electrification of 4107 villages, execution of turnkey projects and also provided third party inspection services. While the NTPCES is also rendering services for retail distribution of power and management consultancy to DISCOMs and other power generating companies, then its functionality with the assessee company cannot be held as comparable. We are also not in agreement with the conclusion of the DRP/TPO that the functional profile of NTPCES is similar to Bechtell Corporation USA i.e. holding company because we have to compare comparability of assessee company and not its holding company.

Turning to the issue of geographical markets of both the companies, undisputedly assessee company having international transactions only with AE exporting 100% services to Bechtell Corporation USA whereas the NTPCES has nil exports having 100% domestic customers who are government companies and departments. We cannot also ignore this fact that the assessee Bechtell has 100% related party transaction with its AE and RPT have not been reported in the annual report of the NTPCES. It cannot be ignored that the contracts purchased for rural electrification schemes essential to NTPCES under Rajiv Gandhi Grameen Vidutikarana Yojana (RGGVY) were not awarded under open tender as per CVC Circular dated 3.3.2007 and on specific query from the Bench. Ld. DR could not point out any fact demolishing this factum.

When we consider the ratio laid down by ITAT Mumbai in the case of Thyssenkrupp India (P) Ltd. vs ACIT (Mumbai) we note that the ITAT Mumbai has categorically held that when the related party transactions are much more than the filter of 25%,

then the same should be excluded. The relevant observations of the Tribunal at page 694 read as under:-

“12.8.1 Next is the case of Engineers India Limited, which was included by the TPO at his own. The learned Counsel for the assessee contended that this case should be ignored because it is a Government Undertaking. It was further pointed out that most of its customers of the 'Turnkey project division' are related parties, being, other Public Sector Undertakings, which is much more than the filter of 25%. The learned Departmental Representative, however, accentuated that the TPO was right in including this case in the list of comparables.

12.8.2 We find it as undisputed that Engineers India Limited is a Government company. It has several segments which also include Turnkey project'. Page 700 of the paper book is a copy of annual report of Engineers India Limited on turnkey project. It can be seen that the revenue has arisen from completing Paraxylene Plant of IOCL and further that company is engaged in execution of other unit of IOCL's Panipat Naphtha Cracker Project. In our considered opinion, this case should not have been included in the list of final comparables for two reasons. First reason is that profit motive is not a relevant consideration in case of Government undertakings. Many Government Undertakings even operate on losses in furtherance of the social obligations of the government. The second reason is that Engineers India Limited earned income from turnkey project by successfully completing the project of IOCL and other Public Sector Undertakings. In that sense of the matter, the related party transactions are much more than the filter of 25%. We, therefore, order for the exclusion of this case from the list of comparables.”

17. In view of proposition laid down by the ITAT, Mumbai, we observe that in that case, Engineers India Ltd. earned income from turnkey projects by

successfully completing the project of IOCL and other public sector undertaking and the related party transaction were much more than the filter of 25%, therefore, the order for exclusion of Engineers India Ltd. was passed by the Tribunal. In the present case, the NTPCES was sheltered by its holding company NTPCES and government companies and departments awarded/entrusted various projects/contracts for rural electrification, distribution of power and project management consultancy, therefore, NTPCES loses the tag of comparability with the assessee Bechtell India. We also find it appropriate to mention that it cannot be ignored that the NTPCES is also enjoying settlement of all employees from the holding company NTPCS at cost and the benefits received from the holding company and related party transactions (RPT) are not monetised in the annual report and in absence of specific data in this regard, NTPCES cannot be held as comparable with the assessee company. Therefore, AO/TPO was not justified in including NTPCES in the final set of comparables for benchmarking impugned international transaction of the assessee company and they are directed to delete the same. We order accordingly.

Adjudication of comparability of CIEL with the assessee company

18. Ld. counsel of the assessee company reiterated the functionality of the assessee company Bechtell India submitted that the CIEL is not functionally similar to the assessee company due to its special features and monopoly based contract awarding privileges granted by ONGC and other government

companies. Ld. Counsel strongly contended that the CIEL is a government company and it was a division of Engineers India Ltd. till 1994 from which it was demerged as a 100% subsidiary company of Engineers India Ltd. (EIL). Ld. Counsel pointed out that CIEL undertakes third party inspection and certification of equipment supplied by the vendors and fabrication and installation work of contracts of ONGC under MOU between EIL and ONGC dated 11.4.1985 on nomination basis. Referring to page 365 to 773 and 803 to 805 Volume IV of assessee's paper book submitted that the terms of said MOU are not known and open to the public domain and hence it can be safely inferred that the CIEL is enjoying the benefits of awarding of contract work on nomination basis without any open tender from its holding company EIL and other government companies. Ld. Counsel also pointed out that the CIEL also carries on similar Third party inspection (TPI) and certification work independently for other public sector undertaking and it cannot be compared with assessee Bechtell India who is rendering only engineering support services including related drawing and design, as per specification of foreign AE. Ld. Counsel vehemently contended that the assessee Bechtell India is providing primary engineering support services along with design and drawings as per specification of the foreign associated enterprise which clearly denotes primary and preparatory work for intuition of execution of work contract whereas the CIEL provides services of third party inspection (TPI) and certification of equipment supplied by the vendors and fabrication and installation of work

contracts of ONGC which is a service rendered after commissioning and installation of project.

19. Ld. Counsel also pointed out that CIEL provides aforesaid services to its domestic government companies and PSU having insignificant export of services whereas the assessee Bechtell India is exporter of 100% services to its AE. Ld. Counsel also pointed out that the assessee Bechtell India receives its remuneration/revenues from its AE in foreign exchange having forex fluctuation risk whereas the CIEL having insignificant forex earning of 3.75% of operating revenue as per Schedule III at page 803 of Volume IV of paper book of the assessee. Ld. Counsel vehemently contended that the related party transaction (RTP) are 100% in the case of assessee Bechtell India whereas the RTP of CIEL are only monetary transaction with the holding company having 19.60% transaction with ONGC, IOCL etc. which are not quantified. Ld. Counsel also pointed out that the jobs awarded by ONGC on nomination basis are being governed by the MOU or by holding company dated 11.4.1985.

20. Ld. Counsel also pointed out that contracts being awarded to CIEL for rural electrification schemes sanctioned to NTPCES are not awarded under open tender as per CVC Circular dated 3.3.2007 and hence, this company having privilege of awarding contracts and job on nomination basis without any open tender cannot be held as functionally comparable with the assessee company.

21. Replying to the above, ld. CIT DR submitted that apart from engineering design, project support and procurement services also has objects like project

monitoring and control and construction services. Thus, functionally it is no different from Certification Engineers International Ltd. (CEIL). Ld. DR also pointed out that unlike the 1980s, government companies now carry on business in an environment of open competition and therefore price paid by one PSU or government company to another for goods or services represents Arms's Length Price (ALP). Ld. CIT DR contended that in this situation of open market environment, MOU between EIL and ONGC referred to in the annual report of CIEL for FY 2008-09 pertaining to AY 2009-10 has no relevance.

22. Ld. CIT DR also submitted that the TPO rightly observed that since a person holding voting shares of 26% in a company is considered to be its AE u/s 92A(2)(b), therefore, RPT filter of 25% of total revenue is justified, therefore, RPT filter of 25% without recognizing non-monetized benefits flowing from holding company to CEIL/NTPCES has been correctly applied. Ld. CIT DR strongly contended that the transactions between two government companies or public sector undertakings should not be considered to be related party transactions because shares in government companies are held by the President of India merely in the name and no effective control is exercised by him. Ld. CIT DR lastly submitted that no adverse inference needs to be drawn from non-disclosure of transactions between two state-controlled enterprises as no such requirement is prescribed in AS-18. Ld. DR finally submitted the action of the AO/TPO by inclusion of CIEEL in the final set of comparables for benchmarking of impugned international transactions of the assessee company.

23. Ld. Counsel of the assessee also placed rejoinder to the aforesaid submissions and contentions of the ld. CIT DR and submitted that the ld. DRP has duly noted the business functions of the assessee and have reproduced the same at page 2 of its order u/s 144C (5) of the Act. Ld. Counsel of the assessee vehemently contended that the ld. DRP agrees that the conclusion of the ld. TPO that the assessee Bechtel India is primarily engaged in rendering engineering support services by way of procuring and supplying design and drawings as per specifications of the AE by using the IPR supplied by the AE Bechtel Corporation USA. Ld. Counsel further pointed out that it is for this reason that the DRP upheld the two filters applied by the AO for the purpose of selecting comparables viz. (i) companies having revenue of less than Rs. 5 crore from rendering support services and; (ii) revenue from engineering support services is less than 75% of total operating revenue. Ld. Counsel also canvassed another submission that the ld. TPO/DRP have applied aforesaid two filters for selecting comparables because they accept that the primary business of the assessee company is of procuring design and drawings for AE enabling them to execute engineering products for clients outside India. Ld. Counsel contended that the ld. TPO/DRP have wrongly rejected the assessee's objection regarding inclusion of CIEL on altogether different basis i.e. the issue regarding functional non-comparables; is also not acceptable that in the cases of TNMM analysis one examines the comparables at a very broad level unlike CUP analysis where exact similarity is required. Ld. Counsel has also drawn our

attention towards relevant part of the DRP order available at page 48 of the assessee's paper book wherein sole criterion adopted by the DRP for treating NTPCES and CIEL s comparable to the assessee is that like Bechtel India, these two companies employ high-end technology and handling sources and personnel.

24. Ld. Counsel finally pointed out that CIEL is not functionally comparable with the assessee Bechtel India not only due to aforesaid reasons but related party transaction declared by CIEL withholding company are only 19.60% and transaction with other AE/government companies and departments like ONGC, IOCL etc. are not quantified. To support this contention he has drawn our attention towards assessee's paper book Volume II page 215 the submission of the assessee before DRP. Ld. Counsel parted with the argument that the AO/DRP/TPO should be directed to delete CIEL from the final set of comparables which is clearly functionally different with the assessee company.

25. On careful consideration of above rival submissions of both the sides, t the very outset, let us deal with the issue of related party transactions (RPT). Ld. DR relying on the TPO's observations submitted that since the person holding voting shares of 26% in a company is considered to be its AE u/s 92A(2)(b) of the Act, thereafter RPT filter of >25% of total revenue is justified. Ld. DR further pointed out that RPT filter of 25% without recognising non-monetized benefits flowing from the holding company CIEL/NTPCES has been correctly applied. Ld. DR has also contended and reiterated that the transaction

between two government companies should not be considered to be RPT because shares in government companies are held by the President of India merely in his name and there is no effective control exercised by him and they cannot be treated as related parties. To support this contention, Id. DR has placed reliance on the decision of ITAT Delhi in the case of Nokia India (P) Ltd. vs DCIT reported as 214-TII-224-ITAT-DEL-TP and has drawn our attention towards para no. 15 and 16 of this order and submitted that after considering the ratio of all relevant judgments and orders, the ITAT Delhi categorically held that the percentage of RPT to make a company as ineligible for comparison should be taken as more than 25% and not 15% as suggested on behalf of the assessee.

26. On the issue of RPT, it has been contended by the Id. Counsel of the assessee that 25% filter is not an appropriate filter for RPT and this test cannot be applied mechanically as if it has statutorily provided without exception. Ld. Counsel placing reliance on the decision of ITAT in the case of Motorola Solutions India (P) Ltd. in ITA No.5637/D/11 submitted that the RPT filter must not exceed 15%. Ld. Counsel vehemently contended that prerequisite of arriving at ALP with the transaction of tested party should be benchmarked with the uncontrolled transaction under Rule 10B(1)(e)(ii) of the Rules. Finally, Id. counsel submitted that the filter should be restricted to 15% of the total revenue. On careful consideration of above submissions, we are of the view that the ITAT Delhi in the case of Nokia India (P) Ltd. (supra) held that in principle if

any company though functionally comparable but is more than specific percentage of RTP, then the same should be ignored by treating as a controlled transaction. The Tribunal in this order further held that the percentage of RPT to make the company as ineligible for comparison should be taken as more than 25% and it was held that a company can be considered as incomparable if its RPT exceeds 25%. The relevant operative part of this order in para 15 and 16 read as under:-

"15. The assessee has relied on the decision of [BMW India Pvt. Ltd. vs. Addl. CIT](#) (ITA No. 5354/D/2012) dated 16th August, 2013. The assessee has filed following additional written submissions to consider the judgment of BMW India P. Ltd. (supra) while deciding the issue relating to AMP on behalf of the assessee:

"Subject: Additional Written Submission to consider the judgment of BMW India Pvt. Ltd. vs. Addl. CIT (I.T.A .No.-5354/DeII2012) while deciding the issue relating to advertising, marketing and promotion ("AMP") on behalf of the Appellant. This is with respect to Motorola Solutions India Private Limited ("MSILP") appeal no. ITA 56371 Dell 2011 for Assessment Year ("AY") 2007-08. The hearings for the same were concluded on July 18, 2013 and the order was reserved on that date. The matter is now awaiting pronouncement of the decision by Your Honours. In the meantime the!' Bench of the Hon'ble Income Tax Appellate Tribunal ("Tribunal"), New Delhi has pronounced its decision in the case of BMW India Pvt. Ltd. vs. Addl.. CIT (I.T.A .No.- 5354/DeI/2012 for AY 2008-09) ("BMW India order"). The said order was passed on August 16, 2013. Your Honours attention may kindly be drawn to the following: As mentioned in the BMW India order, BMW India acted as a distributor of motor vehicles and parts. During the year under consideration in the order, under the Transactional Net Margin method ("TNMM") applied by BMW India its operating profit margin was higher than the operating profit margin of the comparable companies. During the transfer pricing assessment proceedings, the Ld. Transfer pricing Officer ("TPO"), had alleged that BMW India had incurred excessive AMP expenses vis a vis the comparable companies and therefore, should have been reimbursed by the BMW Group for the excessive AMP spend based on the bright line analysis along with a mark-Up. The Hon'ble Dispute Resolution panel ("DRP") confirmed the additions made by the Ld. TPO.

On appeal by BMW India to the Hon'ble Tribunal, the Hon'ble Tribunal pronounced its decision on various issues related to AMP. As already

mentioned above, BMW India was a distributor during the year considered in the order. On these facts, the Hon'ble Tribunal held that this case is distinguishable from the decision of the Special Bench in L.G. Electronics case ("Special Bench") as the fact under consideration in BMW India is the remuneration model of a distributor and not that of a licensed manufacturer. The relevant text of the decision has been provided hereunder: (Para 6.20, page 50 of BMW India order):

Quote On examination of contemporary Guidelines/jurisprudence on the subject, we are of the view that a distributor is rewarded by the entity for whom the distributor works and the rewards are guaranteed upto an extent and the risk component vis-a-vis a manufacturer is necessarily very less. The rewards can be and generally are based on pricing adjustments and can also be compensated over and above that if greater services are rendered and pricing adjustments have not covered the cost of routine services rendered. Generally speaking the remuneration model for a distributor is reward-based and rewards are based on the quantity of sales.

Unquote The second point pronounced by the Hon'ble Tribunal was that during the year under consideration in the order, BMW India's operating profit margin was higher than that of the comparables. The comparable companies set and their margins were not disputed by the Ld. TPO and the Hon'ble DRP. Hence, the Hon'ble Tribunal held that the compensation for AMP services was embedded in the pricing arrangement of the contract goods itself and that no further compensation was required to be made by the Associated Enterprise ("AE"). In other words, BMW India had received compensation for AMP expenses through premium pricing which was demonstrated through its higher profit margins. The relevant text of the Hon'ble Tribunal ruling in case of BMW India is provided here below(Para 6.25, 6.26 page 53, 55 of BMW India order): *Quote We hold that in the facts of the present case the assessee has demonstrated that the compensation for the higher services was embedded in the pricing arrangement of the contract goods itself It is seen that the comparables identified by the assessee and accepted by the TPO as having similar intensity functions have earned profit at the gross and net levels far below the profits both at gross and net levels as achieved by the assessee. In the circumstances as evidenced from record, we are inclined to agree with the submissions advanced on behalf of the assessee that no further compensation was required to be made by the AE as the same has already been received. Thirdly, the Hon'ble Tribunal in BMW India order provided that BMW India was rewarded by price adjustments to earn profits which included the cost of AMP with mark up. It held that the tax department cannot insist that the mode of compensation received by BMW India from its AE necessarily had to be direct compensation and that pricing adjustment was not acceptable.*

The relevant text of the Hon'ble Tribunal ruling in case of BMW India is provided here below(Para 6.27, page 56 of BMW India order):

Quote The claim of the assessee has merit as the assessee with the AE can agree to be rewarded/ remunerated by price adjustments to earn profits

which include the cost of rendering services with profit. The department cannot insist in the absence of any provision under the Act that the mode of compensation to the assessee by the foreign AE necessarily has to be directed compensation and pricing adjustment is not accepted. Unquote The Hon'ble Tribunal further held that (Para 6.26, page 55 of BMW India order): Quote In support of the remuneration model of the assessee who is a distributor rewarded by way of price adjustments to ensure profitability upto mutually accepted terms is a well- recognized and well-accepted method for compensating a distributor. Unquote Further, on the issue of the mark up the Hon'ble Tribunal in the BMW India order held as under (Para 6.28, page 58 of BMW India order):

Quote We hold that in the facts of the present case there was no occasion for the AE to further compensate the assessee for the services rendered towards building the brand of the AE as the same already stood factored in the pricing adjustment of the contract goods. As such the occasion to consider the applicability of mark-up does not arise. Unquote The Hon'ble Tribunal, in para no. 6.27 of the BMW India order has also mentioned that the Special Bench has accepted that there are diverse nature of facts, business models and peculiar terms and conditions of different assesses and there cannot be any straight jacket formula.

Applicability to MSIPL As provided in the detailed hearings and submissions provided, MSIPL for the relevant year under consideration also acted as a distributor of mobile handsets, walkie-talkies and telecom equipment. During the year under consideration, under the TNMM analysis the operating profit margin on sales (OP/Sales) of MSIPL was higher than that of the comparable companies. This has been mentioned in para 1 of page 1 of the written submission filed with Your Honours on May 20, 2013 and again on para 5 of page 133 of the written submission filed with Your Honours on May 20, 2013. The Ld. TPO did not have any dispute relating to the TNMM analysis conducted by the Appellant. The only dispute was on the matter of AMP expenses. The Ld. TPO based on the bright line analysis held that MSIPL should have been reimbursed by the AE for the excess AMP expenses incurred by it along with a mark-up. The Appellant filed an appeal before the Hon'ble Tribunal. The grounds related to AMP issue are covered in grounds nos. 2.1 to 2.10 and 3. (The details have been mentioned in para 4-43 of page 2-23 of the written submission filed with Your Honours on May 20, 2013 and again in para 8 of page 133-138 of the written submission filed with Your Honours on May 20, 2013.) In this regard we humbly submit that the decision in case of BMW India order also applies to MSIPL, as the facts of MSIPL are similar to that in the BMW India order. Hence, we humbly submit that the decision rendered in the BMW case has a direct bearing on the AMP issue. This has been summarized as under:

1.BMW India is a distributor of motor vehicles and related parts. MSIPL is also a distributor. Hence, what is relevant for consideration is the remuneration model of a distributor in both the cases.

2. BMW India's operating margin was higher than that of the comparables. Similarly, MSIPL also operated at a higher net operating margin than that of the comparables. This is demonstrative of the fact that the compensation for the alleged higher services was embedded in the pricing arrangement of the contract goods itself and that no additional remuneration was required from the AEs. In other words, like it has been held in the BMW India order, the compensation for the alleged excess AMP expenses was received through premium pricing which can also be demonstrated through its higher profit margins.

In the BMW India order, the Hon'ble Tribunal has held that the department cannot insist that pricing adjustment cannot be accepted as mode of compensation. Herein, it may be reiterated, that MSIPL has already received the said pricing adjustment through credit notes as a cost credit! purchase price adjustment from its AEs. This has been mentioned in para no 18 of page 11 of the written submission filed with Your Honours on May 20, 2013 and in para 8(1) of page 134 of the written submission filed with Your Honours on May 20, 2013."

15.1 Thus, the main contention of assessee is that remuneration model in case of Distributor towards AMP Expenses is different from the compensation model in case of License Manufacturer. Therefore, before considering the application of BMW's case to assessee's case, it is necessary that the business profile of assessee's case viz-a-viz BMW's case with reference to LG's Spl. Bench case is to be considered. Admittedly, the decision in the LG's case has been rendered in regard to AMP Expenses and for quantification of AMP Expenses also detailed guidelines have been laid down in the case of LG. 15.2 In case of LG Electronics brief facts were as under: "The factual matrix of the case is that L.G. Electronics Inc. (hereinafter called as —LGK), is a Korean based company, engaged in the business of manufacture, sale and distribution of electronic products and electrical appliances such as television, audio/video equipments, washing machines, refrigerators and air- conditioners etc. Pursuant to the approval of the Govt. of India, conveyed vide letter dated 29-1-1997, LGK was permitted to establish a wholly owned subsidiary in India. L.G. Electronics India Pvt. Ltd. (hereinafter called as —LGI), that is the assessee in question, was incorporated in 1997 as a wholly owned subsidiary of LGK. An agreement was entered between LGK and LGI on 10th March 1997, as per which both entered into a mutual foreign collaboration agreement. Thereafter a Technical assistance and royalty agreement was entered into between these two entities on 1-7- 2001 by which LGI, in the capacity of a licensee, obtained a right to use the technical information, designs, drawings and industrial property rights for the manufacture, marketing, sale and services of the agreed products from the LGK i.e. the licensor."

16. In assessee's case the factual matrix has been reproduced earlier. Assessee is primarily engaged in the distribution of telecom equipment, mobile phones and provision of telecommunication service in India. The company also provides software development services to the group companies. Additionally the company also provides marketing and

administrative support services to its group company. In the case of BMW the factual matrix was as under: 2.4 "A perusal of the same shows that the TPO took note of the facts that the BMW Group has global operations in 3 segments namely Automobiles, Motorcycles and Financial Services. The parent company of the group is BMW AG i.e. the associated enterprise (hereinafter referred to as the "AE") which is headquartered in Munich, Germany and is primarily engaged in the manufacturing of automobiles and motorcycles. The major car brands manufactured by BMW AG are stated to be BMW, Mini and Rolls-Royce. The TPO takes note of the fact that the assessee had undertaken the following international transactions:

1.	Purchase of raw material	167,051,934	TNMM
2.	Purchase of traded vehicle	535,438,461	RPM
3.	Purchase of spare parts	18,057,016	RPM
4.	Purchase of fixed assets	175,346,819	CUP
5.	Purchase of software	78,880,000	CUP
6.	Receipt of technical support service	29,449,506	CUP
7.	Receipt of IT support services	2,739,917	CUP
8.	Market survey expenses	11,711,690	CUP
9.	Reimbursement of personal cost	17,252,074	CUP
10.	Reimbursement of expenses	12,270,724	CUP
11.	Interest of loan	12,9773,291	CUP

2.5 Referring to the Transfer Pricing Study of the assessee, the TPO observed that the assessee described its activities as that of a distributor. The TPO referred to the Importation Agreement between the parent company BMW AG and the assessee and observed that the same had been entered into w.e.f. 01.01.2006 and it stated that the assessee had the following duties in regard to marketing and promotion of the products of the parent company:

"2.2. Responsibility in the Contract Territory BMW India represents the interest of BMW AG in the Contract Territory. It is responsible for the sale promotion and the full utilization of the market potential for the Contract Goods in the Contract Territory.

It is further responsible for ensuring the provision of the best possible customer service and adequate stocks of original BMW parts in the Contract Territory. Furthermore, BMW India undertakes the following functions in the Contract Territory in accordance with the laws of the contracting territory:

- Establishment and supervision of an efficient BMW distribution network; • Performance of an adequate advertisement and sales promotion as well as public and media relations.*
- Collection, evaluation and communication of market information to BMW AG.*

3. Scope of the Activity of BMW India 3.1 BMW India will meet its responsibility for the promotion of sales and the full utilization of the market potential for the Contract Goods by applying its best efforts and adequate resources toward effective sales promotion and advertising for the Contract Goods including available optional equipment and accessories."

27. In view of above, we are inclined to accept the contention of the Id. CIT DR because there is no straitjacket formula given in either section 92A(2)(b) or in Rule 92A(2)(b) or in Rule 10B of the Rules for applying filter to the related party transactions, however, it is a well-settled proposition that if any company is functionally comparable with the taxpayer but at the same time it is more than a specific percentage of RTP, then the same should be ignored by treating it as a controlled transaction and hence, the view taken by the ITAT Delhi in the case of Nokia India Pvt. Ltd. (supra) is a balanced view supported by various orders of the Tribunal on the issue. Therefore, we are inclined to accept the contention of the Id. CIT DR that a company should be considered as non-comparable only if its RPT exceeds 25%.

28. The next issue for our consideration is the functional comparability of the assessee Bechtel India with CIEL. We have already noted the functional profile of the taxpayer assessee in para 16 as stated above. That the functional profile of CIEL has been submitted by the Id. Counsel of the assessee which explains the details of services offered by CIEL, area of certification expertise and another important area of energy efficiency audit functions by the assessee CIEL. The relevant operative part reads as under:-

“4. Services Offered by CEIL:

CEIL is India's leading Certification and Inspection agency for offshore Oil & Gas Process & Well platforms, Petro-chemical Refineries, Submarine and Cross country Pipelines etc. CEIL provides services designed to suit project requirements throughout the life span of a plant / facility from concept to commissioning, revamping and health check. It promotes Safety, Quality and Reliability throughout the design and operating life of all types of equipment, structures, pressure vessels, pipelines and rotating machinery. The services cover all types of capital goods and equipment during manufacture and erection stages for oil & gas and general engineering sectors, encompassing;

- ~ Review of Detailed Engineering*
- ~ Independent Analysis and Review of Designs/Drawings*
- ~Conformance of Materials & Equipments to National/International Codes -*
- ~ Review and Approval of Inspection Test Plans*
- ~Review of Installation, Pre-commissioning and Commissioning Procedures*
- ~ Third Party Inspection Services / Pre-shipment Inspection*
- ~ Supervision of Site Construction for cross country water / gas pipelines*
- ~ PMC Services for Infra structure projects of Municipalities*
- ~ HAZOP Studies / Quantitative Risk Analysis*
- ~ Mitigation Measures*

Report with recommendations to reduce the risk factor is issued after studying the above.

5.7 Energy Efficiency Audit

In addition to Certification Services, CEIL also carries out Energy Audit, Base Line Verification of energy intensive facilities e.g. pumping stations, municipal lighting, and commercial buildings as per client's requirements. CEIL is also prepared to provide Energy Service Contracting services (ESCO) for rehabilitation / replacement of energy inefficient equipments / appliances and to be paid back from affected savings in energy consumption.

6. Areas of Certification Expertise:

CEIL avails a total synergetic support of its parent company EIL which has skilled and experienced professionals located at Head Office and spread across India and abroad who are fully conversant with national and international codes backed by over

4 million man hours of experience. It has on its roll Engineers qualified by various recognized NDT bodies like ASNT, ISNT and QMS.

CEIL's expertise covers Design Verification, Quality Services and Commissioning Assistance on:

~ High pressure Reactors, Pressure Vessels, Columns, Heat Exchangers,

Reformers of carbon steel, stainless steel, alloy steels & non ferrous materials

~ Clad Columns, Storage Tanks, Horton Spheres, Mounded Tanks

~ Equipment for Combustible / Explosive Classifications, Occupational Safety and Hazardous Area Classifications

~ Instrument Air / Plant Air Systems, Air Drying Plants, Gas dehydration units

~ Heating, Ventilation and Air Conditioning (HVAC) Systems

~ Line Pipes, Pipe Coating and Piping Appurtenances ”

29. In view of above, the assessee taxpayer Bechtel India which is rendering engineering support services including related design and drawing as per specification of its foreign AE Bechtel Corporation USA cannot be compared with a company which is engaged in the functions of third party inspections (TPI), certification of equipment supplied by vendors & installation of work of contractors of ONGC and other government departments and private sector undertakings. The CIEL having domestic consumers, government companies and public sector undertaking having insignificant export surplus cannot be compared with the assessee Bechtel India which is 100% exporter of services to its AE Bechtel Corporation, USA.

30. We may point out that functions of a company should be determined having regard to its data mentioned in the financial results filed along with

return of income and annual report which is a primary resource and general information in the annual report is more accurate and this fact has not been controverted by the Id. CIT DR. From the functional profile of assessee Bechtel India and functional profile of CIEL as reproduced hereinabove, it is amply clear that the CIEL carries on business of certification and third party inspection of equipments provided by a contractor and obviously certification and TPI functions are dissimilar from the business of rendering engineering support services including related design and drawing as per specifications of foreign AE and by using intangibles/IPR of parent company.

31. Ld. DR could not demolish this factum that the certification/TPI involves testing/assessing and auditing of the work done by the high-end technocrats which conforms to specifications prescribed in the contract; meets quality standard of work and material; meets safety standards; meets environmental standards and satisfactory works, plant commissioning and installation of various works and projects for the employer like ONGC. The CIEL certifies the work of the contractor that the employer accepts the work undertaken as per specifications of the contract and then makes the payment. Per contra, the business functional profile of assessee company is to perform the work of preparing and supplying design and drawings given by its parent Bechtel Corporation USA. In this modus operandi this work is outsourced by the non-resident AE to the assessee Bechtel India which carry out the work as per specifications given by the outsourcing company AE. We may also point out

that the revenue of CIEL from export of surplus is 3% which is insignificant and the income from export of services by the assessee Bechtel India is 100% of operating income as there is no domestic client, thus, as per Rule 10B(2)(d) of the Rules, the comparability test also fails on this count.

32. On the basis of foregoing discussion, we have no hesitation to hold that the functions of assessee Bechtel India are quite dissimilar with CIEL which was wrongly taken by the TPO as a suitable comparable for benchmarking of impugned international transaction undertaken by the assessee during the relevant financial period. The functional dissimilarity as well as distinction in the geographical market in the light of foreign exchange fluctuation risk of the assessee company coupled with below 25% RPT undertaken by the CIEL, we, therefore, decline to agree with the conclusion of the AO/DRP/TPO that the CIEL is a suitable comparable for the purpose of proposed TP adjustment made by the authorities below. Functional dissimilarity and other aspects cannot be ignored and these factors clearly demonstrate that CIEL should not have been included in the final set of comparables for making transfer pricing adjustment pertaining to the impugned international transactions of the assessee company and we order to exclude the same from the final set of comparables. It is ordered accordingly.

Corporate issue of Mark to Market losses Ground no. 5 to 5.4

33. On the issue of Mark to Market losses, the Id. counsel reiterating its written submissions dated 17.6.2015 pointed out that the assessee claimed mark

to market losses of Rs.21.80 crore on foreign exchange forward contracts as on 31.3.09 which was wrongly disallowed. Ld. Counsel of the assessee further pointed out that the AO erred in holding that the Mark to Market losses in respect of re-measuring the foreign exchange forward contract as on balance sheet date are notional and contingent in nature which are not allowable. Ld. Counsel vehemently pointed out that the AO further erred in placing reliance on Instruction No. 3/2010 dated 23rd March 2010 issued with respect of assessee's trading in forex derivatives and these instructions were issued after completion of financial period under consideration, thus, the same was not applicable to the assessee and further said instruction is ultra vires to the scope of section 119 of the Act.

34. Ld. Counsel also contended that the AO erred in holding that Mark to Market losses in respect of re-measuring the foreign exchange forward contract as on balance sheet date is not allowable as the forward contracts have not been taken for the purpose of business on raising of export invoice but taken without due exposure. Ld. counsel has further drawn our attention towards order of ITAT in assessee's own case for AY 2008-09 reported as **Bechtel India Pvt. India Ltd vs ACIT(2013) 33 Taxman.com 213 (Delhi Tribunal)** and submitted that the mark to market losses in respect of foreign exchange forward contracts as on the balance sheet date was allowed to the assessee. Ld. counsel of the assessee also took us through the written submissions dated 13.6.15 filed on 17.6.15 which read as under:-

“Schedule XIII - A. Significant Accounting Policies:-

“ iv) Foreign exchange transactions

Foreign exchange transactions are recorded at the exchange rate prevailing at the date of transaction. Realized gains and losses on foreign exchange transactions during the year are recognized in the Profit and Loss Account. Foreign currency monetary assets and liabilities are translated to India Rupees at year end rates and any resulting gain/loss on such translation is also recognized in the Profit and Loss Account.

v) Forward foreign exchange contracts

The company enters into forward foreign exchange contracts with the bankers to mitigate the risks associated with foreign exchange fluctuations associated with the accounts receivable and forecasted sales transactions. Any premium or discount arising at the inception of the forward exchange contract, which have been taken on underlying transaction, is recognized as expenses/income over the life of the contract and exchange differences arising on such forward exchange contract is recognized in the Profit and Loss account in the reporting period in which the exchange rate changes. The fair value of forward foreign exchange contracts, which have been taken to cover foreign exchange risk in respect of probable forecasted transactions, being the difference between the contracted rate and forward rate at the Balance Sheet date, are recognized in the profit and loss account. ”

(Pg. 470 & 476/Vol.II)

The following table sums up the facts :- Rs. In Crores

(Rs. In Cr.)

(rounded)

<i>a. All 9 foreign exchange forward contracts (F.C) were entered With authorized bank on 6.8.2008 maturing every successive Month starting from 3.4.2009 to 4.12.2009</i>	<i>119.50</i>
<i>b. Export sales booked during Financial Year 2008-09</i>	<i>178.36</i>
<i>Financial year 2007-08</i>	<i>159.23</i>
<i>c. Receivables as on 31.3.2009</i>	<i>71.64</i>
<i>Receivables as on 31.3.2009</i>	<i>41.61</i>
<i>d. Foreign exchange (USD) actually received in Financial Year 2008-09</i>	<i>156.72</i>

Financial year 2007-08	167.31
e. Value of Unexpired FCs as on 31.3.2009	119.50
Value of unexpired FCs as on 31.3.2008	96.00
f. Invoices raised by 6.8.2008 (pg. 362/P.B. Vol.-II)	58.09
g. All 9 contracts were ultimately settled through delivery of contracted worth of U.S. dollars.	Rs. 119.50 crores

Ref : a) Pg. 61-66 of P.B. Vol.-I

b) Pg. 355 of P.B. Vol.II

c) Pgs. 751-753 of P.B. Vol. IV

d) Draft assessment order for A.Y. 2010-11 Pg. 754/PB Vol.-4.

e) Assessment order u/s 143(3)/144C dated 30.1.2015 for A.Y. 2010-11 (para 6 at Annexure 1)

4. **Ld. DRP:**

i) Ignores accounting policy followed by assessee for foreign exchange (forward) transactions. Pg. 462-476 & 450-51/P.B.Vol.-II, AS 11 & AS 30 read with AS 1.

ii) *The DRP ignores the judgment of Hon'ble Delhi High Court in Virtual Soft Systems Ltd. (341 ITR 593) brought to its notice. It has been held therein that:- "10 the fact that the opinion of the Institute of Chartered Accountants of India was expressed in a Guidance Note which had not attained a mandatory status, would not provide a basis to the Assessing Officer to disregard the books of account of the assessee and in effect method of accounting for leases, followed by the assessee. "*

iii) *The action of the Ld. DRP is illegal in not following the order of the Hon'ble Tribunal for A.Y. 2008-09 without distinguishing it on facts. As held by the Hon'ble Supreme Court in CIT Vs. Ralson Industries Ltd. (288 ITR 322), "where an order is passed by a higher authority, the lower authority is bound thereby keeping in view the principles of natural justice". It is significant to note the DRP's order dt. 26.11.2013 is appealable u/s 253(1)(d) of the Act and was not binding on the Department.*

iv) *Holds Supreme Court decision in Woodward Governor is not applicable.* Pg. 382/P.B.Vol.-II

v) *Follows CBDT Instruction no. 3/2010.*

vi) *DRP selectively quotes guidelines issued by RBI. It ignores the Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000 readwith Schedule 1 of the Regulation-4. The said Schedule states that a forward fore. contract can be booked by an authorized dealer on the basis of reasonable estimate after verifying the documentary evidence. (Ref. Pgs. 728-733 of PB Vol.-IV).*

vii) *The Chart at Pg. 751/Vol.-IV, which summaries, the year-wise position of forex booked/ receivables etc. is at Annexure-2A.*

viii) *The DRP verifies FIRC's and does not dispute that all the FCs were ultimately selected through delivery of contracted amount of US dollars. (Para 3.7.1 at Pg. 36 of DRP order at Pg. 65 of P13 Vol.-I).*

5. *The Ld. DRP alleges that the FCs were not taken out by the assessee for business purpose. This bald allegation is not substantiated by the DRP. Further, the allegation made by the Ld. DRP is self-contradictory. In the preceding assessment year, the Ld. AO had disallowed similar Mark to Market accounting of loss on unmatured FCs on the last date of accounting year; i.e., 31.3.2008. However, this loss has been allowed by the AOIDRP in the succeeding assessment year 2009-10 on cash basis. Thus, the DRP admits that foreign exchange forward contracts are not speculative and they are also for 'business purpose. The facts this year are same as in the preceding A.Y. 2008-09. Similarly, actual loss on the FC on maturity have been allowed in the succeeding assessment year 2010-11. (Tile chart summarizing the effect of the orders is at (Pg. 753/Vol.- IV Annexure 2B)*

6. Findings of the Hon'ble Tribunal in A.Y. 2008-09:-

- i) *Forex fluctuation loss on unexpired FCs booked on 31.3.2008 is covered by the Hon'ble Supreme Court decision in the case of Woodward Governor (312 ITR 254)*
- ii) *The assessee follow mercantile system and the loss is booked on a scientific basis in the ordinary course of business.*
- iii) *The loss has been incurred for hedging of foreign currency fluctuation involved in export sales; which is a business decision to safeguard its interest.*

- iv) *This loss is not notional and it is business loss. It has to be allowed following the Hon'ble Supreme Court in Woodward Governor case.*

CBDT Instruction no. 3 duly noted by Tribunal (Pg. 365/Vol.-II)

Transactions not speculative u/s 43(5):-

7. *Alternatively; the DRP, after examining all the invoices raised by the assessee on AEs, holds the FCs' to be speculative transactions as It found that the aggregate amount of 'invoices raised' did not cover the exposure as per the FCs booked by the assessee with Bank of America on 6th August 2008. According to DRP, the assessee should have booked the FCs only after it had raised an invoice and only to the extent of amount as per each and everyone of the hundreds of invoices raised by the assessee under continuous service contracts with the AEs, which normally run for several months overlapping more than one financial year. The sample FCs and corresponding invoices, which run into hundreds, are at Pgs. 737-743 of Vol.-IV.*

The Ld. DRP has failed to appreciate that it would be not only unpractical, but will also be extremely costly proposition to take out forward contract for everyone of the hundreds of invoices issued to the AE under each of the service contracts (Ref. TP Study at Pg. 582/Vol.-III). It is for this reason that the RBI regulations clearly provide that where the amount is not ascertainable the forward contract may be taken on the basis reasonable estimate expected export receipts.

8. *The Ld. ORP has erred in treating clauses of proviso to section 43(5) as sub-sections of that section. It has thus erred in law in applying proviso (b) and (d) to section 43(5) of the Act. The proviso merely excepts transactions, which are other-wise speculative under main without first ascertaining as to whether the FC transactions are speculative as per section 43(5).*
9. *The Ld. DRP, after verifying all the Forex Inward Remittance Certificates (FIRC), admits that all Forward Contracts were*

ultimately settled through the delivery of prescribed quantity of US dollars on the due date. This was brought to the notice of ORP vide letter dt. 12.11.2013 at Pg. 354IVol.-IJ. Hence, the settlement of FCs through actual delivery of US dollars have been wrongly treated as speculative transactions u/s 43(5) of the Act.

10. *DRP holds that FCs are covered by "section 43 (5)(b)" and "section 43 (5)(d)". Apparently, reference is to the proviso (b) and (d) to section 43(5) of the Act. Thus, the Ld. DRP has erred in invoking the proviso to section 43(5) without bringing the transaction into the fold of main section.*

There is no dispute that all forward contracts were "ultimately" settled through delivery of the underlying commodity, i.e., U.S. dollars. The Ld. D.R.P. itself has recognised this fact as may be seen from the Tables at Pg. 32 & 37 of ORP order (Pg. 61 & 66IVol-f). This being the undisputed factual position, the impugned transactions clearly do not fall within the meaning of the term 'speculative transaction' as defined in section 43(5) of the Act. It may be noted that for the purpose of section 43(5), it is not necessary, or even relevant, that the forward contract is settled within the accounting year. What is relevant is that it is ultimately settled through delivery of the commodity contracted for. Further, as held by the Apex Court, if the transaction satisfies the condition of 'actual delivery' of the contracted commodity, the transaction cannot be held to be speculative. (Ref. Devenport and Co. P. Ltd. Vs. CIT (1975) 100 ITR 715 (SC) at Pg. 759/vol.-IV).

Proviso to Sec. 43(5) not applicable:-

11. *Since the main section 43(5) of the Act is not applicable to the facts of the case, the Ld. ORP erred in law in invoking the proviso to that section. The ORP's action of invoking the proviso to Sec. 43(5) is manifestly erroneous. It is settled law that- if a contract is ultimately settled by way of actual delivery (as opposed to constructive delivery) of the underlying commodity, it is not speculative. (Ref. Davenport & Co. P. Ltd. Vs. CIT 100 ITR 715,*

SC). Also see the Hon'ble Tribunal in London Star Diamond Co. Vs. DCIT [2013J 38 Taxmann.com 338 (Mum. Trib).

12. Considering the fact that all the FCs are ultimately settled through delivery of US dollars.

it's clear that the decisions of the Tribunal/ High Court relied on to by the DRP are not relevant as all those decisions deal with a situation where contract is cancelled because of non-delivery of dollars and settlement is reached by paying the difference between the contracted price and the price of the commodity on the date of settlement.

AO/DRP in A.V. 2010-11:-

13. In the succeeding A.Y. 2010-11, the actual loss incurred was Rs. 15.75 crores and the remaining amount of Rs. 6.05 crores was offered to tax by the assessee in its return for A. Y. 20 10-11, which is accepted by the AO. (Re .Pg. 753 & 754I Vol.-IV). The DRP has also not interfered with the decision of the AO. Thus we have a situation where AO/DRP have treated FCs to be non-speculative transaction entered into by the assessee company for business purpose in the immediately preceding and succeeding year.”

35. Ld. DR supporting the action of the AO/DRP submitted that the assessee company does not specify the test of transaction that have been excluded under the extant provision as deemed speculative transaction because it had not clearly demonstrated that the transactions were in respect of raw material or merchandise; the assessee is not a member and the assessee company failed to demonstrate that the transaction in question were ‘has in’ transactions in absence of details of forex forward contracts which were not linked to the trade/export. Ld. CIT DR further pointed out that the assessee is not a member of a forward market or an exchange and it is not the business of the assessee

company to undertake foreign exchange forward contracts. Ld. CIT DR further pointed out that forward contracts on certain dates could have been of higher value than the export receivables and as such, the assessee did not demonstrate rupee to rupee and date specific correlation between the FCs and the export invoices, specially when few forward contracts cancelled before the maturity dates clearly demonstrate the characteristics of speculation activity. Placing reliance on the decision of **Hon'ble Bombay High Court in the case of CIT vs Badridas Gauridu Pvt. Ltd. (2004) 134 Taxman 376 (Bombay)** submitted that this aspect/issue needs to be examined in details so as to consider the nature of such losses to adjudicate the allowability and in that case the matter was set aside by the Tribunal on this issue as the assessee had not furnished requisite details to the AO.

36. Ld. CIT DR further pointed out that in the case of DCIT vs Bank of Bahrain and Kuwait in ITA No. 4404 & 1883/Mum/2004 the Special Bench of ITAT Mumbai while holding that mark to market losses in respect of forward foreign exchange contracts debited to profit and loss account is allowable and at the same time, CBDT Instruction No. 3/2010 mandates that instruction from CBDT were either not pointed out to the ITAT or was subsequent to this order. Ld. CIT DR also vehemently contended that the question in the said case was whether mark to market loss was a real loss or a notional loss and the issue of speculation u/s 43(5) was not before the Tribunal and hence benefit of the Special Bench order for claiming allowability cannot be extended to the

assessee. Ld. CIT DR also pointed out that the special bench order was passed in the case of assessee bank and assessee of the present case is an engineering service provider assessee so the business profile varies substantially.

37. Replying to the above ld. Counsel of the assessee also placed written rejoinder to the written reply and submissions of the DR on the issue of mark to market losses, ld. Counsel submitted that the contentions of the ld. CIT DR are misconceived, that the assessee fails to satisfy any of the clauses of the proviso to section 43(5) of the Act, therefore, mark to market loss of forward contracts are not allowable being speculation losses. Ld. Counsel strongly contended that merely the ld. CIT DR reiterating the view as expressed by the ld. DRP and the DRP has ignored the main provisions of section 43(5) of the Act as the revenue has to show as to how the present case is covered by the definition of speculative transaction as defined in section 43(5) of the Act. Ld. Counsel also pointed out that the assessee accounts for forward contract loss based upon a consistency followed by accounting policy as stated in its final audited statement and since all forward contracts are settled by the actual delivery of contracted amount, therefore, it is not a speculative transaction u/s 43(5) of the Act. Ld. counsel also pointed out that the assessee accounts for forward contract loss based upon consistency, followed by accounting policy as stated in its final audited statement and since all forward contracts are settled by the actual delivery of contracted amount, therefore, it is not a speculative

transaction u/s 43(5) of the Act and there is no question of applicability of proviso to the said provision.

38. Placing reliance on the judgement of **Hon'ble Supreme Court in the case of Devenport & Co. Pvt. Ltd. vs CIT 100 ITR 715** submitted that a transaction which is otherwise speculative would not be a speculative transaction within the meaning of Explanation (2) if actual delivery of the commodity or the scrips has taken place. Ld. Counsel lastly pointed out that in the similar set of facts and circumstances, the issue has already been decided in favour of the assessee by the Tribunal for AY 2008-09 in assessee's own case (supra).

39. On careful consideration of above submissions of both the sides, at the very outset, we find it appropriate to reproduce written reply of the ld. CIT DR on the issue of mark to market losses, written submissions of the assessee as already reproduced herein above. The relevant written submissions of the ld. CIT DR read as under: -

"Synopsis of DR submissions

Date of submission: 09/07/2014

Name of Assessee: Bechtel India P Limited

AY: 2009-10

ITA No.: 882/D/2014

May the Hon'ble 'T' Bench be pleased to consider:

Note on Forex Hedging Losses:

The company's case does not satisfy the test of transactions that have been excluded under the extant provisions as deemed speculative transactions as:

- it had not clearly demonstrated that the hedging transactions were with respect to raw materials or merchandise:*
- the assessee is not a member of a forward market or an exchange.*
- The Company failed to demonstrate that the transactions in question were hedging transactions as no details were furnished.*
- the details of forex forward contracts were not linked to the trade/export.*
- FCs on certain dates could have been of higher value than the export receivables. As such, the assessee did not demonstrate rupee-to-rupee and date-specific correlation between the FCs and the export invoices.*
- Apparently few Forward Contracts cancelled before the maturity date, which was a characteristic of speculation activity or there were any alterations.*

In view of the above, the following submissions are made:

A. Forward Contracts are to be treated as commodity as held in 38 taxmann.com 338 (Mumbai-Trib.). Reliance on the decision or the Bombay High Court in the case of CIT v. Badridas Gauridu Pvt Ltd 2004 134 Taxman 376 (Bombay) and UT v. Soorajmull Nagarmull [1981] 129 ITR 169 (Cal) in the case of London Star Diamond Company (I) P. Ltd v. DCIT [2013] 38 taxmann.com 338 (Mumbai-Trib.). Relevant extract of para 19 of the judgment reads as under:

"Para /9. The above----- .Although there is decision of the Tribunal where it is held that the FCs are not commodities, considering the judgment of Hon'ble High court of Calcutta in the case of Sooraj Mull Magarmull supra, which was followed by the judgment of jurisdictional High Court in the case of Badridas Gauridu Pvt Ltd (supra), needs to be followed by us. The principle of "judicial discipline" assumes importance and therefore, the "commodity" includes the forward contract'. Thus, in principle, the forward contracts, being commodity, should fall in the definition of 'speculation transaction' and the same is subjected to fulfilment of other conditions specified in sub-section (5) of section -43 of the Act. Having held so, we shall now examine if the impugned contracts/transactions constitute "hedging transactions" and covered by the exclusion provisions of clause (a) to the proviso to section 43(5) of the Act. "

Further, the paras 34, 35 & 36 of the order need to be examined in details so as to consider the nature of such losses which require

detailed examination to see the allowabilty. In this case, the matter was set aside by IT AT on this issue as the assessee had not furnished requisite details to the AO.

Mumbai Tribunal - S. Vinodkumar Diamonds Pvt. Ltd. v. Addl CIT (2013- TIOL-452- ITAT -MUM) has held such transactions to be Speculative in nature. Assessee was in the business of manufacturing and export of diamonds and claimed deduction for loss in tax return on account of exchange rate fluctuations, including loss on forward contracts squared up during the year and marked-to-market losses on outstanding contracts at the year end. The Assessing Officer (' AO') and the CIT(A) disallowed the loss and treated the loss as 'speculation loss', relying on an instruction and circular issued by the Central Board of Direct Taxes (CBDT) regarding this matter (Instruction No.] 3 of 2010dated 23 March 2010 and Circular No.23 of 1960 dated 12 September 1960).

In this case, ITAT Mumbai has drawn a distinction between hedging transaction and speculative transaction, observing that 'speculative transaction' is a contract for purchase or sale of any commodity, stocks or shares that is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrip & on the other hand, a hedging transaction is a contract entered into to protect against possible price fluctuations in the commodity / goods traded by the assessee. ITA T has formulated seven tests to determine a hedging transaction as a non speculative transaction For the purpose of clause (a) of proviso to section 43(5) of the Act. The ITAT Mumbai noted that as the assessee was a dealer in diamonds, hence only forward contracts in diamonds could be treated as hedging contracts. Further, the forward contracts for foreign exchange were closed without actual delivery. Assessee was also unable to establish that booking and cancellation of forward contracts of foreign exchange were in respect of specified export or import. Hence, the loss on forward contract on cancellation and marked-to- market on outstanding contracts as on year end on hedging foreign exchange risk was held to be a speculative contract.

B. Explanation to S. 37(1) inserted by the Finance Act 1998 with retrospective effect from 1-4-1962 reads as under:

"Explanation - For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have

been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure." The forex derivative contracts entered into in excess of the underlying foreign exchange exposure of the assessee are apparently in violation of the guidelines of RBI and FEMA and therefore hit by Explanation to S. 37(1).

This explanation impliedly leads us to the conclusion that such losses on FCs are not allowable to the assessee. CBDT has also issued Instruction No. 03/20 I 0, dated 23-3-2010 to assessing officers regarding the loss on account of currency derivatives. The crux of the said instruction is as under:

(1) In respect of MTM losses debited to Profit and Loss account, the Assessing Officers are instructed to disallow the same while computing the taxable income.

(2) In respect of actual or crystallized losses, the Assessing Officers are instructed to verify whether the losses are on account of speculative transaction as specified u/s.43(5) and decide in accordance with law.

The above instructions render claims of deduction for mark to mark losses provided for in the books in respect of open contracts untenable. However, to be fair, it may also be pointed out that in the case DCIT v. Bank of Bahrain and Kuwait, (ITA Nos. 4404 & 1883/Mum./2004 reported in www.itatonline.org) the Special Bench of Mumbai ITAT, while holding that MTM losses in respect of forward foreign exchange contracts debited to profit and loss account is allowable, has made the following observations:

(i) A binding obligation accrued against the assessee the minute it entered into forward foreign exchange contracts.

(ii) A consistent method of accounting followed by the assessee cannot be disregarded only on the ground that a better method could be adopted.

(iii) The assessee has consistently followed the same method of accounting in regard to recognition of profit or loss both, in respect of forward foreign exchange contract as per the rate prevailing on March 31.

(iv) A liability is said to have crystallised when a pending obligation on the balance sheet date is determinable with reasonable certainty. The considerations for accounting the income are entirely on different footing.

(v) *As per AS-II, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.*

(vi) *The forward foreign exchange contracts have all the trappings of stock-in-trade.*

(vii) *In view of the decision of the Supreme Court in the case of Woodward Governor India (I) P. Ltd., the assessee's claim is allowable.*

(viii) *In the ultimate analysis, there is no revenue effect and it is only the timing of taxation of loss/profit.*

This creates a situation where on one hand a Special Bench decision allows MTM losses, while on the other hand CBDT Instruction mandates disallowance. Apparently, the instruction from CBDT was either not pointed out to the ITAT or was subsequent to this order. Also, the question in the said case was whether MTM loss was a real loss or notional loss and the issue of speculation under 43(5) was not an issue before the ITA T.

On this background, the benefit of this Special Bench order for claiming allowability of MTM losses despite the instruction to the contrary by the CBDT is not available especially due to the facts that the assessee failed to discharge its onus on giving real time data. Besides, the assessee in our case is Engg. Service exporter whereas this AB order was rendered for a bank, so the business profile varies substantially.

C. Recent:

RBI in order to regulate the currency market volatility has allowed the trading in currency future and forward on April 20,2007. As there was difficulty in managing the currency future along depending on FOREX with other derivatives traded in Security exchange market depending on SENSEX, therefore, RBI and SEBI formed a standing committee to analyze the trade in currency forward and future market around the world and thus laying down the guideline to introduce and manage the exchange traded currency future market in India. The committee submitted the report on May 29,2008 . RBI and SEBI are now cooperating and working together to manage this segment of future and option trading in India. Various currency derivatives have been introduced by NSE and MCX to make Indian Securities market globally competitive and larger. The issue therefore calls for detailed adjudication and is not covered in favour of the assessee."

40. We further find it appropriate to reproduce written submission/rejoinder of the assessee to the written reply/submissions of the Id. CIT DR dated

19.6.2015 which were placed before us on 26.6.15. For the sake of clarity in our findings, rejoinder to the written submissions of the Id. CIT DR is being reproduced below:-

*“BEFORE THE HON'BLE INCOME TAX APPELLATE TRIBUNAL, DELHI
BENCH 'I-1' NEW DELHI*

Bechtel India Private Limited

ITA No.882/Del12014

Assessment Year: 2009-10

Rejoinder to the Written Submission of the Learned Departmental Representative (Ld. DR) in respect of the 'Mark to Market' loss of Rs. 21.80 crores as on 31.03.2009 on the foreign exchange forward contracts (FCs)

It is humbly submitted that this Rejoinder may kindly be read along with the Corporate Tax Submission dated 17.06.2015 submitted before your Honours

Rejoinder:

1. The Ld. CIT (DR) has emphasized that the assessee fails to satisfy any of the clauses of the proviso to section 43(5) of the Act. Therefore, marked to market losses on FCs are not allowable, being speculation losses.

This contention is misconceived. The Ld. CIT (DR) merely reiterates the same view as expressed by the Ld. DRP. Both the Ld. DRP & CIT(DR) have ignored the main provision of section 43(5) . They have in the first place, failed to show as to how the impugned case is covered by the definition of 'speculative transaction' as defined in section 43(5) of the Act. All the contentions of the Ld. CIT(DR) have already been met in our submission dated 17.06.2015.

The relevant provisions of section 43(5) which defines the term "speculative transaction" reads as under:

.. (5) "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

Provided that for the purposes of this clause-

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in

respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; or

(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange:

shall not be deemed to be a speculative transaction. "[Emphasis supplied]

The facts of our case are:-

i. The assessee is an exporter of services for which it receives consideration in US Dollars through direct remittance into its bank account.

ii. In India, US dollars is not money but commodity which can be sold or bought in Indian rupees, which is the only legal tender in India.

iii. The rate of US Dollars fluctuates against the INR. In order to protect its business against the fluctuations in US Dollars vis-a-vis INR, the assessee hedges its foreign currency export receivables and forecasted sales transactions by entering into FCs with its Bank.

IV. The assessee accounts for the FCs based upon a consistently followed accounting policy as stated in its audited financial statements (Pg 1 of Corporate Tax Submission dated 17.06.2015).

V. FCs were taken from the authorized dealer Bank in terms of the FEMA regulations notified by the RBI. The RBI regulations (The Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000 read with, Schedule 1 of the Regulation-4-Ref. pgs., 728-733 of PE Vol.-IV clearly provide that where the amount is not ascertainable the forward contract may be taken on the basis reasonable estimate expected export receipts. The said Schedule states that a forward forex contract can be booked by an authorized dealer on the basis of reasonable estimate after verifying the documentary evidence. The bank after satisfying itself in terms of the FE MA regulations has issued the FCs. The facts are not in dispute at all. The matter has already been

discussed at Point No. 7 of our submission dated 17.06.2015 before, your Honours. Thus, there is no requirement for demonstrating rupee-wise and date-specific correlation of export receivables for being not considered as a speculative, transaction.

VI. It is an undisputed fact that all FCs were ultimately settled by delivery of contracted US dollars. The Ld. DRP has verified all the Foreign Inward Remittance Certificates (FIRC) for receipt of US dollars against respective FC and it is not disputed that all the FCs were ultimately settled through delivery of contracted amount of US dollars (Para 3.7.1 of DRP order at Pg 65 of PB Vol.1). Since, all FCs are settled by actual delivery of the contracted amount of US dollars, it is not a speculative transaction under section 43(5). Since it is not a speculative transaction under section 43(5), there is no question of applicability of proviso to section 43(5) of the Act.

Reliance in this regard is placed on the following:

- Hon'ble Supreme Court in the case of Davenport & Co. P. Ltd. v. CIT, reported in (100 ITR 715), wherein the Apex Court has held as under:*

“For income-tax purposes speculative transaction means what the definition of that expression in Explan. 2 says. Whether a transaction is speculative in the general sense or under the Contract Act is not relevant for the purpose of this Explanation. The definition of 'delivery' in S. 2(2) of the Sale of Goods Act which has been held to include both actual and constructive or symbolical delivery has no bearing on the definition of 'speculative transaction' in the Explanation. A transaction which is otherwise speculative would not be a speculative transaction within the meaning of Explan. 2 if actual delivery of the commodity or the scrips has taken place; on the other hand, a transaction which is not otherwise speculative in nature may yet be speculative according to Explan. 2 if there is no actual delivery of the commodity or the scrips. The Explanation does not invalidate speculative transactions which are otherwise legal but gives a special meaning to that expression for purposes of income-tax only. "[Emphasis supplied]

- In the case of Commercial Motors Ltd. v. Dy. CIT [2013J 218 taxmann.com 69(AII.)it was held that" the word "periodically" or "ultimately" makes it clear that the provisions of section 43(5) are applicable where a part of the contract or the entire contract has been settled otherwise than by actual delivery of the goods".*

- Also in the case of *R. Chinnaswami Chettiar v. CIT* [1974J 96 ITR 353 (Mad.) it was noted that "the emphasis in section 43(5) of the Act is on the words. "periodically or ultimately settled otherwise than by actual delivery". The word "settled" is Used in this part of the section without any restriction as to whether it was before breach or after breach. Whether the settlement was before or after breach of the contract is immaterial if actual delivery of the goods is absent. In fact, even in cases where the contract is highly speculative and amounts to a wagering contract, it was settled by actual delivery, for the purpose of section 43(5), it is not a speculative transaction. Thus the section dispenses with all other formalities except that there must be actual delivery or transfer of the commodity when the contract is settled. [Emphasis supplied]

vii. It has been clearly demonstrated beyond doubt that the FCs were taken for hedging against foreign exchange fluctuations in the normal course of export business as has already been held in favor of the assessee on similar facts in the earlier year i.e. AY 2008-09 by the Hon'ble Delhi IT AT (Pg.365 of the PB Vol. II).

2. It is humbly submitted that the reliance placed by the Ld. CIT(DR) on the decision in the case of *BadridasGauridu (P) Ltd. v. CIT* 134 Taxman 376 (Bombay), *CIT v. Sooraj Mull Nagarmull* 129 ITR 169 (Cal.), *London Star Diamond Co. Vs. DCIT* 38 Taxmann.com 338 (Mum. Trib) and *S.Vinodkumar Diamonds Pvt. Ltd. vs. Addt. CIT* 35 taxmann.com 337 (Mumbai IT AT), is wholly misplaced as these judgments are in context of cancellation of forward contracts and consequential settlement of contract through payment of difference between the value of foreign exchange on the contracted rate in INR and the prevailing rate on the date of settlement. The Ld. CIT(DR) lost sight of the undisputed facts of the case that none of the FCs of the assessee were cancelled and all FCs were fully honored by delivery of contracted US dollars. This fact is verified by the Ld. DRP in their order at Para 3.7.1 of DRP order at Pg 65 of PB Vol.1.

3. The reference by the Ld. CIT(DR) to the Explanation to section 37(1) of the Act is misplaced and irrelevant. It is an undisputed fact that the FCs were legally entered into by the assessee with Authorized Dealer Bank in terms of the RBI regulations. It is also undisputed that no illegality is ever found out or alleged by either the Bank or the RBI against the assessee in respect of the FCs. Also, the RBI regulations permits taking FCs based on reasonable

estimate export receipts as discussed above. It is undisputed that the value of FCs is more than the export sales and export receivables. Thus, it cannot be said that entering into FCs is in violation of the RBI guidelines and the allegation that it is hit by explanation to section 37(1) is misplaced.

4. Reliance on the CBDT Instruction No. 23/2010 dated 23-3-2010 is also misplaced. The Ld. CIT(DR) fairly observed that MTM loss was held to be allowable by the Special Bench of Hon'ble Mumbai ITA T in the case of DCIT vs. Bank of Bahrain and Kuwait ([2010] 41 SOT 290) dated 13-08-2010. The observations of the Ld. DR that the said decision is contrary to the CBDT instruction is wholly misplaced as it is a settled principle that CBDT instructions are not binding on the Appellate Authorities. Also, the said decision of the Mumbai ITAT is later in time as against the issuance of the CBDT instruction.

It is also worth mentioning that the said instruction was specifically considered by the Hon'ble Delhi ITAT in the assessee's own case for AY 2008-09 and after considering it the Hon'ble Delhi IT AT decided the matter in favor of the assessee and the matter stands covered in favor of the assessee in the year under consideration.

5. The Ld. DR also referred to a report of a Committee formed by RBI and SEBI for analyzing the trade in currency forwards and future market and laying down guidelines. It is mentioned that the said Committee submitted its report on 29-05-2008. However, how that would impact the instant transaction in FCs by the assessee is not stated. The instant FC transaction is entered into in terms of RBI Regulations (supra). Thus, this observations of the Ld. CIT(DR) towards Committee report losing sight of the applicable RBI regulations is wholly irrelevant.

6. In view of the above, it is submitted that the MTM loss for AY 2009-10 is allowable to the assessee based on the decision of the Hon'ble ITAT in assessee's own case for AY 2008-09 as there is no change in the facts and circumstances of the case. Further, to the extent of actual loss in the subsequent year has been allowed on cash basis by the Ld. AO/DRP in the Assessment Year 2010-11, which has been accepted by the Department. Thus, the whole dispute is regarding timing of allowance.

Dated: 26.06.2015”

41. At the very outset, we observe that undisputedly, the assessee company is exclusively exporting engineering design services to its non-resident AE for which it receives consideration in foreign exchange by way of direct remittance to its bank in India. During the relevant previous year, the assessee entered into 9 foreign exchange forward contracts on 6.8.2008 with an authorised dealer of the bank in order to protect the value of anticipated sale proceeds receivables from its AE in the form of foreign exchange i.e. USD. The first of 9 contracts would mature on 3.4.2009, therefore contract would start maturing every succeeding month and the last contract would mature on 4.12.2009. Undisputedly, the total value of forward contract was Rs. 19.50 crore and in accordance with its method of accounting, the assessee booked loss of Rs.21.8 crore on the unexpired contracts as on 31.3.09 being the difference in the INR value of USD as on 31.3.09 with the value of which contracts were agreed to be settled.

42. From the assessment order it is apparent that the AO had disallowed the said claim of the assessee on the ground that the loss booked and claimed by the assessee is a notional loss which is not allowable. Ld. Counsel has drawn our attention towards Schedule XIII of the significant accounting policies of the assessee and submitted that where the company enters into forward foreign exchange contract with the bankers to mitigate the risk associated with the foreign exchange fluctuation which is further associated with the accounts receivables and amount forecasted sales transactions. It was also pointed out

that the fair value of forward foreign exchange contract which have been taken to cover foreign exchange risk in respect of probable forecasted transaction have a difference between the contracted rate and forward rate at the balance sheet date are recognised in the P&L account. He has drawn our attention towards assessee's paper book Volume II pages 470 to 476 to support this fact. Ld. Counsel also pointed out that in assessee's own case for AY 2008-09 ITA Delhi 'I' Bench order dated 8.3.2013 as in ITA No. 5895/D/2012 and allowed similar claim of the assessee in regard to foreign exchange forward contract, therefore, he submitted that the issue is squarely covered in favour of the assessee by the order of the Tribunal in assessee's own case for the relevant assessment period.

43. Ld. CIT DR elaborated his written synopsis/submissions as above and submitted that as per CBDT Instruction No. 03/2010 dated 23.3.10 the AO recording losses on account of currency derivatives and as per these said instructions in respect of MTM losses debited to P&L account, AO instructed to disallow the same while computing the taxable income. Ld. CIT DR further submitted that as per said instructions in respect of actual crystallized loss, the AO is instructed to verify whether the losses are on account of speculative transaction as specified u/s 43(5) of the Act and to decide in accordance with them. Therefore, above instructions render claim of deduction for mark to market losses provided for in the books in respect of open contracts untenable. Ld. CIT DR also contended that the claim of national loss is not allowable and it

is also relevant to examine that whether at the time of booking loss, the contract was completed and performed by way of actual physical delivery of foreign exchange, otherwise the same has to be treated as speculative transaction and notional loss thereon cannot be claimed as allowable.

44. Ld. CIT DR fairly submitted that in the DCIT vs Bank of Bahrain and Kuwait (supra), Special Bench of ITAT while holding the MTM losses in respect of foreign exchange contracts debited to P&L account has held as allowable with certain observation but this creates a situation where on the other hand special bench decision allows MTM loss while on the other hand CBDT instructions mandates disallowance. It was also contended on behalf of the revenue that the instructions from CBDT (supra) was either not pointed out to the special bench or was subsequent to this order and the question in the said case was whether MTM loss was a real loss or a notional loss and the issue of speculation u/s 43(5) was not an issue before the Special Bench, therefore, the same was not considered. Ld. CIT DR further contended that in this background of aforesaid facts and issues before the Special Bench, the Bench of ratio of the Special Bench order for claiming allowability of MTM losses despite the instructions to the contrary by the CBDT is not available due to the fact that the assessee failed to discharge its onus on giving real time data regarding its claim, specially to demonstrate that the contracts were finalised and performed by way of actual physical delivery of foreign exchange resulting into booked/claimed losses therefrom. Ld. CIT DR finally prayed that the issue

is not covered in favour of the assessee and this issue calls for detailed adjudication in the light of CBDT Circular No. 03/2010 (supra) and other relevant provisions of the Act.

45. Ld. Counsel of the assessee also placed written rejoinder to the written synopsis of the Id. CIT DR on 29.6.15 as reproduced hereinabove. Ld. Counsel submitted that the contention of the Id. CIT DR emphasising that the assessee fails to satisfy any of the clauses of the proviso to section 43(5) of the Act, therefore, mark to market losses on forward contracts are not allowable being speculative losses and this contention is misconceived. Ld. Counsel further pointed out that as per relevant provisions of section 43(5) which defines the term speculative transaction, means transaction in which a contract for the purchase or sale of any commodity including stocks and shares periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrips. Ld. Counsel summarising his main argument also contended that the assessee is an exporter of services for which it receives consideration in USD through direct remittance into its bank accounts. In India USD is not a money but commodity which can be sold or bought in Indian rupee and the rate of USD fluctuations against INR, therefore, in order to protect its business losses against fluctuations in USD vis-a-vis INR, the assessee has as its foreign currency receivable and forecasted sales transaction by entering into forward contracts with its banks. Ld. Counsel pointed out that the assessee accounts for forward contract based upon a consistently followed accounting policy as stated in its

audited financial statement and forward contracts were undertaken from the authorised dealer bank in terms of FEMA regulations notified by the RBI and as per RBI regulations where the amount is not ascertainable, the forward contract may be taken on the basis of reasonable estimates expected export receipts.

46. Ld. Counsel has further drawn our attention towards order of Id. DRP and submitted that it is undisputed fact that all forward contracts were ultimately settled by delivery of contracted USD and this fact was verified by the DRP, therefore, the same cannot be terms as speculative transaction u/s 43(5) of the Act and therefore, there is no question of applicability of proviso to section 43(5). Ld. Counsel further pointed out that case laws relied by Id. CIT DR are in the context of cancellation of forward contracts and settlement of contract through payment of difference between the value of foreign exchange in contract rate in INR and prevailing rate on the date of settlement. Ld. Counsel further contended that reliance placed by the Id. CIT DR on these judgements is wholly misplaced perhaps he lost sight of the undisputed fact that none of the forward contracts of the assessee were cancelled and all forward contracts were fully honoured by delivery of contracted USD. This fact was also verified by the Id. DRP in their order at page 3.7.1 at page 65 of paper book volume I of the assessee. Ld. Counsel also contended that CBDT instruction dated 23.3.2010 (supra) are not binding on the appellate authorities and the decision of Special Bench Mumbai in the case of DCIT vs Bank of Bahrain and Kuwait (supra) dated 13.8.2010 was passed in later time against the issuance of CBDT

instruction. Lastly, Id. Counsel vehemently contended that the revenue is harping on the baseless and incorrect propositions which have been settled by the ITAT Delhi in assessee's own case for AY 2008-09 on the similar set of facts and circumstances and hence the issue is squarely covered in favour of the assessee by this order of the Tribunal.

47. At the very outset, we respectfully take cognizance of decision of ITAT 'I' Bench in assessee's own case for AY 2008-09 (supra) wherein the issue of mark to market losses has been decided in favour of the assessee with following observations:-

"8. Coming to the corporate additions i.e. disallowance of losses, it clearly emerges from the record that the assessee in respect of foreign exchange realization follows mercantile system of accounting and not cash system of accounting. The loss has been incurred for hedging of foreign currency fluctuation involved in sales invoices on the basis of forward contracts, which is a business decision to safeguard its interest. The loss has been incurred on the basis of scientific method in the ordinary course of business. The loss being based on a scientific method in the ordinary course of business. The loss being based on a scientific method, on the basis of contractual liability with banks and on mercantile system has to be allowed to the assessee following Hon'ble Supreme Court judgment in the Case of Woodward Governor India P. Ltd. 312 ITR 254. Our view is further fortified by the fact that DRP in its own order in subsequent year has itself held that the issue about the loss on mercantile system is pending dispute in A.Y. 2008-09. Therefore, the allowability of the loss on actual payment in A. Y. 2009-10 has been made subject to the allowability of the loss for A.Y. 2008- 09. This stand of the DRP itself negates the observations of assessing officer that it is a notional loss and establishes that it is a business loss incurred by the assessee on mercantile system which method is consistently followed by the assessee. Under these circumstances, we are inclined to allow the foreign

exchange fluctuation loss to assessee in this year. This ground of the assessee is allowed.”

48. In AY 2008-09, the claim of loss of Rs. 20,55,724 was claimed by the assessee with following submission and contentions:-

"5.1 During the previous year 2007-08, the appellant entered into foreign exchange forward contracts with banks in order to hedge foreign currency fluctuation and incurred a (net) foreign exchange loss of Rs. 20,55,724/- as a result of "marking to market" the forward contracts that were outstanding on March 31, 2008.

5.2. Ld. Counsel for the assessee Shri Sandeep Chaufla contends that:

(i) There is no dispute about the incurrence of this loss as in the subsequent year the AO after due verification has allowed these losses;

(ii) Similarly, there is no dispute on the method of accounting followed by the assessee is mercantile as the AO has recorded this fact in the assessment order.

(iii) It is not disputed that these losses have been recognised by the assessee in accordance with applicable accounting standards/policies in this regard.

(iv) The AO has raised only dispute that this loss is not allowable as deduction in the year of incurrence computed under mercantile system by following the accounting standards in this respect or at the time of realization of export proceeds on maturity of forward contracts.”

49. Undisputedly, the facts and circumstances of the present case are more or less similar to the present AY 2009-10 and the assessee booked mart to market loss of Rs.21.80 crore as on 31.3.09 being difference in the INR value of the USD as on 31.3.09 and the value of which the hedging contract was agreed to be settled. We further note that the assessee is following mercantile system of account for recognition of this loss in its financial statements. When we see the

order of the DRP para 3.7.1, then it is amply clear that the ld. DRP has alleged that the forward contracts are not fully supported by the underlying support invoice both in terms of the amount as well as the tenure. DRP has drawn the table in this appeal and thereafter noted that out of 9 forward contracts, the assessee has only used 4 forward contract fully and the assessee has not used these forward contracts immediately but started using them against the sale invoice after the lapse of time of few months. Ld. DRP further noticed that contract no. 1461 was used for the first time on 31.10.08 for a nominal sum of USD 632 and thereafter in November for USD 144247 and balance in December 2008 for USD 2755121. Thus, it shows that there was no underlying asset for this contract from 6.8.2008 till 31.10.08. The entire forward contract could be utilised only by 31.12.08. For the sake of clarity in our conclusion para 3.7.1 of the ld. DRP order is being reproduced below:-

“3.7.1 Without prejudice to the above, in case the higher appellant authorities' grants relief to the assessee on account of its claim discussed above, the relevant issue for consideration would be to what extent the claim made by the assessee is admissible? This for the reason that in this case, the FCs are not fully supported by the underlying export invoices both in terms of the amount as well as the tenor.

Thus, an attempt was made by the Panel to ascertain as to what extent and how the assessee has used these FCs? The said position is given in the table below:

DETAIL OF OUTSTANDING FORWARD COVERS AS ON 31 ST MARCH, 2009, FOR WHICH INVOICING DONE TILL MARCH, 2009								
Contract No.	Contract Date	Contract Value (US \$)	Invoice Date	Invoice Amt. USD	Invoice Amt.- INR	Underlying Assets as at 31.03.09	FIRC No.	FIRC Date
146164	6-Aug-08	2,900,000	Oct-08 Nov-08 Dec-08	632 144,247 2,755,121	31,640 7,208,024 131,942,759	YES YES YES	156473	2-Apr-09
146166	6-Aug-08	2,900,000	Oct-08 Nov-08 Dec-08 Jan-09 Mar-09	(5,001) 33, 512,400 2,392,577 (9)	(250,495) 1,627 24,538,846 116,877,386 (452)	YES YES YES YES YES	157124	4-May-09
146167	6-Aug-08	3,000,000	Jan-09 Feb-09 Mar-09	830,550 2,169,380 70	40,572,363 108,230,382 3,567	YES YES YES	157869	4-Jun-09
146169	6-Aug-08	3,100,000	3,100,000	Jan-09 Feb-09 Mar-09	637 1,041,624 2,057,739	YES YES YES	158594	3-Jul-09
146171	6-Aug-08	828,047	Mar-09	828,047	42,296,660	YES	159290	4-Aug-09
Sub-Total		12,728,047		12,728,047	628,559,352		Grand Total	
146171	6-Aug-08	2,271,953	Beyond 31.3.09			NO	159290	4-Aug-09
146173	6-Aug-08	3,200,000	Beyond 31.3.09			NO	159930	4-Sep-09
146174	6-Aug-08	3,300,000	Beyond 31.3.09			NO	160558	1-Oct-09
146175	7-Aug-08	3,000,000	Beyond 31.3.09			NO	161236	4-Nov-09
146176	7-Aug-08	3,100,000	Beyond 31.3.09			NO	162068	4-Dec-09
Sub-Total		14,871,953						
GRAND TOTAL		27,600,000						

It can be seen that out of the 9 FCs, the assessee has used only 4 FCs fully. The assessee has not used these FCs immediately but started using them against the sales invoices after a lapse of time of few months. To elaborate it further, it is noticed that the contract no. 146164 was used for the first time in 31st October 2008 for nominal sum of US\$ 27,55,121. Thus, it is evident that there was no underlying asset for this contract from 6.8.2008 till 31st October 2008. The entire FC could be utilized only by 31st December 2008.

Likewise the contract no. 146167 and 146169 taken on 6.8.2008 have been started to be used by the assessee from

January 2009 onwards. Thus, there was no underlying asset for these contracts from 6.8.2008 till 31.12.2008.

Out of the firth FC bearing no. 146171 only a small part of US\$8.28 (total US\$31 lakh) has been used by 31st March 2009 while the remaining 4FCs were not utilized at all till 31.03.2009.”

50. There is no observation of the Id. DRP in para 3.7.1 which support the contention of the assessee that all forward contracts were duly honoured by delivery of contracts under USD. In this situation, in principle, we agree that in view of the ratio laid down by Hon’ble Supreme Court in the case of Woodward Governor (312 ITR 254), while the assessee is following mercantile system of accounting, the loss suffered by the assessee by fluctuation in the foreign exchange as on the date of balance sheet is an item of expenditure u/s 37(1) of the Act. Under this proposition and dicta of Hon’ble apex court, and facts emerging from the DRP order, we find it appropriate that the issue requires detailed examination and verification and calculation on scientific basis at the end of the AO/DRP in the light of relevant proposition and provisions of the Act. Therefore, relying on the said propositions and following the judgement of Hon’ble apex court in the case of Woodward Governor (312 ITR 254), we restore this issue to the file of AO/DRP for a fresh adjudication after factual analysis and examination of the impugned transactions after affording due opportunity of hearing for the assessee and without being prejudiced by the earlier orders.

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51. Accordingly, ground no. 5 to 5.4 of the assessee are allowed for statistical purposes in the manner as indicated above. Ground no. 6 being consequential and ground no. 7 being premature are dismissed.

52. In the result, the appeal of the assessee is partly allowed on transfer pricing issue and partly allowed for statistical purposes on the corporate ground of mark to market losses.

Order pronounced in the open court on 14.10.2015.

Sd/-

(S.V. MEHROTRA)
ACCOUNTANT MEMBER

Sd/-

(CHANDRAMOHAN GARG)
JUDICIAL MEMBER

DT. 14th OCTOBER 2015
'GS'

Copy forwarded to:-

1. Appellant
2. Respondent
3. CIT(A)
4. CIT 5. DR

By Order

Asstt. Registrar