IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad 'A' Bench, Hyderabad

Before Smt. P. Madhavi Devi, Judicial Member
and Shri Inturi Rama Rao, Accountant Member

ITA No.316/Hyd/2015
(Assessment year: 2010-11)

Dy. Commissioner of Income Tax, Circle 8(1) Hyderabad (Appellant)	Vs.	M/s. Kirby Building Systems India Ltd Medak PAN: AABCK 0239 M (Respondent)

For Revenue: Shri D. Srinivas, DR
For Assessee: Shri Farrokh V. Irani

Date of Hearing : 05.08.2015
Date of Pronouncement : 07.08.2015

O R D E R

Per Smt.P. Madhavi Devi, J.M.

This is a Revenue appeal for the A.Y 2010-11 against the order u/s 143(3) r.w.s. 144C(1) of the I.T. Act, 1961, dated 30.01.2015.

2. Brief facts of the case are that the assessee company is engaged in the business of manufacture of pre-engineered building system products, filed its return of income on 13.10.2010 declaring total income of Rs.6,40,81,725. On verification of the record, the AO observed that assessee has entered into international transactions exceeding Rs.15.00 crores. Therefore, he made a reference to the TPO u/s 92C of the Act for determination of the Arms' Lengh Price of international transactions.

3. During the transfer pricing proceedings u/s 92CA(3) of the Act, the TPO observed that the assessee has entered into various international transactions with its AE's and the payment of royalty and technical services under a common agreement for both technical knowhow fees and royalty to its AE at Kuwait was one of the transaction. As per the said agreement, assessee paid royalty @ 7.5% on the sales amounting to Rs.9,39,74,409 and Rs.61,77,041 towards technical fee. He observed that royalty and fee for technical services are transactions for intangible services and therefore, TPO accepted the CUP method adopted by the assessee as the most appropriate method and further observed that two independent comparables i.e. M/s Cold Steel Corporation and Tiger Steel Engineering (P) Ltd were adopted by the TPO in the assessee's own case in the earlier A.Ys and the assessee had raised similar objections against these companies before the TPO for the relevant A.Y also. After considering assessee's objections at length, the TPO held that these two comparables were selected for comparison and analysis on the basis of information furnished by the tax payer itself. Further, TPO also observed that for financial year 2009-10 and the preceeding previous years from the P&L a/c, it is evident that most of the work is outsourced by the assessee on job work basis. Therefore, he came to the conclusion that assessee has engaged third parties to get the work done on the projects undertaken in a significant way, meaning thereby, that the work involved is a low end job which does not require any speciliazed skills. Therefore, he was of the opinion that there was no need for obtaining any technical services by the assessee from its AE. As regards payment of royalty, the TPO held that unless it is shown that tangible and direct benefit is derived by the assessee and that the royalty payment made, is commensurate with the

benefit that is derived or accepted to be derived when parties deal with each other at ALP, the ALP of such payment of royalty would have to be treated as either 'Nil' or only to the extent it is shown that the benefit actually was derived from such payment. He observed that since the assessee has not received any technical assistance from its AE, the ALP of the payment made by the assessee to its AE's on account of intangible/royalty and technical service fees is nil. He accordingly made adjustment of the entire amount of Rs.,9,39,74,409 and Rs.61,77,041 u/s 92CA of the I.T. Act. Similarly, the TPO also made adjustment of Rs.1,07,99,889 as an ALP adjustment on reimbursement of expenses received. On the basis of the said T.P. order, AO proposed the draft assessment order dated 19.03.2014. Against the said order, assessee preferred objections before the DRP. The DRP, vide order dated 24.12.2014 observed that the assessee had entered into similar international transactions with its AE in the earlier A.Ys i.e. A.Ys 2006-07, 2007-08, 2008-09 and 2009-10 and the issue had travelled upto the Tribunal and the Tribunal by its order dated 18.07.2014 in ITA Nos.1651/Hyd/2010 & ITA No. 1975/Hyd/2011 and orders dated 19.11.2014 in ITA Nos. 1759/Hyd/2011 and ITA No.262/Hyd/2014 has decided the issue in favour of the assessee. The DRP deleted the ALP adjustment proposed by the AO. Pursuant to the same, the final assessment order was passed u/s 143(3) r.w.s. 144C(1)of the Act without making any TP adjustment on royalty and reimbursement of expenses. Against this order, dated 30.01.2015, the Revenue is in appeal before us.

4. The ld DR, while supporting the Transfer Pricing order, submitted that the DRP has erred in holding that the royalty

payment/fee for technical services is not warranted, though the TPO has held that the applicant was not able to substantiate that any benefit was derived by the tax payer by the services provided by the AE requiring such payments.

5. The ld Counsel for the assessee, on the other hand, reiterated the submissions made by the assessee before the authorities below and has also relied upon the decision of the Tribunal in assessee's own case for the earlier A.Ys wherein similar transactions have been analysed by the Tribunal and thereafter relief granted to the assessee. A copy of the said order of the Tribunal is filed before us.

6. Having regard to the rival contentions and also the material on record, we find that the assessee had entered into international transactions for payment of royalty and fee for technical services vide agreement dated 1.4.2000. Further we find that this agreement had undergone several amendments and the assessee had started paying royalty only from the P.Y 2005-06 onwards. Therefore, the ALP adjustment of these transactions has arisen only from P.Y 2005-06 onwards. This Tribunal, in assessee's own case for A.Ys 2006-07 onwards, had considered this issue at length and had come to the conclusion that it is not required by the assessee to demonstrate that payment of royalty is justified as such agreements are periodically approved by the RBI and by the Ministry of Industries and the assessee was paying the amount as per the agreements. For coming to the conclusion, the Tribunal relied upon the decision of the Hon'ble Delhi High Court in the case of CIT vs. EKL Appliances (ITA Nos.1068 of 2011 and 1070 of 2011 dated 29.03.2012). This decision of the Tribunal was also

followed by the Coordinate Bench of this Tribunal in assessee's own case for A.Ys 2008-09 and 2009-10 holding that the royalty paid by the assessee was at ALP. The relevant paragraphs are reproduced hereunder for the sake of ready reference:

> "4. Ground Nos. 1 to 8 pertain to the disallowance of payment of royalty and technical service fee to M/s. Kirby Building Systems, Kuwait analysed under the provisions of transfer pricing. Briefly stated, assessee M/s. Kirby Building Systems India Ltd., is engaged in the business of manufacture of Pre-Engineered Steel Building System (PEB) Products. For the year under consideration, assessee filed return of income declaring total income of Rs.6,82,39,910/-. A.O. noticed that it had international transactions with its AE to an extent of Rs.15,96,89,713/-. The following are the details of international transactions entered into by and between the taxpayer and the AE :

Name of the AE	International transaction	Value in INR
Kirby Kuwait	1. Payment of royalty & technical services fee	137,037,502
	2. Payment of interest (ECB in Kuwait Dinar)	1,473,502
	3. Payments towards reimbursement of expenses	657,120
KIMMCO	Purchase of insulating material	19,429,932
Alghanim Mauritius	Payment of interest on (ECB in USD)	1,031,517

> 5. The TPO vide order dated 30.10.2009 accepted the operating transactions consisting of purchase of insulating material and of payment of interest, reimbursement expenses as at arm's length price. However, payment of royalty and technical services fee of Rs.13,70,97,902/- were considered as not at arm's length. After giving opportunity to the assessee, the TPO was of the opinion that there was no need to pay any royalty and technical service fee to the AE. His order vide para 10.2 to 10.4 on the issue is as under :
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> "10.2.Royalty/technical services fee paid to Kirby Kuwait (AE) During the Financial Year under consideration, the tax payer has debited an amount of Rs.17,71,37,206/- towards royalty at the rate of 7.5% on sales. During F.Y. 2004-05, the taxpayer has paid royalty at Rs.6,77,67,700/- to Kirby, Kuwait (AE) at the rate of 3.5% on sales.
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> As per the agreement entered by and between the taxpayer and it's AE at clause-4, the rates for payment of royalty are given. Except that, nothing is mentioned. What is the basis for which royalty is paid by the taxpayer

remained unsubstantiated. In its reply dated 10.03.2009, the taxpayer in response to query no.10 has replied as under :

"Kirby India has technology collaboration with Kirby Kuwait. In this regard, Kirby India has entered into a TSA with Kirby Kuwait. The initial term of the agreement was for 7 years starting from 1st April, 2000 to 31st March, 2007. However, owing to business exigencies, the TSA was amended intermittently to provide for waiver of the royalty during the years 2000 to 2004. The amendments have resulted in deferring the payment of royalty to subsequent years. However, the amendment in the royalty rates and the payments terms are subject to the condition that the royalty payments will not exceed the potential outflow as agreed in the original TSA. Further, in respect of the lump sun technical fee, the sum of USD 2,000,000 which was agreed as per the original TSA, has not been revised but the payment terms have been amended to defer the payment over a certain number of years up to 2017."

Taxpayer failed to furnish any FAR analysis in respect of royalty payment. It is pertinent to note that no royalty was paid by the taxpayer from year 2000 to 2004. Just because RBI fixed the limits of royalty rates, the same is taken as bench mark for payment of royalty. However, one has to understand that the RBI limits is nothing to do with determination of arms length price under the provision contained under section 92 of I.T. Act, 1961. RBI limits are meant to regulate foreign exchange as part of forex management. The reason give for not paying royalty by the taxpayer between the years 2000 to 2004 is that there were no profits made during the said financial years. This is not correct. In fact, for F.Y. 2003-04, the taxpayer has earned a net profit margin of 6.67%. The claim of the taxpayer that there is a substantial expansion of the manufacturing facility during the F.Y. 2003-04 is also not correct. No significant expansion took place during that year. Plant machinery valued at Rs.2,64,35,261 is only added. A net profit of Rs.6,71,10,235 was made on sale of Rs.108,38,57,968. These are not valid reasons for paying royalty in some years and not paying in some other years. When the taxpayer did not paid royalty from year 2000 to 2004 (4 years), there is no reason/basis as to why the royalty should be paid in subsequent years, more so, based on an agreement, which is never implemented. Also, the amount paid towards technical services at Rs.59,20,536/- remained unsubstantiated by the taxpayer with reference to the benefits derived and services rendered. The taxpayer failed to bring out any evidence in support of the technical services actually received.

Hon'ble Supreme Court in the case of Union of India vs. Gosalia Shipping P. Ltd., 113 ITR 307 (SC) held that :

"It is true that one cannot place over reliance on the farm which the parties give to their agreements or on the label which they attach to the payment due from one to other. One must have regard to the substance of the matter and if necessary, tear the veil in order to see

whether the true character of a payment is something other than what by a clever devide of drafting it is made to appear."

10.3. Shifting of profits to no tax jurisdiction :

Rule of substance over form is the key in examining the agreements entered by and between the taxpayer and it's A.E. in respect of payment made towards royalty and technical fees as these transactions are controlled. After examining the available information/evidence on record and analysis thereon, the only inference that can be drawn is that these two transactions that is payment towards royalty and technical services is that they are not at arms length. In the guise of these payments, the taxpayer is shifting profits to no tax jurisdictions like Kuwait and Mauritius, thereby enriching themselves without paying taxes that are due in the country where the taxpayer operates. The profits declared by the taxpayer are not comensurating with the functions performed and risk assumed in the country of operations.

10.4. Brand value :

The taxpayer has also taken brand value as one of the factors for payment of the so-called technical services/royalty. Kirby, India sets its footprint in the country in the year 2000. What brand value Kirby, Kuwait commands in a country like India where the usage of pre-engineered steel buildings are at a nascent stage. Only after year 2000, the infrastructure sector has opened up which started accepting these pre-engineered steel structures in industrial sector. PESBs are not consumer products which can be bought off the shelf from any store. Also it is important to note that brand value is developed from the contributions made by all the group entities of MNEs. Therefore, Kirby, India has developed its own brand value by spending huge amounts on marketing, development and advertisements as discussed in the earlier part of this order. Significant costs have been incurred by Kirby, India in marketing of its product in the country. Also, the PESBs are customized to the needs of the customers with reference to locations and functionality of the business. The PESBs which are prevalent in Kuwait cannot be simply replicated here in India. Kirby, India has spent huge amounts in marketing development and business promotion to familiarize their products. Developed in-house expertise and most of the works are also outsourced on job work basis. Therefore, creation of brand value is from all sides and from all entities of a multinational group. No payment on account of brand value by the taxpayer to its AE is not justified.

In view of the above discussion, it is concluded that the payment made by the taxpayer to its A.E. on account of technical services is excessive as already huge payments were made in the past several years. Neither taxpayer nor its AE could substantiate the actual technical services rendered, costs incurred/contributed, benefits derived. The arms length price of the payment made towards

technical services is at Rs.59,20,536/- is taken as NIL under CUP method. As the payment of royalty on sales is without any basis and hence the transaction is treated as sham and no method is adopted. The arms length price of the royalty paid at Rs.17,71,37,206/- is taken at NIL."

Accordingly, he has suggested disallowance of the entire amount pertaining to technical services and royalty to an extent of Rs.18.30 crores.

6. Assessee filed its objections before the DRP. The DRP after analyzing the transactions of the AE and various agreements entered by the assessee with AE with reference to payment of technical fee and royalty gave partial relief by stating as under :

"8.3 After going through the entire material provided by the taxpayer and after extensive discussion of the TPO, we are of the view that Kirby India has established a plant In the outskirts of Hyderabad with technical assistance from its AE. Definitely, the AE has to be paid in terms of royalty and technical knowhow fee for the same. The main question here is whether the technical fee/royalty paid vis-a-vis the profit earned by the taxpayer and the services rendered by the AE are adequate or whether they are within the ALP. The following table gives the fee for technical services debited into the Profit & Loss Account by the taxpayer during the last so many years as under :

Financial Year	Technical Fees paid in Rs.
2005-06	59,20,536
2004-05	1,90,05,260
2003-04	1,02,87,965
2002-03	63,84,953
2001-02	10,74,145
2000-01	2,43,259
Total	4,29,16,118

8.4. As seen from the above table, the taxpayer during the last six years has debited to the Profit & Loss Account to the tune of Rs. 4,29,16,118/- on account of technical services. The benefit derived by the taxpayer from the above technical services, we are of the view is adequately compensated and hence further technical fee payment in this year is not necessary. The action of the TPO in taking technical fee payable for this year as "nil" is upheld. In respect of royalty, during the financial year under consideration the taxpayer was paying the royalty @7.5% on sales and debited an amount of Rs. 17.71 crores. As one could see, the AE is declaring 15% profit and the taxpayer has declared nearly 6% profit, whereas the royalty payment is @7.5% of the sales. Besides, this makes us to infer that there is a shifting of profit from India to its AE. We also tend to believe that since shifting of profits to its AE in countries non taxable, there would be a tendency to shift the profit from the taxpayer to its parent companies. Now the question is how to quantify them. During the FY 2004-05, the taxpayer has paid the royalty @ 3.5% on sales of Rs. 6,77,67,700/-. We are of the view that during this year also the

royalty payment of 3.5% on sales would meet the requirement of ALP. To this extent, the TPO's report is modified i.e. ALP in respect of royalty payment is calculated as under :

Price Received vis-a-vis the Arms Length Price:

The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length Price as under :

Arms Length Price of payment made towards technical services NIL

Price shown in the international transactions Rs.59,20,536/-

Shortfall being adjustment u/s.92CA. Rs.59,20,536/-

Arms Length Price of payment made towards royalty Rs.17,71,37,206/-

Price shown in the international transactions Rs. 8,26,64,030/-

Shortfall being adjustment u/s.92CA. Rs.9,44,73,176/-

Summary of adjustments u/s.92CA:

(1) In respect of payment made towards technical services. Rs.59,20,536

(2) In respect of payment made towards royalty Rs.9,44,73,176

Total Rs.10,03,93,712

7. Thus the assessee has got partial relief from the DRP. Therefore, it has raised various grounds on the denial of claim of payment of technical services and restriction of royalty to the AE in its grounds 1 to 8.

8. Ld. Counsel drew our attention to the activities of the assessee company, reliance on technical expertise of Kirby Building Systems, Kuwait and the sequence of events to submit that originally assessee has entered into an agreement for technical assistance and technical services with Kirby Building Systems Kuwait on 1st April, 2000 in which it undertook to pay an amount of 2 Million US Dollars as technical service fee. This amount was to be paid, 1/3rd on approval of collaboration agreement from Reserve Bank of India, 1/3rd on delivery of knowhow documentation and balance in 4 years after the proposal was approved by the RBI. However, vide amended agreement dated 07.09.2001 it was understood that lump sum amount of 2 Million USD would be paid in 5 equal installments beginning from the year December, 2002 with modified terms of payment of Royalty and Technical fee. Since the assessee company was incurring losses and was in requirement of working capital, there was further amendment on November 12, 2002 with further modifications. Since assessee paid only an amount of 0.4 Million US

dollars as on that date, the technical fee was to be paid at 2,67,000 USD in the year 2003 and 1,00,000 USD each from 2004 to 2016 and balance 33000 US Dollars in the year 2017. It was submitted that lump sum technical fee payable at the time of initial operations of the company was in fact deferred so as to suit the assessee company in its working capital requirement. Accordingly, it was submitted that assessee paid US $1,00,000 as technical fee in the year under consideration.

9. With reference to royalty, it was submitted that in the original agreement dated 01.04.2000 royalty was payable on domestic sales at 2.5% in the first year and 5% from second year i.e., 2002 onwards up to 31.03.2007. However, assessee has not paid any royalty in the year 2000-2001 and vide agreement dated 07.09.2001, the terms were changed to pay royalty at 5% on domestic sales and 5% on export sales from the year 2002 to March, 2007. In spite of that, assessee did not pay any royalty in the years 2002 and 2003. Therefore, vide agreement dated 12.11.2002, this was changed to no royalty up to March 2003 and 7.5% on domestic sales and 8% on export sales for 3 years up to March, 2007. This was however, further modified vide agreement dated 17.12.2005 to nil royalty up to 2004 and 7.5% on domestic sales for 3 years and 8% of export sales for 3 years, that too up to March, 2007. All the agreements were approved by RBI as well as Industries Department, Government of India. It was submitted that assessee in the impugned year has claimed the royalty at 7.5% on domestic sales and 8% on export sales.

10. It was submitted that assessee has never paid any royalty at 3.5% on domestic sales and to that extent both TPO and DRP wrongly considered the payment at 3.5% and allowed the amount at that rate. It was submitted that royalty in A.Y. 2005-06 was paid at 7.5% on domestic sales which was allowed. As far as the technical knowhow is concerned, this amount was payable in a lump sum amount initially which was deferred and only USD 1,00,000 was paid in the year.

11. With reference to the total denial of technical knowhow fees and partial denial of royalty by the DRP, it was submitted that either the TPO or the DRP has no jurisdiction to deny the claim in its entirety as they have only power to examine the arm's length price of the payments made to AE. It was further submitted that in case of T.P. adjustments, the A.O. disallowed the entire claim invoking the provisions of section 37(1), whereas DRP partially allowed the amount of Royalty without any comparative study under various methods prescribed under the provisions for examining the arm's length price of the transactions entered into by the assessee with its AE. Since the TPO has no jurisdiction to examine the allowability of royalty claim, action of the TPO/DRP is not sustainable. For this proposition, the Ld. Counsel relied upon the decisions of the Hon'ble High Court of Delhi in the case of CIT vs. EKL Appliances Ltd. 1068 of 2011 dated 29.03.2012 which in turn, was followed by Coordinate Benches of ITAT, Mumbai in SC Enviro Agro India Ltd. vs. DCIT ITA.Nos. 2057, 2058/Mum/2009 dt.07-11-2012 and in the case of

Thyssen Krupp Industries India P ltd vs. ACIT, Mumbai ITA.No.7032/Mum/2011 dated 27.11.2012 and also by the Coordinate Bench at Hyderabad in the case of DCIT vs. Air Liquide Engineering India P. Ltd., in ITA.No.1040/Hyd/ 2011 and others dated 13.02.2014. It was the submission that A.O. cannot disallow the amount in its entirety without examining the arms length price of the transaction.

12. Coming to the observations of the TPO that there was shifting of profits to no tax jurisdiction, it was submitted that this argument cannot be accepted in view of the provisions of T.P. and also on further fact that assessee has paid the taxes on the amounts in India. It was submitted that the royalty and technical fee payable are on net basis. Therefore, assessee has grossed-up the amounts and to an extent of about 32% assessee has paid taxes including service tax, cess and other taxes. The Ld. Counsel referred to the detailed submissions made before the DRP on this issue.

13. It was further contended that assessee's agreements with AE were approved by RBI and also by the Department of Industries and therefore, the TPO/DRP has no role to deny the claim which was approved by other Government Authorities. Ld. Counsel on a clarification about the working of royalty clarified that even though the rate agreed/approved stood at 7.5% of domestic sales or 8% of export sales, as per the policy of the RBI there are various exclusions in considering the turnover. Therefore, the effective date of royalty was much less whereas, the DRP has approved the rate at 3.5% on the gross domestic sales. Therefore, there is a little variation in the amounts taken.

14. Summarising the arguments, Ld. Counsel submitted that DRP/TPO has no jurisdiction to restrict the amount to NIL. Ld. Counsel made various propositions as under and as supported by various decisions of the Coordinate Benches/High Court.

i. That TPO has to apply method while considering the adjustments to the international transactions.

For this he relied on

(i) Merck Ltd., Mumbai vs. DCIT, Circle 6(3), Mumbai ITA.No.925/Mum/2007 dt. 19.07.2013.
(ii) Johnson & Johnson Ltd., Mumbai vs. CIT-LTU, Mumbai ITA.No.83/Mum/2011 dated 05.02.2014.

(iii) Kodak India P. Ltd., Mumbai vs. ACIT 10(1), Mumbai ITA.No.7349/Mum/2012 dated 30.04.2013

(iv) Reebok India Co. vs. ACIT, New Delhi ITA.No.5857/Del/2012 dt. 14.06.2013

ii. The TPO has no jurisdiction to question the business prudence of the assessee in paying various royalties/technical knowhow fee.

(i) Johnson & Johnson Ltd., Mumbai vs. CIT-LTU, Mumbai ITA.No.83/Mum/2011 dated 05.02.2014.

(ii) Reebok India Co. vs. ACIT, New Delhi ITA.No.5857/Del/2012 dt. 14.06.2013.

iii. The TPO has no jurisdiction to disallow the entire amount without determining the ALP

(i) SC ENVIRO Agro India Ltd., Mumbai vs. DCIT 3(3), Mumbai ITA.Nos.2057 & 2058/Mum/2009 dated 07.11.2012

(ii) M/s. Thyssen Krupp Industries India P.Ltd., Mumbai vs. ACIT, C.C.3(3), Mumbai ITA.No.7032/Mum/2011 dt. 27.11.2012 iv. The TPO has no jurisdiction to disallow or differ from the agreements which are approved by other Government Authorities like Department of Industries or by Reserve Bank of India.

(i) SC ENVIRO Agro India Ltd., Mumbai vs. DCIT 3(3), Mumbai ITA.Nos.2057 & 2058/Mum/2009 dated 07.11.2012

v. The benefit derived by the assessee is also not relevant for considering the payment of royalty and technical knowhow fee and relied on the following case laws

(i) DCIT, Circle1(1), Hyderabad vs. M/s. Air Liquide Engineering India P. Ltd., Hyderabad ITA.No.1040/Hyd/2011 etc., dt. 13.02.2014

(ii) ACIT, Cir.4, Ahmedabad vs. Hitachi Home & Life Solutions (India) Ltd., ITA.No.2361 & 2362/Ahd/2008 etc., dated 24.09.2013.

15. Learned D.R. however, relied on the detailed orders of the TPO and DRP to submit that there is no necessity to pay royalty at higher amount and so the authorities are within the jurisdiction to restrict the amount at NIL on technical services fee and 3.5% on gross sales as far as royalty is concerned. He relied on the orders of the authorities.

16. Ld. Counsel, in reply, also clarified various issues raised and placed on record a cumulative payment of royalty and technical services fee by the assessee over a period to submit that effective rate of royalty is very much less. It was submitted that the assessee has paid cumulative royalty as percentage of cumulative sales at 3.75% up to A.Y. 2009-2010. It was submitted that the payment of technical knowhow and royalty should be allowed in full.

17. We have considered the rival contentions and examined the orders of the authorities, documents placed on record and relevant case law relied upon. Kirby Building Systems India P. Ltd., is a wholly

owned subsidiary of Alghanim Industries, a Kuwait based Multi-Billion Conglomerate. It is one of the world's largest producers of Pre- Engineered Steel Buildings (in short "PEB") and has been operational for more than 38 years since 1976. To pioneer the PEB concept, it has set up a plant in India in the year 1999 with a manufacturing facility with a capacity of 60,000 MT per annum at Hyderabad. It was submitted that Kirby Kuwait has extremely talented pool of skilled structural engineers, designers and detailers conversant with Indian and Internationally acclaimed codes and engineering practices. All the buildings designed by Kirby are custom designed using latest domestic/international codes and standards such as IS, MBMA, AISC, AISI and AWS. PEB technology has various advantages being flexibility in expansion, faster installation, energy efficient and practically maintenance free with superb quality and also earthquake resistant. It has applications starting from factories and warehouse to air-craft hangers, stations, ship yards, work-shops, Stadiums etc. Assessee indeed pioneered a new concept of Pre-Engineering Steel Building with the technical help of its AE.

18. There is no dispute with reference to the fact that assessee was promoted by the Kirby Building Systems, Kuwait and its original technical service agreement for payment of lump sum amount of $ 2 million dollars as technical knowhow fee and royalty of 2.5% in the first year and 5% from second year onwards up to March 31, 2007 was approved by the RBI and Ministry of Industries. It is also a fact that assessee did not remit any of those amounts in those years and the agreement was amended periodically. As stated above in the facts of the case, in the impugned year assessee has paid $ 1 lakh dollars as technical knowhow fee and royalty at 7.5% on domestic sales as per the agreements entered into and approved by the authorities.

19. In the guise of examining the payments under T.P. provisions, it is noticed that the TPO has not analysed these payments either under TNMM method or under any other method which require to be analysed as per the provisions. However, the TPO has examined the business necessity of payment of technical knowhow fee and royalty under the provisions of section 37(1)rather than under the provisions of T.P. His decision of not allowing any royalty payment or technical knowhow payment and determining the ALP at NIL cannot be sustained in view of the fact that this technical knowhow fee and royalty were agreed upon when the assessee has originally entered into agreement as on 01.04.2000 much before the T.P. provisions came on statute. It may be another reason that assessee has revised the agreement and paid subsequently, partly in the impugned year, but that does not prevent assessee claiming expenditure which was necessary for its business operations in view of the agreement entered at the time of establishing the unit in India. Had there been no revision of the agreement, the payment of technical knowhow fee would have been over by the year 2002 itself. Assessee paid in a sense belatedly the same amount which was payable originally due to rescheduling in payment period. No extra amount was required to be paid. Moreover, on the entire turnover in the intervening years,

assessee also would have paid royalty. However, due to business requirements, both the parties agreed to revise the royalties. TP provisions does not empower the TPO to decide about the commercial decisions and determining the ALP at NIL thereby, denying the entire claim instead of allowing the amount on the basis of ALP to be determined under the provisions.

20. The Hon'ble Delhi High Court in the case of CIT vs. EKL Appliances ITA.No.1068 of 2011 and 1070 of 2011 dated 29th March, 2012 considered similar issue whether the TPO has power to restrict in determining the ALP at NIL under the provisions of T.P. when he was supposed to have determined the arms length price of the international transaction. The Hon'ble Delhi High Court after examining the facts of the case held under :

> *"19. There is no reason why the OECD guidelines should not be taken as a valid input in the present case in judging the action of the TPO. In fact, the CIT (Appeals) has referred to and applied them and his decision has been affirmed by the Tribunal. These guidelines, in a different form, have been recognized in the tax jurisprudence of our country earlier. It has been held by our courts that it is not for the revenue authorities to dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. We may refer to a few of these authorities to elucidate the point. In Eastern Investment Ltd. v. CIT, (1951) 20 ITR 1, it was held by the Supreme Court that "there are usually many ways in which a given thing can be brought about in business circles but it is not for the Court to decide which of them should have been employed when the Court is deciding a question under Section 12(2) of the Income Tax Act". It was further held in this case that "it is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned". In CIT v. Walchand & Co. etc., (1967) 65 ITR 381, it was held by the Supreme Court that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the Revenue. It was further observed that the rule that expenditure can only be justified if there is corresponding increase in the profits was erroneous. It has been classically observed by Lord Thankerton in Hughes v. Bank of New Zealand, (1938) 6 ITR 636 that "expenditure in the course of the trade which is un-remunerative is none the less a proper deduction if wholly and exclusively made for the purposes of trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense". The question whether an expenditure can be allowed as a deduction only if it has resulted in any income or profits came to be considered by the Supreme Court again in CIT v.*

Rajendra Prasad Moody, (1978) 115 ITR 519, and it was observed as under: -

"We fail to appreciate how expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of Section 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income."

It is noteworthy that the above observations were made in the context of Section 57(iii) of the Act where the language is somewhat narrower than the language employed in Section 37(1) of the Act. This fact is recognised in the judgment itself. The fact that the language employed in Section 37(1) of the Act is broader than Section 57(iii) of the Act makes the position stronger.

20. In the case of Sassoon J. David & Co. Pvt. Ltd. v. CIT, (1979) 118 ITR 261 (SC), the Supreme Court referred to the legislative history and noted that when the Income Tax Bill of 1961 was introduced, Section 37(1) required that the expenditure should have been incurred "wholly, necessarily and exclusively" for the purposes of business in order to merit deduction. Pursuant to public protest, the word "necessarily" was omitted from the section.

21. The position emerging from the above decisions is that it is not necessary for assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above".

22. Even Rule IOB(l)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for assessee to have incurred the same or that in the view of the Revenue the expenditure was un- remunerative or that in view of the continued losses suffered by assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that assessee has suffered continuous losses. The financial health of assessee can never be a

criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that assessee ought not to have entered into the agreement to pay royalty/brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised.

23. Apart from the legal position stated above, even on merits the disallowance of the entire brand fee / royalty payment was not warranted. Assessee has furnished copious material and valid reasons as to why it was suffering losses continuously and these have been referred to by us earlier. Full justification supported by facts and figures have been given to demonstrate that the increase in the employees cost, finance charges, administrative expenses, depreciation cost and capacity increase have contributed to the continuous losses. The comparative position over a period of 5 years from 1998 to 2003 with relevant figures have been given before the CIT (Appeals) and they are referred to in a tabular form in his order in paragraph 5.5.1. In fact there are four tabular statements furnished by assessee before the CIT (Appeals) in support of the reasons for the continuous losses. There is no material brought by the revenue either before the CIT (Appeals) or before the Tribunal or even before us to show that these are incorrect figures or that even on merits the reasons for the losses are not genuine.

24. We are, therefore, unable to hold that the Tribunal committed any error in confirming the order of the CIT (Appeals) for both the years deleting the disallowance of the brand fee l royalty payment while determining the ALP. Accordingly, the substantial questions of law are answered in the affirmative and in favour of assessee and against the Revenue. The appeals are accordingly dismissed with no order as to costs".

20.1. The Principles laid down by the Hon'ble Delhi High Court in the above said case equally applies to the facts of the case. What TPO has done in the present case is to hold that assessee need not pay any royalty or technical knowhow fee to the AE. Even though DRP has partly modified the payment of royalty, what we noticed is that they also made a mistake in allowing only 3.5% of royalty when in fact, there is no such claim in any of the earlier years. As submitted by the Ld. Counsel in the course of arguments/presentation before us assessee claimed at 7.5% in earlier year which was also allowed.

20.2. Moreover, the payment of royalty over the period up to A.Y. 2009-10 and technical knowhow fee was summarized by the

assessee in the following table which was filed during the course of hearing before us in order to substantiate the arguments that the cumulative royalty as percentage of cumulative sales is much less at 3.08% up to the impugned year which is still less than what the DRP allowed.

A.Y	Net sales of PEBs (excluding excise duty) (Rs.Cr.)	PBIT – Rs. Cr.	Royalty payment Rs. Cr.	Technical fee payment Rs. Cr.	Royalty (as % sales)	Cumulative royalty as % of cumulative sales
2001-02	47.15	-1.69	--	0.02	0.05%	0.05%
2002-03	76.32	5.66	---	0.11	0.14%	0.11%
2003-04	85.81	6.17	---	0.64	0.74%	0.37%
2004-05	100.68	8.78	---	1.03	1.02%	0.58%
2005-06	193.34	17.46	5.36	1.78	3.69%	1.78%
2006-07	231.69	13.05	13.26	0.45	5.92%	3.08%
2007-08	282.78	23.01	15.82	0.44	5.56%	3.79%
2008-09	390.54	29.33	15.75	0.39	4.14%	3.88%
2009-10	816.69	54.08	33.06	0.49	4.11%	3.96%

20.3. Further as there was a mismatch of percentages in the royalty claimed, clarification was sought in the course of argument and Ld. Counsel explained that even though royalty had a fixed percentage of 7.5% agreed, it was not on gross sales but on net sales, as RBI has excluded various amounts. It was also submitted that DRP without studying the terms and conditions of payment of royalty as approved, allowed royalty at 3.5% on gross sales which technically is also almost equivalent to the royalty claimed by the assessee on net sales basis. It was submitted that as percentage of sales, royalty payment in the impugned year was only 5.92%. Be that as it may, we are not in a position to approve the action of the A.O. / DRP in restricting the royalty and total denial of Technical services fee without any basis at NIL under the guise of T.P. provisions. In view of this, we are not in agreement with the action of the TPO / DRP.

20.4. In the course of arguments, Ld. Counsel made various propositions on payments of Royalty and technical services fee and cited the decisions of the Coordinate Benches of the Tribunal in the case of SC ENVIRO Agro India Ltd., Mumbai vs. DCIT 3(3), Mumbai ITA.No.2057 & 2058/Mum/2009 dated 07.11.2012, M/s. Thyssen Krupp Industries India P. Ltd., Mumbai vs. ACIT, CC 3(3),m Mumbai in ITA.No.7032/Mum/2011 dt. 27.11.2012, Air Liquid India P. Ltd.,

vs. DCIT, Circle 1(1), Hyderabad ITA.No.1159/Hyd/2011 etc., dt. 13.02.2014 and host of other decisions as stated in the submissions above to substantiate various propositions. Suffice to say that we have considered various legal principles on the issue. We are of the opinion that apart from legal position, even on merits the disallowance of entire technical knowhow payment and part disallowance of royalty payment to AE was not warranted.

21. There is one more aspect to the above issue. The agreements were periodically approved by RBI and by Ministry of Industry and assessee was paying the amounts as per the agreements. Even though approval by the other Governmental authorities does not prevent TPO in examining the ALP as per the provisions of the Act, what we noticed was that TPO did not examine the issue under the T.P. provisions at all but took upon the role of an A.O. in analyzing the commercial expediency of payment of royalty and technical knowhow under the provisions of section 37(1). Since the agreements were approved by the authorities and considering the facts of the case, we are of the opinion that the royalty fee and technical knowhow are at arm's length and that assessee's claim should be allowed as such. There is no information brought on record by the TPO that the payment at 7.5% on the net sales is not at arm's length as there was no other comparable case brought on record. Generally, the Government of India is approving the royalty payments at 7.5% of the sales and this approval given by the RBI and Ministry of Industry is at par with similar agreements being approved in other contracts/agreements. Considering these aspects, we are of the opinion that royalty and technical knowhow payments made by the assessee to its AE are considered at arm's length and thereby, the grounds raised by the assessee on this issue are allowed. A.O. is directed to allow the amounts as claimed".

Taking the said decisions into consideration and also the fact that the TPO has followed his approach for the earlier A.Ys in holding that the ALP adjustment was necessary, we are inclined to apply the decision of the Coordinate Bench for the earlier A.Ys also to the A.Y in the appeal before us. We find that the DRP has only followed the decision of the ITAT in assessee's own case for earlier A.Ys. As the DRP has only followed the precedent on the issue in the assessee's own case and has accordingly issued directions to the AO and the assessment order is in consonance with such directions of the DRP, we do not find any reason to interfere with the same.

7. In the result, Revenue's appeal is dismissed.

Order pronounced in the Open Court on 7th August, 2015.

Sd/-	Sd/-
(Inturi Rama Rao)	**(P. Madhavi Devi)**
Accountant Member	**Judicial Member**

Hyderabad, dated 7th August, 2015.
Vnodan/sps

Copy to:

1. *Dy. Commissioner of Income Tax, Circle 8(1), C Block, IT Towers, AC Guards, Hyderabad*
2. *M/s. Kirby Building Systems India Ltd., Plot Nos. 8 to 15, Pashamylaram, Phase-III, IDA, Medak 502307*
3. *DRP, Hyderabad*
4. *Add.CIT (T.P) Hyderabad*
5. *The DR, ITAT, Hyderabad*
6. *Guard File*

By Order