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

BEFORE SHRI G.S. PANNU, ACCOUNTANT MEMBER AND
SHRI RAM LAL NEGI, JUDICIAL MEMBER

ITA NO. 7767/MUM/2012 : **(A.Y : 2008-09)**

Evonik Degussa India Private Limited (Degussa India Pvt. Ltd.) Krislon House, Sakivihar Road, Sakinaka, Andheri (East), Mumbai 400 072. (Appellant) **PAN : AAACH3690Q**	Vs.	DCIT (OSD), Circle-3(1), Mumbai (Respondent)

Assessee by	:	**Shri Dhanesh Bafna & Ms. Chandni Shah**
Revenue by	:	**Shri Darse Samuel**
Date of Hearing	:	**02/11/2016**
Date of Pronouncement	:	**11/11/2016**

O R D E R

PER G.S. PANNU, AM :

The captioned appeal filed by the assessee is arising from order dated 25.10.2012 passed by the Assessing Officer u/s 143(3) r.w.s 144C(13) of the Income Tax Act, 1961 (in short 'the Act') giving effect to the directions of Dispute Resolution Panel (DRP) dated 05.09.2012.

2. In this appeal, assessee has raised the following Grounds of appeal :-

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"1. On the facts and circumstances of the case, and in law, the learned Assessing Officer ('AO')/Dispute Resolution Panel ('DRP')/Transfer Pricing Officer ('TPO') erred in making an upward adjustment of Rs.1,28,41,639/- to the income of the Appellant in respect of provision of testing and analytical services by –

a. rejecting comparables from the set provided by the Appellant;
b. including companies which are not functionally comparable;
c. denying economic adjustment to the Appellant;
d. using current year's financial data (i.e. Financial Year 2007-08) as against average margin of 3 years of comparable companies; and
e. denying (+/-) 5% range benefit available under proviso to Section 92C(2) of the Income-tax Act, 1961 (the Act).

The Appellant prays that the AO be directed to delete the aforementioned adjustment.

2. On the facts and circumstances of the case, and in law, the learned AO/ DRP/ TPO erred in making a notional addition of Rs. 14,49,180/- towards interest on perceived delay in collection of receivables from the associates enterprises.

The Appellant prays that the aforementioned notional addition be deleted.

3. On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in directing and the learned AO erred in not allowing deduction in respect of foreign travel expense of Rs. 27,00,124/- (being 25% of the total foreign travel expense of Rs. 1,08,00,496).

It is prayed that the AO be directed to delete the disallowance of foreign travel expense."

3. Before we proceed to adjudicate the respective Grounds of appeal, the brief background is that the appellant is a company incorporated under the provisions of the Companies Act, 1956 and is a wholly owned subsidiary of Evonik Degussa GmbH, Germany. For the

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assessment year under consideration, it filed a return of income declaring total income of Rs.5,81,54,328/-, which has been subject to a scrutiny assessment whereby the total income has been assessed at Rs.7,51,45,270/- after making certain additions/disallowances, which are the subject matter of appeal before us in terms of the abovestated Grounds of appeal.

4. The issue in Ground of appeal no. 1 relates to addition of Rs.1,28,41,639/- made by the Assessing Officer on account of transfer pricing adjustment in relation to research and development support services provided by the assessee to its associated enterprises. It has been explained that Evonik Degussa group at the global level is, *inter-alia*, involved in the business of manufacture of speciality chemicals. The assessee-company, which is a 100% subsidiary of Evonik Degussa in India is, *inter-alia*, providing various services to its associated enterprises and one such segment is provision of support services in connection with research and development. Such rendering of services constituted 'international transactions' within the meaning of Sec.92B of the Act. During the year under consideration, assessee had earned a sum of Rs.8,66,71,378/- from its associated enterprises for providing support services in connection with research and development. While benchmarking such 'international transactions', assessee adopted the Transaction Net Margin (TNM) method as the most appropriate method, on which there is no dispute. Assessee had earned a margin of 19.05% on operating costs and the margin of the comparables selected by it came to 16.45%. As a consequence, assessee asserted that the stated value of the transactions was at an arm's length price. The

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Transfer Pricing Officer (TPO), in-turn, selected a set of six comparables, which are tabulated in para 6.4 of the order of TPO dated 28.10.2011, whose arithmetic mean of margins came to 36.70%. Considering the said margin as an arm's length margin, the TPO determined adjustment of Rs.1,28,41,639/-, which according to him was required to be made in order to bring the stated value of transactions to its arm's length price. The Assessing Officer has finalised the assessment in conformity with the aforesaid order of TPO as the objections filed by the assessee before the Dispute Resolution Panel (DRP) against the draft assessment order were not accepted. In this background, assessee is in appeal before us.

5. Before us, the learned representative for the assessee has raised two issues which relate to inclusion of certain concerns in the final set of comparables, which according to the assessee is not justified. Before we proceed further to evaluate the two specific pleas raised before us, it would be appropriate to bring out the functions performed by the assessee in the course of rendering support services to the associated enterprises in connection with research and development. Notably, the support services provided by the assessee are in the nature of laboratory research and analytical/testing facilities for certain products developed and/or manufactured by the associated enterprises. From the order of authorities below as well as other material on record, it emerges that assessee provided assistance to its associated enterprises in conducting and co-ordinating testing, trials and experiments; interpretation of results of various such trials; assistance in literature search and any other services required by the associated enterprises

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with respect to the above. It is also emerging from record that in order to perform such functions, assessee is maintaining laboratory premises and employing necessary infrastructure suitable for such research and analytical testing.

6. The first plea of assessee is that the TPO erred in including M/s. Celestial Labs Ltd. in the final set of comparables since the said concern is functionally dissimilar. The learned representative pointed out that in the preceding Assessment Year 2007-08, the Tribunal vide its order in ITA No. 7653/Mum/2011 dated 21.11.2012 had upheld the plea of assessee that the said concern was functionally dissimilar to the assessee and thus, it is liable to be excluded. In this connection, the learned representative for the assessee referred to the following discussion in the order of Tribunal dated 21.11.2012 (supra) :-

> *"18. .... Coming to the inclusion of Celestial Labs Ltd., it is seen that the said company is engaged in the business of supporting pharmaceutical and biotechnology companies with customised information technology solution. It is mainly engaged in the software development in drug designing tool, bio informatics service and data warehousing. More than 96% of its revenue is from this service which are mostly in the nature of drug designing tool and Sap services. The profile of the company, as highlighted by the learned Counsel for the assessee (which are illustrated in para 8 above), shows that its functions are entirely different from that of the assessee company which is mainly into testing and analytical service in R&D. While carrying out comparability analysis, one has to examine the functional profile of the company and the attributes of the products and services provided. If the products and services are different, then it becomes very difficult to compare the PLI with the tested party. The functional analysis shows that this company is mainly engaged in development of specific type software services and products. Thus,*

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Celestial Labs Ltd. which is mainly a software development company and engaged in bio informatics services cannot be said to be functionally comparable with that of the assessee and, therefore, it cannot be included for comparability analysis in the set of comparables taken by the TPO. Accordingly, we uphold the contentions of the assessee that the said company cannot be included."

7. It has been canvassed before us that there is no change in facts in the instant year as compared to Assessment Year 2007-08 and, therefore, the decision of Tribunal dated 21.11.2012 (supra) is squarely applicable in this year also. On this aspect, we find that before the TPO also, assessee had asserted that the activities carried out by M/s. Celestial Labs Ltd. were not comparable with the activities of assessee and, therefore, it was not a good comparable. The submissions of assessee have been reproduced by the TPO in para 6.1 of his order. The submissions put forth by the assessee show that M/s. Celestial Labs Ltd. is a concern engaged in software development which, *inter-alia*, also included development of software products. The order of Tribunal dated 21.11.2012 (supra) brings out that the functional profile of the said concern has been found to be incomparable with the activities undertaken by the assessee in the course of providing support services to its associated enterprises in connection with research and development. Considering the aforesaid precedent and also that the fact-position in the instant year is *pari materia* with that noted by the Tribunal in Assessment Year 2007-08 (supra), the said concern is directed to be excluded from the final set of comparables for the purpose of comparability analysis.

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8. Secondly, the plea of assessee is for exclusion of M/s. TCG Lifesciences Ltd. from the final set of comparables on the ground that more than 35% of the total revenues earned by the said concern are from sale of chemical compounds and, therefore, such a concern is incomparable with the tested activities of the assessee, which does not involve sale of any products. At the time of hearing, the learned representative pointed out that before the TPO itself assessee had raised such an objection, as can be seen from para 6.1 of the order, and that the same has been unjustly rejected by the lower authorities.

9. On this aspect, the ld. DR pointed out to the discussion in para 6.3 of the order of TPO wherein it is contended that notwithstanding the income from sale of chemical compounds, the said concern was indeed also engaged in providing research services and, therefore, the same has been included as a good comparable.

10. Having considered the rival stands, we find that the plea of assessee is quite potent and is also borne out of the material on record. In this context, our attention was also invited to the Paper Book wherein is placed the relevant extracts from the Annual Financial Statements of M/s. TCG Lifesciences Ltd. which show that the total sales have been classified as 'contract research operations' – Rs.86,68,09,176/-, which are stated to include sale of chemical compounds valued at Rs.31,93,33,202/-. The Annual Financial Statements clearly brings out that not only the sale of chemical compounds is substantial, but even the segmental data relating to the research operations is not available so as to facilitate comparison with

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assessee's activity of providing support services in connection with research and development to its associated enterprises. Thus, in view of the aforesaid fact-situation, the aforesaid concern is liable to be excluded from the final set of comparables. Thus, on this aspect, assessee succeeds.

11. At the time of hearing, the learned representative for the assessee had pointed out that if M/s. Celestial Labs Ltd. and M/s. TCG Lifesciences Ltd. are excluded from the final set of comparables, the arithmetic mean margin of the remaining comparables would come to 23.16%, which would fall within the ± 5% range vis-a-vis assessee's margin of 19.05%, as mandated u/s 92C(2) of the Act. Therefore, the international transactions of provision of support services in connection with research and development rendered by the assessee to its associated enterprises would be at arm's length price and no further adjustment would be required. We have already upheld the plea of assessee for exclusion of M/s. Celestial Labs Ltd. and M/s. TCG Lifesciences Ltd. from the final set of comparables and, therefore, the matter is restored back to the file of Assessing Officer who shall verify the aforesaid contention of assessee and accordingly delete the addition of Rs.1,28,41,639/-. At this stage, we may also note that the other pleas raised by the assessee in its Grounds of appeal with regard to addition of Rs.1,28,41,639/- are rendered academic and have not been adverted to, and they are kept open, since necessary relief already stands allowed to the assessee. Thus, insofar as Ground of appeal no. 1 is concerned, assessee succeeds, as above.

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12. The next Ground raised by the assessee is with respect to addition of Rs.14,49,180/- made by the Assessing Officer on the basis of order of TPO on account of interest on delay in realisation of dues from associated enterprises. On this aspect of the matter, it was a common point between the parties that an identical addition has been dealt with by the Tribunal in the case of assessee for Assessment Year 2007-08 vide order dated 21.11.2012 (supra), wherein the addition has been deleted. In particular, our attention has been invited to the following discussion in the order of Tribunal dated 21.11.2012 (supra) :-

> *"23. In ground no.2, the assessee has challenged the addition of Rs.9,83,383, on account of notional addition towards interest on the amount receivable from the A.E.*
>
> *24. The TPO observed that the assessee has given credit of thirty days in the invoices raised against the A.E. However, there has been delay in making the payment by the A.E. beyond the stipulated credit period and on such delayed payment, the assessee has not charged any interest. Accordingly, he computed the interest @ one percent per month for the period of delay beyond thirty days and accordingly he worked out the notional interest to be received by the assessee at Rs.9,83,383.*
>
> *25. Objection before the DRP by the assessee was rejected.*
>
> *26. Learned Counsel Shri Kanchan Kaushal submitted that the assessee is a zero debt company and it does not have any borrowings from external sources, therefore, it is not required to pay any interest. There have been some situations that there has been delay in making the payments by the A.Es beyond the normal credit period, however, no interest has been charged for the reason that there is no interest cost to the assessee. Moreover, there is no such agreement between the assessee and the A.E. to charge interest on delayed payments. He, therefore, contended that charging of notional interest in the*

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international transaction is wholly erroneous. Learned Counsel further pointed out that the assessee has been raising the bills on quarterly basis and the payment has thus received after the bills only. Therefore, the delay cannot be attributed purely on account of delayed payments made by the A.Es. Moreover, the business transaction has to be decided between the two parties and there cannot be any presumption by the A.O. about charging of notional interest on such delayed payment.

27. Learned Departmental Representative, on the other hand, relying upon the order of the TPO and DRP's direction, submitted that in some cases delay is of more than 200 days and if one has to judge in relation to the third party whether such a long credit would have been given by the assessee. Therefore, the TPO has rightly charged the interest.

28. After carefully considering the rival submissions and the orders of the TPO as well as the direction of the DRP, we find that the assessee has no interest liability and it does not have any external borrowings. Even if the payments have been made by the A.E. beyond the normal credit period, there is no interest cost to the assessee. Moreover, there is no such agreement whereby interest is to be charged on such a delayed payment. From the summary of payment submitted by the learned Counsel, it is seen that the billing is done on quarterly basis and, accordingly, the payment is being received. Therefore, the delay is not wholly on account of late payment by the A.Es only. Moreover, the T.P. adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income. Thus, on the facts and circumstances of the case, we are of the opinion that addition an account of notional interest relating to alleged delayed payment in collection of receivables from the A.Es, is uncalled for on the facts of the present case and is, accordingly, deleted."

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13. Since it was a common point between the parties that the aforesaid decision is squarely applicable in the instant year also, and in order to ensure consistency, the impugned addition of Rs.14,49,180/- is directed to be deleted. Thus, on this aspect, assessee succeeds.

14. The last addition in dispute is with respect to a sum of Rs.27,00,124/- out of foreign travel expenses. In this context, the brief facts are that during the year under consideration, assessee had incurred an expenditure of Rs.1,08,00,496/- on foreign travel expenses of Directors and other officials of the company. On being show caused to furnish the details and the purpose for which the expenses were incurred, assessee furnished reply, which has been reproduced by the Assessing Officer in the draft assessment order dated 9.12.2011. After considering the explanations furnished by the assessee, the Assessing Officer held that the entire expenditure was disallowable since the details did not show that the visit to the foreign countries had resulted in any benefit to the assessee-company. So however, the DRP, after considering the objections of the assessee, directed that the addition be restricted to 25% of the total expenses. Hence, in the final assessment order, the Assessing Officer has restricted the disallowance to Rs.27,00,124/-, against which assessee is in appeal before us.

15. Before us, the singular plea of the assessee is that complete details of the expenses were submitted to the lower authorities, copies of which have been placed in the Paper Book at pages 171-334. It has been pointed out that there is no justification for the *adhoc*

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disallowance inasmuch as the expenditure has been incurred on the employees of the assessee-company and related to its business.

16. On the other hand, the ld. DR referred to the stand of the lower authorities and supported the *adhoc* disallowance sustained by the DRP. It has also been pointed out that in Assessment Year 2009-10, the Tribunal in ITA No. 1125/Mum/2014 dated 18.9.2014 had upheld the disallowance to the extent of 10% of the expenditure.

17. We have carefully considered the rival submissions. At the outset, it is to be noted that the entire disallowance is based on mere conjectures and surmises. In fact, what the DRP records in para 6.3 of its order is that the details of expenses are "*inadequate and not fully satisfactory*". In our considered opinion, the aforesaid inference of the DRP is not based on any factual support and, in fact, not even a single instance has been brought out which would show non-business purposes of the expenditure. In fact, detailed submissions - employee-wise and visit-wise, showing the purpose of visits has been placed in the Paper Book. Inspite of such details being available on record, the lower authorities have gone by mere generalized observations, which are devoid of any factual support. In Assessment Year 2009-10 the Tribunal vide its order dated 18.9.2014 (supra) upheld the disallowance of 10%, but it took note of observations of the lower authorities that "*some of the airway bills were not in the name of assessee-company*". Quite clearly, even the *adhoc* disallowances are also required to be founded on certain specific discrepancies, an aspect which is conspicuous by its absence in the orders of authorities below for the year under

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consideration. Therefore, in our view, no disallowance can be upheld in this year on the basis of the order of Tribunal for Assessment Year 2009-10, which has been rendered in the background of specific findings of the lower authorities in that year. Considering the entirety of circumstances, in our view, in the absence of any specific discrepancy/infirmity having been brought out by the lower authorities, the *adhoc* disallowance of 25% of foreign travel expenses is untenable and is hereby directed to be deleted. Thus, on this aspect also, assessee succeeds.

18. In the result, appeal of the assessee is allowed, as above.

Order pronounced in the open court on 11th November, 2016.

Sd/-	Sd/-
(RAM LAL NEGI)	**(G.S. PANNU)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai, Date : 11th November, 2016

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3) The CIT(A) concerned
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5) The D.R, “K” Bench, Mumbai
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By Order

Dy./Asstt. Registrar
I.T.A.T, Mumbai

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