

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई

IN THE INCOME TAX APPELLATE TRIBUNAL

'D' BENCH, CHENNAI

श्री एन.आर.एस. गणेशन, न्यायिक सदस्य एवं
श्री ए. मोहन अलंकामणी, लेखा सदस्य केसमक्ष

BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.454/Mds/2015

निर्धारण वर्ष / Assessment Year : 2010-11

M/s Orbinox India Pvt. Ltd.,
SF No.608/3A2B, 608/3A1B,
Echaneri Chettipalayam Road,
Echaneri Post,
Coimbatore - 641 021.

v. The Deputy Commissioner of
Income Tax,
Corporate Circle – 1,
Coimbatore.

PAN : AAACO 5826 A

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by : Sh. SP. Chidambaram, Advocate
प्रत्यर्थी की ओर से/Respondent by : Dr. Milind Madhukar Bhusari, CIT

सुनवाई की तारीख/Date of Hearing : 09.06.2016

घोषणा की तारीख/Date of Pronouncement : 01.09.2016

आदेश / O R D E R

PER N.R.S. GANESAN, JUDICIAL MEMBER:

This appeal of the assessee is directed against the order of the Assessing Officer, consequent to the directions of Dispute Resolution Panel, Chennai, dated 26.11.2014 and pertains to assessment year 2010-11.

2. Sh. SP. Chidambaram, the Ld.counsel for the assessee, submitted that the assessee-company is engaged in the business of manufacturing and sale of knife gate valves, Level transmitters and Solutions to its customers in India for application of energy and process control industries. According to the Ld. counsel, Knife gate valves constitute around 98% of total revenue of the assessee-company. The other products constitute only 2% of the total revenue. The assessee markets its products under the brand name "Orbinox". The Ld.counsel further submitted that the assessee is a wholly owned subsidiary of OVI, Spain.

3. The Ld.counsel for the assessee submitted that during the year under consideration, the assessee imported raw material and components. The assessee has also sold finished products in domestic market and also exported the same to its Associate Enterprises outside the country. The assessee has also paid interest on external commercial borrowings. The Ld.counsel further submitted that the assessee has paid royalty to its parent company. In respect of export made to Associate Enterprises outside the country, the assessee adopted Transaction Net Margin Method as most appropriate method for computation of arm's length price.

However, the Transfer Pricing Officer adopted Cost Plus method as most appropriate method. According to the Ld. counsel, the assessee sold the same product to its Associate Enterprises outside the country as well as third parties in the domestic market. Therefore, according to the Ld. counsel, the two set of transactions are not comparable. Hence, the Cost Plus method cannot be the most appropriate method. According to the Ld. counsel, for the purpose of Cost Plus method, there must be comparable line of transaction. Comparison of export transaction with domestic segment for determination of arm's length price is not correct. According to the Ld. counsel, export of goods to Associate Enterprises by the assessee and sale of same goods in the domestic market are two different segments of the assessee and, therefore, the same cannot be compared.

4. Sh. SP. Chidambaram, the Ld.counsel for the assessee, further submitted that in the export segment, the assessee has not taken any pain for marketing. The same products, which are sold in the domestic market, require much effort for marketing. In the case of export business, according to the Ld. counsel, the same was made to group companies outside the country while selling the

same in over 70 countries and goods sold in export market is very high volume. The assessee is not expected to give any warranty to the goods sold outside the country. The group companies, which are borrowing the goods from the assessee, provided after sales warranty. In the case of domestic sales, according to the Ld. counsel, the assessee has to provide after sales warranty. Business development is the key function which leads to increase the domestic sales. The products sold under domestic market are unique to the requirement of customers. Specifications are complicated and varieties are too many. Therefore, according to the Ld. counsel, such products cannot be compared to the products which are sold in the export market. The Ld.counsel further submitted that only limited volume of goods are sold in the Indian market, therefore, the two segments cannot be compared at all. Referring to the decision of Pune Bench of this Tribunal in Alfa Laval (I) Ltd. v. DCIT (2014) 46 taxmann.com 394, the Ld.counsel submitted that when the assessee was engaged in the business of manufacturing and sale of industrial products in export segment and domestic segment, the TPO was not justified in adopting Cost Plus Method as most appropriate method in order to make adjustment to the assessee's arm's length price in respect of international

transaction entered with Associate Enterprises. Therefore, according to the Ld. counsel, the adjustment made by the TPO by following Cost Plus Method as confirmed by Dispute Resolution Panel is not justified.

5. On the contrary, Dr. Milind Madhukar Bhusari, the Ld. Departmental Representative, submitted that the assessee adopted Transaction Net Margin Method as most appropriate method. However, the Transfer Pricing Officer found the Cost Plus Method would be the most appropriate method. Cost Plus Method is about comparing the mark-up earned on the cost by the assessee-company with that of the comparables after giving necessary adjustments to nullify the differences between the tested party and the comparables. According to the Ld. D.R., the assessee had two tangible segments, namely, Associate Enterprises and non-Associate Enterprises. Therefore, comparison of international segment was made in the present case, after giving necessary adjustment, the gross profit mark-up adjusted was 37.29% in the AE segment and it was 65.14% in the non-AE segment. According to the Ld. D.R., the data regarding both the segments were available with the assessee for entire period. The assessee sold the

manufactured products to its Associate Enterprises below the arm's length price and thereby violated the transfer pricing norms. Therefore, according to the Ld. D.R., the Transfer Pricing Officer made adjustment by following Cost Plus method.

6. Referring to the travel expenses debited to Profit & Loss account to the extent of ₹29,73,052/-, the Ld. Departmental Representative submitted that the assessee-company claimed a sum of ₹28,00,563/- as applicable to the domestic transaction and requested to adjust the entire sum of ₹28,00,563/- in the non-AE segment. The Ld. D.R. further submitted that the entire expenditure incurred in a particular segment cannot be adjusted with other segment. All the domestic travels are grouped under non-AE segment and most of the abroad visits are grouped under AE segment. Therefore, the travel expenses incurred in domestic market cannot be adjusted with export segment. The Ld. D.R. further submitted that both the export segment and domestic segment are comparable one, therefore, the Assessing Officer by rightly comparing both the segments, made adjustment towards arm's length price.

7. We have considered the rival submissions on either side and perused the relevant material available on record. The assessee exported the manufactured goods to its Associate Enterprises outside the country and the same was sold in the domestic market to non-AEs. The assessee prepared the transfer pricing documents by adopting Transaction Net Margin Method as most appropriate method. However, the Transfer Pricing Officer took the Cost Plus Method as most appropriate method. For adopting most appropriate method, it is necessary to find out the method which suits to the facts and circumstances of the particular international transaction. In respect of Transaction Net Margin Method, the net profit margin realized by the enterprise from an international transaction entered into with an Associate Enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base needs to be considered. The net profit margin realised shall be taken into account to arrive at the arm's length price in relation to international transactions.

8. In the case of Cost Plus Method, the direct and indirect costs of production incurred by the enterprise in respect of the property

transferred or services rendered needs to be determined. The amount of normal gross profit mark-up to such costs arising from the transfer of similar property by the enterprise or by an unrelated enterprise in a comparable uncontrolled turnover or number of such transactions, needs to be determined. The sum so arrived has to be taken as arm's length price in relation to supply of property or provision of services by the enterprise. Therefore, a bare reading of Rule 10B(1)(c) provided for arm's length price by adopting Cost Plus Method shows that indirect and direct cost of production needs to be determined besides normal profit mark-up to such costs. The normal mark-up to the costs need to be adjusted to the functional and other differences, if any, between international transaction and comparable uncontrolled transaction.

9. In the case before us, the Transfer Pricing Officer has taken comparable transaction of the assessee in the domestic market. The Transfer Pricing Officer has not taken any pain to compare the transaction in an uncontrolled transaction. As rightly submitted by the Ld.counsel for the assessee, when the goods are exported to Associate Enterprises outside the country, no marketing effort needs to be done. The Associate Enterprises purchased products

from the assessee and they sold the same. It is not in dispute that the Associate Enterprises purchased the goods from the assessee for selling the products over 70 countries. For the purpose of determination of Cost Plus method, one of the conditions required is normal mark-up profit in the comparable uncontrolled transactions. From the orders of the lower authorities and the written submission filed by the assessee, it appears the products sold in the export market is different from the one which was sold in the domestic market. In the domestic market, the assessee has provided extensive after sale service support, replacement of goods, servicing, installation, etc. besides extensive marketing and sales effort. Whereas, in the case of export segment, the specifications of the products sold are totally different. The assessee has not made any effort for marketing its products and the assessee has not provided any after sales service support. It also appears that in the domestic market, the products are unique to the customers' requirement. In view of the variations in the specifications of the products exported by the assessee and sold in the domestic market, prima facie, it appears the same products cannot be functionally compared. For the purpose of selecting the most appropriate

method, the following shall be taken into consideration as specified in Rule 10C(2) of Income-tax Rules, 1962 which reads as follows:-

- (a) the nature and class of the international transaction;
- (b) the class or classes of Associate Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (c) the availability, coverage and reliability of data necessary for application of the method;
- (d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (f) the nature, extent and reliability of assumptions required to be made in application of a method.

One of the factors to be taken into consideration is the nature and class of the international transaction. The availability, coverage and reliability of data necessary for application of method. In the case before us, both, the Transfer Pricing Officer as well as the Dispute Resolution Panel have not taken into consideration the factors which are required to be considered as provided in Rule 10C of Income-tax Rules, 1962 for the purpose of determining the most appropriate method. Furthermore, the functional similarity is one of the most relevant factors for the purpose of determining the arm's

length price. When the assessee claims that the products exported and sold in domestic market are of different specifications, the same has to be taken into consideration by the authorities below. Moreover, the Pune Bench of this Tribunal in Alfa Laval (I) Ltd. (supra) found that when the manufactured goods are exported and also sold in the domestic market, the TPO was not justified in adopting Cost Plus Method as most appropriate method.

10. The Transfer Pricing Officer has compared the transaction of the assessee with Associate Enterprises outside the country with the transaction made by the assessee in domestic market. This Tribunal is of the considered opinion that the arm's length price required to be determined is in respect of the transaction made by the assessee with Associate Enterprises outside the country. Therefore, it is for the Transfer Pricing Officer to find out a similar transaction in uncontrolled market of the similar products in the export market. Comparison of domestic market with export transaction may not be justified. The climatic condition in the domestic market is totally different from the climatic condition of export market. Therefore, this Tribunal is of the considered opinion that the sale in the domestic market cannot be compared with sales

made in the export market. The sale in the export market must be compared with sales made in the export market by similarly placed companies in an uncontrolled transaction. The Transfer Pricing Officer has not taken effort to compare the tested party with export transaction made in an uncontrolled transaction. Since such an effort was not made either by the Transfer Pricing Officer or by the Dispute Resolution Panel, this Tribunal is of the considered opinion that the matter needs to be reconsidered. Accordingly, the orders of the authorities below are set aside and the entire issue is remitted back to the file of the Assessing Officer. The Assessing Officer shall make a reference again to the Transfer Pricing Officer. On such reference, the Transfer Pricing Officer shall examine the export segment of the assessee in relation to its transaction with Associate Enterprises and the transaction of similarly placed companies with similar products in the export market in an uncontrolled transaction and thereafter determine the arm's length price in accordance with law.

11. In the result, the appeal filed by the assessee is allowed for statistical purposes.

Order pronounced on 1st September, 2016 at Chennai.

sd/-

(ए. मोहन अलंकामणी)

(A. Mohan Alankamony)

लेखा सदस्य/Accountant Member

sd/-

(एन.आर.एस. गणेशन)

(N.R.S. Ganesan)

न्यायिक सदस्य/Judicial Member

चेन्नई/Chennai,

दिनांक/Dated, the 1st September, 2016.

Kri.

आदेश की प्रतिलिपि अग्रेषित/Copy to:

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. The ITO (Hqrs) (International Taxation), Chennai
4. TPO – V, Chennai
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF.