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

BEFORE SHRI G.S.PANNU, ACCOUNTANT MEMBER
AND
SHRI AMARJIT SINGH, JUDICIAL MEMBER

ITA No. 1443/Mum/2011
(Assessment Year : 2004-05)

The ACIT 10(2),
Room No.432, 4th Floor,
Aaykar Bhavan,M.K.Road,
Mumbai 400 020 ..... Appellant

Vs.

M/s. Dow Agrosciences India Pvt. Ltd.
Unit No.1, Corporate Park,
V.N.Purav Marg,Chembur,
Mumbai -71
PAN:AAACD 3813H .... Respondent

Appellant by : S/Shri B.S. Bist & N.K.Chand
Respondent by : Shri M.P.Lohia

Date of hearing : 05/08/2016
Date of pronouncement : 10/08/2016

ORDER

PER G.S.PANNU,A.M:

The captioned appeal filed by the Revenue pertaining to assessment year 2004-05 is directed against an order passed by CIT(A)-15, Mumbai dated 02/12/2010, which in turn arises out of an order passed by the Assessing Officer under section 143(3) of the Income Tax Act, 1961 (in short 'the Act') dated 22nd December, 2006.

2. The Grounds of appeal raised by the Revenue read as under:-

"1.On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting- the disallowances of travelling and conveyance of Rs.1,12,39,325/- without appreciating that the assessee in the course of the assessment proceedings did not submit the complete details of the travelling and conveyance expenses to justify and establish that the entire expenditure was laid out or expended wholly and exclusively for the purposes of its business.

2. On the facts and the circumstances of the case and in law , the Ld. CIT(A) erred in deleting the disallowance of freight & forwarding charges of Rs. 3,35,04,706/- without appreciating that the assessee in the course of the assessment proceedings did not submit the complete details of the freight & forwarding charges to justify and establish that the entire expenditure was laid out or expended wholly and exclusively for the purposes of its business.

3. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the disallowance of miscellaneous expenditure of Rs. 3,81,11,1741- without appreciating that the assesseee in the course of assessment proceedings did not submit the complete details of the miscellaneous expenditure to justify and establish that the entire expenditure was laid out or expended wholly and exclusively for the purposes of its business.

4 (i) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the adjustment of Rs. 1,21,81,647/- made by the Transfer Pricing Officer and Assessing Officer towards the royalty payment by holding that the royalty payments made by the assesseee meets the arms length test.

(ii) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) failed to appreciate that the assessee has received know how only for one product has also not received any patent but has ended up paying more royalty than the UK counterpart who is the only Associated Enterprise to whom the technological knowhow is granted and who is paying royalty at 3% of sales of the product and hence the TPO and AO were justified in restricting the royalty as 5% of the export sales instead of 8% as claimed by the assesseee. (iii) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) failed to consider the fact that even if the RBI permits a royalty rate of 8% on . exports, but considering that no DOW group entity pays royalty at a rate higher than 5% the rates could not be said to be at arms length and the TPO and AO was justified in making the, adjustment"

5. The appellant craves leave to add, amend, very omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of appeal."

3. The respondent assessee is a company incorporated under the provisions of the Companies Act, 1956 and is, inter-alia, engaged in the business of manufacture and trading of pesticides, agro-chemicals and seeds. The return of income filed by the assessee for assessment year 2004-05 was subject to a scrutiny assessment under section 143(3) of the Act, whereby the final tax liability was determined on the basis of the book profit in terms of section 115JB of the Act. The Assessing Officer had made certain disallowances/additions while computing the income under normal provisions of the Act, which were challenged in appeal before the CIT(A), who has deleted the same. Against such action of the CIT(A), Revenue is in appeal before us on the above stated Grounds of appeal.

4. In so far as Grounds of appeal No.1 to 3 are concerned, the same relate to an adhoc disallowance made by the Assessing Officer @50% of total expenses debited under the head 'travelling and conveyance, 'freight and forwarding charges' and Miscellaneous expenditure. As per the discussion in para5 of the assessment order a common point raised by the Assessing Officer is that assessee did not furnish complete details of the expenses party-wise, amount wise and justification for the same alongwith supporting documents. As a consequence, the Assessing Officer disallowed 50% of the expenditure debited in the P&L Account under each of the aforesaid heads and accordingly the disallowance worked out under various heads was as under:-

Travelling and conveyance	-	Rs. 1,12,39,325/-
Freight and forwarding charges	-	Rs. 3,35,04,706/-
Miscellaneous Expenses	-	Rs. 3,81,11,174/-

The assessee company carried the matter in appeal before the CIT(A). The CIT(A) has deleted the entire additions primarily on the ground that similar additions made in assessment year 2003-04 were deleted by him. The CIT(A) has also noted that assessee was directed to produce the sample copies of certain supporting evidences, which were examined by him. Against such action of the CIT(A), Revenue is in appeal before us.

5. Before us, it a was a common point between the parties that the order of the CIT(A) for 2003-04 was examined by the Tribunal vide ITA No.630/Mum/2011 dated 20/01/2014 and the issue were restored back to the file of the Assessing Officer with directions to readjudicate the claim of the assessee as per provisions of law. Following the said precedent and considering that in the instant year CIT(A) has also relied upon his own order for assessment year 2003-04, we hereby set-aside the order of the CIT(A) and restore the matter back to the file of the Assessing Officer to readjudicate the issue in terms of the directions of the Tribunal dated 20/1/2014(supra) and as per law. Thus, Grounds of appeal No.1 to 3 are allowed for statistical purposes.

6. Grounds of appeal No.4(i) to 4(iii) relate to an addition of Rs.1,21,81,647/- made by the Assessing Officer while determining the arm's length price of the international transactions entered into by the assessee with its associated enterprise.

6.1 Relevant facts relating to the said issue can be summarized as follows. The assessee company paid royalty to DowElanco BV (in short 'Dow Netherland') for receiving a non-assignable and non-exclusive licence to use the process utilizing technology at its manufacturing plant to manufacture Chloropyrifos ('CHP'), the use and sale of CHP and its formulation made there-from in India and also for export of CHP and its formulations. The assessee company paid royalty to its associated enterprise (i.e. Dow Netherlands) @ 5% on net domestic sale of CHP and 8% on net export sales of CHP. The net sales for the said purpose was meant "gross sales less loaded cost of imported imputs, returns, allowances, rebates, discount, transport", etc. which was in accordance with the Foreign Exchange Control Regulations. The Assessing Officer referred the matter of computation of arm's length price of the said international transaction to the Transfer Pricing Officer(TPO). The TPO passed an order under section 92CA(3) of the Act whereby, following his stand for the earlier assessment year of 2003-04, determined an adjustment of Rs.1,21,81,647/-, which according to him was required to be made in order to bring the said stated value of the expenditure on royalty to its arm's length price. The aforesaid amount was added to the returned income by the Assessing Officer while finalizing assessment under section 143(3) of the Act, which was challenged in appeal before the CIT(A). The CIT(A), by way of a brief discussion vide para 8.4 of his order, deleted the addition following his order for the immediately preceding assessment year of 2003-04 on a similar issue. Hence, the appeal of the Revenue before us.

7. At the time of hearing, it was pointed out that for assessment year 2003-04 the Tribunal vide order dated 20/01/2004(supra) had affirmed the action of the CIT(A) in deleting the addition. So however, Ld. Representative for the assessee pointed out that the Tribunal had upheld the ultimate conclusion of the CIT(A) to delete the addition on an alternate plea and that it would be in the fitness of things that the matter in the present year be decided independently inasmuch as on other aspects also the impugned decision of the CIT(A) is unimpeachable.

7.1 In order to appreciate the aforesaid, the following discussion is relevant. The royalty paid by the assessee to its associated enterprise i.e. Dow Netherlands has been approved by the Secretariat of Industrial Approval (SIA), Ministry of Industry(Government of India) vide communication dated 07/09/1996 and also by the Reserve Bank of India dated 11/03/1997. Before us, a reference has also been made to Paper Book, wherein the aforesaid communications have been placed as also a communication SIA dated 22/1/1997, which is in continuation to its earlier approval dated 17/09/1996. In terms of such approvals, assessee is permitted to pay its foreign collaborator i.e. Dow Netherlands, royalty @ 5% on domestic sales and 8% on export sales. In this background, before the TPO assessee asserted that since royalty was paid in terms of the approvals by the Central Government, the payment of royalty was at arm's length rate. In other words, the rate of royalty approved by the Central Government was used as a reliable data for benchmarking the transaction of payment of royalty. In this manner, assessee adopted the Comparable Uncontrolled Price (CUP)

method as the most appropriate method to benchmark its international transaction of royalty and the rate approved by the Central Government was used as a reliable CUP data. Similar was the position taken by the assessee in assessment year 2003-04. Apart there-from, assessee had also canvassed that even after application of the Transactional Net Margin Method (TNMM) to test the arm's length nature of its transaction of payment of royalty, no adjustment was necessitated. Be that as it may, the TPO noted that another associate enterprise of the assessee namely, UK King Lynns Plant (in short 'Dow UK') was also paying royalty to Dow Netherlands, which was at lower rates. Based on the above, the TPO determined that the royalty paid by Dow UK was a comparable transaction and accordingly determined the arm's length royalty payment at 3% for domestic as well as 5% for gross export sale, which were the rates at which royalty was paid by DOW UK to DOW Netherlands. In assessment year 2003-04 as also in the instant assessment year, assessee had challenged the aforesaid action of the Transfer Pricing Officer. Firstly, it was canvassed that the rate of royalty payments having been approved by the Government of India, such rates constitute a valid CUP data and no further adjustment was required to the stated value of the royalties paid. Secondly, Ld. Representative for the assessee also pointed out that the comparable transaction adopted by the Transfer Pricing Officer i.e. payment of royalty by Dow UK to Dow Netherlands was a wrong approach inasmuch as comparison could be made only with an uncontrolled transaction, whereas in the case of Dow UK and Dow Netherlands, both were associate enterprises and, therefore, payment of royalty by DOW UK to DOW Netherlands

was a controlled transaction and accordingly, the same could not be considered as a valid CUP data. In so far as the latter plea of adoption of controlled transaction was concerned, the CIT(A) in assessment year 2002-03 has accepted the plea of the assessee. However, with regard to the plea of the assessee based on the rate of royalty approved by the Central Government is concerned, the CIT(A) rejected the same as according to him, such rates could not be considered as valid CUP data. The CIT(A) had however, allowed relief by benchmarking royalty payment under the TNMM whereby, the margins from the manufacturing activities of the assessee were found to be favourable vis-à-vis those of the comparables concerns. The Tribunal in assessment year 2003-04 upheld the ultimate conclusion of the CIT(A) to delete the addition on the ground that the basis on which the royalty was paid by the Dow UK to Dow Netherlands was different than that was paid by assessee to Dow Netherlands in as much as Dow UK was paying royalty as a percentage of gross sales, whereas assessee was paying royalty at net sales, in accordance with Foreign Exchange Control Regulations. The Tribunal found that if the royalty payable was calculated by adopting the same basis, then the royalty being paid by Dow UK was higher than what has been paid by assessee company to Dow Netherlands and, thus, the royalty paid by the assessee was at an arm's length rate , and no adjustment was required. On this basis, the Tribunal affirmed the order of the CIT(A) deleting the addition in assessment year 2003-04.

7.2 Now in the present year, the case of the assessee is that the plea that rate of royalty approved by the Central Government as also by the

Reserve Bank of India constitutes a valid CUP data has been affirmed by the Hon'ble Bombay High Court in the case of CIT vs. SGS India Pvt. Ltd., ITA No.1807 of 2013 dated 18/11/2015. In this context, the Ld. Representative for the assessee pointed out that before the Hon'ble High Court, the Revenue had relied upon Press Note No.9 (2000 series) issued by Central Government for adopting the rates of royalty prescribed therein for benchmarking royalty payable. In this context, reference was made to para 8 of the order of the Hon'ble High Court, wherein clause(IV) of the Press Note was specifically noted, which provided for payment of royalty upto 8% on export sales and 5% on domestic sales. The Ld. Representative for the assessee explained that though clause (IV) of Press Note No.9 (2000 series) considered by the Hon'ble High Court related to payment of royalty by a wholly owned subsidiary to its offshore parent company, but similar treatment has been extended even to other entities also vide A.P.(DIR Series) Circular No.5 dated 21/7/2003 issued by Reserve Bank of India, Exchange Control Department, Central Office, Mumbai, a copy of which has been placed on record. The Ld. Representative for the assessee pointed out that before the Hon'ble High Court, Revenue stated the Press Note No.9 (2000 series) dated 8/9/2000 was applicable to examine the reasonableness of the royalty paid while computing the arm's length price.

7.3 On the basis of aforesaid it is canvassed that the royalties paid by the assessee are in terms of the approval granted by SIA as also in terms of Circular No.5 dated 21/7/2003(supra) of the Reserve Bank of India

and, therefore, the royalties paid @ 8% on export and 5% on domestic sales are to be considered at arm's length rate.

7.4 Although the Ld. Departmental Representative did not dispute the factual matrix, but he has merely relied upon the order of the TPO in support of the case of the Revenue.

7.5 In our considered opinion, following the judgment of the Hon'ble Bombay High Court in the case of SGS India Ltd.(supra), the payment of royalty by the assessee to its associated enterprise, Dow Netherlands @ 5% on domestic sales and 8% on export sales is liable to be considered as at an arm's length rate in view of the Circular No.5 dated 21/7/2003(supra). Therefore, the addition made by the Assessing Officer on this count is unsustainable. In the ultimate analysis, we uphold the action of the CIT(A) in deleting the addition, albeit, on a different ground.

8. In the result, appeal of the Revenue is partly allowed, as above.

Order pronounced in the open court on 10/08/2016

Sd/-	Sd/-
(AMARJIT SINGH)	(G.S. PANNU)
JUDICIAL MEMBER	ACCOCUNTANT MEMBER

Mumbai, Dated 10/08/2016
Vm, Sr. PS

Copy of the Order forwarded to :

1. The Appellant ,
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

//True Copy//

(Dy./Asstt. Registrar)
ITAT, Mumbai