

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI S. JAYARAMAN, ACCOUNTANT MEMBER

IT(TP)A No.770/Bang/2012
Assessment year : 2005-06

Molex India Tooling Pvt. Ltd., (Now known as Molex India Pvt. Ltd.), C/o. Deolotte Haskins & Sells, Chartered Accountants, Deloitte Centre, Anchorage II, 100/2, Richmond Road, Bangalore – 560 025. PAN: AAACM 6091N	Vs.	The Assistant Commissioner of Income Tax, Circle 12(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	S/Shri P.K. Prasad, Umashankar Gautam, Advocates & Nishit Bhuwarka, CA
Respondent by	:	Smt. Swapna Das, Jt. CIT (ITAT-2)(DR)

Date of hearing	:	03.11.2016
Date of Pronouncement	:	25.01.2017

ORDER

Per Sunil Kumar Yadav, Judicial Member

This appeal is preferred by the assessee against the order of the
CIT(Appeals) *inter alia* on the following concise grounds:-

“1. The learned Commissioner of Income-tax (Appeals) /
Assessing Officer / Transfer Pricing Officer ('Lower Authorities')

erred in not considering and rejecting Kabra Winders Ltd. and United Drilling Tools Ltd. as comparable companies.

2. The learned Lower Authorities erred in not appreciating the fact that the Appellant incurred losses due to the economic conditions and not on account of international transactions undertaken by the Appellant.

3. The learned Lower Authorities erred in not appreciating that the Gross Margin of the Appellant is in line with the Gross Margin of the comparable companies.

4. The learned Lower Authorities erred in not appreciating the fact that the loss incurred by the Appellant at net margin level was due the underutilization of production capacity.

5. The learned Lower Authorities erred in providing adjustment on account of underutilization of production capacity only to depreciation cost and not to all the fixed costs of the Appellant.

6. The learned Lower Authorities erred in not restricting the adjustment provided to the Appellant to the international transactions undertaken by the Appellant with its Associated Enterprises ('AEs').

7. The learned Lower Authorities erred in considering the interest expense as operating while computing the operating cost mark-up of the Appellant.

8. The learned Lower Authorities erred in not considering the multiple year data and using contemporaneous data while performing the economic analysis.

9. The learned Lower Authorities erred in not providing the benefit of + / - 5% as per the section 92(C)(2) of the Income-tax Act, 1961.

The Appellant craves leave to add, to alter or amend the aforementioned grounds of appeal.”

Consolidated additional grounds

1. The learned Commissioner of Income-tax (Appeals) / Assessing Officer/ Transfer Pricing Officer ('Lower Authorities') erred in not providing an adjustment for the differences in the working capital position of Molex India Tooling Private Limited vis-a-vis that of the comparable companies, while determining of the arm's length price
2. The learned Lower Authorities erred in law and on facts in considering non-comparable companies, Kulkarni Power Tools Limited, as comparables while determining of the arm's length price.
3. The learned Lower Authorities erred in computation of operating cost mark-up of the Appellant and the comparable companies.

The Appellant craves leave to add, alter, amend or withdraw all or any of the Grounds of Appeal and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing, Further, this ground of appeal is independent of the grounds of appeal already filed by the appellant.”

2. During the course of hearing, the Id. counsel for the assessee has invited our attention that the issue involved in this appeal is with regard to grant of capacity utilization adjustment and working capital adjustment. He invited our attention that the issues were also raised in assessee's own case during the AY 2006-07 and the Tribunal has re-examined the issue in the light of the order of the Tribunal in the case of *DCIT v. Class India Pvt. Ltd. in ITA No.1783/Del/2011* wherein the Tribunal has restored the matter to the AO/TPO for granting capacity utilization adjustment as per the guidelines given by the Tribunal in the case of *DCIT v. Class India Pvt. Ltd.*

(*supra*). The Tribunal has also allowed working capital adjustment. The Id. counsel further contended that in the light of the view taken by the Tribunal in the succeeding year, the matter should also be restored back to the AO/TPO for readjudication of the issue. Copy of the Tribunal in assessee's own case for AY 2006-07 is placed on record at pages 813 to 829 and the order of the Tribunal in the case of *DCIT v. Class India Pvt. Ltd. (supra)* is placed on record at pages 831 to 855 of the compilation of the assessee.

3. The Id. DR did not dispute these facts.

4. Having carefully examined the orders of lower authorities in the light of rival submissions, we are of the view that since the Tribunal has taken a view in assessee's own case in the succeeding year, we do not find any justification to take a contrary view in this appeal. We, however, for the sake of reference extract the relevant observations of the Tribunal as under:-

“We have considered the rival submissions. We find that apart from the request of the assessee for inclusion of two comparables and exclusion of two comparables, the main grievance of the assessee is regarding non-granting of adjustment on account of lower capacity utilization and working capital adjustment. In this regard reliance has been placed by the Id. AR of the assessee on various judicial pronouncements noted in the synopsis reproduced above. For exclusion of Electronica Machine tools Ltd., and Kulkarni Power Tools Ltd., assessee pointed out the annual reports of these two companies on the issue regarding these two companies raised by way of filing additional grounds. Regarding inclusion of two companies i.e M/s Guindy Machine

Tools Ltd., and M/s United Drilling Tools Ltd., It has been submitted before us that these companies were rejected because unavailability of data, but since the data of these two companies are now available in the annual report of these two companies, these two companies should be considered as good comparables. In view of these facts, we are of the considered opinion that the issue regarding inclusion of these two companies should go back to the file of the TPO/ AO for fresh decision. We order accordingly.

Regarding the adjustment on account of lower capacity utilization and working capital adjustment, we find that it is noted by the DRP in para-3.2 on page-3 of its order that the TPO highlighted the major cost shown in the P&L account was the depreciation which in the case of tax payer was about 20% of the total cost against an average of 3.5% in the case of comparables. Thereafter, it is noted by the DRP that neutralize this difference the TPO has considered PBDIT as PLI by following the Tribunal order in the case of Sechefenacker Mothers on Ltd., Vs ITO(2009-TIOL-376-ITAT-Delhi. It is further noted by the DRP in the same para with regard to the claim of assessee for other costs such as employee cost, repair and maintenance cost, office supplies, filing fee etc., It has been observed by the TPO that these cases are slightly higher than the comparables in the ratio of about 7 to 6 but just because the costs were higher, adjustment could not be considered. In the light of these facts, now we consider the applicability of various judgments cited by the Id. AR of the assessee on this issue.

First judgment cited is the Tribunal order rendered in the case of CIT Vs Class India Pvt.Ltd., in ITA No.1783/Del/2011 dated 12-08-2015. Copy available on pages 701 -726 of the paper book, para no.9.3 to 10.2 of this Tribunal order available on pages 714 to 720 of the paper book are relevant for the present issue in dispute hence, these paras are reproduced herein below for the sake of ready reference;

“9.3. Sub-rule (2) of Rule 10B provides that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to certain factors which have been enumerated therein. Rule 10B(3) states that an uncontrolled transaction shall be comparable to an

international transaction, if either there are no differences between the two or a 'reasonably accurate adjustment can be made to eliminate the material effects of such differences". When we read sub-clauses(ii) & (iii) of Rule 10B(1)(e) in juxtaposition to sub-rules (2) & (3) of rule 10B, the position which emerges is that the net operating profit margin of comparable companies calls for adjustment in such a manner so as to bring both the international transaction and comparable cases at the same pedestal. In other words, if there are no differences in these two, then the average of the net operating profit margin of the comparable companies becomes a benchmark. However, in case there are some differences between the comparables and the assessee, then the effect of such differences should be ironed out by making suitable adjustment to the operating profit margin of comparables. That is the way for bringing both the transactions, namely, the international transaction and the comparable uncontrolled transactions, on the same platform for making a meaningful and effective comparison. The above analysis overtly transpires that the law provides for adjusting the profit margin of comparables on account of the material differences between the international transaction of the assessee and comparable uncontrolled transactions. It is not the other way around to adjust the profit margin of the assessee. In other words, the net operating profit margin realized by the assessee from its international transaction is to be computed as such, without adjusting it on account of differences with the comparable uncontrolled transactions. The adjustment, if any, is required to be made only in the profit margins of the comparables.

9.4. Reverting to the facts of the instant case, we find that the authorities below have adjusted the operating costs of the assessee in allowing the capacity adjustment. As against that, the correct course of action provided under the law is to adjust the operating costs of the comparable and their resultant operating profit. There is hardly need to accentuate that there can be no estoppel against the law. Once the law enjoins for doing a particular thing in a particular manner alone, it is not open to anyone to adopt a contrary or different approach. As the authorities below have adopted a course of action in allowing adjustment, which is not in consonance with law, we cannot approve the same. The impugned order is set aside and the matter

is restored to the file of the TPO/AO for giving effect to the amount of idle capacity adjustment in the operating profit of the comparables and not the assessee.

ii. How to compute capacity utilization adjustment under TNMM :-

10.1. Under the TNMM, the ALP of an international transaction is determined by computing and comparing the percentage of operating profit margin realized by the assessee with that of the comparables. We have noticed above that the difference in the capacity utilizations is an important factor, which needs to be adjusted. No mechanism has been given under the Act or the rules for computing the amount of capacity utilization adjustment.

10.2. On an overall understanding, we feel that under the TNMM, the first step in granting capacity utilization adjustment is to ascertain the percentage of capacity utilization by the assessee and comparables. There can be no difficulty in working out these percentages. The second step is to give effect (positive or negative) to the difference in the percentage of capacity utilizations of the assessee vis-à-vis comparables, one by one, in the operating profit of comparables by adjusting their respective operating costs. Operating costs can be either fixed or variable or semi-variable. One needs to split semi-variable costs into the fixed part and variable part. In so far as the variable costs and the variable part of the semi-variable costs are concerned, these remain unaffected due to any under or over utilization of capacity. Accordingly, such variable operating costs remain unchanged. The adjustment is called for only in respect of the fixed operating costs and fixed part of semi-variable costs. Such costs are scaled up or down by considering the percentage of capacity utilization by the assessee and such comparable. It can be illustrated with the help of a simple example. Suppose the fixed costs incurred by a comparable (say, A) are Rs. 100 and it has capacity utilization of 50% as against the capacity utilization of 25% by the assessee. The above percentages show that the assessee has incurred full fixed costs with 25% of the utilization of its capacity, as against A incurring full fixed costs with 50% of its capacity utilization. This divulges that the assessee has incurred relatively more fixed costs and A has incurred lower costs. In order to make an effective comparison, there arises a need to obliterate the effect of this difference in capacity

utilizations. It can be done by proportionately scaling up the fixed costs incurred by A so as to make it fully comparable with the assessee. This we can do by increasing the fixed costs of A to Rs. 200 (Rs.100 into 50/25) as against the actually incurred fixed costs by it at Rs.100. When we compute operating profit of A by substituting the fixed costs at Rs.200 with the actually incurred at Rs.100, it would mean that the fixed costs incurred by the assessee and A are at the same capacity utilization. There can be converse situation as well. Suppose the fixed costs incurred by a comparable (say, B) are Rs. 100 and it has capacity utilization of 25% as against the capacity utilization of 50% by the assessee. The above percentages show that the assessee has incurred full fixed costs at 50% of the utilization of its capacity, as against B incurring full fixed costs at 25% of the capacity utilization. This deciphers that the assessee has incurred relatively lower fixed costs and B has incurred higher costs. This difference in capacity utilizations can be eliminated by proportionately scaling down the fixed costs incurred by B so as to make it fully comparable. This we can do by reducing the fixed costs of B to Rs. 50 (Rs.100 into 25/50) as against the actually incurred fixed cost by it at Rs.100. When we compute operating profit of B by substituting the fixed costs at Rs.50 with the actually incurred at Rs.100, it would mean that the fixed costs incurred by the assessee and B are at the same capacity utilization level.”

From the above paras of the Tribunal order, it is seen that the Tribunal has given a detailed guidelines as to how to make or grant capacity utilization adjustment. Hence, we feel it proper that this matter also should go back to the file of the AO/TPO for granting capacity utilization adjustment as per the guidelines given by the Tribunal in the case of DCIT Vs Class India Pvt.Ltd., (Supra). It is ordered accordingly.

In the result, the appeal stands allowed for statistical purposes in the terms indicated above.”

5. Accordingly, following the order of the Tribunal, we restore the matter to the file of the AO to readjudicate the issue of lower capacity

utilization and working capital adjustment in the light of the finding of the Tribunal in assessee's own case for the AY 2006-07. Accordingly, the order of the CIT(Appeals) is set aside and the matter is restored to the AO/TPO in the terms indicated above.

6. In the result, the appeal is allowed for statistical purposes.

Pronounced in the open court on this 25th day of January, 2017.

Sd/-

(S. JAYARAMAN)
Accountant Member

Sd/-

(SUNIL KUMAR YADAV)
Judicial Member

Bangalore,
Dated, the 25th January, 2017.

/D S/

Copy to:

1. Applicant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.