

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'C', BANGALORE

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

AND

SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

I.T(TP).A No.309/Bang/2015
(Assessment Year : 2010-11)

Indigra Exports P. Ltd,
46, 2nd floor, CC Villa, Ejipura Main Road,
Viveknagar Post, Bangalore 560095 .. Appellant
PAN : AAACI3513M

v.

Deputy Commissioner of Income-tax,
Circle -11(4), Bangalore .. Respondent

I.T(TP).A No.193/Bang/2015
(Assessment Year : 2010-11)
(By the Revenue)

Assessee by : Shri. C. J. Brito, CA
Revenue by : Shri. Sanjay Kumar, CIT-III

Heard on : 13.10.2015
Pronounced on : 10.11.2015

ORDER

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :

These are appeals filed by the assessee and Revenue respectively against an assessment order dt.25.02.2014 passed pursuant to directions of DRP u/s.144C of the Income-tax Act, 1961 ('the Act' in short).

02. Appeal of the Revenue is taken up first for disposal. Revenue has taken altogether eight grounds of which grounds 1, 7 and 8 are general needing no specific adjudication. There is no ground 3 in the appeal form.

03. Vide its grounds 2 to 4, Revenue is aggrieved on the directions given by the DRP on the working capital adjustment to be made while working out the Profit Level Indicator (PLI).

04. Facts apropos are that the assessee, a subsidiary of one Brachot Hermant N. V. A, Belgium, was in the business of manufacturing and exporting cut and polished granite slabs. Its international transactions with AE were on account of export of granite slabs and the revenue earned therefrom was Rs.15,55,02,752/-. For justifying the prices charged for exports to its AE, assessee had carried out a TP study using capitaline data base. From such database itself assessee had selected 14 comparable companies. While working out the PLI of the comparable companies, assessee had made a working capital adjustment. As per the assessee, it was carrying no debtors and the exports made to the AEs were all on advance payments received from them. Thus to bring compatibility of the comparables on par with that of the assessee, assessee sought and made a working capital adjustment. However, TPO was of the opinion that claim for adjustment on account of working capital was not allowable since such

adjustments, if carried out, would give a place of dominance to the financial activities rather than the operating business activities.

05. Aggrieved on not considering a working capital adjustment for working out the average PLI of the comparables, assessee preferred an application before the DRP. DRP agreed with the contentions of the assessee and directed the AO to compute the mean of the working capital adjustment for the selected comparables and allow appropriate adjustment.

06. Now before us, Ld. DR strongly assailing this direction of the DRP submitted that the comparables selected by the assessee which remained in the list after giving directions of the DRP were worked in a business environment which was on par with that of the assessee. As per the Ld. DR assessee could not show that the comparables were carrying any huge inventory or were having huge debtors. In the absence of credible data, as per the Ld. DR there was no way any working capital adjustment could be considered while working out the average PLI of the comparables.

07. Per contra, Ld. AR supported the orders of DRP.

08. We have perused the orders and heard the rival contentions. Revenue has not disputed the averment of the assessee that it was carrying no debtors and its supplies to the AEs were always funded by them through advances. Effectively what it would mean was that assessee did not need

any working capital loan at all and was relying on its own resources. This definitely gave an advantage to the assessee. Rule 10B(3) of the Act is reproduced here under :

(3) An uncontrolled transaction shall be comparable to an international transaction if-

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market ; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Hence to bring the uncontrolled transaction comparable to the transactions of an assessee, it is required to eliminate the material differences which are likely to affect the price or cost or profits arising from the transactions. Assessee had given a detailed working capital study of the twelve comparables selected by it and worked-out the average working capital and the ratio of the average working capital to sales of such comparables. There is no case for the Revenue that the comparables considered were not carrying debtors, inventories and creditors. When assessee was not having any debtors and was entirely funded by advance received from AE abroad against supplies, then in order to bring parity between the results of the selected comparables and that of the assessee it is essential that adjustment for the working capital is made on the results of such comparables. Only

then can the uncontrolled transaction become comparable to the international transactions of the assessee. In such a situation we are of the view that DRP was correct in giving the direction to the AO to carry out the necessary working capital adjustment in working out the average PLI of the comparables. We do not find any reason to interfere with the order of the DRP. Grounds 2 to 4 of the Revenue stand dismissed.

09. Vide its grounds 5 and 6, grievance raised by the Revenue is that DRP held the exchange loss / gain as operating in nature for working out the PLI of the assessee. As per the Revenue, DRP did not verify whether there was any nexus between foreign exchange loss / gain with the business activity of the assessee.

10. Financial results of the assessee showed that its earnings from export on granite slabs to AE were Rs.15,55,02,752/-. In our opinion, given this fact situation, foreign exchange gain / loss could have been considered as non-operational only if the AO could show that such gains / loss came out of hedging and transactions which were independent of the business revenue earning transaction of the assessee. The preponderance of probability will always weigh in favour of the assessee when its revenues are only from exports. In such a situation we cannot take a presumption that foreign exchange gain / loss were not having any nexus to the

operations of the assessee. Coordinate bench in the case of Triology E-Business Software India P. Ltd v. DCIT [(2013) 140 ITD 540] had held as under at para 79 of its order

(B) Treating foreign exchange gain or loss and provision for bad debts as non-operating in nature and fringe benefit tax as part of operating cost:

As far as foreign exchange gain/loss being considered as not forming part of the operating cost, the reasoning of the revenue is that such loss or gain cannot be said to be one realized from international transaction though they may form part of the gain/loss of the enterprise and therefore they should be excluded while determining operating cost. On the above issue we find that the Bangalore Bench of ITAT in the case of Sap Labs India (P) Ltd. Vs. ACIT (2011) 44 SOT 156 (Bang.) has taken the view that Foreign Exchange Fluctuation gains are required to be added to operating revenue. Following the same, the AO is directed to accept the claim of the Assessee in this regard. As far as provision for bad debts are concerned, the TPO has accepted that the same would be part of operating expenses provided the same is incurred every year for at least three years and the manner in which provision is made is consistent. The Assessee in reply to the query of the TPO on the above aspect has not furnished any details. We are of the view that the Assessee should be afforded opportunity to explain its position on the above and the AO is directed to consider the same in accordance with law. As far as Fringe Benefit Tax (FBT) is concerned, the same was not considered by the TPO as part of operating cost in the case of comparables and therefore the same should also not be considered as part of operating cost of the Assessee. We hold accordingly and direct the AO to compute the operating cost of the Assessee.

Accordingly we are of the opinion that DRP was justified in directing the AO / TPO to consider foreign exchange gain / loss as operational in nature. Grounds 5 and 6 of the Revenue stand dismissed.

11. Now we take up appeal of the assessee. Assessee in its appeal has taken four grounds of which ground 4 is general needing no adjudication.

12. Vide its ground 1 and 2 assessee is aggrieved that adjustment sought by it for under utilisation of rated capacity was not allowed while comparing its results with that of the comparables selected for the TP study.

13. Facts apropos are that assessee had in its TP documentation worked out its PLI as under :

	(Rs.in crores)
Sales	15.71
Less : Operating Cost	18.41
Operating Profit	-2.70
Add : Depreciation	3.30
	0.60
Less : Depreciation allowed (10%)	0.32
Adjusted operating profit	0.28
PLI (adj OP/Total Sales)	1.78%

14. Assessee had in the above work-out added back the actual depreciation charged and deducted only 10% of such depreciation for arriving at the PLI. Because of this adjustment, operating loss of 2.70%

became positive operating profit of 1.78%. For restricting the depreciation to 10% of the actual debit in the profit and loss account, argument of the assessee was that there was huge under utilisation of the installed capacity. According to the assessee, depreciation on fixed assets that was to be considered while working out the operating profit should only be in proportion to the actual utilisation of the installed capacity. Assessee pointed out that its turnover had gone down by 60% compared to that of the preceding year and only 10% of the installed capacity was used.

15. TPO required the assessee to give details of its claim of under utilisation of capacity. To this assessee stated that economic slow-down, frequent power disruptions, spiralling cost of the raw material all resulted in lower utilisation of the capacity, leading to under absorption of fixed costs. As per the assessee, its capacity utilisation for the relevant previous year was only about 28,336 sq.mts of granite blocks though it installed capacity for 2,88,000 sq.mts. However TPO was not impressed. According to him, the reasons for under utilisation stated by the assessee applied equally for its competitors also. Comparables also suffered from the same business negativities. As per the TPO for the previous year relevant to A. Y. 2009-10 assessee had claimed full depreciation, but still it had substantial operating profit. Thus, as per the TPO, assessee was not

able to substantiate its claim for adjustment of depreciation while working out its PLI. Though the assessee tried to elaborate on its objections stating that it did not own any granite quarry of its own but was dependent on third party supplies and difficulties faced due to Government restrictions on mining, TPO was of the opinion that assessee could not effectively prove any under utilisation. TPO after studying the 14 comparable companies selected by the assessee came to a conclusion that these comparable companies which were facing the same business contingencies, had increased their sales volumes from that of the preceding previous year. Thus as per the TPO assessee could not bring out a case for making any adjustment for the depreciation while working out its PLI. AO / TPO thereafter computed the adjustment required u/s.92CA of the Act, by working out the PLI of the assessee without making any adjustment for depreciation.

16. Assessee's application before the DRP on this issue also did not meet with any success. DRP noted that though there was a 57% decrease in the sales of the assessee when compared with its sales for the preceding year, a similar trend existed in the case of Neelkanth Rock Minerals Ltd and Ceeta Industries Ltd which were in the list of selected comparables. Or in other words as per the DRP the reasons for under utilisation shown by assessee

was adverse business environment, and this remained same for all similarly placed companies in this line of business.

17. Now before us, the Ld. AR strongly assailing the orders of authorities below submitted that its turnover had fell from Rs.36.51 crores to 15.7 crores when compared to the preceding year. When the assessee was operating in a lower capacity it had to absorb the fixed cost on a lesser production. Ld. AR submitted that Rule 10B(3) required adjustment for differences that could materially affect the net profit margin. Capacity under utilisation, according to him, was an important factum affecting the net margin in the open market. Ld. AR submitted that adjustments for differences, when it could be carried out with reasonable accuracy had to be done before attempting a comparison. Reliance was placed on the coordinate bench in the case of *Genysis Integrating Systems India P. Ltd v. DCIT* [64 DTR 225].

18. Per contra, Ld. DR strongly supported the orders of authorities below.

19. We have perused the orders and heard the rival contentions. Case of the assessee is that it had a capacity for production of 1,22,233 sq.mts of granite but it had only produced 28,336 sq.mt during the year. As per the assessee, because of this its sales went down by more than 60%. This does

indicate underutilisation of capacity and assets. Fixed cost remaining the same, irrespective of the actual utilisation, such cost had to be charged to the production and this is a costing principle that apply to all business and not assessee alone. Among the comparables selected, we find that two companies namely, Neelkanth Rock Minerals Ltd and Ceeta Industries Ltd also had a trend of decreasing sales. Reasons shown by the assessee for under utilisation are that there were difficulties in procuring raw material, not owning any captive mines, and severe shortage of power. These vagaries of business are nothing but adverse environment faced by all competitors who are selected as comparables. Assessee's contention is that its fixed assets were under utilised and therefore there should be an adjustment in depreciation. In our opinion it would only mean that wear and tear of the fixed assets were considered at a lower level than what it would have been if such assets were used without respite. Depreciation on fixed assets need not be directly proportional to utilisation of machinery. Assets can get depreciated by non usage as well. Hence attempt of the assessee to have a lesser charge of depreciation while working out its PLI in the guise of under utilisation of capacity, in our opinion, was not correct. No doubt, as mentioned by the Ld. AR, Rule 10B(1)(e) requires adjustment of differences between international transactions and the comparable

uncontrolled transactions which would materially affect the net material margin. However, assessee here was unable to establish that the comparables had claimed depreciation after considering their capacity utilisation. Further assessee also could not establish the existence of a linear relationship between its depreciation cost and machine utilisation. We are therefore of the opinion that ground 1 and 2 of the assessee does not merit acceptance. Such grounds are dismissed.

20. Vide its ground 3 assessee is aggrieved that the AO while passing the order while giving effect to the DRP directions made an addition for the working capital adjustment whereas it was required to be reduced while working out the adjusted average PLI.

21. Assessee has produced before us a chart according to which the average working capital adjustment that was required to be done for working out the average PLI of the comparables was (-) 2.85%. TPO had however added 2.85% to the unadjusted average PLI of the comparables. We are of the opinion that this issue also requires a fresh look by the AO / TPO. If the working capital adjustment was negative, AO / TPO should rework the adjusted PLI of the comparables after reducing the quantum of such adjustment from the average PLI of the comparables. Ordered accordingly. Ground 3 of the assessee is allowed for statistical purpose.

22. To summarise the result, appeal of the Revenue is dismissed whereas appeal of assessee is allowed for statistical purpose.

Order pronounced in open court on 10th day of November, 2015.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

(ABRAHAM P GEORGE)
ACCOUNTANT MEMBER

MCN*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax
4. Commissioner of Income-tax(A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar