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

BEFORE SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

AND

SHRI. VIJAYPAL RAO, JUDICIAL MEMBER

I.T(TP).A No.1660/Bang/2012
(Assessment Year : 2008-09)

M/s. Kohler India Corp. P. Ltd,
No.138/6, 1st floor, 6 "A" Cross,
Raj Mahal Vilas Extension, Sadashivanagar,
Bangalore 560 060 .. Appellant
PAN : AABCK2145E

v.

Deputy Commissioner of Income-tax,
Circle -11(5), Bangalore .. Respondent

Assessee by : Shri. K. R. Vasudevan, Advocate
Revenue by : Ms. Neera Malhotra, CIT

Heard on : 01.02.2016
Pronounced on : 19.02.2016

O R D E R

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :

In this appeal filed by assessee directed against an assessment made on 23.10.2012, pursuant to directions of Dispute Resolution Panel ('DRP' in short), u/s.144C(5) of the Income-tax Act, 1961 ('the Act' in short), it

has altogether raised six grounds, of which, grounds 1 and 2 are general in nature needing no specific adjudication. Ground 6 is consequential in nature assailing initiation of penalty proceedings u/s.271(1)(c) of the Act.

02. Ground.3 of the assessee is reproduced here under:

> *3. That on facts and circumstances of the case and in law, the Ld. AO/ Ld. TPO/Ld. DRP erred while making an addition of Rs. 19,61,28,232 to the value of international transactions by:*
>
> *(i) rejecting Resale Price Method ("RPM") and selecting Transactional Net Margin Method ("TNMM") as most appropriate method for distribution segment of the Appellant;*
>
> *(ii) wrongly computing the relevant cost base of the distribution segment while applying the TNMM for distribution segment;*
>
> *(iii) not providing the computation of operating profit margin on sales of the comparable company at 17.72% under TNMM;*
>
> *(iv) wrongly computing the operating profit margin on sales of the comparable company at 17.72% as against 11.96% under TNMM and thereby erroneously increasing the transfer pricing adjustment by Rs. 2,20,43,542;*
>
> *(v) wrongly including the provision for warranty of Rs. 50,78,903 and fees of Rs. 81,90,00 paid to the Registrar of Companies in the cost base for arriving at the operating profit margin of the Appellant under TNMM even when the aforesaid provision and fee were disallowed as allowable expenditure u/s 37 by the Ld. AO;*

(vi) not conducting a fresh benchmarking analysis while applying the TNMM as most appropriate method for distribution segment; and

(vii) wrongly considering the value of purchase of goods at Rs. 19,61,28,232 instead of Rs. 1 7,71,37,313/-.

03. Facts apropos are that assessee trading in generator parts and servicing of generators had filed its return of income for the impugned assessment year declaring nil income. Assessee had during the relevant previous year entered into international transactions with its 'Associated Enterprise' ('AE' in short) mainly consisting of purchase of finished goods. Assessee had two segments of operation, namely, distribution and power. AE from which assessee bought the finished goods for sale in India was its principal, namely, Kohler Company USA. Finished goods were bath fittings and sanitaryware products. International transactions undertaken by the assessee during the relevant previous year with its AE were as under:

Sl No	Particulars	Amount (Rs.)
1	Purchase of Finished goods(Distribution)	19,61,28,232#
2	Purchase of Finished goods(power)	1,05,40,487
3	Purchase of fixed assets	2,99,096
4	Reimbursement of expenses by AEs(power)	65,34,133
5	Reimbursement of expenses by AEs(Distribution)	15,86,470
6	Reimbursement of expenses to AEs(Distribution)	8,95,008

figure taken from Form.no.3CEB

04. Since the PLI of international transactions pertaining to power segment was considered by the TPO to be at arms length, there was no recommendation on this segment by the TPO when the issue of pricing of the international transactions were referred to him by the AO. However, with regard to the distribution segment, TPO did not accept the TP documentation filed by the assessee. Assessee had followed 'Resale Price Method' ('RPM' in short) for justifying the ALP of the purchase cost of goods from its AE abroad. As per the assessee it was selling the products imported from its AE in India as such and there was no value addition. Kitchen, bath and sanitary ware products, similar to the ones dealt with by the assessee, were imported and sold by other Indian comparable companies and as per the assessee data with regard to such companies were available in public domain. Contention of the assessee before the TPO was

that data on purchase and sale of kitchen and bath fittings of other companies with various brand names were available. As per the assessee, it was only doing trading activity of finished goods imported from its AE abroad and had sold the finished goods received by it as such in the domestic market. As per the assessee, though it was having exclusive right to sell Kohler kitchen and bath fittings in India, this did not result in a monopoly situation since there were similar products of various brands like Parryware, Hindware and Jaquar, sold by other competing, independent companies. In other words as per the assessee when items similar to that which were sold by it were also sold by unrelated parties in independent transactions, RPM was the best method which could be adopted for testing its international transactions.

05. However, TPO was not impressed by the above contentions of the assessee. According to him, for application of RPM, Rule 10B(1)(b) of IT Rules, required adjustments to be made for differences in the international transactions of the comparable uncontrolled transactions which had a material effect on the gross profit. As per the TPO, it was not possible to ascertain the material differences that might be there, considering the manner in which assessee had carried on its business and the manner in which independent enterprises chosen by the assessee had carried on their

business. Hence, according to him adjustment as required under the above mentioned Rule was not possible. As per the TPO, assessee was not a mere reseller which performed simple services like that of a forwarding agent. Assessee had a good marketing net work and had also spent substantial money for advertisement and selling expenditure. TPO noted that accounting treatment of the assessee and the comparable companies selected by it, with respect to direct expenditure was not available in public domain. He thus held that the RPM adopted by the assessee could not be considered as the most appropriate method ('MAM' in short). He substituted such method with TNMM and proceeded with the computation of ALP. For this, he took Euro Merchandise (India) Ltd, which was one of the comparable selected by assessee itself in its RPM based TP study. As per the TPO, the said Euro Merchandise (India) Ltd was having a PLI of 17.72%. Applying 17.72% as arms length TP margin, TPO recommended an upward adjustment of Rs.19,61,28,232/-, u/s.92CA of the Act on the international transactions of the assessee.

06. When a draft assessment order on the lines mentioned above was proposed, assessee chose to move the DRP. Primary objection of the assessee before the DRP was on the rejection of RPM as the MAM and

adopting TNMM in its place. Relying on Rule 10C(1) and (2) of the Rules, assessee argued before the DRP that the method which was best suited to the facts and circumstances of each particular international transaction and which provided most reliable result for an ALP analysis was required to be adopted. As per the assessee, if the upward adjustment recommended by the TPO, applying TNNM was sustained, it would mean that assessee had incurred ''nil cost for the goods resold by it. As per the assessee, it had incurred a loss on the international transactions in the distribution segment due to expenditure of Rs.9,73,20,890/- for establishing show-room, advertisement and business promotion. Further as per the assessee, expenditure incurred by it was of a nature which effected the net profit and hence application of TNNM would not give fair results. Contention of the assessee was that selling prices were not related to the cost incurred by it, but was determined by market forces. Or other words, by prices of similar products sold by competitors. Assessee also submitted that it was only in its second year of operation and the benefits of expenditure on sales promotion and advertisement were expected down the line.

07. However, DRP was not impressed by the above arguments. As per the DRP assessee was performing value added services and was not a distributor simplicitor. Assessee had in the later years started manufacturing of the very same items. DRP thus held that TPO was justified in adopting TNMM in place of RPM considered by the assessee.

08. Now before us, Ld. AR strongly assailing the orders of authorities below submitted that in the first year of its operation also assessee had followed RPM in its TP study for international transactions in the power and distribution segment. As per the Ld. AR, assessee was selling kitchen, sanitary and bath fittings in India, directly importing it from its AE abroad. Assessee was not doing any processing of these items. Similar items were sold by its competitors in India like, Parryware, Hindware etc., As per the Ld. AR, lower authorities took a wrong presumption that advertisement and selling expenditure resulted in a value addition to the goods sold. Goods sold were not subjected to any value addition by the assessee. Ld. AR submitted that in a similar situation this Tribunal in the case of DCIT v. M/s. Sanyo India P. Ltd v. ACIT [(2015) 45 CCH 0098 – Bang-Trib], held that RPM was the best one for testing the international transactions relating to sale of goods purchased from AE, as such. Reliance was also placed on

the judgment of Bombay High Court in the case of CIT v. L'oreal India P. Ltd [(2015) 117 DTR 0460]. According to the Ld. AR, substantial expenditure were incurred on advertisement and marketing since this was the second year of its operation in India, but this did not make any value addition to the products which were sold, in the same state in which it was imported.

09. Per contra, Ld. DR strongly supporting the orders of the authorities below, submitted that assessee could not show how TNMM was not the appropriate method when the comparable company considered both by the assessee as well as by the TPO was the very same, namely, Euro Merchandise (India) Ltd. Relying on the judgment of Hon'ble Delhi High Court in the case of Sony Ericson Mobile Communications India (Pvt) Ltd v. CIT [(2015) 374 ITR 118], Ld. DR submitted that in the said case TPO had used both RPM and TNMM and this was accepted. As per the Ld. DR though the judgment of Hon'ble Delhi High Court was in relation to the AMP expenditure, analysis done by the TPO in the said case used both RPM and TNMM. As per the Ld. DR, when adjustments which would bring the prices charged by the tested party on the same footing as the prices charged by the comparables, could not be carried out with reasonable accuracy, RPM could not be accepted. As per the

Ld. DR, in such a situation TNMM was more appropriate. Thus as per the Ld. DR lower authorities were justified in adopting TNMM in place of RPM considered by the assessee.

10. We have perused the orders and heard the rival contentions. Adjustment recommended by the TPO was confined to finished goods purchased by the assessee from its AE abroad under the distribution segment and sold here as such. Items involved were kitchen and bath fittings. Assessee had not done any further manufacturing or processing of these goods, but had sold it as such. Assessee had adopted RPM for justifying the cost of purchase from its AE abroad. There is no doubt that assessee had incurred substantial marketing and administrative expenditure coming to Rs.9,73,20,890/-. This resulted in a loss to the assessee in its distribution segment during the relevant year. For justifying the pricing of its international transactions under this segment assessee had selected as comparable Euro Merchandise (India) Ltd, under the RPM. TPO though he rejected the RPM and adopted TNMM as MAM, had also considered the very same comparable. Nevertheless, TPO in our opinion, ought have made a close analysis of the items which were bought by the assessee from its AE abroad and sold as such in India, to verify whether such items were comparable with the items sold by Euro Merchandise (India) Ltd, or any other companies like Hindware, Parryware etc. Where an assessee

suggests RPM as the MAM it is imperative that the products sold by the tested Indian entity is subjected to a close comparison with those which are sold by the comparables. Unless and until this is done it may not be possible to come to a conclusion whether RPM can be applied or not. RPM depends on a mechanism of verification of margins at gross levels and not at net levels. This is obvious from Rule 10B(1)(b) of the Act, which is reproduced hereunder :

10B. Determination of arm's length price under section 92C.

(1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:

(a) .....

(b) resale price method, by which—

(i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified ;

(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions ;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services ;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market ;

(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise ;

11. Before rejecting the RPM, TPO should have made an analysis to see whether the required data regarding the set of comparables dealing in similar products could be obtained from public data bases. Only if it can be shown that the adjustment specified in the above Rule was not possible, RPM can be rejected as MAM. No doubt Ld. AR placed reliance on the decision of coordinate bench in the case of M/s. Sanyo India P. Ltd (supra). However, goods sold by M/s. Sanyo India P. Ltd, were similar to goods sold by the chosen comparables viz., Televisions, Projectors, Refrigerators etc., Assessee in the said case, had while adopting the RPM as the MAM found five comparable companies for testing the value of its international transactions with its AE. It was on account of this reason, this Tribunal held that the RPM was MAM in the said case. As against this here assessee was selling kitchen and bath fittings, and whether there were other comparables in similar business

sufficient enough to make a representative sample has not been verified by any of the lower authorities. The question whether RPM is the MAP depends on such an analysis. We are therefore of the opinion that the matter as to the selection of MAM and also the pricing of international transactions of the assessee with regard to its distribution segment requires a fresh look by the TPO / AO. We set aside the orders of authorities below and remit the issue back to the file of TPO / AO for consideration afresh. In the circumstances, we keep the issues raised by the assessee in its grounds 3(ii) to 3(vi) open. AO shall also consider the correct value of the purchase while computing assessee's ALP, whatever may be the MAM finally selected by him. Ground 3 of the assessee is treated as partly allowed for statistical purpose.

12. Vide its ground 4, assessee is aggrieved that provision of warranty of Rs.50,78,903/- was disallowed. Facts apropos are that assessee was required to provide details of the provisioning made on warranty during the course of assessment proceedings. Reply of the assessee was that faucets sold by it and used for residential purpose had a warranty of seven years and those for commercial purpose had a warranty of five years. For kitchen and bath fittings there was a warranty of one to ten years. AO

refused to consider the claim of the assessee. In the draft assessment order he was of the opinion that the claim of warranty provision was in the nature of contingent liability. However when the matter reached the DRP it directed the AO to have a relook at the provisioning for warranty considering the judgment of Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd vs CIT [(2009) 314 ITR 62].

13. Assessee pursuant to the directions of the DRP gave details of the warranty period with reference to various types of products sold by it. As per the assessee it was making a warranty provision of 1% of net sales and the subsequent trends show that the provisioning was correctly done. However, AO did not accept the above contention. According to the AO the test laid down by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd (supra), required the assessee to make an estimate of its present obligation resulting from the past events. As per the AO, commercial warranty for all its products was only two years. For sale in residential areas, maximum warranty was for three years except for two out of nine products. Thus according to the AO assessee's claim that its warranty crystalised in fourth or fifth year of sale was not acceptable. Further as per the AO, assessee had not written back the excess

provisioning made by it in the subsequent years. He thus held that the conditions laid down by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd (supra), was not satisfied. He disallowed the provision for warranty.

14. Before us, Ld. AR submitted that provisioning for warranty was made on a scientific basis. Since it was in the second year of operation, it was not possible for it to go by historical data. Nevertheless considering the period of warranty given to each of the products sold by it, assessee had made a conservative estimate of 1% of the sale value of provisioning. As per the Ld. AR, conditions set out by the Hon'ble Apex Court was satisfied. Reliance was also placed on the judgment of Hon'ble jurisdictional High Court in the case of CIT v. Denso Kirloskar [(2013) 34 Taxman.comm 238].

15. Per contra, Ld. DR supported the order of the lower authorities.

16. We have perused the orders and heard the rival contentions. It is an admitted position that assessee was making warranty provision at 1% of the gross sales. It might be true that assessee might not be having historical data for making an exact working of the warranty provision which was

required. However, admittedly assessee's parent company abroad was in the business of selling Kohler bath and sanitary fittings since the last very many years. Therefore, it is not a case where assessee could not have compiled sufficient data in support of its warranty provision. AO has given a clear finding that except for two items, assessee's warranty period never exceeded three years. Conditions set out by Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd (supra), for allowing a claim of warranty as under :

a) An enterprise has a present obligation as a result of a past event.

b) It is probable that an outflow of resources will be required to settle the obligation.

c) A reliable estimate can be made of the amount of obligation.

17. While it is true that assessee had a present obligation on account of warranty resulting out of its sales and it was also probable that there could be an outflow of resources for settling such obligation, the third condition, viz., making of a reliable estimate has not been done by the assessee. In our opinion, unless and until scientific data is produced by an assessee in support of the estimate of warranty provisioning, an estimate cannot be

presumed as a reliable one. Assessee having failed to do so, disallowance was rightly done by the lower authorities. We do not find any reason to interfere. Ground 4 of the assessee stands dismissed.

18. Vide its ground 5, assessee is aggrieved that expenditure of Rs.81,90,000/- paid to the Registrar of Companies for increasing authorised capital was disallowed.

19. Ld. Counsel for the Assessee submitted that even if it was considered as a capital out go assessee would be eligible for claiming amortisation of such expenditure u/s.35D of the Act. Ld. AR submitted that such alternative contention was placed by the assessee before DRP. As per the Ld. AR, DRP has held that assessee to be eligible for such claim. However, AO had not allowed the amortisation available to it u/s.35D of the Act.

20. Per contra, Ld. DR supported the order of AO.

21. We have perused the orders and heard the rival contentions. Section 35D of the Act is reproduced hereunder :

Amortisation of certain preliminary expenses.

(1) Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2),—

(i) before the commencement of his business, or

(ii) after the commencement of his business in connection with the extension of his undertaking or in connection with his setting up a new unit,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation :

Provided that where an assessee incurs after the 31st day of March, 1998, any expenditure specified in sub-section (2), the provisions of this sub-section shall have effect as if for the words "an amount equal to one-tenth of such expenditure for each of the ten successive previous years", the words "an amount equal to one-fifth of such expenditure for each of the five successive previous years" had been substituted.]

(2) The expenditure referred to in sub-section (1) shall be the expenditure specified in any one or more of the following clauses, namely :

(a) expenditure in connection with—

(i) preparation of feasibility report;

(ii) preparation of project report;

(iii) conducting market survey or any other survey necessary for the business of the assessee;

(iv) engineering services relating to the business of the assessee:

Provided that the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or of any other survey or the engineering services referred to in this clause is carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board;

(b) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;

(c) where the assessee is a company, also expenditure-

(i) by way of legal charges for drafting, the Memorandum and Articles of Association of the company;

(ii) on printing of the Memorandum and Articles of Association;

(iii) by way of fees for registering the company under the provisions of the Companies Act, 1956 (1 of 1956);

(iv) in connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus;

(d) such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of this Act) as may be prescribed.

19. It is clear that once the type of expenditure mentioned under sub-section (2) is incurred by an assessee, it shall be allowed a deduction as per

sub-section (1) in the manner specified therein. Thus it is clear that AO when he had made disallowance of the share issue expenditure in the nature of fees paid to Registrar of Companies for increasing authorised capital, he ought to have allowed the amortisation of such expenditure u/s.35D(1) of the Act. DRP had accepted this claim of the assessee at para 10.2 of its order. We therefore direct the AO to grant amortisation of such expenditure to the assessee as specified u/s.35D of the Act. Ground 5 of the assessee stands partly allowed.

20. In the result, appeal of the assessee is partly allowed for statistical purpose.

Order pronounced in the open court on 19th day of February, 2016.

Sd/-	Sd/-
(VIJAY PAL RAO) JUDICIAL MEMBER	(ABRAHAM P GEORGE) ACCOUNTANT MEMBER

Assistant Registrar