INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-2": NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No.:-2051/Del/2015
Assessment Year: 2010-11

Kehin India Manufacturing Pvt. Ltd. (Formerly Keihin Panalfa Ltd. 2315/23, Opposite Payal Cinema, Behind Karim Restaurant, Delhi Road, Gurgaon – 122 001, Haryana (PAN AAACK5968J)	Vs.	DCIT Circle-14(2), Room No. 317-B, C.R. Building, I.P. Estate New Delhi 110 002
(Appellant)		**(Respondent)**

Assessee by:	Shri Pradeep Dinodia, Adv. Ms. Pallavi Dinodia, Adv.
Department by :	Shri Sanjai Kumar Yadav, Sr.DR
Date of Hearing	11/07/2018
Date of pronouncement	05/10/2018

O R D E R

PER AMIT SHUKLA, J.M.

The aforesaid appeal has been filed by the assessee against final assessment order dated 30.1.2015, passed u/s 143(3) read with section 144C, in pursuance of directions given by the Dispute Resolution Panel vide order dated 21.11.2014. In various grounds of appeal the assessee has challenged the transfer pricing adjustment of Rs. 8,57,73,481/- in respect of purchase of traded goods by the

assessee from its AE, whereby the TPO has rejected the TNMM adopted by the assessee and held that RPM should be the most appropriate method of benchmarking international transactions; secondly, assessee has challenged disallowance of Rs. 15,20,117/- on account of business entry charges after invoking provision of section 40A(2)(b); and lastly, disallowance of Rs. 3,639/- on account of warranty expenses.

2. Brief facts and background *qua* the issues raised in transfer pricing adjustment are that, Keihin India Manufacturing Private Limited ('KIMPL'/assessee') is a manufacturing concern specialised in automotive air conditioning systems and equipments for automobiles. The majority stake (74%) in the assessee is held by Keihin Corporation, Japan ('Keihin Japan') and remaining stake viz. 26% is held by Panalfa Automotive Pvt. Ltd. Honda Motors Co. Ltd. (Japan) which owns 41.33% of the equity of Keihin Japan; and 99.99% of the equity in Honda Siel Cars India Limited ('HSCI') to whom all the sales are made by the assessee. The business of the assessee company was divided into two segments, viz., manufacturing segment and trading segment. It has reported following international transactions with its AE:-

S.No.	Nature of International Transaction	Value (In INR)
1	Purchase of raw materials parts and components	8719,53,836

2	Purchase of traded goods	4267,98,329
3	Purchase of Capital goods	3,65,340
4	Payment of Royalty	36,02,990
5	Payment of Technical Guidance fee	2,37,409
6	Amount Payable	4122,11,455
	Total	17151,69,359

3. The traded goods were imported by the assessee from its AE and was sold to AE in India, thus, both the limbs of the transactions were from the related parties. To benchmarking the international transaction both in the manufacturing and trading segment the assessee has adopted TNMM as MAM by selecting itself as the 'tested party' and calculated the PLI OP/Sales of the manufacturing segment at 9.40% and the manufacturing segment and (-)1.08% in the trading segment. In so far as benchmarking by adopting TNMM as Most Appropriate Method in the manufacturing segment the same has been accepted by the TPO. The assessee for the trading segment after detailed search process in its transfer pricing study report has finally shortlisted three comparable companies which were as under :-

S.No.	Companies	PLI
1	Autolite(I)	2.75%
2	PAE Ltd.	2.74%
3	Spectra Industries Ltd.	1.68%
	Average	2.39%

Since the assessee's margin was (-1.08%), hence it was reported that it has yet to be arms length principle as it was within +/-5% range.

4. Ld. TPO has however rejected the assessee's selection of TNMM as MAM and instead held that RPM on the facts of the assessee's case should be the MAM. Ld. TPO has noted the transaction in this segment in the following manner:-

> *"KPL is engaged in the trading of Electronic Control Units (ECU's) which it purchases from, its AE's and sells to its only customer India i.e. Honda Siel Cars India Ltd. (HSCI). The Company places Purchase orders with Honda Trading Corporation, Japan-on the basis of the requirements of its customer, HSCI. Thus, KPL maintains an inventory and all risks associated with inventory management vests with it. Thus, KPL performs routine sales and distribution functions. Its activities include price negotiation, order receipt and subsequent processing, packaging, transportation, invoice generation, follow up on customer outstanding etc.*
>
> *The functions performed by KPL under its Trading segment are tabulated below;*

S.No.	*Function /*	*KPL*	*AEs*	*Explanations*
1	*Procurement of ECU's*	*Yes*	*No*	*KPL is responsible for purchasing the ECU's from Honda Trading Corporation, Japan based on the requisition raised on It by HSCI*
2	*Inventory Management*	*Yes*	*No*	*It is the responsibility of KPL to warehouse the goods once they arrive in India till the time they are sold to HSCI. All functions regarding warehousing; maintaining and moving of the goods to the factory of HSCI are KPL.*
3	*Quality Control*	*Yes*	*Yes*	*The quality of the purchased goods is the responsibility of the vendor. However, KPL*

		Limited		*provides after sales services and warranty services for the goods traded by it to HSCI which are later recovered from the final vendor.*
4	*Marketing Sales & Distribution*	*No*	*No*	*KPL does not conduct any advertisement functions with regard to the purchase and sale of Traded Goods.*

Before proceeding into the affairs of the trading segment further there is a need to mention about the parties that are interacting in the transaction.

The TP study at page 20 mentions that the only customer of KPL is Honda Siel Cars India Limited (HSCIL).The purchases made for affecting this sale are from Honda Trading corporation Japan. It may be noted in the group over view that the assessee itself is connected with Honda Motors Limited (it has 41.33% share in Keihin corporation which in turn has 74% stake in the assessee company). Honda Motors are also having stake in Honda Trading Corporation. Thus these constitute a group of associated enterprises.

Similarly the party to whom the assessee is affecting sale is also connected with the group. As mentioned above the sale is made to HSCIL, an entity connected with the Honda group. Thus on both ends that is at the end of the purchase and also at the end of the sale the assessee can be said to be having controlled transaction."

Thus, he has categorically noted that the transaction at both the ends i.e., at the end of the purchase and also the end of the sale, was controlled transaction with the AE. Despite noting this important fact that both purchases and sales are with the AE, he has proceeded to

apply RPM. He further noted that the gross profit of the assessee has been worked out at 0%, i.e., it is not making any profit at gross profit level and there is negative profit at the net level. This he has tried to demonstrate at page 10 of his order. Thus, he held that in an independent situation and uncontrolled circumstances, no one would do the business at a 0% margin at a gross level and will not continue to bear continuous loss. The reasons given by him for rejecting the TNMM has been dealt in his order in detail after relying upon OECD guidelines and observed that, *firstly*, assessee does not bear any inventory risk; *secondly*, there is no liability to promote the product ; *thirdly*, no inventory is maintained as when it gets confirmed order from the customers, that is, it procures the same from its AE; and *lastly*, there is no market risk. Thus, when the assessee is having minimal distributor risk, not adding any value to the product neither on account of brand building promotion nor marketing, then TNMM cannot be applied, *albeit* in such a situation RPM is the most appropriate method. After relying upon various decisions, he justified the application of RPM by taking the same set of three comparables chosen by the assessee under RPM and held that average gross profit margin of the comparables were 17.77% and accordingly, made the adjustment of Rs. 16,50,21,780/-. The said adjustment after the stage of DRP has been reduced to Rs. 8,57,73,481/-, because DRP has

directed to restrict the TP adjustment proportionate to the international transaction only.

5. Before us Ld. Counsel for the assessee submitted that TPO has undertaken incorrect FAR analysis and in all the earlier years TNMM has been accepted as the most appropriate method and in support he has given the litigation history on selection of MAM in the case of the assessee:

AY	Position taken by Revenue Authorities on selection of MAM
2006-07	TNNM as MAM accepted by the Ld. TPO for Trading Segment and no adjustment made under TNMM in this segment.
2007-08	TNNM as MAM accepted by the Ld. TPO for Trading Segment and no adjustment made under TNMM in this segment
2008-09	TNNM as MAM accepted by the Ld. TPO for Trading Segment and no adjustment made under TNMM in this segment
2009-10	TNNM as MAM accepted by the Ld. TPO under Trading segment and the TP adjustment in this segment should b e deleted in view of recent ITAT order in assessee's own case (Appeal effect to be given by the Ld. AO)
2010-11 (in appeal)	TNNM as MAM rejected by the Ld. TPO under Trading segment and selection of RPM as MAM by the Ld. TPO.

6. Thus, he submitted that principle of consistency should be followed especially when there is no change in the material facts and the nature of transaction with the AE is the same. In support of such

consistency of approach, reliance was placed on catena of judgments which have been given in his synopsis filed before us. Thus, he prayed that once there is no change in FAR of the assessee then following the earlier year precedence, TNMM should be adopted as MAM. Without prejudice, he has also submitted that if RPM method is applied then various adjustments are required to be made for which he has given a detailed analysis in his written submissions.

7. On the other hand, Ld. DR strongly relying upon the order of the TPO and DRP submitted that the TPO has given a very detailed analysis as to why RPM should be MAM, because the assessee is performing routine distributor function wherein it is purchasing the goods from the AE and selling the same to another AE without making any value addition. In such a situation RPM is the most appropriate method. He also referred to the judgements which have been referred in the TPO's order specially in the case of **Mattel Toys (I) (P) Ltd. vs. DCIT (2013) 34 taxman.com 203 (Mumbai)**.

8. We have heard the rival submissions and also perused the relevant material referred to at the time of hearing. It is an undisputed fact that assessee has purchased traded goods from AE amounting to Rs. 42,67,98,329/- which is subject matter of transfer pricing adjustment. Assessee is purchasing the goods from Honda Trading Corporation , Japan and only customer to whom it is selling the

Honda Siel Cars India Limited which is an entity connected with the Honda group. The share holding of the assessee by different AEs including one with whom the assessee has undertaken the transaction of purchase and sale has already been given in an earlier part of the order. Thus, both Honda Trading Corporation Japan and HSCIL are associated enterprises of the assessee. As observed by the TPO, on both the ends, i.e., purchase and sale transaction is with the related parties, i.e., are controlled transactions. Once both the legs of the transactions are with the AE, then whether under these circumstances RPM can be held to be most appropriate method or not. The relevant Rule 10B (1)(b) which describes the RPM method reads as under :-

> *"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 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 properly 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."

9. Clause (i) clearly envisages that RPM would be applicable only where prices at which property purchased or services obtained by the enterprises are from an AE which is resold to unrelated enterprises. RPM method can be applied where the price of the property purchased from an AE has to be benchmarked. But if the goods or property or services are obtained from the AE and is resold or provided to related enterprises, i.e., AE again, then RPM cannot be applied. RPM is a method for computing the arms length price in respect of purchase of property from AE. The method is nothing but a backward calculation from resale price to obtain the purchase value in an independent scenario. That is the reason why it is applicable only when resale is made to an unrelated party, because if the resale price *per-se* is tainted then it would be impossible to compute arm's length price in respect of purchase of property. Thus, RPM cannot be held to be the

most appropriate method when both the limbs of the transaction i.e., the purchase of the goods and resale are with AE, because, both are related parties and are controlled transactions. Accordingly, we reject the applicability of RPM as MAM in the case of the assessee.

10. Now coming to the applicability of TNMM as MAM, we find that in all the earlier years TNMM has been finally held to be most appropriate method on the facts of the assessee's case and since there is no change in material facts or FAR, then TNMM should be adopted as the most appropriate method to benchmark the international transaction of the assessee with the AE in the trading segment. Since this method has not been analysed by the TPO and the same comparable selected by the assessee has been adopted by the TPO for the purpose of RPM, therefore, we are of the opinion that the matter should be remanded back to the file of the TPO and AO, firstly, to consider TNMM as the MAM constituting the past history of the assessee; and secondly, to carry our fresh search analysis of the comparables and then benchmark the assessee's transaction in the trading segment. The TPO shall give effective opportunity to the assessee to substantiate its case and after analysing the comparables, ALP of the Trading Segment should be determined. All the other grounds raised by the assessee before us relating to transfer price adjustment shall be open before the TPO, except for the directions

given herein above. In the result, ground pertaining to transfer pricing adjustment is treated as partly allowed for statistical purposes.

11. Coming to the corporate tax issues, the assessee has challenged the disallowance of Rs. 15,20,117/- in respect of business centre charges. Brief facts are that, the assessee has claimed amount of Rs. 59,82,672/- in the heads of expenses which has been classified u/s 40A(2)(b). The AO held that similar disallowance was made in A.Y. 2009-10 and therefore same is to be repeated again. However, the DRP in the assessment year 2009-10 has deleted the said addition following the ITAT order of the earlier years. The AO has held that, since revenue has filed an appeal before the Tribunal against the order passed by DRP for the year 2009-10, therefore, he has repeated the said disallowance. The DRP though has deleted the said addition but AO in the final assessment order disregarding the directions of the DRP has again repeated the same. Relevant observation of the DRP reads as under:-

> *"13.2 The submissions of the assessee and the facts have been carefully considered. A similar issue arose in A.Y. 2009-10 and the addition made by the A.O. has been deleted by the DRP with the following observations:*
>
> *10.3 The Panel has examined the matter. The disallowance proposed by the AO is based upon the facts as are continuing from the earlier years. In the light of the decision of the ITA T in the taxpayer's own case in A Y 2003-04 and that Appeal u/s*

260A has not been filed, the Panel is of the opinion that the proposed disallowance cannot be sustained. The AO is therefore, directed to exclude the said disallowance in final order.

13.3 We are in agreement that the reasoning given by the DRP in AY 2009-10. Considering the facts and following the reasoning given by the DRP in earlier year, the addition proposed by the AO is not justified and is deleted. The Ground is allowed. "

12. After hearing both the parties, it is seen that assessee has paid a sum of Rs. 59,82,672/- to M/s Panalfa Automotive Pvt. Ltd. towards business centres charges. Since it was one of the persons specified u/s 40A (2)(b), AO held that sum of Rs. 15,20,117/- is excessive and unreasonable. DRP following the earlier year order of the Tribunal has deleted the addition. Once DRP in its order has deleted the said addition, then AO was bound by such direction and he could not have repeated the same addition simply on the ground that department has not accepted the earlier years orders of the DRP. Thus, AO has grossly erred in law in not giving effect to the DRP direction and accordingly, we set aside TPO's finding and confirmed the deletion of the said disallowance by the DRP. In the result this ground raised by the assessee is allowed.

13. Similarly on the issue of disallowance of 3,639/- on account of warranty expenses, DRP has deleted the said disallowance which AO has again repeated it without following the DRP's direction which is

against the provision of law and accordingly, the said disallowance is directed to be deleted.

14. In the result appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the Open Court on 5th October, 2018.

sd/- **sd/-**

(PRASHANT MAHARISHI) **(AMIT SHUKLA)**
ACCOUNTANT MEMBER **JUDICIAL MEMBER**

Dated: 05 /10/2018

Veena

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi