IN THE INCOME TAX APPELLATE TRIBUNAL

"A" BENCH : BANGALORE

BEFORE SHRI ARUN KUMAR GARODIA, ACCOUNTANT MEMBER AND

SHRI LALIET KUMAR, JUDICIAL MEMBER

Appeal No.	Appellant	Assessment Year	Respondent
IT(TP)A No. 239/Bang/2015	M/s. Essilor Manufacturing (India) Pvt. Ltd., #4A, L&M, KIADB Industrial Area, Doddaballapur, Bangalore, Karnataka – 561 203. **PAN: AAACI4572J**	2010-11	The Deputy Commissioner of Income Tax, Circle – 3 (1) (2), Bangalore.
IT(TP)A No. 2124/Bang/2016		2008-09	The Assistant Commissioner of Income Tax, Circle – 2 (1) (2), Bangalore.
IT(TP)A No. 2125/Bang/2016		2009-10	
IT(TP)A No. 211/Bang/2015	The Deputy Commissioner of Income Tax, Circle 3 (1) (2), Bangalore.	2010-11	M/s. Essilor Manufacturing (India) Pvt. Ltd., #4A, L&M, KIADB Industrial Area, Doddaballapur, Bangalore, Karnataka – 561 203. **PAN: AAACI4572J**
IT(TP)A No. 1166/Bang/2015	The Deputy Commissioner of Income Tax, Circle – 2 (1) (2), Bangalore.		

Assessee by	:	Shri Chavali Narayan, CA
Revenue by	:	Shri C.H. Sundar Rao, CIT (DR-I) & Shri Vikas K. Suryawanshi, Addl. CIT (DR)
Date of hearing	:	10.01.2019
Date of Pronouncement	:	25.01.2019

O R D E R

PER BENCH:

Out of this bunch of 5 appeals, two appeals are directly filed by the assessee before the Tribunal against the order passed by the AO on 30.09.2016 as order giving effect to ITAT's Order for Assessment Years 2008-09 and 2009-10. Remaining three appeals are for Assessment Year 2010-11 and out of these three appeals, two appeals are filed by the revenue out of which one appeal is filed in course of proceedings u/s. 154 r.w.s. 144C(5) of IT Act, 1961. The remaining appeal of the revenue for Assessment Year 2010-11 is against the direction of the DRP dated 21.11.2014. The appeal filed by the assessee for this year is against the assessment order dated 30.12.2014 for Assessment Year 2010-11 passed by the AO u/s. 143(3) r.w.s. 144C of IT Act, 1961 as per the directions of DRP. All these appeals were heard together and are being disposed of by way of this common order for the sake of convenience.

2. Regarding the two appeals of the assessee for Assessment Years 2008-09 and 2009-10, it was pointed out by the bench that how these appeals can be filed directly before the Tribunal. In reply, it was submitted by ld. AR of assessee that the relevant Tribunal order dated 24.02.2016 in IT (TP) A Nos. 1019 & 1020/Bang/2014 is available on pages 3 to 35 of the appeal memo in both these appeals and in particular, our attention was drawn to Para no. 6.6 and 8.4 of this Tribunal order. He also submitted a copy of a Tribunal order rendered in the case of Mercedes Benz Research & Development vs. DCIT in IT (TP) A No. 348/Bang/2014 dated 31.03.2017 and our attention was drawn to pages 4 and 5 of this Tribunal order. It was pointed out by the bench that in this case, it was held by the Tribunal that in case where the Tribunal remanded the matter back to the record of the TPO/AO with specific direction, the TPO/AO had no discretion but to strictly follow the directions of the appellate authority on an issue and their role is restricted only for recomputation of the amounts or verification of certain facts for deciding the issue on merits or on legal point then in such a situation, if the TPO/AO has not given proper effect to the directions of the Tribunal, the appeal against such order of the TPO/AO would lie before the Tribunal as held by the co-ordinate bench of the Tribunal in the case of Tally Solutions Pvt. Ltd. Vs. DCIT as reported in 30 ITR (Trib) 591 (Bangalore). He submitted that in the present case also, specific directions were given by the Tribunal in its order dated 24.02.2016 which are not given proper effect to by the AO and therefore, the appeal is correctly filed before the Tribunal. The ld. DR of revenue submitted that the appeal filed by the assessee directly before the Tribunal is not maintainable.

3. We have considered the rival submissions. First of all we reproduce Para no. 8.4 of the impugned Tribunal order dated 24.02.2016 in assessee's own case for Assessment Years 2008-09 and 2009-10. This Para reads as under.

> "*8.4 Having considered the rival submissions and the relevant material on record, we find that this company was selected by the TPO and included in the list of comparables for determination of ALP. The TPO has not discussed anything in its order regarding inviting the objections of the assessee on the point of functional*

comparability of this company. Thus it appears that the TPO has considered this company without discussing the relevant facts regarding the functional comparability of this company. The assessee has brought before us the relevant facts regarding the nature of the business activity of this company as well as the products manufactured by this company. From the Schedule 16 of the profit and loss account, the product description given includes pre-optic component, instrument assemblies/sub-assemblies. The raw-material consumed by this company includes glass, lenses and metals. Thus it is clear that this company is not in the manufacturing activity of optical, plastic lenses of human care but the product of this company is catering to the needs of the industry, armed forces and other organizations in the field of space applications, night vision equipments, etc. Accordingly, in the facts and circumstances of the case, we admit the additional ground raised by the assessee and set aside the issue of functional comparability of this company to the record of the Assessing Officer/TPO for proper examination and verification of the issue and decide after considering the relevant facts as well as the objections of the assessee."

4. From this Para of the Tribunal order, it comes out that the matter was remanded by the Tribunal to the file of AO/TPO for proper examination and verification of the issue to decide after considering the relevant facts as well as the objection of the assessee. Hence, it is seen that in the present case, there is no specific direction resulting into no discretion to the AO/TPO. Hence, in our considered opinion, this Tribunal order rendered in the case of Mercedes Benz Research & Development Vs. DCIT (supra) is not applicable in the present case. We are of the considered opinion that in the facts of present case, the assessee should have filed appeal before ld. CIT(A) but since this was not done by assessee and assessee filed appeal directly before the Tribunal under misunderstanding, we feel it proper to dismiss these two appeals of assessee for Assessment Years 2008-09 and 2009-10 for this reason that the appeal cannot be filed by assessee directly before the Tribunal but the assessee is at liberty to file the appeal before ld. CIT(A) if the assessee is so advised and if the assessee does so then the time consumed in filing the appeal before the Tribunal and dismissal thereof should not be considered for computing the delay in filing the appeal before CIT(A). Accordingly, the assessee's appeals for Assessment Years 2008-09 and 2009-10 are dismissed.

5. Now we take up the appeal of the assessee for Assessment Year 2010-11 in IT(TP)A No. 239/Bang/2015. The grounds raised by the assessee are as under.

> "*Based on the facts and circumstances of the case and in law, Essilor Manufacturing (India) Private Limited respectfully craves leave to prefer an appeal against the order passed by Deputy Commissioner of Income Tax, Circle - 3(1)(2) (-A0'), dated 30 December 2014, under section 143(3) read with section 144C of the Income Tax Act, 1961 (Act') ("impugned order"), in pursuance of the directions issued by Dispute Resolution Panel (`DRP'), Bangalore dated 21 November 2014 under section 144C(5) of the Act on the following grounds:*
>
> *That on the facts and circumstances of the case and in law:*
> *1. The order of the learned AO and directions of the Hon'ble DRP are based on incorrect interpretation of law and therefore are bad in law.*
>
> *2. The learned AO has erred in assessing the total income at Rs. 61.201,389 as against returned loss of Rs. 88,618,941 computed by the Appellant.*
>
> ***Corporate Tax Grounds***
>
> *3. The Learned AO ("AO")/ Learned DRP ("DRP") has erred in law and in facts by disallowing expenses of Rs. 70.653,000 (being Moulds written off) on the basis that such expenditure is capital in nature without appreciating the fact that Moulds are in the nature of consumables and form an integral part of the production process and hence, are in the nature of inventory.*
>
> *4. The AO/ DRP has failed to appreciate that the loss incurred on account of Moulds written off is a loss incidental to the business carried on by the Appellant.*
>
> *5. Without prejudice to the above, in case the Moulds are considered/ treated as capital assets, then depreciation on the same should be provided from the year of acquisition under the Written Down Value ("WDV") method for the respective AYs.*
>
> *6. The AO has erred in disallowing expenses of Rs. 735,000 (being consumption of Moulds) without appreciating the fact that the same is a revenue expenditure and allowable as deduction under section 37(1) of the Act.*
>
> *7. The AO/ DRP have failed to appreciate the fact that Moulds do not satisfy the essential features of a fixed asset (eg, "useful life" of the Moulds cannot be determined; Moulds do not provide any enduring benefit).*

8. The learned AO/ DRP has erred, in law, and in facts, in setting off the brought forward losses with the adjustment made and consequential incorrect carry forward of losses.

9. The Learned AO has erred, in law, and in facts. in initiating penalty proceedings under Section 274 read with Section 271(1)(c) of the Act, without appreciating the fact that the Appellant has not concealed or furnished any inaccurate particulars of income.

Transfer Pricing Grounds

10. The impugned order has erred in making an addition of Rs. 83,421,123 to the total income of the Appellant on account of adjustment in the arm's length price of the international transactions u/s 92CA of the Income-tax Act. 1961.

11. The learned TPO/AO/DRP has erred, in law and in facts, by not accepting the economic analysis undertaken by the Assessee in accordance with the provisions of the Act read with the Rules, and conducting a fresh economic analysis for the determination of the ALP in connection with the impugned international transactions of mass production and Rx business activity and holding that the Assessee's international transactions are not at arm's length.

12. The learned TPO/AO/DRP has erred, in law and in facts. by wrongly rejecting 2 companies viz Triveni Glass Limited and IAG Company Limited as comparables.

13. The learned TPO/AO/DRP has erred, in law and facts, by not making suitable adjustments to account for differences in the accounting treatment for depreciation, capacity adjustment and risk profile of the Assessee vis-à-vis the comparables.

14. Without prejudice to the above, the learned TPO/AO has erred in computing the transfer pricing adjustments for both mass production business and Rx business activity post DRP directions.

15. The learned TPO/AO/DRP have erred, in law and facts, in computing the ALP without giving benefit of +/- 5 percent under the proviso to section 92C of the Act.

Each of the ground is referred to separately, which may kindly be considered independent and without prejudice of each other.

The Appellant craves leave to add, alter, amend. vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal. so as to enable the Hon'ble Tribunal to decide on the appeal in accordance with the law."

6. The assessee has also raised an additional ground which reads as under.

"*16. The learned TPO/AO/DRP have erred, in law and in facts, by not providing working capital adjustment benefit to the Assessee.*"

7. It was submitted by ld. AR of assessee that assessee has filed an application for admission of additional ground along with the additional grounds in which it is stated that the additional ground raises an issue which is fundamental to the appeal and the non-admission and non-adjudication of the same would result in an incomplete appreciation and adjudication of the matter. Reliance has been placed on two Tribunal orders rendered in the case of Essilor Manufacturing (India) Pvt. Ltd. Vs. DCIT in IT(TP)A Nos. 1019 & 1020/Bang/2014 and in the case of TNT India Pvt. Ltd. Vs. ACIT in ITA No. 1442/Bang/2008. He also submitted in the said application that the issue raised in the additional ground is legal issue and arise out of the order of the lower authorities and in this regard, reliance has been placed on the judgement of Hon'ble Apex Court rendered in the case of National Thermal Power Corporation Vs. CIT (229 ITR 383). He submitted that this additional ground should be admitted. The ld. DR of revenue submitted that necessary facts regarding the additional ground are not available on record. Therefore, this additional ground should not be admitted.

8. We have considered the rival submissions. As per the additional ground raised by the assessee as reproduced above, the assessee is requesting for granting of working capital adjustment benefit to the assessee. This is admitted position of fact that this issue was never raised by assessee before TPO/AO/DRP. This is also true that for decision regarding allowability of working capital adjustment, certain facts are to be looked into as to what is the working capital in the case of tested party and in the case of comparables. The assessee has filed three paper books. Paper Book I contains 374 pages but it does not contain the TP study undertaken by the assessee or any working of working capital adjustment being requested by the assessee as per additional ground. The Paper Book II is containing 177 pages from pages 375 to 551 and this contains copy of Annual Report of GKB Ophthalmic Ltd., GKB Vision Ltd. and Techtron Polylenses Ltd. for Financial Year 2009-10 and this paper book also does not contain the amount of working capital or working capital adjustment being requested by

the assessee as per additional ground. Paper Book III is from pages 552 to 781 and this paper book contains 12 judicial pronouncements, some photos of moulds and extract of financials of the company for the year ended 31.03.2008 and 31.03.2009 and this also does not contain the position of working capital of the tested party or of the comparables. Hence, it is seen that in the present case, the relevant facts to be examinedfor the purpose of deciding the issue in respect of the requested working capital adjustment is not available before the Tribunal and this is admitted position that this claim was never made by the assessee before the AO/TPO or DRP and the orders of lower authorities also do not contain anything on this factual aspect. In light of this factual position, now we examine the applicability of the judgement of Hon'ble Apex Court rendered in the case of National Thermal Power Corporation Vs. CIT (supra). In this case, Hon'ble Apex Court has also considered its earlier judgement rendered in the case of Jute Corporation of India Vs. CIT (187 ITR 688) and thereafter held that the Tribunal has jurisdiction to examine the question of law which arises from the facts as found by the authorities below and having a bearing on the tax liability of the assessee. In our humble understanding, as per this judgement of Hon'ble Apex Court, the Tribunal has jurisdiction to examine the question of law which arises on the facts as found by the authorities below. We have seen that in the present case, there is no finding of facts of the authorities below in respect of working capital of the tested party and of the comparables. In our considered opinion, this judgement does not help the case of the assessee in respect of admission of additional ground. In view of the facts of the present case as discussed above as per which the necessary facts were neither available before the authorities below nor made available before the Tribunal, this additional ground raised by the assessee cannot be admitted. Accordingly we do not admit the additional ground raised by the assessee.

9. It is submitted by ld. AR of assessee that ground nos. 1 and 2 are general and out of remaining grounds, he submitted that Ground no. 9 is premature and regarding the remaining ground nos. 3 to 7, he submitted that only one issue is involved in these grounds i.e. regarding disallowance made by the

AO of Rs. 706.53 Lakhs being moulds written off on this basis that such expenditure is capital in nature. This is also submitted that this is the alternative claim of the assessee that even if the moulds are considered as capital asset then depreciation on the same should be allowed from the year of acquisition under the Written Down Value "WDV" method for the respective AYs. He drawn our attention to Note No. 17 in the audited accounts for the present year as available on page no. 249 of paper book and pointed out that in this note no. 17, this is stated that the company has discontinued the casting process from 01.07.2009 and the coating business w.e.f. 15.01.2010 which can be referred to as the "Mass Production Business" and the company started the new Rx Business as an EOU w.e.f. 01.01.2009. He further submitted that in the same note, this is also noted that technical feasibility study was carried out to determine the usefulness of the Fixed Assets and Inventories used in the Mass Production Business that has been existing up to the date of discontinuance and based on this study, the management has decided Write-off of Certain Fixed Assets and inventory, which are no longer useful. At this juncture, the bench wanted to know as to whether this technical feasibility study report was submitted before the lower authorities and whether the same is available in the paper book before the Tribunal. In reply, it was submitted by ld. AR of assessee that the same was not submitted before the lower authorities and the same is not available before the Tribunal also. He submitted that since the deduction on account of moulds purchase in each year were allowed in earlier years, as per the principle of consistency, it should be allowed in the present year also and for examining the technical feasibility study report, the matter may be restored back to the file of AO/TPO for fresh decision. It is also submitted by ld. AR of assessee that copy of submissions filed with the AO on 12.02.2014 in course of assessment proceedings is available on pages 106 to 117 of paper book that includes legal opinion on accounting treatment of 'moulds' by comparable company. He pointed out that as per legal opinion provided by Shri Amarchand Mangaldas on 02.08.2006, it was stated that moulds could be treated as inventories and not as fixed assets. He drawn our attention to page no. 239 of paper book which contains

Schedule 11 to the financial audited accounts and pointed out that as per the same, Stores and Spares Consumed in the present year is of Rs. 146.87 Lakhs and it does not include any amount of glass moulds. Whereas in the preceding year, the total amount of Stores and Spares Consumed was Rs. 154.11 Lakhs including glass moulds of Rs. 29.06 Lakhs. The ld. AR of assessee placed reliance on the following judicial pronouncements.

A) CIT Vs. Mysore Spun Concrete Pipe (P) Ltd. (Kar), 1991 194 ITR 159
B) CT Vs. Jagatjit Industries Ltd. (Delhi) 2000 241 ITR 556
C) CIT Vs. Aditya Ferro Allyos (P) Ltd. (2014) 51 taxmann.com 529 (Madras HC)
D) CIT Vs. Malerkotla Steel & Alloys (P) Ltd. (2011) 10 taxmann.com 278 (Punjab & Haryana HC)
E) B.R. Ltd. Vs. V.P. Gupta, CIT 113 ITR 647 (SC)
F) CIT Vs. Margarine & Refined Oils Co. Ltd. (Kar) 2006 154 Taxman 95 (Karnataka HC)

10. As against this, ld. DR of revenue supported the orders of authorities below. This is also submitted by ld. DR of revenue that manufacturing is continuing and assessee is in business and therefore, it should be held that moulds are part of Plant and machinery.

11. We have considered the rival submissions. We find that this is true that as per the assessee itself, the assessee has stated in Note no. 17 of audited accounts available on page no. 249 of paper book that the management has carried out a technical feasibility study to determine the usefulness of the Fixed Assets and Inventories used in the Mass Production Business that had been existing up to the date of discontinuance. Based on this study, management has decided to Write-off certain fixed assets and inventory which are no longer useful. This technical feasibility study report was neither made available to the lower authorities nor before the Tribunal. Moreover in earlier years, the moulds were considered as inventory and the same was accepted by the revenue also. As per principle of consistency, in the present year also, the same should be accepted as inventory and not as

fixed asset but in orderto quantify the allowability of assessee's claim in respect of Write-off of inventory of moulds, it's market value at the time of valuing the same has to be considered in the closing inventory and the inventory thereof at the end of the preceding year should be considered as opening inventory if already not considered as such. As per the judgement of Hon'ble Karnataka High Court rendered in the case of CIT Vs. Mysore Spun Concrete Pipe (P) Ltd. (supra), it was held that expenditure on replacement of moulds is revenue expenditure. Respectfully following this judgement, we hold that moulds has to be treated as inventory and not as capital asset but the assessee's claim for write-off of entire amount of moulds as inventory is not allowable and even if the moulds are no more usable, it will have same value and such fair market value of the moulds has to be considered as an asset in the balance sheet. The balance amount can be allowed as write off and for doing this exercise, we deem it proper to restore back the matter to the file of AO for fresh decision with the direction that the assessee should bring on record the technical feasibility study report undertaken by the assessee for the purpose of write-off of inventory. The assessee should also bring on record the fair market value of the inventory of the moulds as on 31.03.2010 and thereafter, the AO should decide the issue as per law as per above discussion after providing reasonable opportunity of being heard to assessee. Ground no. 5 is rejected. This alternative claim does not survive once we hold that the moulds are part of inventory. Ground nos. 3, 4, 6 and 7 are allowed for statistical purposes.

12. Regarding ground nos. 8 and 9, it was submitted by assessee in the chart that these are general grounds and hence, not required to be adjudicated upon.

13. Regarding various grounds raised by the assessee in respect of TP adjustment also, it is submitted by assessee in the chart that ground nos. 10, 11 and 14 are general grounds and ground nos. 12 and 15 are not contested. Hence these grounds are rejected accordingly.

14. Regarding ground no. 13, he submitted that the assessee's claim is this that suitable adjustment should be made on account of differences in the

accounting treatment for depreciation of the assessee vis-à-vis the comparables. It is submitted in the chart that TPO did not accept the assessee's contention in this regard and DRP directed to remove depreciation from cost base for both assessee as well as comparables to remove anomaly in depreciation rates as per its rectification order and the assessee supports the same. It is also submitted by the assessee in the chart that the comparables followed SLM and charged depreciation as per the rates prescribed under schedule XIV of the Companies Act, 1956 whereas the assessee company has a policy of charging depreciation on SLM each year at rates higher than the Companies Act due to its overall group policy and therefore, depreciation should be removed from the cost base as directed by the DRP. This is also the claim of the assessee that TPO/AO or DRP has erred by not making suitable adjustments to account for differences in the accounting treatment for capacity adjustment of the assessee vis-à-vis the comparables. It is submitted that the TPO did not accept the assessee's contention and the DRP also upheld the action of TPO as per original order but as per order u/s 154, it was held by the DRP that profit before depreciation should be considered for the assessee as well as comparables. The assessee supports this order of DRP u/s 154 and in addition to this, this is the request of the assessee that appropriate capacity adjustment should be allowed as relevant information for capacity utilised by assessee and comparables is available. Reliance was placed on Tribunal order rendered in the case of DCIT Vs. Claas India Pvt. Ltd. in ITA No. 1783/Del/2011.

15. We find that this issue regarding depreciation adjustment and capacity utilization adjustment decided by the DRP as per para no. 7.2 of its directions which is reproduced hereinbelow for ready reference.

> "*7.2 The assessee follows a method of charging depreciation on its assets on a straight line basis at a higher rate than provided for Companies Act. As different methods are followed in this regard by comparables, it would be difficult to make accurate adjustments for this purpose Similarly adjustment for underutilization of capacity cannot be considered in the absence of information in this regard in the public domain. We are in agreement with the findings of the TPO. No interference called for. This objection is rejected.*"

16. From the above para of the DRP directions, it comes out that regarding the claim for difference in method of debiting depreciation of its assets by the tested party and the comparables, DRP has come to the conclusion that it would be difficult to make accurate adjustment for this purpose. We are of the considered opinion that if the operating profit before depreciation is considered for the comparison of the profit of the tested party and the comparables, the effect of different method of charging depreciation by the tested party and the comparables will be neutralized. We direct accordingly.

17. Regarding the claim of adjustment for under utilization of capacity, we find that as per ground of objection no. 5 raised by the assessee before DRP, it was the grievance of the assessee that the TPO/AO have erred in law and in facts by not making suitable adjustments to account for differences in the accounting treatment for depreciation, capacity adjustment and risk profile of the assessee vis-à-vis the comparables. This objection of the assessee was decided by DRP as per para 7.2 as reproduced above and in this regard, it is stated by DRP that adjustment for under utilization of capacity cannot be considered in the absence of information in this regard in the public domain. In this regard, ld. AR of assessee has placed reliance on a Tribunal order rendered in the case of DCIT Vs. Claas India Pvt. Ltd. (supra) as per the chart submitted before the Tribunal. Copy of this Tribunal order is available on pages 617 to 642 of the paper book. Paras 9.1 to 10.3 of this Tribunal order are relevant in respect of allowance of capacity adjustment. For ready reference, these paras of this Tribunal order are reproduced hereinbelow from pages 628 to 637 of the paper book.

> "***i. Capacity adjustment should be allowed in whose hands ?***
> *9.1. It has been noticed above that the assessee claimed idle capacity adjustment by reducing its own operating costs. It is further observed that the authorities below have reduced the amount of adjustment by excluding certain costs from the ambit of the costs qualifying for adjustment. However, the adjustment has been ultimately allowed from the operating costs incurred by the assessee. In such circumstances, the question arises as to whether the action of the authorities in allowing the reduction of the operating costs incurred by the assessee, is in accordance with law? In order to find answer to this question, we need to refer to the manner of computation of the arm's length price under TNMM, which has been set out in Rule*

10B(1)(e) as under:-

"(e) transactional net margin method, by which,--
(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base ;
(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;
(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, 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 net profit margin in the open market ;
(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;
(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction."

9.2. Sub-clause (i) in the process of determination of the ALP under the TNMM talks of the computation of net operating profit margin realized by the assessee from an international transaction. Sub-clause (ii) is the computation of net operating profit margin realized by an unrelated enterprise from a comparable uncontrolled transaction. Thisrefers to determining the operating profit margin of comparables with the same base as that of the assessee. Sub-clause (iii) provides that the net profit margin realized by a comparable company, determined as per sub-clause (ii) above, 'is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, ... which could materially affect the amount of net profit margin in the open market.' It is this adjusted net profit margin of the unrelated transactions or of the comparable companies, as determined under sub-clause (iii), which is used for the purposes of making comparison with the net profit margin realized by the assessee from its international transaction as per sub-clause (i).

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 eliminatethe 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 uncontrolledtransactions. 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 thefile 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 Ahas 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 byproportionately 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.

10.3. Turning to the facts of the instant case, we find that both the TPO as well as the ld. CIT(A) have proceeded on a wrong premise not only by allowing capacity utilization adjustment in the assessee's profit, which is contrary to the legal position as discussed above, but also by considering all the comparables as one unit with the average percentage of their respective capacity utilizations. It is further observed that in the calculation of such capacity utilization adjustment, the ld. CIT(A) has considered four companies as comparable, which view has been modified by us supra inasmuch as we have held that M/s Eicher Motors and M/s. Force Motors are incomparable. Naturally, they would also goout of reckoning in the computation of idle capacity utilization adjustment. In the absence of the availability of financials of all the comparable companies, it is not possible at our end to work out the amount of capacity adjustment in the manner discussed above. Ergo, we set aside the impugned order and direct the TPO/AO to work out the amount of capacity utilization adjustment afresh in terms of our above observations. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings."

18. Respectfully following this tribunal order, in the present case also, we restore this issue to the file of AO/TPO to decide this issue afresh as per the directions in this Tribunal order after providing adequate opportunity of being heard to the assessee.

19. Ground no. 15 is not contested by the assessee as per the chart submitted before the Tribunal and therefore, rejected accordingly.

20. In the result, the appeal of the assessee for Assessment Year 2010-11 is partly allowed for statistical purposes in the terms indicate above.

21. Now we take up the revenue's appeal for Assessment Year 2010-11 in IT(TP)A No. 211/Bang/2015. The grounds raised by the revenue are as under.

"*1. The directions of the Dispute Resolution Panel are opposed to law and facts of the case.*

2. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in holding that foreign exchange loss/gain is operating in nature without ascertaining its nexus with the business activity of the assessee and without appreciating the fact that such loss/gain that is attributable to the operating activity is not derived from the operating activity.

3. On the facts and in the circumstances of the case the Dispute

Resolution Panel erred in concluding that forex gain/loss are to be treated as operating in nature as while they may be incidental but cannot be deemed as operating in nature since, they are not critical to operational activities of the business conducted by the assessee.

4. For these and other grounds that may be urged at the time of hearing, it is prayed that the directions of the Dispute Resolution Panel in so far as it relates to the above grounds may be reversed.

5. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above."

22. It was submitted by ld. DR of revenue that ground no. 1 is general. regarding ground no. 2, he submitted that this is not a finding of DRP that foreign exchange loss/gain is in respect of turnover of the present year and without this finding, this decision of DRP cannot be approved. The ld. AR of assessee supported the order of DRP on this issue.

23. We have considered the rival submissions. We find that as per ground of objection no. 3 raised by assessee before DRP, this is the grievance of the assessee that the ld. TPO and AO have erred by taking into consideration foreign exchange fluctuation gain / loss as non-operating in nature while computing the operating margin of the assessee as well as the comparable companies. As per para 5.1 of its directions, it was held by DRP that the AO is directed to consider the foreign exchange fluctuation in respect of the assessee company as well as the comparable companies as operating in nature while determining the margin in the case of the assessee company and the comparables. While doing so, the DRP has followed the Tribunal order rendered in the case of SAP Labs India Pvt. Ltd. Vs. ACIT [2010] 6 ITR (Trib) 81 (Bang.-ITAT). As per this Tribunal order, it was held that foreign exchange fluctuation gains to be added to the operating revenue. There is no quarrel of this aspect but for the purpose of TP analysis, we have to work out not only the operating profit but the operating profit margin percentage which can be computed by dividing the operating profit by corresponding turnover. Hence, in our considered opinion, if the turnover in respect of any part of the operating profit is not included in the denominator then such part of profit cannot be included in the numerator for the purpose of computing operating profit margin percentage because it will give

improper result. For this purpose, it is very essential to find out as to whether foreign exchange fluctuation gain / loss is in respect of turnover of the present year or in respect of turnover of an earlier year and whether the same can be considered for the purpose of computing operating profit margin percentage because it can be so considered only if such foreign exchange fluctuation gain / loss is in respect of the turnover of the present year only. If it is for an earlier year's turnover, then such turnover is not forming part of denominator and as a consequence, such fluctuation gain / loss cannot be forming part of the numerator. Since on this aspect, there is no finding of any of the authorities below, we feel it proper to restore this matter to the file of AO/TPO for fresh decision in the light of above discussion after providing reasonable opportunity of being heard to assessee. Accordingly ground nos. 2 and 3 of revenue's appeal are allowed for statistical purposes. Remaining ground nos. 1, 4 and 5 are general which do not call for any adjudication. This appeal of the revenue in IT(TP)A No. 211/Bang/2015 is allowed for statistical purposes.

24. Now we take up the second appeal of the revenue in IT(TP)A No. 1166/Bang/2015. The grounds raised by the revenue in this appeal are as under.

> "*1. The order of the Ld. DRP is contrary to the facts and circumstances of the case and hence not sustainable.*
>
> *2. By directing to adopted operating margin excluding depreciation the Hon'ble DRP has erred in directing the TPO/AO to adopt Cash Profit method to compute Profit Level Indicator(PLI)*
>
> *3. The Hon'ble DRP has erred in directing the TPO/AO to compute the operating margins of the assessee and that of comparables excluding the depreciation amount from the operating cost.*
>
> *4. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the DRP in so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.*
>
> *5. The appellant craves leave to add, alter, amend and/or delete ant of the grounds mentioned above.*"

25. It is submitted by ld. DR of revenue that the impugned order passed by DRP u/s. 154 r.w.s. 144C(5) of IT Act, 1961 on 25.02.2015 is not proper because

there was no apparent mistake in the earlier order of DRP which was rectified by DRP as per this order. He submitted that therefore, this order of DRP should be set aside. The ld. AR of assessee supported this order of DRP.

26. We have considered the rival submissions. In our considered opinion, this appeal of the revenue has become academic only because while deciding the appeal of the assessee for the same Assessment Year, in respect of ground no. 13, we have held that as per Para no. 16 above that the operating profit of the tested party and the comparables should be considered by taking profit before depreciation. As per the impugned order passed by the DRP u/s. 154 also, the DRP held that profit before depreciation should be considered. Since this issue is decided by us on the same line while deciding the appeal of the assessee, the appeal of the revenue has become of academic interest only and hence, we dismiss the same.

27. In the result, this appeal of the revenue is dismissed

28. In the combined result, the appeal of the assessee for Assessment Years 2008-09 and 2009-10 are dismissed whereas the appeal of the assessee for Assessment Year 2010-11 is partly allowed for statistical purposes and out of the two appeals of revenue for Assessment Year 2010-11, the appeal of the revenue in IT(TP)A No. 211/Bang/2015 is allowed for statistical purposes and the appeal of the revenue in IT(TP)A No. 1166/Bang/2015 is dismissed.

Order pronounced in the open court on the date mentioned on the caption page.

Sd/-	Sd/-
(LALIET KUMAR)	(ARUN KUMAR GARODIA)
Judicial Member	Accountant Member

Bangalore,
Dated, the 25th January, 2019.
/MS/

Copy to:

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

By order

Assistant Registrar,
Income Tax Appellate Tribunal,
Bangalore.