

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I-2' NEW DELHI**

**BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER**

**ITA No. 6775/Del/2015
Assessment year: 2011-12**

DCIT, Circle-25(1), C.R. Building, New Delhi.	vs	Terex India Pvt. Ltd., 5 th Floor, West Wing, E-City, Tower-2, #94/2 & 95/2, Electronic City Phase-I, Hosur Main Road, Bangalore-560100
Appellant		Respondent

**ITA No. 6783/Del/2015
Assessment year: 2011-12**

Terex India Pvt. Ltd., 5 th Floor, West Wing, E-City, Tower-2, #94/2 & 95/2, Electronic City Phase-I, Hosur Main Road, Bangalore-560100	vs	DCIT, Circle-25(1), C.R. Building, New Delhi.
Appellant		Respondent

**Assessee by: Shri Ved Jain, Adv.
Shri Ashish Chadha, Adv.
Department by: Shri H.K. Choudary, C.I.T. DR**

**Date of hearing: 17.01.2019
Date of pronouncement: 26.03.2019**

ORDER

PER SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER :

These are cross appeals arising from the final assessment order passed by the Assessing Officer (AO) consequent to the

directions of the Ld. Disputes Resolution Panel for Assessment Year (AY) 2011-12.

2.0 The brief facts of the case are that the assessee is a wholly owned subsidiary of Terex US and is engaged in the business of manufacturing and marketing of Crushers and Screeners and also provided business support and engineering design services to its Associated Enterprises (AEs). For the year under consideration, the return of income was filed declaring a loss of Rs. 32,04,68,240/-. Since, the assessee had entered into international transactions during the year under consideration, the AO referred issue of determination of the Arm's Length Price (ALP) of the international transactions entered into by the assessee to the Transfer Pricing Officer (TPO).

2.1 The TPO proposed adjustment on three accounts as under:

- a. Business Support Segment: Rs.18,24,354/-
- b. Technical (Engineering Design) Support Service:
Rs.1,20,99,788/-
- c. Purchase of raw material: Rs.12,93,90,068/-

2.2 The AO, in the draft assessment order, made the addition as proposed by the TPO and also made addition on account of Foreign Exchange Loss of Rs. 2,04,92,202/- and on account of provision for warranty of Rs. 1,97,33,000/-.

2.3 The assessee filed objections against the draft assessment order before the Ld. DRP. The Ld. DRP, vide Order dated 07.09.2015, gave partial relief in respect of the Transfer Pricing (TP) adjustment. Consequent to that, the TPO passed its Order dated 20.10.2015 whereby the adjustments on account of TP were as under:

- a. Business Support Segment: Nil
- b. Technical (Engineering Design) Support Service:
Rs.44,03,813
- c. Purchase of raw material: Rs.8,28,99,850

2.4 The Ld. DRP deleted both the additions made by AO on corporate issues i.e. Foreign Exchange Loss and Provision for Warranty.

2.5 Aggrieved by the order of the Ld. DRP, both Revenue and Assessee are in appeal before us.

2.5.1 The grounds raised by the revenue in ITA No. 6775/Del/2015 are as under:

“1. On the facts and in the circumstances of the case, the DRP-2 erred in directing AO to complete the assessment as per observation made by DRP in the order which resulting in reducing the addition to Rs.8,73,03,663/- in place of original recommended ALP of Rs.14,33,14,210/- for the international transactions undertaken the assessee company with its associate/parents enterprise.

“2. On the facts and in the circumstances of the case, the DRP-2 erred in directing TPO to exclude below mentioned below companies from the final set of comparables:

- i) Global Procurement Consultant Ltd.*
- ii) Certification engineers International Ltd.*
- iii) Rites Ltd.,*
- iv) REC Power Distribution Company Ltd.*

3. On the facts and in the circumstances of the case, the DRP-2 erred in directing TPO/AO to ignore the figures of depreciation and machinery repairs as asset based manufacturing company like Terex India, depreciation cannot be segregated from the computation of the margins of the company which forms an integral part of the business operations of the company.

4. On the facts and in the circumstances of the case, the DRP-2 erred in deleting the addition of Rs. 2,04,92,202/- as proposed by Assessing Officer on account of foreign exchange loss.”

5. The appellant craves, leave or reserving the right to amend modify, alter, add or forego any ground(s) of appeal at any time before or during the hearing of this appeal.”

2.5.2 The grounds raised by the assessee in ITA No. 6783/Del/2015 are as under:

1. *The order of the learned Deputy Commissioner of Income Tax, Circle- 25(1), New Delhi ('Assessing Officer' or 'AO') passed pursuant to the order of the learned Deputy Commissioner of Income Tax (Transfer Pricing Officer) - 3 (2), (1), New Delhi (Transfer Pricing Officer' or 'TPO') and the directions issued by the Hon'ble Dispute Resolution Panel (the 'DRP'), to the extent prejudicial to the Appellant, is erroneous, bad in law and contrary to the facts and circumstances of the case.*
2. *That on the facts and in the circumstances of the case the TPO, AO and DRP erred in making an adjustment of INR 8,73,03,663/-to the Arm's Length Price ('ALP') of the Appellant's international transactions with Associated Enterprises ('AEs').*

Grounds relating to Manufacturing segment:

3. *The TPO, AO and DRP have erred, in law and facts, by not appreciating that the losses incurred by the Appellant were on account of various economic and commercial reasons due to the fact that the subject year is the initial year in which the Appellant has commenced its full-fledged manufacturing operations.*
4. *The DRP, ought to have rejected McNally Sayaji Engineering Ltd as a comparable since the said company is engaged in non-comparable functions/ products and does not satisfy the comparability criteria.*

5. The TPO, AO and DRP have erred, in law and in facts, in not appreciating the business/ economic circumstances faced by the Appellant and consequently not allowing the following economic adjustments claimed by the Appellant while comparing the operating margins:

5.1 Adjustment for differences in capacity utilisation

- The TPO, AO and DRP erred both in facts and law by not appreciating that the overheads relating to Manufacturing Segment was incurred for manufacturing of 238 units (100% of total capacity) although the appellant could produce only 98 units (41.18% of total capacity) due to various economic and commercial reasons.*
- The TPO, AO and DRP erred both in facts and law in not accepting computation of appropriate profitability earned from Manufacturing Segment by not appreciating the fact that the proportionate overheads incurred for unutilized capacity cannot be treated as expenditure incurred for determining the profitability earned from Manufacturing Segment.*

5.2 Adjustment for differences in customs duty incurred

- The TPO, AO and DRP erred both in facts and law in not allowing adjustment to the tune of non-deductible customs duty on imports made by the Appellant*

5.3 Adjustment for abnormal foreign exchange fluctuations

- The DRP ought to have considered foreign exchange loss*

incurred by the Appellant as abnormal and accordingly excluded the same from the operating expenses incurred by the Appellant in manufacturing segment

- *Without prejudice to the above ground, the DRP ought to have considered 2,04,92,202 as non-operating item since the same relates to exchange fluctuations on account of purchase of fixed assets, which is a transaction in the nature of non-operating item.*
6. *The TPO, AO and DRP have erred, in law and facts, by disregarding the pricing policy submitted by the Appellant and the overseas benchmarking conducted to justify the arm's length nature of such transactions. Thus, DRP, and consequently TPO and AO, have erred in not appreciating the fact that the AEs have not made excessive margins on the exports made to the Appellant and accordingly, the loss was not attributable to the international transactions undertaken by the Appellant with the AEs*
7. *The TPO, AO and DRP have erred, in law and in facts, by not restricting the transfer pricing adjustment in respect of the import of raw materials transaction to the value of consumption of materials of the Appellant.*

Grounds in relation to Engineering Design Services ('EDS') segment:

8. *The TPO, AO and DRP have erred, in law and in facts, by not accepting the economic analysis in respect of EDS segment undertaken by the Appellant in accordance*

with the provisions of the Act read with the Rules, thereby arbitrarily rejecting the comparables chosen by the Appellant and conducting a fresh economic analysis for the determination of the ALP in connection with the impugned international transaction to hold that the Appellant's international transaction is not at arm's length.

9. *The TPO, AO and DRP have erred, in law and in facts, by rejecting the entire benchmarking analysis (comparable search) performed by the Appellant for EDS segment without providing any cogent reasons. The action of adhoc rejection of Appellant's benchmarking analysis (comparable search) by TPO, AO and DRP is arbitrary and illegal and accordingly, the entire comparable set of Appellant should be reinstated.*
10. *The TPO, AO and DRP have erred, in law and in facts, by not providing the details of the search process followed by them in respect of the EDS segment.*
11. *The TPO, AO and DRP have erred, in law and in facts, by selecting following companies as comparables which do not satisfy various comparability criteria without considering the submission filed by the Appellant:*
 - *Ashok Leyland Project Services Ltd.*
 - *Bengal SREI Infrastructure*
 - *Development Ltd. IBI Chematur*
 - *(Engineering & Consultancy)
Ltd.*
 - *Mahindra Consulting
Engineers Ltd.*

- *Mitcon Consultancy & Engg. Services Ltd.*
- *TCE Consulting Engineers Ltd.*

12. *The TPO, AO and DRP have erred, in law and in facts, by applying certain quantitative and qualitative filters which are arbitrary in nature for identifying the comparables in respect of EDS segment.*

13. *The TPO, AO and DRP have erred, in law and in facts, by not making suitable adjustments to account for various differences in the risk profile of the Appellant vis-à-vis the comparables*

Grounds in relation to Business Support Services (BSS) segment:

14. *The TPO, AO and DRP have erred, in law and in facts, by not accepting the economic analysis in respect of BSS segment undertaken by the Appellant in accordance with the provisions of the Act read with the Rules, thereby arbitrarily rejecting the comparables chosen by the Appellant and conducting a fresh economic analysis, by selecting companies which are not comparable to the Appellant, for the determination of the ALP.*

Grounds common to both EDS and Manufacturing segments:

15. *The TPO, AO and DRP have erred, in law and in facts, by not considering multiple year data for determining the arm's length margin/ price and restricting to only financial year (FY) 2010-11 data which was not available to the Appellant*

at the time of complying with the transfer pricing documentation requirements.

16. *The TPO, AO and DRP have erred, in not allowing the benefit of +/- 5% under the proviso to section 92C(2) of the Income-Tax Act.*
17. *The AO has grossly erred in law, facts and circumstances of the case by Initiating penalty proceedings u/s. 271(1)(c) of the Act.*

3.0 Since the issues involved in the cross appeals are common, both are being taken together.

3.1 Ground Nos. 1 and 5 in the Revenue's appeal are general in nature and hence need no adjudication.

3.2.0 In Ground No. 2 of its appeal, the Revenue is contesting the exclusion of 4 comparables. Out of these 4, one comparable, i.e. Global Procurement Consultants Ltd. is of the Business Support Segment and other 3 are related to Engineering Support Services segment. In the Business Support Segment, the assessee applied Transactional Net Margin Method (TNMM) to determine the arm's length price. The Profit Level Indicator (PLI), i.e. OP/TC of the assessee was 14% and the PLI of the 8 comparables used by the assessee in its TP Study was 12.66% and, thus, the transaction was considered at Arm's

Length. The TPO, however, rejected 4 comparables out of the 8 comparables selected by the assessee company and included 10 new comparables after carrying out a fresh search. The TPO, therefore, on the basis of 14 comparables, worked out the PLI of this segment at 21% and thus proposed an adjustment of Rs.18,24,354/-.

3.2.1 Aggrieved by the order of the TPO, the assessee filed objections before the Ld. DRP. The Ld. DRP, while deciding the adjustment proposed in the business support service segment, accepted the contention of the assessee regarding the exclusion of only 1 comparable being Global Procurement Consultants Ltd. on the ground that this company is doing World Bank funded projects and the Functions Assets and Risk (FAR) analysis is not similar to that of the assessee company. Consequent to the above order of the Ld. DRP, the TPO passed the order dated 20.10.2015 giving effect to the Ld. DRP's directions. The margin of the 13 remaining comparables has been worked out at 13.96%, which is lower than the 14% of the margin of the assessee company and hence, the adjustment on this Business Support segment was worked out at Nil.

3.2.2 The Ld. Departmental Representative (CIT DR) submitted that the Ld. DRP was not correct in excluding the company Global Procurement Consultants Limited as it is functionally similar. It was stated that this company is in the business of procurement management services and hence needs to be included.

3.2.3 The Ld. Authorised Representative (AR) submitted that this company is functionally different as is evident from the Annual Report. It was submitted that this company has been promoted by the Export-Import Bank of India as is evident from its annual report placed at Paper Book page 323 and it is doing mainly World Bank sponsored projects as can be seen from Paper Book pages 328 – 349. It was submitted that taking into consideration these facts, the Ld. DRP has rightly excluded this company by holding that the FAR is not similar to that of the assessee.

3.2.4 We have considered the rival submissions and have also perused the annual report of this company. On going through the same we note that this is a company promoted by the Export-Import Bank of India. Further, this company is doing mainly World Bank sponsored projects. Keeping it into

consideration these facts we are of the view that this company cannot be considered to be a good comparable and the Ld. DRP was correct in directing exclusion of this comparable. Accordingly, we uphold the order of the Ld. DRP in excluding this comparable and ground 2(i) of Revenue appeal is dismissed.

3.3.0 In the assessee's appeal, Ground No. 14 is on Business Support segment regarding inclusion of 9 comparables selected by the TPO and exclusion of 4 comparables included by the assessee in its TP Study.

3.3.1 It was submitted by the Ld. AR that in case the exclusion of 1 comparable by Ld. DRP, i.e. Global Procurement Consultants Ltd. which is being contested by the Revenue is upheld, then the assessee's Ground No. 14 regarding inclusion and exclusion of comparables will become academic.

3.3.2 Since we have upheld the exclusion of Global Procurement Consultants Limited by the Ld. DRP and after exclusion of this comparable, the margin of Business Support segment will be within the range of +/- 5%, assessee's Ground No. 14 regarding exclusion of 9 comparables taken by the TPO and inclusion of 4 comparables taken by the assessee in its TP

study have become academic in nature and accordingly, is dismissed as *in fructuous*.

3.4.0 In Ground Nos. 2(ii), (iii) & (iv), the Revenue is challenging the exclusion of three comparables by the Ld. DRP in the technical support services (Engineering Design Services) Segment.

3.4.1 In the Technical Support service segment, the assessee's margin was 12.39%, and on the basis of margin of 9 comparable companies considered by the assessee in the TP Study at 8.41%, the transaction was considered to be at arm's length. The TPO, however, carried out a fresh search. He rejected all the 9 comparables of the assessee and considered 13 new comparables with an average margin of 33.89%, and made an adjustment of Rs.1,20,99,788/-.

3.4.2 Aggrieved by the order of the TPO, the assessee filed objections before the Ld. DRP challenging inclusion and exclusion of the comparables as well as the margins of the comparables. The objections were classified into three parts, i.e. Government companies, accounting being different as Accounting Standard AS-7 has been followed which is different than the assessee and the third being other filters. The Ld. DRP accepted

the contention of the assessee by rejecting the following four comparables:

- i. Certification Engineers International Ltd.– FAR different
- ii. Kitco Ltd.– Government company
- iii. RITES Ltd.– Government company
- iv. REC Power Distribution Company Ltd. - Government company

3.4.3 The Ld. DRP, however, rejected the contention of the assessee for exclusion of other comparables. Aggrieved by the order of the Ld. DRP, the Revenue in Ground Nos. 2(ii), (iii) and (iv) is challenging the exclusion of following three comparables, i.e.

- i. Certification Engineers International Ltd.
- ii. RITES Ltd.
- iii. REC Power Distribution Company Ltd.

3.4.4 The Revenue has not challenged the exclusion of KitcoLtd by the Ld. DRP.

3.4.5 The assessee in its Ground Nos. 11 and 12 is challenging the directions of the Ld. DRP in not excluding the remaining comparables.

3.4.6 First we take up the Ground Nos. 2(ii), (iii) and (iv) where the Revenue is challenging the exclusion of the comparables as under:

(i) Certification Engineers International Ltd.:

It was submitted by the Ld. CIT DR that the services being provided by this company are technical in nature and similar to that of the assessee company. The TPO has given detailed reason in its order for inclusion of this comparable and the Ld. DRP was not justified in excluding this comparable.

In reply it was submitted by the Ld. AR that this company is majorly involved in government related services and is a group concern of Engineers India Ltd., which is majorly involved in performing government related contracts. In support of his submission, the Ld. AR invited attention to the annual report of this company placed at page 294 of the Paper Book wherein the various projects undertaken by the company are listed. It was submitted by the Ld. AR that the

Ld. DRP has taken into consideration all these facts and that this company has been rightly excluded by the Ld. DRP from the list of comparables, as the company is not performing functions similar to the assessee company. The Ld. AR placed Reliance on various judgements where Government undertakings have not been considered as comparable.

Adjudication on the comparable - Certification Engineers International Ltd. :

We have considered the rival submissions and perused the orders passed by the TPO and the Ld. DRP. On going through the annual report, we note that this company is mainly involved in Government related services. Further, it is a group concern of Engineers India Limited which is also involved mainly in performing Government related contracts. Accordingly, we uphold the direction of the Ld. DRP in excluding the above comparable. Our above view gets supported from the following judicial precedents:

- i. ITAT Delhi in the case of AT&T Communication Services India Pvt. Ltd. v. ACIT in ITA No. 1016/Del/2015 dated 15.02.2018;
- ii. ITAT Bangalore in the case of KHF Components Pvt. Ltd. v. ITO in ITA No. 1748/Bang/2013 dated 17.06.2016;
- iii. ITAT Delhi in the case of Bechtel India Pvt. Ltd. v. DCIT in ITA No. 1478/Del/2015 dated 21.12.2015

(ii) RITES Ltd.:

It was submitted by the Ld. CIT DR that the TPO has considered this company as a good comparable after taking into account the FAR of this company and that of the assessee. The Ld. CIT DR submitted that merely because the company is a Government company, it cannot be a good ground for exclusion of such company.

In response, it was submitted by the Ld. AR that the turnover of this company is more than Rs.200 crores, which was the upper turnover filter adopted by the assessee company, and thus, the company could not be considered as a comparable company. This fact is evident from the

Profit & Loss account of the company at Paper Book Page 211, wherein the income of the company is shown as Rs.488.33 crores, as compared to the assessee company's revenue of Rs.9.08 crores. Further, the company is a Government of India undertaking and mostly manages contracts provided by the Government of India. The Ld. AR placed Reliance on various judgements where Government undertakings have not been considered as comparable.

Adjudication on the comparable – RITES Ltd.:

We have considered the rival submissions and perused the orders passed by the TPO and the Ld. DRP. On going through the annual report, we note that this company undertakes and manages mostly the contracts provided by Government of India. Further, the turnover of this company is more than the turnover filter adopted for the purpose of exclusion and inclusion of the comparable. The turnover of the assessee is 9.08 Crore as against 488.33 Crore of this comparable. In view of these facts, we uphold the direction of the Ld. DRP in excluding this comparable and the ground raised by the Revenue is rejected.

(iii) REC Power Distribution Company Ltd.:

It was submitted by the Ld. CIT DR that the TPO has selected this company as a comparable since the profile of the company is similar to that of the assessee company. It was submitted that the Ld. DRP was not justified in rejecting the same only on the ground that this company is a Government of India undertaking.

In response, it was submitted by the Ld. AR that the company does not qualify the 75% service revenue filter adopted by the TPO. This fact is evident from the Profit & Loss account and Schedule 6 at Paper Book Pages 273 and 277 wherein the consultancy income is shown at Rs. 6,92,57,295/-, out of the total income of Rs. 20,44,65,943/- which is only 33.87%. It was contended that on this ground itself, the company needs to be excluded from the list of comparables. It was further pointed out by the Ld. AR that this company is a Government of India undertaking, as is evident from the Director's Report at Paper Book pages 267 – 271.

Adjudication on the comparable – REC Power Distribution Co. Ltd.:

We have considered the rival submissions and perused the orders passed by the TPO and the Ld. DRP. On going through the annual report, we note that this company has consultancy income of 6.93 Crore out of the total income of Rs. 22.45 Crore which is only 34% of the total revenue. Thus, this company fails the 75% service revenue filter adopted by the TPO. Further, from the annual report it is evident that this company undertakes and manages mostly the contracts provided by Government of India. In view of these facts, we uphold the decision of the Ld. DRP in excluding this comparable and ground raised by the Revenue is rejected.

3.4.7 Ground Nos. 11 and 12 in the assessee's appeal are regarding exclusion of certain comparables in the Engineering Services segment. The contention of the assessee is that the TPO and the Ld. DRP both have gone wrong in including seven comparables while determining the arm's length price of the engineering design services segment. It was submitted by the Ld. AR that the assessee is engaged in providing technical and engineering services to its AE and only such comparables need to be considered which are providing similar services and

accordingly, the Ld. AR pleaded for excluding the 7 comparables. The Ld. CIT DR supported the orders of the TPO and the Ld. DRP confirming inclusion of these 7 comparables. Each of these comparables is being considered as under:

a) Ashok Leyland Project Services Ltd.:

We have perused the financials of the company placed at Paper Book pages 375-432. On going through the same, we note that the functional profile of the company is not similar to that of the assessee company as the said company is engaged in wind farm development. During the year under consideration this company has disposed of its wind energy division on a slump sale, which has affected the profits derived by the entity during the year. This fact is also evident from the Director's Report of the company. The major profits earned by this company were from the discontinued operations, i.e. the wind energy division, and the company was incurring losses in the other division. The fact that the company was majorly involved in the wind energy development is also evident from the fact that consultancy income earned by the company during the year

was only Rs. 2,12,06,096/- in comparison to the income from energy charges amounting to Rs. 7,30,89,013/-. Moreover, this company follows the project completion method for accounting of its revenue from consultancy services. Taking into consideration the above facts, we are of the view that the functional profile of this company is not comparable with that of the assessee company and accordingly, we direct the AO to exclude this comparable.

b) Bengal SREI Infrastructure Development Ltd.:

We have perused the financial statements of the company placed at Paper Book page 433 – 460. On going through the same, we note that this company, during the year, was majorly involved into infrastructural development and that too for Government of India. This fact also gets supported from the Director's Report of the company and the segmental reporting of the company wherein it has been stated that the company is primarily engaged in infrastructure project advisory. Taking into consideration all the above facts, we are of the view that the functional profile of this company does not make it a good comparable with that of the

assessee company and, accordingly, we direct the AO to exclude this comparable.

c) IBI Chematur (Engineering & Consultancy) Ltd.:

We have perused the financial statements of the company placed at Paper Book pages 461 – 490. On going through the same, we note that this company fails the 75% service revenue filter which has been adopted by the TPO. This fact is corroborated from the Profit & Loss account of the company, wherein the Engineering Service charges of the company are shown at Rs. 18,88,21,452/-, out of the total revenue of the company of Rs. 29,74,92,912/-. Therefore, the service/revenue ratio of the company comes out to 63.47%, which is less than 75%, which is one of the filters adopted by the TPO himself. Moreover, no segmental information with regard to the different segments of the company is available in the financial statements. This company has been considered by the ITAT Delhi Bench in the case of Bechtel India (P.) Ltd. v. DCIT in ITA No. 1478/Del/2015 dated 21.12.2015 and in the case of BG Exploration & Production India Ltd. v. JCIT in ITA Nos. 1170 & 1581/Del/2015 dated 24.04.2017 wherein it has been

held to be not a good comparable. Taking into consideration all the above facts, we are of the view that this company is not a good comparable with that of the assessee company and, accordingly, we direct the AO to exclude this comparable.

d) Mahindra Consulting & Engg. Services Ltd.:

We have perused the financial statements of the company placed at Paper Book pages 491 – 509. On going through the same, we note that this company is engaged in providing a variety of services, only one of which is engineering services and segmental information about the Engineering Services is not available. Further, this company recognizes its revenue on percentage completion method, as stated in the notes to accounts which is different than the method of revenue recognition being followed by the assessee company. The revenue recognition method impacts the profit of an enterprise and as such a company cannot be compared with another company in case where methods of revenue recognition are different. Further, this company has been held to be not a good comparable by the ITAT Delhi Bench in

the case of Alcatel-Lucent India Ltd. v. ITO in ITA Nos. 2154 & 2209/Del/2014 dated 06.04.2018 and in the case of Alcatel-Lucent India Ltd. v. DCIT in ITA No. 6856/Del/2015 dated 06.11.2017. Taking into consideration all the above facts, we are of the view that this company is not a good comparable with that of the assessee company and, accordingly, we direct the AO to exclude this comparable

e) Mitcon Consultancy & Engg. Services Ltd.:

We have perused the financial statements of the company placed at Paper Book pages 510 – 564. On going through the same, we note that this company is into providing training services, and more than 25% of the income has been derived from such activities. The fact that this company is into training services is also evident from the Director's Report of the company wherein different assignments undertaken by the company are mentioned which include entrepreneurship and vocational training division, Mitcon e-school and BT and pharma centers etc. On going through the Profit and Loss A/c of this company placed at Paper Book page 532, we note that this company has substantial income from vocational

training programmes, income from IT training and income from laboratories. It is also seen that the income from consultancy fees earned by the company during the year is only Rs. 28,70,17,235/-, out of the total revenue of Rs. 47,81,96,289/-, which is only 60.02%. The TPO has applied filter of 75% service revenue. Applying this filter, this company fails the test applied by the TPO. We also note from Paper Book page 536 that this company has received various grants from the Government of India which has also affected the profitability of the company. This company has also been rejected to be considered as a comparable by the Hon'ble High Court of Delhi in the case of Pr. CIT v. WSP Consultants India (P.) Ltd. in ITA No. 935 of 2017 dated 03.11.2017 and ITAT Delhi Bench in the case of Granite Services International (P.) Ltd. v ACIT in ITA No. 532/Del/2016 dated 12.09.2017. Taking into consideration all the above facts, we are of the view that this company is not a good comparable with that of the assessee company and, accordingly, we direct the AO to exclude this comparable.

f) TCE Consulting Engineers Ltd.:

We have perused the financial statements of the company placed at Paper Book page 565 – 650. On going through the same, we note that this company should not be compared to the assessee as the company does not satisfy the upper turnover filter adopted by the assessee of Rs.200 crores. This fact is evident from the income statement of the company at Paper Book Page 629, wherein the income of the company is reflected at Rs.416.02 crores, as compared to Assessee Company's turnover of Rs.9.08 crores. The turnover of this company is almost 46 times more than that of the assessee company, and therefore, the company should not be considered as a comparable to the assessee company. We further note that the brand name has enabled this company to capture major government contracts and other high-profile customers. Further, this company recognizes its revenue on percentage completion method, as is evident from the disclosure made by the company, which is different from the method of revenue recognition being followed by the

assessee company. This company has been rejected as a good comparable by the ITAT Ahmedabad Bench in the case of Schutz Dishman Biotech P. Ltd. v. DCIT in ITA No. 954/Ahd/2012 dated 05.06.2018, ITAT Mumbai Bench in the case of Jacobs Engineering India Pvt. Ltd. v. DCIT in ITA No. 7194/Mum/2012 dated 17.05.2017 and ITAT Pune Bench in the case of MSC Software Corporation India Pvt. Ltd. v. ACIT in ITA No. 46/PN/2013 dated 22.03.2017. Taking into consideration all the above facts, we are of the view that this company is not a good comparable with that of the assessee company and, accordingly, we direct the AO to exclude this comparable.

(g) HSCC (India) Ltd.:

We have perused the financial statements of the company. On going through the same, we note that this company is a Government of India Enterprise and the major part of the business is from the Government itself. Accordingly, we hold that this is not a good comparable and direct the AO to exclude the same.

3.5.0 Ground No. 3 in the Revenue's Appeal is regarding the direction of the Ld. DRP in excluding the amount of depreciation and machinery repairs while computing the margin of the assessee and the comparable in the Manufacturing segment. Ground Nos. 3 & 5.1 in the assessee's appeal are regarding the adjustment on account of capacity utilization while determining the arm's length price in the manufacturing segment. Since, the issue involved in the Revenue's appeal and the assessee's appeal in these grounds are common, both are being taken together.

3.5.1 In the manufacturing segment, the assessee company computed its OP/Sales at -31.28% in comparison to the margin of its 3 comparables at 7.30%. The assessee made an adjustment on account of capacity utilization and custom duty adjustment, foreign exchange fluctuation on capital assets in its TP study and after making such adjustment it was held in the TP study that the margin is at arm's length price. The TPO, however, carried out a fresh search and recomputed the margin at 2.46% on the basis of three comparables. The TPO rejected the adjustments on account of capacity utilization, custom duty adjustment and foreign exchange fluctuation on capital assets and proposed an adjustment of Rs. 12,93,90,068/-.

3.5.2 Before the Ld. DRP, the assessee pleaded for exclusion of McNally Sayaji Engineering Ltd. as a comparable. The assessee also contended that the computation of operating margin at 16.06% is also wrong and that the correct margin is 9.32%. The assessee also asked for Custom duty adjustment as the assessee is heavily reliant on imports, capacity utilization adjustment and foreign exchange adjustment.

3.5.3 The Ld. DRP in its order dated 07.09.2015 rejected the contention of the assessee for exclusion of McNally Sayaji Engineering Ltd. On the error in computation of margin, the Ld. DRP directed the TPO to verify the same. On the custom duty adjustment and such adjustment in any case to be restricted to the value of consumption of goods, the Ld. DRP rejected the contention of the assessee. The Ld. DRP rejected the contention of the assessee to allow adjustment on account of capacity utilization in the absence of necessary information being available. The Ld. DRP, however, allowed the assessee partial relief in lieu of capacity utilization adjustment by directing the TPO to exclude the amount of depreciation and machinery repairs for computation of margins of the comparables as well as of the assessee.

3.5.4 Supporting Ground no. 3 in Revenue's appeal, it was contended by the Ld. CIT DR that the Ld. DRP in Para 9.3 on page 9 has given the direction for excluding depreciation and repair of machinery so as to remove inequality while making comparison with the comparables. It was submitted that the Ld. DRP was not justified in giving such directions as depreciation and repair of machinery are important components of the cost.

3.5.5 In response, it was submitted by the Ld. AR that while making comparison the various inequalities have to be removed while comparing the margins. It was submitted that the Ld. DRP has given detailed reasons and as such the direction given by Ld. DRP needs to be sustained.

3.5.6 In reply to Ground No. 3 of the Revenue's appeal and supporting Ground nos. 3 & 5.1 of the assessee's appeal, it was submitted by the Ld. AR that the assessee company has commenced its commercial operations in October, 2009 only. It was submitted that during the year under consideration, the assessee company was able to produce only 98 units of equipment, whereas the installed capacity was for 238 units. This fact is evident from the financial statements of the assessee company, wherein these details are reflected at Paper Book Page

19. It was submitted that this fact shows that the capacity utilization ratio of the assessee company is 41.17% only. It was further submitted that during the course of transfer pricing proceedings, as well as before the Ld. DRP, the assessee had duly submitted its capacity utilization figures for a period of five years to demonstrate that the capacity was heavily unutilized during the year under consideration. It was submitted that the losses incurred by the assessee company during the year under consideration was on account of substantial fixed costs, which could not be recovered fully because of less capacity utilization. Thus, the losses could not be attributed to the international transactions undertaken by the assessee during the year. The Ld. AR submitted that the comparables selected by the TPO were well established companies, whereas the assessee was in its first year of operation, and in order to compare the said companies with the assessee, capacity utilization adjustment was required to be made. It was submitted that the purpose and intent of the comparability analysis is to examine whether or not, the values stated for the international transactions are at ALP i.e. whether the price charged is comparable to the price charged under an uncontrolled transaction of similar nature. It was submitted that

the Income Tax regulations do not provide that the adjustments cannot be made on the results of the tested party. It was prayed that the adjustment on account of capacity utilization should be provided to the assessee company. The Ld. AR, in support of the contention, placed reliance on the judgment of the Hon'ble Bombay High Court in the case of CIT v. Petro Araldite Pvt. Ltd. in ITA No. 1540 of 2014 dated 26.04.2018 and on the following judgments:

- (i) ITAT Bangalore in the case of IKA India Pvt. Ltd. v. DCIT in ITA No. 2192/Bang/2017 dated 17.09.2018 – Relevant findings being in Para 22 – 36;
- (ii) ITAT Bangalore in the case of Biesse Manufacturing Co. Pvt. Ltd. v. ACIT in ITA No. 97, 493/Bang/2015 dated 06.11.2015 – Relevant findings being in Para 10.4.1 – 10.4.8;
- (iii) ITAT Delhi in the case of DCIT v. Panasonic AVC Networks India Co. Ltd. in ITA No. 4620/Del/2011 – Relevant findings being in Para 5;

3.5.7 The Ld. AR also invited our attention to the order passed by the TPO whereby the TPO himself has appreciated the

fact that if there are differences between the comparables and the taxpayer, then the effect of such differences should be ironed out by making suitable adjustment to the operating margins of the comparables. It was submitted by the Ld. AR that the TPO, after appreciating this fact, however, has not given the assessee the benefit of this adjustment merely on the ground that the data of capacity utilization with regard to the comparables was not available. It was submitted that this cannot be a reason to deny capacity adjustment. The Ld. AR submitted that if something is practically difficult, it should not mean that without adjusting the differences such comparable will become a good comparable. In such a scenario, it was submitted, that no adverse inference could be drawn against the assessee.

3.5.8 It was further submitted by the Ld. AR that the TPO as well as the Ld. DRP have not controverted the fact that the capacity utilization of the assessee company was around 41.17% only. The Ld. AR emphasised that the fact that the TPO has wide powers of issuing notice u/s 133(6) of the Act and calling for requisite information, which the TPO has not exercised, shows that the TPO has not made any efforts to find out as to what was the capacity utilization level of the comparable companies. It was

submitted that the matter may be remanded back to the TPO to make necessary enquiry and, thereafter, make necessary adjustment on account of capacity utilization, after analyzing the capacity utilization ratio of comparables. It was submitted that in similar circumstances, the ITAT Mumbai Bench in the case of JCIT v. Kiara Jewellery P. Ltd. in ITA No. 8109/Mum/2011 has remanded back the matter to the TPO to make necessary enquiry and, thereafter, make capacity utilization adjustment. Further reliance in this regard was placed on the following judgments:

- i. ITAT Pune in the case of Tasty Bite Eatables Ltd. v. ACIT in ITA No. 1682/PN/2011;
- ii. ITAT Madras in the case of Mando India Steering Systems P. Ltd. v. ACIT in ITA No. 2092/Mds/2012.

3.5.9 In response, the Ld. CIT DR submitted that in absence of credible data, the TPO was justified in not allowing the capacity utilization adjustment. It was submitted that it is the assessee's responsibility to provide the necessary details and data and that in absence of such details and data, the TPO will be well within his right to not to make any adjustment on account of the difference in the capacity utilization. It was also submitted that adjustment, if any, can be made only in the

comparables and not to the tested party. The Ld. CIT DR supported the order passed by the TPO and as confirmed by the Ld. DRP.

3.5.10 We have heard the rival submissions have also perused the order passed by the TPO and the Ld. DRP. From the facts, we note that this is the second year of the commercial operations by the assessee company. The fact that only 41.18% of its installed capacity of the manufacturing segment was utilized during the year is also not in dispute. In fact, the TPO in his order, has stated this fact. However, the TPO has rejected the assessee's contention in Para 21 of its order by stating as under:

"21. Discussion on capacity adjustment claimed by taxpayer

The taxpayer had claimed capacity adjustment stating that only 41.18% of its installed capacity of the manufacturing segment had been used.

Taxpayer has further stated that the comparables were well established companies with positive growth rate during the year.

In absence of details of installed capacity and their utilization in case of comparable companies, it is difficult to find out whether the other companies are working to their full capacity or not.

Rule 10B(3) provides for making adjustments only if the differences are material and reasonably accurate adjustments can be made to eliminate the material effects of such differences. In this case, neither the differences are material nor reasonably accurate adjustments can be made as the data on capacity utilization of other comparable companies is not available.

Taxpayer has quoted several decisions for reliance on claim of capacity utilization adjustment. However, it is seen that in all cases, courts have enquired whether the differences are material and whether reasonably accurate adjustment can be made. As it is not possible to know whether there is material difference between capacity utilization of taxpayer and comparable companies and thereafter give reasonably accurate adjustment for the same in the present case. Hence, the claim of capacity utilization adjustment is not acceptable.”

3.5.11 The TPO in his order accepts that Rule 10B(3) provides for making the adjustment if the differences are material and reasonably accurate adjustment can be made to eliminate the material effect of such differences. However, he has refused to make the adjustment, as is evident, from his order on the

reasoning that neither the differences are material nor reasonably accurate adjustment can be made as the data on capacity utilization of other comparable company is not available. The TPO has further stated that it is not possible to know whether there is material difference between the capacity utilization of the tax payer and the comparable companies. After going through the facts we are of the view that the finding of the TPO that differences are not material is factually incorrect. In fact, in the subsequent Para of his order quoted hereinabove, the TPO, himself, has contradicted himself by stating that it is not possible to know whether there is material difference between capacity utilization of the tax payer and the comparable companies. On going through the facts, it is evident that the assessee company has been able to utilize only 41.18% of the installed capacity and this is the second year of production which is increasing in the subsequent years as is evident from the table in the figures provided by the assessee as under:

A.Y.	Installed capacity	Actual production	Capacity Utilization
2010-11	238	17	7.14%
2011-12	238	98	41.18%
2012-13	238	128	53.78%
2013-14	252	175	69.45%

3.5.12 Thus, there is under-utilization of the capacity in the year under consideration. Now, the next issue is whether the TPO was correct in concluding that in absence of details/difficulty in finding out the details about the other comparables, the benefit of capacity adjustment could not be allowed to the assessee. In this regard, the TPO has relied on Rule 10B (3). It may be relevant to quote Rule 10B (3) which reads as under:

“10B (3) An uncontrolled transaction shall be comparable to an international transaction [or a specified domestic 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.”*

3.5.13 On going through the above Rule we note that the mandate of this rule is that an uncontrolled transaction shall be comparable if none of the differences are likely to materially affect the profit arising from such transaction and, further, reasonable accurate adjustment can be made to eliminate the material

effects of such differences. Accordingly, if there is a difference which materially affects the profit and such difference can be eliminated by making reasonably accurate adjustment then only, the transaction will be comparable. It does not mean that when there is material difference and assessee or the TPO is not able to make a reasonable accurate adjustment to eliminate the effect of such difference then the transaction will become comparable. In such a situation the exercise has to be abated and TPO cannot go ahead by using the comparables without making adjustment for the differences. The TP rules are to be interpreted in a fair and equitable manner both for the tax payer and the Revenue and they cannot be used to in a way so as to be disadvantageous to the tax payer. The whole purpose of determining arm's length price is to find out the value which is independent of all influences, may it be, related party or any other circumstance which is affecting such price. Thus, we hold that the TPO was not correct in denying the benefit of adjustment on account of capacity utilization. Our view is supported by the order of the Bangalore Bench of the ITAT in the case of IKA India Private Limited vs. DCIT IT(TP)A No. 2192/BANG/2017 dated 17.09.2018 wherein a similar issue of adjustment on account of

capacity utilization had come up. The Bangalore Bench analyzed the statutory provisions and the OECD guidelines and after referring to the various judgments held that capacity adjustment is to be allowed and it is the TPO who has to use his power to collect the information and that the TPO cannot require the assessee to perform an impossible task. The relevant finding reads as under:

“We have heard the submissions of the assessee and the ld. DR on the issue raised by the assessee in ground No.7.

22. We shall first see the statutory provisions relevant to the issue. Rule 10B(1)(e) of the Rules states that adjustments should be made to account for: "...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".

23. Rule 10B (2) of the Rules provides comparability of an international transaction with an uncontrolled transaction needs to be judged with reference to certain specified factors. One such factor is conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and

level of competition and whether the markets are wholesale or retail.

24. Rule 10B(3) of the Rules provide that: "An uncontrolled transaction shall be comparable to an international transaction if — (i) none of the differences, if any, IT(TP)A No.2192/Bang/2017 Page 14 of 39 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."

25. As per Section 92C of the Act, ALP is required to be computed using any of the given six methods and in the manner as is prescribed in Rule 10B of the Rules. Rule 10B in turn states that the most appropriate method would be one which inter alia provides the most reliable measure of ALP, and one of the important factors to be taken into account herein is the ability to make reliable and accurate adjustments.

26. The OECD Guidelines on this aspect is as follows:- Para 1.35 of the OECD Guidelines states as follow IT(TP)A No.2192/Bang/2017 Page 15 of 39 circumstances of the parties, and the business strategies pursued by the parties." Further, Para 2.74 of the OECD Guidelines while laying down the comparability criteria to be adopted while applying the transaction net margin method states as follows: "..... Thus

where the differences in the characteristics of the enterprises being compared have a material effect on the net margins being used, it would not be appropriate to apply the transactional net margin method without making adjustments for such differences. The extent and reliability of those adjustments will affect the relative reliability of the analysis under the transactional net margin method' (Emphasis supplied)

27. US transfer pricing Regulations on this aspect is as follows :- In addition, the US transfer pricing regulations, u/s 482 of the Internal Revenue Code (hereinafter referred to as 'the US regulations') also support the above. Regulation 1.482-1(d)(2) of the US regulation states as follows: "In order to be considered comparable to a controlled transaction, an uncontrolled transaction need not be identical to the controlled transaction, but must be sufficiently similar that it provides a reliable measure of an arm's length result. If there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results. For purposes of this section, a material difference is one that would materially affect the measure of an arm's length result under the method being applied."

28. The Indian transfer pricing regulations, OECD Guidelines and the US transfer pricing regulations call for an adjustment to be made in case of material differences in the transactions

or the enterprises being compared so as to arrive at a more reliable arm's length price/ margin. While the IT(TP)A No.2192/Bang/2017 Page 16 of 39 Indian transfer pricing regulations refer to the adjustments on uncontrolled transactions, however the same has to be read with Rule10B(3) of the Rules which clearly emphasizes the necessity and compulsion of undertaking adjustments. Hence in case appropriate adjustments cannot be made to the uncontrolled transaction, due to lack of data, then in order to read the provisions of transfer pricing regulations in harmony, the adjustments should be made on the tested party. In the following decisions it has been held that adjustment to the profit margins have to be made on account of underutilization of capacity:

(i) In the case of M/s. Mando India Steering Systems Private Limited vs Assistant Commissioner of Income Tax, [I.T.A. No. 2092/Mds 12012], the Tribunal upheld the contention of the taxpayer for making a suitable adjustment on account of idle capacity for the purpose of margin computation. The relevant extract is reproduced as below: "10. We are of the considered view that underutilization of production capacity in the initial years is a vital factor which has been ignored by the authorities below while determining the ALP cost. The TPO should have made allowance for the higher overhead expenditure during the initial period of production."

(ii) In the ruling of DCIT Vs Panasonic AVC Networks India Co Ltd (I.T.A. No.: 4620/De1/2011), it was held

that:- "5. Capacity underutilization by enterprises is certainly an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits. Of course, the fundamental issue, so far as acceptability of such adjustments is concerted, is reasonable accuracy embedded in the mechanism for such adjustments, and as long as such IT(TP)A No.2192/Bang/2017 Page 17 of 39 an adjustment mechanism can be found, no objection can be taken to the adjustment."

(iii) In the case of Biesse Manufacturing Company Limited (IT(TP) A Nos. 97 & 493/Bang/2015) for AY 2010-11, the Tribunal held as follows: "10.4.1. We have heard the rival contentions and perused and carefully considered the submissions made and material on record; including the judicial pronouncements cited. The issue for consideration is whether adjustment for under-utilisation of capacity is allowable in the case on hand and if so, the manner of computation thereof and the quantum of adjustment..... 10.4.5 In the above cited case of the Mumbai Tribunal i.e. Petro Araldite P. Ltd. (supra), the Tribunal has upheld the principle that adjustment for capacity underutilisation can be granted Following the decision of the ITAT, Mumbai in the case of Petro Araldite P. Ltd. (supra), we hold that any adjustment for capacity underutilisation can be granted....."

(iv) In the recent case of GE Intelligent Platform Private Limited (IT(TP)A No. 148/Bang/2015 and 164/Bang/2015) for AY 2010-11 was held as follows: "8 now the law is quite settled to the extent that

once there is unutilized capacity or men power, such underutilization impacts margin and therefore, the adjustment should be made while computing the ALP If the underutilization is more than average underutilization of the industry then necessary adjustment is required to be made to the margin of computing ALP....."

29. Moreover, the above argument of the assessee for grant of capacity utilization adjustment is also supported by the following decision of Bangalore ITAT in the case of Genisys Integrating Systems (India) Pvt. Ltd (ITA No.1231/Bang/2010). Relevant extract of the decision is under:-

"15.2 We agree with this contention of the counsel for the assessee. All the comparables have to be compared on similar standards and the assessee cannot be put in a disadvantageous position, when in the case of other companies adjustments for under utilization of manpower is given. The assessee should also be given adjustment for under utilization of its infrastructure. The AO shall consider this fact also while determining the ALP and make the TP adjustments. With these directions, the appeal of the assessee is disposed of."

30. The reliability and accuracy of adjustments would largely depend on availability of reliable and accurate data. For certain types of adjustments, relevant data for comparables may either not be available in public domain or may not be reliably determinable based on information available in public domain, whereas, it may be possible to make equally reliable and accurate adjustments on the tested party (whose data would generally be easily accessible).

31. In such a scenario, one has to resort to the provisions of Rule 10B(3)(ii) which provides for making “reasonably accurate adjustments” for eliminating any material differences between the two transactions being compared. The purpose or intent of the comparability analysis is to examine as to whether or not, the values stated for the international transactions are at ALP i.e., whether the price charges is comparable to the price charges under an uncontrolled transaction of similar nature. The regulations don’t restrict or provide that the adjustments cannot be made on the results of the tested party. Therefore, keeping in mind the aforesaid objective, the net profit margin of the tested party drawn from its financial accounts can be suitably adjusted to facilitate its comparison with other uncontrolled entities/transactions as per sub-clause (i) of rule 10B(1)(e) of the Rules itself. The absence of specific provision in Rule 10B(1)(e)(iii) of the Rules does not impede the adjustment of the profit margin of tested party. The above view has also been upheld in the following decisions:- • Capegemini India Pvt. Ltd. (ITA No.7861/Mum/2011) • Demang Cranes & Components (India) Pvt Ltd. [49 SOT 610 (Pune)]

32. As far as data of comparable companies on capacity utilization being not available in public domain is concerned, it is practically not possible to obtain data on capacity utilization of comparable companies and consequently compute adjustment on the comparable companies, the operating cost of the tested party is adjusted for capacity utilization adjustment.

33. *The assessee has under-utilized capacity during the subject AY and is accordingly factually and legally eligible to an adjustment for the same. Therefore, such a benefit cannot be denied to the assessee only for the reason that the data about comparable companies is not available. Requiring the assessee to produce such a data which is not available in public domain would tantamount to requiring the Appellant to perform an impossible task. The only way to get the data in the current case, would be where the TPO collates the same from the comparable companies by exercising his powers under section 133(6) of the Act. The relevant extracts of the section are as under:-*

"(6) require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act :"

34. *In this regard, we find that the Mumbai ITAT in case of M/s Kiara Jewellery P.Ltd. (I.T.A.No.8109/Mum/2011), has directed the AO/ TPO to obtain the exact details of capacity utilization of comparable companies, if not available in public domain. The relevant extract of the aforesaid decision is as under:-*

"11. Keeping in view the decision of the Tribunal in the case of Petro Araldite (P) Ltd (supra) laying down the guidelines on the issue of capacity utilization, we consider it appropriate to restore this issue relating to adjustment on account of capacity utilization in the case of assessee company to the file of AO/TPO for deciding the same afresh keeping in view the said guidelines. If the exact details of capacity utilization of the comparable companies are not available in the public domain, the AO/TPO is directed to obtain the same directly from the concerned parties and to decide this issue afresh after giving assessee an opportunity of being heard."

35. Accordingly, we direct the TPO to exercise powers under section 133(6) of the Act to call for information on capacity utilization of the comparable companies such as — • Installed Capacity, • Actual Production in Units, • Break-up of Fixed Cost and Variable Cost; • Segmental/ product wise information, if any.

36. Post obtaining the information, he is requested to provide the assessee an opportunity by sharing the details so obtained, and accordingly, grant the adjustment for capacity under-utilized. Ground No.7 is decided accordingly. “

3.5.14 Now, coming to the methodology to be adopted for allowing the capacity adjustment in this case. The Ld. DRP has taken cognizance of the same but instead of allowing the adjustment on account of capacity utilization, it has directed to

exclude depreciation and repairs of machinery from the comparables as well as the assessee. We are of the view that capacity adjustment is not limited to depreciation and repair of machinery. In a business entity, there are certain fixed overheads such as rent, administrative expenses etc., which have to be incurred irrespective of the percentage of capacity utilization. There are variable expenditures which are in direct proportion to the production i.e. the capacity utilized. The net margin of an entity will vary with that of another entity in case there is a difference in the capacity utilization. If there is higher capacity utilization, then the fixed overheads get spread over such higher capacity utilization with the result that the net margin of such entity will be much higher as compared to the another entity where the capacity utilization is low and as such there is a higher proportion of fixed overheads which get allocated to such lower capacity/production. Thus, the right method is to identify all the fixed expenses including depreciation and to adjust the same in the ratio of the capacity utilized. In view of the above analysis, we direct the TPO to exercise his powers under section 133(6) of the Act and to call for the information on capacity utilization of comparable companies.

After obtaining the information, he will share the details so obtained with the assessee and give an opportunity to the assessee and grant adjustment for capacity under-utilized.

3.5.15 Ground No. 3 of Revenue's appeal and Ground Nos. 3 & 5.1 of assessee's appeal are disposed of accordingly.

3.6.0 Ground No. 4 in the Revenue's Appeal is against the direction of the Ld. DRP in deleting the addition of Rs. 2,04,92,202/- proposed by the AO on account of Foreign Exchange Loss. The Assessing Officer proposed this addition holding that the claim of the assessee is not allowable in view of the provisions of section 43A of the Act. The Ld. DRP directed deletion of the addition by holding that the same is allowable in view of the judgement of the Hon'ble Supreme Court in the case of CIT vs. Woodward Governor India Private Limited 312 ITR 254 (SC).

3.6.1 It was submitted by the Ld. CIT DR that the Ld. DRP has gone wrong in allowing this deduction ignoring the fact that this loss has occurred on account of fluctuation in Foreign Exchange in respect of loan taken by the assessee for the

purpose of capital assets and hence, the same cannot be allowed as revenue expenditure.

3.6.2 In reply, the Ld. AR submitted that the Ld. DRP was right in allowing the deduction as the issue is squarely covered by the judgement of the Hon'ble Supreme Court in the case of CIT vs. Woodward Governor India Private Limited (Supra). The Ld. AR also placed reliance on the judgement of the Hon'ble Delhi High Court in the case of Pr. CIT vs. Seagram Manufacturing Private Limited in ITA No. 885/2016 dated 09.12.2016 and Pr. CIT vs. Rampgreen Solutions Private Limited in ITA No. 340/2016 dated 27.05.2016.

3.6.3 We have considered the rival submissions. On going through the draft assessment order, we note that the assessee company has taken an ECB Loan from Terex Corporation for acquiring capital assets and this amount represents loss arising on account of the fluctuation in the Exchange Rate of this loan. The assessing officer disallowed the same by holding that the same was of capital nature and that in view of the provisions of section 43A of the Act the same was not revenue in nature. The Ld. DRP has held that the assets were purchased in India and, therefore, section 43A is not applicable. Relying on the judgment

of the Hon'ble Supreme Court in the case of Woodward Governor India Private Limited (Supra), the addition was directed to be deleted. It is seen that provisions of section 43A are applicable in respect of any asset acquired from a country outside India. In such case, any difference arising consequent to a change in the Rate of Exchange after the acquisition of such asset, the difference is adjusted against actual cost/written-down value of such asset. Thus, the condition for applicability of this section is that the capital asset is acquired from a country outside India. In the present case, the assets were purchased in India and not acquired from the country outside India. Thus, the Ld. DRP was correct in holding that provisions of section 43A, proposed by the AO in the draft assessment order, are not applicable. This issue, as rightly stated by the Ld. DRP, is covered by the judgement of Hon'ble Supreme Court in the case of Woodward Governor India Private Limited (Supra). Similar issue had come up before the Jurisdictional Delhi High Court in the case of Pr. CIT vs. Seagram Manufacturing Private Limited (Supra) and Rampgreen Solutions Private Limited (Supra) wherein by relying on the judgement in the case of Woodward Governor India Private Limited (Supra), it

has been held that such loss will be revenue in nature. In view of the above facts, we uphold the order of the Ld. DRP.

3.6.4 Ground No. 4 in Revenue's appeal is dismissed.

3.7.0 Now we take up remaining grounds in the appeal of the assessee.

3.7.1 Ground Nos. 1 & 2 in the assessee's appeal are general in nature and, hence, need no adjudication.

3.7.2 Ground No. 4 regarding rejection of one comparable namely McNally Sayaji Engineering Ltd. in the Manufacturing segment is dismissed as not pressed.

3.8.0 Ground No. 5.2 in the assessee's appeal is regarding adjustment on account of non-cenvat-able custom duty on imports made by the assessee company while computing margin of the Manufacturing segment.

3.8.1 The contention of the Ld. AR in this regard is that the company has heavily relied on imports as the end product needs to meet the quality requirements of the customers. It has been submitted that the ratio of imported raw material forms 48% of the total raw material consumed whereas the average imported raw material consumed by the comparables is only 5.93%. On

this basis, it was contended by the Ld. AR that this clearly shows that the non-cenvat-able customs duty has impacted the margins earned by the assessee company during the year. It was submitted by the Ld. AR that the impact of the customs duty on the profitability of the assessee company is of an extra ordinary nature. This fact is evident from the figures of import/sales ratio for five years which were submitted before the TPO as well as before the Ld. DRP. It was contended by the Ld. AR that since the impact of the custom duty on the Profit & Loss account of the assessee is of extra ordinary in nature, the same needs to be excluded while arriving at the operating margin of the assessee company. In support of its submission the Ld. AR placed on the order of ITAT Pune Bench in the case of Skoda Auto India (P.) Ltd. vs. ACIT [2009] 30 SOT 319 and on the order of ITAT Pune Bench in the case of Demag Cranes and Components India Pvt. Ltd. in ITA No. 202/PN/2007.

3.8.2 In response, the Ld. CIT DR submitted that this type of adjustment is not permissible under the TP regulations. It was further submitted that it doesn't matter whether the raw material used is imported or indigenous. The custom duty on import is a

part of the cost and the same has to be taken into account while computing the margin.

3.8.3 We have considered the rival submissions and perused the order passed by the authorities below. The Ld. DRP has rejected this contention of the assessee company on the ground that custom duty does not have any impact on the net profit level of the assessee. While deciding the issue of the capacity adjustment, we have held that in terms of Rule 10B (3) all the adjustments which are materially affecting the transaction being compared need to be eliminated. Thus, in case non-cenvat-able custom duty on import made by the assessee company is materially affecting the transaction vis-à-vis the comparables being considered by the TPO then the same needs to be eliminated. Since, this issue has not been considered by the TPO and considering the fact that we have remitted the matter back to AO for allowing adjustment on account of capacity utilization, we deem it fit to restore this issue also to the TPO. The TPO will examine whether non-cenvat-able custom duty on imports paid by the assessee is materially affecting the PLI of the assessee company and if he finds that this payment of non-cenvat-able custom duty is materially affecting the transaction with that of

the comparables then he will suitably make adjustment thereof.

3.8.4 The ground no. 5.2 is allowed for statistical purposes accordingly.

3.9.0 Ground No.5.3 in the assessee's appeal is regarding adjustment for abnormal foreign exchange fluctuation while computing margin of the Manufacturing segment.

3.9.1 It was contended by the Ld. AR that during the year under consideration, the assessee has incurred foreign exchange loss amounting to Rs. 9.79 crores. Out of this, an amount of Rs. 2,04,92,202/- was on account of restatement of loan liability on account of capital asset/s purchased. Therefore, the amount of Rs. 2,04,92,202/- should be excluded for the purpose of computing the operating margin of the assessee company for the year under consideration. It was further contended by the Ld. AR that the balance Foreign Exchange loss, only to the extent it is relatable to the Manufacturing segment, be considered while computing its margin and not the entire Foreign Exchange loss.

3.9.2 The Ld. CIT DR submitted that foreign exchange loss is considered to be as normal business expenditure and cannot be excluded while computing the PLI of the assessee company.

3.9.3 We have considered the rival contentions. The issue here is exclusion of the foreign exchange loss of Rs. 2,04,92,202/- on account of restatement of loan liability. Thus, this foreign exchange loss is not on account of purchases or sales or any other revenue item. The Ld. CIT DR is correct in its contention that foreign exchange loss is considered to be normal business expenditure while computing margin of the tested party as well as the comparables. However, such foreign exchange loss is of the nature relating to revenue. In the present case, the admitted fact is that this relates to restatement of loan liability. Such expenditure, though, may be allowable as business expenditure while computing the taxable income but the fact that such expenditure is of extra-ordinary nature cannot be ignored. Therefore, we are of the view that this exchange loss of Rs. 2,04,92,202/- needs to be excluded while computing the PLI of the assessee. We are also in agreement with the contention of the Ld. AR that only the Foreign Exchange loss pertaining to the Manufacturing segment needs to be considered while computing margin of the Manufacturing segment. Accordingly, we direct the AO to also exclude Foreign Exchange loss pertaining to other

segments while computing the margin of the Manufacturing segment.

3.9.4 Ground No. 5.3 is allowed for statistical purposes accordingly.

3.10.0 Ground Nos. 6 and 7 in the assessee's appeal are regarding TP adjustment to be restricted to the value of consumption of the raw material purchased from associate enterprise.

3.10.1 It was submitted by the Ld. AR that during the year under consideration, the assessee company has made total purchases for Rs. 105,55,16,000/- from its AE. Out of the above purchases made from the AE, raw material amounting to Rs. 41,34,29,000/- was lying unutilized as closing stock, as is evident from the Schedule 12 of the Balance Sheet at Paper Book Page 13. It was submitted that, thus, while computing the margin only the figure of actual consumption during the year needs to be taken and that the adjustment is to be restricted to the amount of actual consumption of the material purchased from the AE and not to the total amount of the purchases from

AE as has been done by the AO. It was contended by the Ld. AR that it will not be correct to make the adjustment of the entire purchases and still value the closing stock lying unutilized as on the last date of the year at cost without reducing such cost by the adjustment being made on account of arm's length price determined by the TPO for such purchases from the AE. It was submitted by the Ld. AR that the impact on the profit in respect of such material which is lying as closing stock will be reflected in the profits of the assessee company only in the year in which the said raw material is utilized. Therefore, even if an adjustment has to be made to the profit of the assessee company, the same has to be restricted to the extent of raw material consumed during the year by the assessee company. The Ld. AR also submitted that in case such adjustment is to be made on the entire purchases then such adjustment needs to be taken into account while valuing the closing stock.

3.10.2 The Ld. CIT DR, in response, submitted that this adjustment is not permissible under the TP regulations. The Ld. CIT DR relied upon the reasoning given by Ld. DRP that the arguments raised by the assessee are not legally tenable.

3.10.3 We have considered the rival contentions. It is undisputed fact that the assessee has made purchases of Rs. 105,55,16,000/- during the year out of which material worth Rs. 41,34,29,000/- was not consumed during the year and, therefore, the impact on the margin, if any, in respect of such purchases during the year is only of the material consumed and not of the material purchased and which is lying unutilized at the end of the year as closing stock. The purchase cost debited in respect of such raw material and the valuation of such material as closing stock is at same cost. Considering this fact, we direct the TPO that in case any adjustment is required to be made after giving effect to the adjustment on account of capacity and other issues decided by us in this appeal the same is to be restricted to the material purchased from the AE and consumed during the year.

3.10.4 Ground nos. 6 and 7 stand allowed for statistical purposes.

3.11.0 Ground Nos. 8 to 10 in the assessee's appeal are general in nature and need no adjudication.

3.11.1 Ground Nos. 11 & 12 of the assessee's appeal have already been disposed of in Para 3.4.7 of this order.

3.11.2 Ground No. 13 is dismissed as not pressed.

3.11.3 Ground No. 14 is dismissed as not pressed.

3.11.4 Ground No. 15 is dismissed as not pressed.

3.11.5 Ground No. 16 is regarding allowing the benefit of +/- 5% under the proviso to Section 92C (2) of the Act. This ground is a consequential ground and the AO is directed to allow this benefit as per law.

3.11.6 Ground No. 17 is regarding initiation of penalty under Section 271(1)(c) of the Act which is pre-mature and hence, dismissed.

4.0 In the final result, the appeal of the Revenue is dismissed and that of the assessee is allowed for statistical purposes.

Order pronounced in the open court on 26th March, 2019

Sd/-

(N.K. BILLAIYA)

ACCOUNTANT MEMBER

Sd/-

(SUDHANSHU SRIVASTAVA)

JUDICIAL MEMBER

Dated: 26th March, 2019

Copy forwarded to: -

- 1) Appellant
- 2) Respondent

- 3) CIT(A)
- 4) CIT
- 5) DR

True Copy

By Order

ASSTT. REGISTRAR

Date of dictation	Dictate by Dragon
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	
Date on which the final order is uploaded on the website of ITAT	
Date on which the file goes to the Bench Clerk	
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	