

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "B", HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

**ITA No. 2022/Hyd/2017
Assessment Year: 2013-14**

Euroflex Transmissions (India) Private Limited, Plot No. 99, CIE, Phase – II, Gandhinagar, Balanagar, Hyderabad.	vs.	Asst Commissioner of Income Tax, Circle – 17(1), Hyderabad.
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PAN – AAACE5313K

(Applicant)

(Respondent)

Assessee by :	Shri Raghunathan S, AR
Revenue by :	Shri Y.V.S.T. Sai (DR)

Date of hearing : 04-02-2019

Date of pronouncement : 15-02-2019

ORDER

PER P. MADHAVI DEVI, J.M.:

This is assessee's appeal for the A.Y 2013-14 against the assessment order passed u/s 143(3) r.w.s 92CA(3) and 144C(13) of the Income Tax Act, 1961 (the 'Act') dated 25.10.2017.

2. Brief facts of the case are that the assessee company, engaged in the business of manufacturing of high performance flexible disc coupling for application in critical turbo machinery, filed its return of income for the A.Y

2013-14 on 21.09.2013 declaring an income of Rs. 54,15,52,720/- under normal provisions of income tax Act and book profit of Rs. 54,28,24,910/-. During the assessment proceedings u/s 143(3) of the Act, the A.O observed that the assessee has entered into international transactions with its AE. Therefore, the determination of arm's length price of the international transaction was referred to the Transfer Pricing Officer (TPO). The TPO, vide proceedings dated 31.10.2016, proposed adjustment of Rs. 2,72,47,432/- on account of royalty payment. The TPO held that the assessee has failed to prove the benefit obtained by the assessee by use of latest technology. In accordance with the proposed adjustment, the A.O passed the draft assessment order and the assessee preferred its objections before the DRP. However, the DRP confirmed the TPO's order and in accordance therewith, the final assessment order was passed and the assessee is in second appeal before us.

3. The Ld. Counsel for the assessee submitted that the issue of determination of the royalty payment at Rs. Nil by using the benefit test, was considered by the Coordinate Bench of this Tribunal in the case of M/s. Toyota Kirloskar

Auto Parts Pvt Ltd Vs. ACIT, reported in 2015 (1) TMI 921, wherein the Tribunal by following the decision of the Hon'ble Delhi High Court in the case of EKL Appliances has held that the benefit test cannot be adopted and the royalty payment cannot be determined at Rs. 'Nil'. He also drew our attention to the decisions of this Coordinate Benches of the Tribunal at Hyderabad in the cases M/s IWM Constructions Pvt Ltd., Hyderabad in ITA No. 457/Hyd/2007 and 1658/Hyd/2008 dated 20.07.2016 and in the case of M/s. RAK Ceramics India Pvt Ltd., in ITA 193/Hyd/2017 dated 29.11.2017. Thus, he prayed for deletion of the adjustment made in the final assessment order.

4. The Ld. DR, on the other hand, supported the orders of the authorities below.

5. Having regard to the rival contentions and material available on record, we find that the assessee has used the technology supplied by its AE for in its manufacturing process and for such use of technology, it has paid the royalty. The A.O has applied the benefit test and observing that the assessee failed to prove the benefit derived by it by

use of such technology, he has disallowed the entire expenditure by treating the arm's length price at Nil. We find that such an issue had arisen, before the Coordinate Bench of the Tribunal at Bangalore in the case of M/s. Toyota Kirloskar Auto Parts Pvt Ltd Vs. ACIT (supra) to (which one of us, ie. the JM is signatory) and at para 16 of its order, the Tribunal has held as under:

“16. To demonstrate that the price paid by the assessee towards royalty is at arm's length, the assessee has filed copies of the agreement of the AE with its other group companies as well where the rates of royalty are the same. Thus, according to the learned counsel for the assessee, the payment is at arm's length. However, we find that even by adopting the CUP method, the AO has not brought on record any of the comparable companies to arrive at the ALP but has only applied the benefit test to determine the ALP at 'nil'. The learned counsel for the assessee had stated that the very fact that the assessee has manufactured vehicles using the technical know-how of the AE demonstrates that the assessee has benefitted from the use of such technology. He submitted that the finding of the AO that the assessee has not been able to establish the benefit derived by it from the use of technical knowhow is preposterous as the technical know-how was the essence or the heart of the manufacturing process. The fact IT(TP)A No.1462/Bang/2012 M/s.Toyota Kirloskar Auto Parts Pvt.Ltd. Page 15 of 16 that the assessee was engaged in the activity of manufacture itself proves the use of technical know-how by the assessee and therefore, as held by the Hon'ble Delhi High Court in the case of EKL Appliances (cited supra), the AO or the TPO cannot question the commercial expediency of the assessee or the quantum of benefit the assessee derived while making the payment. We agree with this contention of the assessee. The Hon'ble Delhi High Court, in the case of EKL Appliances (cited supra), has clearly held that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity and also that it is not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The Hon'ble Delhi High Court further held that the only condition is that the expenditure should have been incurred wholly

and exclusively for the purpose of business and nothing more and the quantum of expenditure can no doubt be examined by the TPO as per law in allowing as business expenditure but he has no authority to disallow the entire expenditure or part thereof on the ground that the assessee has suffered continuous losses. It was held that so long as expenditure payment has been demonstrated to have been incurred or laid out for the purpose of business, it is no concern of the TPO to disallow the same on any extraneous reasoning and as provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but wholesale disallowance of the expenditure is not contemplated or authorized. Respectfully following the decision of the Hon'ble Delhi High Court, we set aside the finding of the TPO that the ALP of the transaction of royalty is 'nil'. However, for determining the ALP under the TNMM, the assessee as well as the Revenue have to search for comparable companies. Therefore, we remit this issue to the file of the AO/TPO to determine ALP of royalty by adopting TNMM after giving the assessee a fair opportunity of hearing. This issue is accordingly decided in favour of the assessee for statistical purposes."

5.1 Similarly in the case of M/s IWM Constructions Pvt Ltd., Hyderabad (supra) the Tribunal at para 23 of its order has held as under:

"23. The learned Counsel for the assessee submitted that how the business is conducted is the sole decision of the assessee. The learned Counsel placed reliance upon the decision of the Tribunal at Mumbai in the case of Merck Ltd vs. DCIT in ITA No.1946/Mum/2014 dated 31.03.2016 wherein the Tribunal was dealing with the case of an assessee wherein the TPO had treated the ALP of the technical consultancy fees as 'Nil' and thereby proposing ALP adjustment in respect of the entire amount paid to the parent company for technical knowhow fees. The Tribunal at Para 24 of its order has dealt with the issue at length and following the judgment of the Hon'ble Delhi High Court in the case of EKL Appliances Ltd, reported in 345 ITR 241 (Del.) (H.C) held that without evaluation the ALP of a service, it is wholly irrelevant as to whether the assessee benefits from its order or not; the real question is as to whether price of this service is what an independent enterprise would have paid for the same. The Tribunal has also considered that the TPO therein has on the one hand, held that no services are rendered, on the other hand, there were categorical findings that the services rendered are so general in nature that even an

employee of the assessee could have rendered the same. It was in these circumstances that the Tribunal held that though the finding is given to the fact that no services are rendered in the light of the contradiction in the findings and the observations, it is clear that in effect, the commercial expediency of these payment is questioned. In the case before us also, though the TPO & AO have given finding that no services have been rendered to the assessee by the AEs, the AO has also treated the assessee as a representative assessee of the AEs and has treated their income ITA Nos 457 of 07 and 1658 of 08 IWM Constructions P Ltd Hyderabad Page 20 of 22 as chargeable to tax in India in the hands of the assessee on the ground that the employees of the AE's have visited India and have rendered services in India. Therefore, we find that these are contradictory stands of the AO. Similar view has been expressed by the Coordinate Bench of this Tribunal in the case of TNS India (P) Ltd vs. DCIT, reported in 40 ITR (Trib.)125 dated 17.04.2015 after considering the evidence on record to prove that the assessee therein had received services. The Tribunal had also considered and held that the role of the TPO is only to determine the ALP of the transactions. The Tribunal has also relied upon the decision of the Hon'ble Delhi High Court in the case of EKL Appliances (Supra) to hold that the TPO went beyond his jurisdiction in denying the payment of deduction, whereas his role is limited to determining only the ALP. The Hon'ble High Court has held that the TPO cannot question the business decision of an assessee and determine that no services were rendered. Similar view was expressed by other Coordinate Benches of the Tribunal as well. Thus, it can be seen that in the case before us, initially it was the TPO who analysed the transaction and gave a finding that the AEs have not rendered any services to the assessee and that the transactions are sham transactions. It is thereafter that the AO also went into the details of the services rendered by the AE and have come to the conclusions that the transactions are sham. Therefore, it is clear that the TPO has travelled beyond his jurisdiction as held by the Hon'ble Delhi High Court in the case of EKL Appliances (Supra). Further, applying the benefit test i.e. whether the payments made by the assessee are commensurate to the benefits acquired by it under the agreement, also fails, in view of the above decision. Therefore, in our opinion, the TPO as well as the AO ITA Nos 457 of 07 and 1658 of 08 IWM Constructions P Ltd Hyderabad Page 21 of 22 are not correct in holding that the transactions between the assessee and its AEs are sham, particularly since the assessee was responsible for the designing Highway. The findings of the authorities below that the entire work has been executed by the sub contractor has already been found to be not correct. In view of the same, we hold that the assessee has received some services from its AEs. Whether the benefit received by the assessee is commensurate to the payment made by it, cannot be gone into in view of the above cited decisions and

therefore, we set aside the orders of the AO and the CIT (A) on this issue”.

5.2 In the case of M/s. RAK Ceramics India Pvt Ltd., (supra) the Tribunal at para 6 of its order has held as under:

“6. Having regard to the rival contentions and the material on record, we find that the issue as to whether the assessee is required to establish the benefit derived by it and also the ALP rate of royalty has been considered by the Hon'ble jurisdictional High Court in the assessee's own case in ITTA No.595/2016 for the A.Y 2010-11 and vide orders dated 23.12.2016 it was held as under:

“8. Having considered the rival submissions, we find that the assessee offered two transfer pricing studies in relation to payment of royalty. In so far as the acceptable study adopting the Comparable Uncontrolled Price method is concerned, it is not in dispute that the assessee offered three comparables with an average royalty payment of 3.65% as against its own rate of royalty at 3%. Significantly, the TPO rejected these comparables on the ground that they were US based, while the AE of the assessee was UAE based. Having rejected these comparables, it was for the TPO to come up with other comparables so as to justify reduction of the royalty payment. However, no such exercise was undertaken by the TPO and by going into the whys and wherefores of the improvement in the net sales and profit of the assessee, the TPO determined that the reason for the same was increased marketing along with offer of discounts and that there was no justification for payment of royalty at 3% to the AE by the assessee. This reasoning is without legal basis of law as it is not for the TPO to decide the best business strategy for the assessee.

9. In Walchand & Co. (P.) Ltd. (supra), the Supreme Court observed in the context of the Income Tax Act, 1922 that when a claim is made for an allowance by the assessee, the income tax authorities have to decide whether the expenditure claimed as an allowance was incurred voluntarily and on grounds of commercial expediency. The Supreme Court pointed out that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively for the purpose of business, it has to be adjudged from the point of view of the businessman and not of the revenue. The Supreme Court

concluded that it is open to the revenue to come to the conclusion that the alleged payment was not real or that it had not been incurred by the assessee in the character of a trader or that it was not laid out exclusively for the purpose of the business so as to disallow it but it is not the function of the revenue to determine what remuneration should be paid to an employee by the assessee.

10. Applying the same logic to the case on hand, once it is admitted by the Revenue that the assessee entered into a royalty agreement with the AE and the assessee claimed benefit from such agreement, in the form of quantum increase in sales with no apparent increase in production, minimal product recalls and low after sales maintenance cost, and consequently paid royalty in terms thereof, it was not for the TPO to determine as to what could be the other reasons for increase in the assessee's sales and profit.

11. Above all, there is no explanation forthcoming as to why the TPO decided upon 2% instead of the contractual rate of 3% for payment of royalty. No reason is offered by the TPO for picking on 2%. This whimsical fixation by the TPO amounts to an arbitrary and unbridled exercise of power. In consequence, we find that the TPO, having rejected the comparables cited by the assessee, did not take the trouble to examine alternate comparables so as to justify reduction of the rate for payment of royalty and by applying a wholly inapplicable methodology of determining the benefit from payment of such royalty, he capriciously reduced the rate for payment of such royalty from 3% to 2%.

12. On the above analysis, we find no grounds to interfere with the cogent and well reasoned order passed by the Tribunal. No question of law, much less a substantial question of law, therefore arises for consideration in this appeal”.

5.3 Since the issue is common, we hold that the A.O cannot determine the royalty at Nil. Therefore, we remit the issue to the file of the AO/TPO with a direction to determine the arm's length price of royalty by adopting TNMM as the most appropriate method and adopting the suitable comparables. Needless to mention that the

assessee shall be given a fair opportunity of hearing. Accordingly, the appeal of the assessee is treated as allowed for statistical purposes.

6. In the result, the appeal filed by the Assessee is allowed for statistical purposes.

Pronounced in the open court on 15th February, 2019.

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Hyderabad, Dated:15th February, 2019

KRK

- 1) Euroflex Transimissions (Ind) Pvt Ltd, Plot No. 99, CIE, Phase-II, Gandhinagar, Balanagar, Hyderabad.
- 2) ACIT, Circle – 17(1), Hyderabad.
- 3) Dispute Resolution Panel – 1, Bengaluru.
- 4) Pr.CIT-5, Hyderabad.
- 5) The Departmental Representative, I.T.A.T., Hyderabad.
- 6) Guard File.