

**IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH: "I-2", NEW DELHI**

**BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER  
AND  
SHRI O.P. KANT, ACCOUNTANT MEMBER**

ITA No.8155/Del/2018  
Assessment Year: 2014-15

M/s. Sheela Foams Ltd., 37/2, Site-IV, Sahibabad Industrial Area, Ghaziabad	<b>Vs.</b>	ACIT, Central Circle-6, New Delhi
<b>PAN :AAACS0189B</b>		
<b>(Appellant)</b>		<b>(Respondent)</b>

Appellant by	Shri Gaurav Jain, Adv. & Ms. Manisha Sharma, Adv.
Respondent by	Shri H.K. Choudhary, CIT(DR) & Shri Robin Rawal, Sr.DR

Date of hearing	07.02.2019
Date of pronouncement	23.04.2019

**ORDER**

**PER O.P. KANT, A.M.:**

This appeal by the assessee is directed against final assessment order dated 29/11/2018 passed by the Ld. Assistant Commissioner of Income Tax, Central Circle - 06, New Delhi [hereinafter referred to as 'the Assessing Officer'] for assessment year 2014-15 pursuant to the direction dated 28/09/2018 of Ld.

Dispute Resolution Panel (DRP). The grounds of appeal raised by the assessee are reproduced as under:

1. *That the Assessing officer erred on facts and in law in completing assessment under section 144C read with section 143(3) of the Income-tax Act, 1961 ('the Act') at an income of Rs.26,54,56,338/- as against the income of Rs.20,97,70,100/- returned by the appellant.*
2. *That the Assessing officer erred on facts and in law in making an adjustment of Rs.5,56,86,238/- to the income of the appellant by doubting arm's length price ('ALP') of certain specified domestic transactions undertaken during the relevant previous year.*
  - 2.1 *That the Assessing officer/Dispute Resolution Panel ('DRP') erred on facts and in law in computing the adjustment to total income on ad hoc basis, by comparing profitability of the eligible unit with that of the other companies comparable to the appellant company as a whole and applying the profit ratio of the comparable companies to arrive at the arm's length profit of the eligible unit, without following any acceptable methods for determining arm's length price prescribed under section 92C of the Act.*
  - 2 *That the Assessing officer erred on facts and in law in disregarding the directions issued by the DRP under section 144C(5) of the Act wherein the DRP had given a categorical finding that the price adopted by appellant for inter-unit transfer was higher than the purchase price thereof from third parties and thus, there was no basis for enhancing the cost price of raw materials/packing materials/consumables purchased by the Kala Amb unit from other non-eligible units, and proceeding to make adjustment on account of inter-unit transfer of goods ignoring the contemporaneous evidence placed on record by the appellant.*
  - 2.3 *That the Assessing officer/DRP erred on facts and in law in including the common/head office expenses allocated to the Kala Amb unit in the sales ratio, in the specified domestic transactions, without pointing out any discrepancy in the method of allocation of head office expenses employed by the appellant and proceeding to make an adjustment in this regard without any cogent reasoning.*
  - 2.4 *That the Assessing officer/DRP erred on facts and in law in observing that the interest expenditure was required to be allocated to eligible unit at Kala Amb, without appreciating that the eligible unit had had sufficient surplus funds and interest bearing borrowed funds had no nexus with the said unit.*

3. *That the Assessing officer erred in charging interest under section 234B and 234C of the Act.*

**2.** Briefly stated facts of the case are that the assessee company was engaged in the business of manufacturing and trading of “PU Foam Products” and “mattress” (Coir/Foam/spring) product from various units located across the India. The unit of the assessee located “Kala Amb” (Himachal Pradesh) was eligible for various subsidies of Central Excise-duty and sales-tax etc. and also deduction under section 80IC of the Income Tax Act, 1961 (in short ‘the Act’) in respect of the profit derived from the unit. For the year under consideration, the assessee filed return of income on 12/12/2014 declaring total income of Rs.20,97,70,100/-. The case was selected for scrutiny and notice under section 143(2) of the Act was issued and complied with. The Assessing Officer observed, following international and specified transactions carried out by the assessee within the meaning of section 92B and 92BA of the Act:

*“(i) International transactions with Joyce Foam Pty. Limited for purchase and sale of raw material;*

*(ii) Specified domestic transactions of payment of interest, rent, royalty, training fees to Associated Enterprises in India;*

*iii) Specified domestic transactions of inter-unit transfer of raw materials.”*

**2.1** In view of above transactions, the Ld. AO referred the matter to the Transfer Pricing Officer (TPO) for determination of Arm’s Length Price of the transactions. The learned TPO noted the benchmarking of above transactions by the assessee as under:

*“The first two transactions were benchmarked by applying Transactional Net Margin Method (‘TNMM Method’). While applying TNMM method, at the company level, the appellant found companies, having the same product mix and function at the company level as a whole, and compared average profits of those companies, viz.. 2.90% with the operating profit margin of the appellant company being 3.55 %. The latter being higher than that of the comparable companies viz.. 2.90 %, the said transaction was considered to be at arms-length price. The TPO/AO accepted the aforesaid transactions and benchmarking carried out by the assessee was found to be valid and accordingly, no further adjustment thereto was proposed.*

*The third category of specified domestic transactions, viz., inter-unit transaction(s) entered between eligible unit (unit at Kala Amb) and other non-eligible units for transfer of raw material, were benchmarked using the Comparable Uncontrolled Price Method (‘CUP method’), being the most appropriate and preferred method in the facts of the case.”*

**2.2** But, the Ld. TPO found the profit declared by the 80IC eligible unit exceptionally higher (30.71%) as compared to other non-80 IC eligible unit and thus according to him there has been shifting of profit to 80IC unit from non-80IC units. In the transfer pricing study, the assessee selected five comparables and computed their average operating margin at 2.90%. The assessee explained the incentive provided by the government to the unit and high-value product sold as main reasons for higher profit in case of 80IC unit. After considering submission of the assessee, the learned TPO disputed the arm’s length price of inter-unit (specified domestic) transactions with Kala Amb Unit computed by the assessee and proposed a downward adjustment of Rs.11,97,14,215/- to the income of the assessee in the order dated 13/10/2017 under section 92CA(3) of the Act as under:

<b>Particulars</b>	<b>Amount in Rs.</b>
Operating Revenue	660,649,989
ALP Operating Profit / Operating Revenue %	2.90%

<i>Arm's Length Profit</i>	19,158,850
<i>Actual Profit of Eligible Unit</i>	202,894,973
<i>Excess profit over Arm's Length Profit</i> (A)	183,736,123
<i>Total of Expenses of SDT of Eligible Unit</i> (B)	298,252,633
<i>Total Operating Expense of Eligible Unit</i> (C)	457,755,016
<b><i>Proposed Adjustment =(A*B/C)</i></b>	<b>119,714,215</b>

**2.3** The learned TPO taken total of expenses of Specified Domestic Transaction (SDT) at Rs.29,82,52,633/- which is comprised of purchase packing material of Rs.1,77,30,066/-, purchase of raw material of Rs.17,33,72,158/-, purchase of stores and spares of Rs.1,57,48,738/- and apportionment of head office expenses of Rs.9,14,01,671/-. The adjustment has been computed as excess profit transferred in the ratio of the SDT expenses to the total expenses of the eligible unit.

**2.4** The Assessing Officer in the draft assessment order included the adjustment proposed of Rs.11,97,14,215/- by the learned TPO and also proposed addition of Rs.5,16,063/- under section 14A of the Act.

**2.5** Aggrieved, the assessee filed objections before the Ld. DRP. After considering submission of the assessee, the Ld. DRP directed as under:

- 1. On the issue of manner of allocation of common expenses**, while competing deduction under section 80IC of the Act in respect of the eligible unit situated at Kala Amb, the Ld. DRP was observed that the assessee itself has allocated Rs.9,14,01,671/- to the eligible unit and the same

amount had been taken by the learned TPO, hence no further directions were issued on the issue.

2. **On the issue of non-allocation of finance cost**, while computing deduction under section 80IC of the Act in respect of the eligible unit situated at Kala Ambb, the Ld. DRP, directed the AO/TPO to allocate finance cost (excluding income tax) in the ratio of sales/operative revenue of the Kala Amb unit and recompute SDT expenses considered for adjustment accordingly.
3. **On the issue of impact of exemption of taxes on the profitability of kalaAmb unit**, the learned DLP directed the AO/TPO to compute the operating profit margin without considering the excise duty, sales tax and income-tax.
4. **On the issue of invoices for transfer of other consumables/packing materials**, the learned DRP observed that the assessee had apparently transferred the materials to the "Kala Amb" unit at a higher cost than the cost price of purchase from 3<sup>rd</sup> parties, therefore there is apparently no basis for enhancing the cost price of Kala Amb unit, however directed the AO/TPO to examine the details submitted in this regard and give a specific finding in the final order.

**2.6** Further, the learned DRP directed to delete the disallowance under section 14A of the Act.

**2.7** Pursuant to the direction of the learned DRP, the Assessing Officer, computed operating profit of the eligible unit excluding excise duty and sales tax at Rs.10,58,56,914/-, which is reproduced on pages 11 to 15 of the impugned order. While

computing this operating profit excluding excise duty and sales-tax, the Assessing Officer allocated head office expenses of Rs.9,14,01,671/- in conformity with the direction of the learned DRP. On the direction of the learned DRP to examine the details of price at which material was transferred to the eligible unit from other units of the assessee, the Ld. AO/TPO perused few invoices produced by the assessee on test check basis but found the same not readable and incomplete. The learned TPO/AO also observed that goods have been transferred to the eligible unit from non-eligible unit without adding any markup and thus resulted in shifting of the profit to the eligible unit and concluded that purchase made by the eligible unit from the non-eligible unit was not at arm's length and was below the prevailing market rate. In view of the conclusions drawn, the learned TPO /AO computed the adjustment in final assessment order at Rs.5,56,86,238/- as under:

<i>Particulars</i>	<i>Amount in RS.</i>
<i>Operating Revenue</i>	660649989
<i>ALP Operating Profit / Operating Arm's Length Profit</i>	2.90%
<i>Actual Profit of Eligible Unit</i>	19158850
<i>Excess profit over Arm's Length Profit (A)</i>	105856914
<i>Total of Expenses of SDT of Eligible Unit (B)</i>	86698065
<i>Total Operating Expense of Eligible Unit (C)</i>	298252633
<b><i>Proposed Adjustment =(A*B/C)</i></b>	<b>464350385</b>
	<b>55686238</b>

**2.8** The aforesaid adjustment has been challenged by the assessee before the Tribunal.

**3.** The grounds Nos. 1 and 2 of the appeal are general in nature, and hence, we are not required to adjudicate upon is specifically.

**3.1** In ground No.2.1, the assessee has challenged that adjustment has been made on ad-hoc basis without following an acceptable method for determining arm's length price prescribed under section 92C of the Act.

**3.2** The learned counsel submitted that the assessee has applied Comparable Uncontrolled Price (CUP) method for benchmarking the specified domestic transactions of purchase comparing the price at which goods were procured by the assessee from third-party suppliers, which is an internal comparable uncontrolled transaction price. According to the learned counsel the CUP method is the most appropriate method for benchmarking the specified domestic transaction and the result derived from applying the CUP method will be the most direct and reliable measure of arm's length result for the controlled transaction. The learned counsel submitted that in view of his arguments, the learned TPO is not correct in rejecting the CUP method, without pointing out any inaccuracy and applying the arbitrary method.

**3.3** The learned counsel submitted that the method applied by the AO/TPO is some variation of the TNMM method. He submitted that the learned AO/TPO has erred in comparing the average profit of 2.9% of the comparable companies with the profit of the eligible unit, without appreciating that said companies are engaged in manufacture of multiple products and therefore were not functionally similar to the eligible unit, which was engaged in manufacturing of only single item i.e. foam mattresses. The learned counsel suggested that, at best , the

AO/TPO could have compared the profits of the exempt unit of other companies if any engaged in manufacturing of the same product with the profit of the impugned eligible unit but not for the profits of the company as a whole, with the profit of the standalone Kala unit.

**3.4** The learned DR, on the other hand, submitted that the learned TPO applying the TNMM method, compared the margin of the eligible unit with the margin of the comparable companies chosen by the assessee itself and then applied that factor on the cost of specified domestic transactions. According to him, there is nothing wrong in the approach of the learned TPO.

**3.5** We have heard the rival submissions of the parties on the issue in dispute. We find that neither the issue challenging the method of making adjustment to the specified domestic transaction was either raised before the learned DRP nor DRP has adjudicated on this issue. Even this issue has not been taken up before us by way of the additional ground. However, we find that in final adjustments in compliance to the direction of the learned DRP, the AO/TPO has computed the margin of the eligible unit excluding the benefit received on account of excise duty and sales-tax and then compared with the average margins of the comparable companies, which are selected by the assessee itself. The learned AO/TPO, applying the TNMM method, has computed the adjustment in view of difference in margin of the eligible unit and comparables. The functions of the eligible unit are comparable with other comparables at entity level and slight variation in verticals get covered under the TNMM. In our opinion, there is no error in the method of computing arm's length price adopted by the Assessing Officer.

**3.6** Further, on the contention of the learned counsel that only the margin of eligible units if any of the comparable companies, should only be considered for comparison with the margin of the eligible unit of the assessee, we are of the opinion that such comparison of margin of the eligible units of other assesseees will not be an independent uncontrolled transaction and being related party transactions, cannot be considered for comparison with the specified domestic transactions carried out by the assessee. Accordingly, this ground of appeal is rejected.

**4.** In ground no. 2.2, the assessee has challenged that despite the direction issued by the learned DRP, the learned AO/TPO has not considered the invoices issued for inter-unit transfer of goods from the non-eligible unit to the eligible unit vis-à-vis purchase made by the eligible unit from third parties.

**4.1** Before us, the learned counsel referred to para 5 of the impugned order and submitted that the Ld. AO/TPO has not considered the invoices submitted by the assessee for verification as directed by the learned DRP and therefore the issue may be restored back to the Ld.AO/TPO. The learned counsel referred to page 152 of the paper book, and drawn our attention that cloth materials have been transferred from non-eligible unit to the eligible unit at the same prices which the eligible unit purchased from the third parties.

**4.2** The learned DR, on the other hand, relied on the order of the lower authorities.

**4.3** We have heard the rival submission and perused the relevant material on record. The issue in dispute is on the adjustment made to the specified domestic transactions. The very basis of the computation of the adjustment applying TNMM

method is the comparison of the margin of the eligible unit with the average margin of the other comparables. The Ld. AO/TPO has duly considered the direction of the learned DLP for excluding the excise duty on sales tax from the operating profit of the eligible unit so as to remove the effect of the benefit of excise duty and sale tax received by the eligible unit. Thereafter, the effect of the excess margin of the assessee has been translated to the specified domestic transactions of purchases etc. The ld. DRP has already rejected the arm's length price of the specified domestic transaction computed by assessee in case of purchase of packing material (Rs.1,77,30,066/-), purchase of raw material (Rs.17,33,72,158/-) and purchase of stores and spares (Rs.1,57,48,738/-) and accepted the specified transaction of apportionment of head office expenses of rupees Rs. 9,14,01,671/-. The DRP has directed to verify the invoices of the assessee for claim of inter-unit transfer of goods from non-eligible to eligible units and comparison of the same with the transfer of goods from third-party to the eligible unit. In the case of the assessee, we have upheld the TNMM method as most appropriate method of computing arm's length price of the specified transactions, under which margin of the eligible unit is compared with the margin of the comparables. As the arm's length price is not computed on the basis of CUP method, verification of invoices as directed by the learned DRP is not required. Thus, we reject the contention of the learned counsel to restore the matter to the learned AO/TPO for verification of the invoices.

**4.4** The ground of the appeal of the assessee is accordingly dismissed.

**5.** In ground No. 2.3 assessee has challenged adjustment sustained to the specific domestic transaction of allocation of common/head office expenses to the eligible unit despite direction of the dispute resolution panel.

**5.1** We have heard the parties on the issue in dispute and perused the relevant material on record. We find that the learned DRP in para 2.1.4.1.1 of their order has mentioned that the assessee itself has allocated Rs.9,14,01,671/- to the eligible unit and the same amount has been taken by the TPO and is no further directions were required on that. We also note that while computing margin of the eligible unit following the direction of the learned DLP, the AO/TPO has taken the amount of allocation of common/head office expenses at Rs.9,14,01,671/-.

**5.2** But the Ld. AO/TPO has applied the effect of the excess margin on the specified transaction of the allocation of common/head office expenses, ignoring that said transaction has been held by the learned DRP as it arm's length. In our opinion, the Ld.AO/TPO is not justified in making adjustment to the specified transaction of allocation of common/head office expenses of Rs.9,14,01,671/- and accordingly, we direct the Ld. AO/TPO to exclude the said amount from the total specified domestic transaction of the eligible unit of Rs.29,82,52,633/- considered for adjustment. The ground of the appeal of the assessee is accordingly allowed.

**6.** In ground No.2.4, the assessee has challenged the allocation of the finance cost of Rs.65,28,298/- to the eligible unit while working out the profit margin of the eligible unit.

**6.1** The learned counsel submitted before us that the eligible unit has sufficient funds as the unit earned substantial profit in

earlier years and also during the year under consideration. He submitted that no part of head office funds were transferred to the eligible unit and on the contrary a fund of Rs.8,62,58,747/- was receivable from the head office at the end of the year. He further submitted that the assessee company's free reserve of Rs.143.35 crores at the beginning of the assessment year and no fresh borrowings were made during the year by the assessee company. He also submitted that funds were borrowed by the HO in earlier years, which were used for other business unit and therefore the interest expenditure had direct nexus with those units but not with the eligible unit, to allocate any portion thereof as common expenditure to the said unit. The learned counsel further submitted that in the case of the assessee for assessment year 2000-01, similar allocation in respect of the unit at Rakholi-Silvasa was deleted. He also submitted that the Tribunal in the case of the assessee for assessment years 2006-07 to 2008-09 has held that an absence of nexus of borrowed fund with the eligible units, the interest expenditure could not be allocated to the said eligible unit for computing deduction under section 80IB by of the Act.

**6.2** The learned DR, on the other hand, submitted that common/head office expenses have been incurred by the assessee and allocated to the eligible unit and thus it cannot be said that no funds of the head office have been utilized towards the eligible unit. According to him, the decisions of the Tribunal of earlier years are in relation to determining deduction under section 80IB of the Act, whereas in the present year the issue of arm's length price of the specified domestic transaction is concerned.

**6.3** We have heard the rival submissions and perused the relevant material on record. There is no doubt that the assessee company has incurred total finance cost of Rs.11,81,89,903/- during the year under consideration, out of which the Ld.AO/TPO has allocated amount of Rs.65,28,298/- towards the eligible unit on the basis of the allocation key adopted. The learned counsel was asked to justify or correlate the finance cost or interest expenditure toward the specific loan utilized so that it can insure whether same was related to a specific unit. We are of the opinion that the interest or finance cost specific to particular loan utilized by the non-eligible unit may not required to be allocated to the eligible unit. Since no such exercise has done either by the Assessing Officer or by the assessee, we feel it appropriate to restore this issue to the file of the Ld.AO/TPO for determining the amount of finance cost which is not related to any specific unit, for allocation among the various units including the eligible unit on the basis of the allocation key and then compute the margin of the eligible unit and give effect of the said margin to the adjustment to the specified domestic transaction. It is needless to mention that the assessee shall be afforded adequate and reasonable opportunity of being heard. The onus will be on the assessee to justify that particular finance cost or interest cost has been incurred in relation to particular unit and wherever the assessee will be failed to demonstrate relation with particular unit, same amount should be considered for allocation amongst various units. The ground of the appeal is, accordingly, allowed for statistical purposes.

7. The ground No. 3 of the appeal being consequential, we are not required to adjudicate upon and accordingly, dismissed as infructuous.

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

***Order pronounced in the open court on 23<sup>rd</sup> April, 2019.***

Sd/-  
**[AMIT SHUKLA]**  
**JUDICIAL MEMBER**

Sd/-  
**[O.P. KANT]**  
**ACCOUNTANT MEMBER**

Dated: 23<sup>rd</sup> April, 2019.

RK/-[d.t.d.s]

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi