IN THE INCOME-TAX APPELLATE TRIBUNAL "K" BENCH MUMBAI

BEFORE SHRI PAWAN SINGH, JUDICIAL MEMBER AND
SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER

ITA No. 7282/Mum/2017 (Assessment Year 2013-14)

ITA No. 1765/Mum/2017 (Assessment Year 2012-13)

ASB International P. Ltd., Plot No. E-09, MIDC Addl. Ambernath Indl. Area, Anand Nagar, Ambernath (E), Thane-421506. **PAN: AAACA8424F**	Vs.	ACIT Circle-1 Kalyan-421306.
Appellant		Respondent

Appellant by : Shri V.S. Sridharan Sr Advocate
with Ms. Neha Sharma Advocate
& Shri Amar Gahlot

Respondent by : Shri Anand Mohan (CIT-DR)

Date of Hearing : 25.06.2019

Date of Pronouncement : 22.07.2019

ORDER UNDER SECTION 254(1)OF INCOME TAX ACT

PER PAWAN SINGH, JUDICIAL MEMBER;

1. These two appeals by assessee are directed against the assessment order under section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961, passed in pursuance of the direction of Disputes Resolution Panel-1, Mumbai [hereinafter referred to as the "DRP"] dated 29.11.2016 & 28.08.2017 for Assessment Year 2012-13 and 2013-14 respectively . In both the appeals, the assessee raised certain common grounds of appeal, therefore, both the appeals were clubbed, heard

together and are decided by common order. For appreciation of fact, the appeal for Assessment Year 2012-13 was treated as lead case. For appreciation of facts the appeal for AY 2012-13 is treated as lead case, the assessee has raised following grounds of appeal:

1. On the facts and in the circumstances of the case and in law, the learned Joint Commissioner of Income- tax [Transfer Pricing -1 (1)] ('TPO') and the learned AD under the directions of the Hon'ble DRP erred in making an adjustment of Rs 26,03,49,971 under Chapter X of the Act.

2. On the facts and in the circumstances of the case and in law, the learned AD erred in referring the matter to the learned TPO without applying his mind on the benchmarking analysis undertaken by the Appellant and without recording any reasons to show that the' conditions mentioned in section 92C and section 92CA of the Act have been satisfied.

3. On the facts and in the circumstances of the case and in law, the learned TPO and the learned AD under the directions of the Hon'ble DRP erred in making an adjustment of Rs 12,00,25,306 on account of sales to associated enterprise ('AE').

3.1 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AD under the directions of the Hon'ble DRP erred in comparing the AE segment with the non-AE segment thereby not appreciating the qualitative (not quantitative) difference in the business model of the two segments.

3.2 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AD under the directions of the Hon'ble DRP erred in observing that the Appellant is not engaged in contract manufacturing and alluding that a fixed remuneration on cost plus basis has to be provided to contract manufacturers and thereby contract manufacturers should not bear a risk without appreciating that, in business transactions between independent entities, no entity would agree to pay to another a fixed remuneration on a cost plus basis and make it completely free of all risks.

3.3 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in comparing the AE segment with the non-AE segment thereby not appreciating the fact that each of the two segments conducts its business in different markets (the AE segment in the contractors market facing only the

principal manufacturers and the non-AE segment in the general manufacturer's market facing the end users).

3.4 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in comparing the AE segment with the non-AE segment thereby not appreciating the significant differences in functions undertaken, assets employed and risks borne by the AE segment and the non-AE segment, and the fact that such differences are too significant, as a consequent of the qualitative difference of the business models, to apply any adjustments thereto.

3.5 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in not comparing the AE segment with the external contract manufacturer comparables which are the best ALP indicator of and the closest comparables to the AE segment.

3.6 On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in not appreciating the additional evidence filed during the course of proceedings before the Hon'ble DRP.

3.7 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in making an adjustment to the Appellant's international transactions by applying adjustments on an ad-hoc manner which is not reasonable and accurate.

3.8 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in disregarding the benchmarking analysis applying Transactional Net Margin Method ('TNMM') undertaken by the Appellant as per the provisions of the Act.

3.9 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in not comparing the AE segment with appropriate external comparables as identified in the Appellant's Transfer Pricing Study report after granting appropriate adjustments for difference in risks while applying TNMM.

3.10 On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in not allowing relief as per its earlier order solely on the ground that its order is not appealable in the year under consideration, notwithstanding that there are no changes in facts as compared to the earlier year.

4. On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in making an adjustment of Rs 14,02,70,282 on account of royalty paid to the AE.

4.1 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in disregarding the benefits received by the Appellant in lieu of payment of royalty and considering the ALP of the international transaction of payment of royalty as Nil.

4.2 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in disregarding the fact that the royalty transaction is closely linked and inter-related with the other international transactions of the Appellant.

4.3 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in not considering the entity level benchmarking analysis carried out by the Appellant under the TNMM to justify the royalty transaction.

4.4 On the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP erred in disregarding the analysis carried out under the comparable uncontrolled price method and submitted by the Appellant on a without prejudice basis.

4.5 Without prejudice to the other ground of appeal, on the facts and in the circumstances of the case and in law, the learned TPO and the learned AO under the directions of the Hon'ble DRP, erred in not appreciating that transaction of royalty cannot be benchmarked using the profit split method.

5. On the facts and in the circumstances of the case and in law, the learned AO under the directions of the Hon'ble DRP erred in not allowing Rs 54,383 as deduction of the payment of employee's contribution to Employees' State Insurance Corporation.

The Appellant prays that the addition made by the learned AO / TPO and upheld by the Hon'ble DRP be deleted and consequential relief be granted.

The assessee also raised following additional/ revised grounds of appeal

Being aggrieved by the order of the learned ACIT, Circle - 1, Kalyan, ('AO'), read with the order of the learned Dispute Resolution Panel ('DRP'), Mumbai, the assessee begs to revise/ replace the ground of appeal corresponding to earlier Ground of Appeal No.4, with the following grounds:

4. The lower authorities, erred in upholding the adjustment of Rs. 14,02,70,282/- to the income of the assessee on account of royalty paid by the assessee to its associated enterprise.

5. The lower authorities ought to have held that the royalty at 12% of the domestic sales is at arm's length.

5.1. The non-AE segment of the assessee has earned a segmental profit of 15.81% for the year under consideration, after paying royalty at 12% of the domestic sales. Thus, the profit before royalty is 27.81 % for non-AE segment.

5.2. Further, the manufacturing activity of the AE segment has resulted in a segmental profit of 4.63%. Also, a margin of 3% has been granted by the TPO himself suo motu as the margin on the sales function undertaken by the assessee, in A Y s 2010-11, 2011-12 and the current year.

5.3. In view of the above, the royalty of 12% of sales is at arm's length. This is so since the total profit for the non-AE segment before royalty (27.81 %), as reduced by the profit for manufacturing activity (4.63%), and the profit attributable to sales function (3%), amounting to 20.18% (27.81% - 4.63% - 3%), is much more than the royalty paid at 12%.

6. The lower authorities, ought to have noticed that the above methodology meets the provisions laid down in Rule 10AB of the Income-tax Rules, 1962, read with section 92C(1)(f) of the Income-tax Act, 1961, and is the most appropriate method in the present facts, also being retrospective in operation and hence applicable to the year under consideration.

7. The lower authorities, erred in not noticing that the above methodology also broadly corresponds with the provisions laid down in second proviso to Rule 10B(1)(d) of the Income-tax Rules, 1962, relating to Profit Split Method.

8. The lower authorities, erred in not noticing that the above methodology is also in accordance with Paragraph 6.139 of the revised 2015 OECD transfer pricing guidelines, and Paragraph 13 of the 1979 OECD transfer pricing guidelines.

9. The lower authorities, erred in not noticing that the Comparable Uncontrolled Price (CUP method is not the most appropriate method, particularly in the facts of the case which involves royalty for manufacturing of capital goods / assets being injection stretch blow moulding machines.

10.The lower authorities, erred in applying the CUP method, even after their own findings that the comparables are not available particularly in light of

Rule 10C(2)(c) of the Income-tax Rules, 1962, and hence CUP cannot be the most appropriate method in the facts of the present case.

2. Brief facts of the case as extracted from the order of lower authorities are that assessee is a subsidiary of Nissei ASB Machine Co. Ltd. ('ASB Japan' or 'AE'), engaged in the business of Manufacturing of one step as well as two step Injection Stretch Blow Moulding ('ISBM') Machines & Moulds, filed its return of income for Assessment Year 2012-13 on 27.11.2012 declaring total income at Rs. 25,68,76,640/-. Subsequently, a revised return of income was filed declaring the same income. During the assessment the assessing officer noted that in the Form No. 3CEB the assessee has reported international transaction with its associated enterprises (AE) exceeding of Rs. 15 crore. The Assessing Officer made a reference for under section 92CA(1) to the Transfer Pricing Officer (TPO) for determination of Arm's Length Price (ALP). The TPO vide its order dated 30.01.2016 proposed the adjustment of Rs. 26,02,95,588/-, consisting of royalty paid to AE of Rs. 14,02,70,282/- and sales made to the AE of Rs. 12,00,25,306/-. On receipt of report of TPO, the Assessing Officer passed a draft assessment order dated 29.02.2016 and made the addition suggested by TPO.

3. The Assessing Officer also made addition/disallowances of Rs. 54,383/- under section 2(24)(x) and 36(1)(va) by taking view that the

assessee made a payment of employee contribution of ESI (wrongly mentioned as PF in draft assessment order) beyond time allowed under section 36(1)(va). Before making disallowance, the Assessing Officer issued show-cause notice for such disallowance. The assessee filed its reply and stated that due to technical problem with ESIC web-site there was delay in deposit of contribution. The contribution for the month of June 2012 was due on 20.07.2012, however, it was actually deposited on 21.07.2012. The explanation furnished by assessee was not accepted by Assessing Officer. The Assessing Officer disallowed the entire claim/deposits of ESIC. On service of draft assessment, the assessee exercised its option to file objection before the DRP. The DRP vide its direction dated 29.11.2016 upheld the adjustment suggested by TPO by following the direction of DRP for preceding year i.e. for Assessment Year 2011-12 holding that there is no change in the facts of the case. The DRP also upheld the disallowance on account of delay in deposit of ESIC contribution. Therefore, the Assessing Officer passed the assessment order in pursuance of direction of DRP. Aggrieved by the additions on account of transfer pricing adjustment and addition on account of 36(1)(va) the assessee has filed present appeal before this Tribunal.

4. We have heard the submission of ld. AR of the assessee and ld. DR for the revenue and perused the orders of lower authorities. The ld. AR of the assessee submits that the DRP while deciding the objection of assessee followed the order of their predecessor for earlier years i.e. A.Y. 2011-12, the matter traveled to the Tribunal and the Tribunal has set-aside the issue to the file of Assessing Officer /TPO for fresh benchmarking vide order dated 04.01.2017 in ITA No. 2137/2016. The ld. AR submits that in set-aside proceeding, the Assessing Officer/TPO vide order dated 22.11.2018 accepted the concern transaction at ALP by benchmarking the same with external comparables.
5. On the issue of royalty adjustment, the ld. AR of the assessee submits that Non-AE Segment Profit so taken as internal comparable is after the deduction of payment of royalty. Therefore, the other method would result in the correct ALP of royalty at 12% irrespective of the outcome of the adjustment made to the sales margin. It was canvassed by ld. AR of the assessee that whatever be the ultimate outcome of TP Adjustment made qua the AE Segment, it will have no bearing on the determination of ALP qua royalty as "other method". The ld. AR made a following illustration to substantiate his contention.

Particulars	**AY 2012-13**
Royalty payment	12%

Non-AE segment profit (after royalty, as per segmental results)	15.81%
Profit before royalty …. (A)	27.81%
Profits reasonably attributed to sales	3%
Profit attributable to Non-AE segment …(B)	15.81%
Royalty attributable (A) – (B)	**12%**

6. The ld. AR for the assessee further submits that irrespective of adjustment made on sales margin issue and royalty benchmarking are eventually two issues and are not connected to each other and both the issue be decided independent of each other. On the additional grounds/revised ground the ld AR for the assessee submits that the assessee has not raised new plea in the revised grounds and all the facts related to the revised grounds are emanating from the record.

7. On the other hand, the ld. DR for the revenue supported the order of lower authorities. The ld. DR further submits that DRP has followed the earlier years orders for Assessment Year 2011-12 for the sale margin issue, therefore, the matter should be remanded to the file of Assessing Officer/TPO for fresh examination. On the issue of royalty, the ld. DR for the revenue submits that this issue should be set-aside to the file of Assessing Officer/TPO for bench marking as the assessee failed to discharge the primary onus of bench marking the royalty transaction by use of prescribed method under section 92C, the "other method" being most appropriate other method have not been examined

by Assessing Officer/TPO or by DRP and the profits reasonably attributable to manufacturing and sales have to be examined. On the additional/ revised grounds the ld. DR submits that the bench may take decision in accordance with law.

8. We have considered the submission of both the parties and gone through the orders of authorities below. We have noted that the assessee has raised revised/ additional ground of appeal for substituting ground No.4. In our view no new facts are required to be brought on record for adjudication of the revised grounds, thus, the additional grounds of appeal are allowed. We have noted that the ld. DRP while upholding the adjustment on account of international transaction solely relied upon the order of DRP for Assessment Year 2011-12. The co-ordinate bench of Tribunal in appeal for Assessment Year 2011-12 restored the issue to the file of Assessing Officer/TPO for deciding the issue afresh by passing the following order:

> "6.We have heard the rival submissions and perused the material before us. We find that the assessee was supplying goods to its AE.s and non-AE.s, that assessee had considered the entity level data for determining the ALP of the IT.s., that the TPO applied internal TNMM and made an upward adjustment of Rs. 27.31Croes,that he gave an allowance of 3% on account of 'delay in receivables and after sales services and other efforts made under the non- AE business', that the assessee filed additional evidences before the DRP and argued that it was a contract manufacturer or akin to contract manufacturer, that the DRP held that internal TNMM could not be applied

straight away, that the assessee had filed a list of four comparables, that the DRP rejected one of the comparables holding that it was suffering losses and that contract manufacturer could not suffer losses, that no adjustment was allowed on account of capital employed.

6.1.Section 92 and the Rules dealing with TP proceedings were brought on statute to ensure that the price paid by an assessee to its AE for the goods sold/purchased or services rendered/ availed is not less than the fair market value. In short, for an IT, the assessee should charge the same price from its AE as it would have charged from a unknown third party. For determining ALP one of the several methods can be used and several factors have to be considered. But, the base remains the same i.e. determination of fair market value of a transaction entered in to. Fairness demands that the assessee as well as the revenue authorities should avoid arbitrariness ,while determining ALP of an IT. Both should use some reasonable data to prove that IT is above board. Adhoc adjustments, in our opinion, goes against the basic concept of TP. In the case under consideration 3% and 8% allowance was given by the TPO and the DRP. But, how they arrived at those figures is not known. The reasons for adopting a certain percentage does not find place in their orders. They have not discussed as to what was the material that gave them the basis for allowing 3% and 8% adjustment on account of 'delay in receivables and after sales services' and considering the factors like 'bulk manufacturing orders received from AE.s and geographical locations'. But, both the authorities have not cited the instances where an independent assessee, in similar circumstances, had claimed that adjustment on account 'delay in receivables' 'geographical factors' etc. was approximately 3% or 8%.No judicial forum has adopted the said percentage on account of delay in receivables/ bulk manufacturing/geographical location. Even if they had some material supporting their stand, same has not been brought on record. Thus, the order passed by them is a non-speaking order and it falls under the category of an order passed without assigning reasons. Such orders cannot be endorsed. As a representatives of the State, they are supposed to raise and collect only Due taxes from the subjects. As per the scheme and provisions

of the Act, due taxes cannot be determined by making adhoc allowances/disallowances. Before the DRP, the assessee had filed a list of comparables and it was not considered in proper perspective. A comparable cannot and should not be rejected only on the basis of loss suffered by it for a particular year. A persistent loss making comparable can be excluded. But, in the case under consideration, the comparable had not suffered loss year after year. After admitting that internal TNMM could not have been applied straight away, the DRP should have deliberated upon the issue of determination of ALP in a more rational manner. But, it just adopted the easiest route- an ad hoc allowance. It is a fact that more than 60% of the sales turnover of the assessee is with non- AE.s and the profit ratios of non-AE.s and AE.s cannot be same. Besides, the assessee had entered in to an agreement with its AE for supply of goods and working capital adjustment is required to be made. All these factors would affect the ALP of the transactions. Considering the peculiar facts and circumstances of the case, we are of the opinion that the matter needs further verification and investigation. So, in the interest of the justice, we are restoring the matter to the file of the TPO/AO to decide the issue afresh. While determining the ALP, he should consider the data of the companies who are engaged in such activities that are similar or closer to the activities of the assessee and the turnover with the AE.s and Non-AE.s should be of similar volumes. In short, some reasonable comparables should be selected after considering the FAR analysis of such comparable and only then exercise of determining ALP should be completed. Effective ground of appeal is decided in favour of the assessee, in part."

9. Considering the decision of Tribunal in assessee's own case for AY 2011-12 on identical issue of sales adjustment, and the facts that the ld DRP for the year under consideration followed the order for earlier year (AY 201-12) the grounds appeal related to the sales adjustment in the year under consideration is also restore to the file of AO/TPO with

similar direction to consider afresh and pass order in accordance with law. So far as adjustment related with the royalty adjustment is concerned the ld. AR of the assessee submitted that whatever be the ultimate outcome of TP Adjustment made qua the AE Segment, it will have no bearing on the determination of ALP qua royalty as "other method". The ld. AR has given the illustration to substantiate his contention which we have recorded above, which seems to be convincing. Therefore, the issue of royalty adjustment is also restored to the file of AO/TPO to examine is afresh in view of the illustration given by ld AR for the assessee and pass the order in accordance with law. In the result the grounds of appeal No. 1 to 4 and the additional grounds of appeals are allowed for statistical purpose.

10. Ground No. 5 relates to disallowance of deduction of employee's contribution to ESI. The AO disallowed the contribution by taking his view that it was deposited beyond prescribed time provided in ESIC Act. The ld DRP confirmed the same being covered by the CBDT Circular No. 22 of 2015. We have seen that the due date for deposit of employee's contribution was 20.07.2012, however, it was deposited on 21.07.2012. The assessee explained before AO that due to technical fault with the website of ESIC it could not be deposited in time. We have noted that the assessee had deposited the contribution before

filing of return of income. The Hon'ble Bombay High Court in CIT Vs Ghatge Patil (368 ITR 479 Bom) held that if the employer deposited the contribution of welfare of employee, before the due date of return of income, they would be entitled for such deduction as per the proviso of section 43B. Therefore, considering the same analogy we direct the AO to allow the deduction claimed by the assessee on account of employee's contribution of ESI as it was paid before due date of filing the return of income the assessee. In the result the ground No. 5 of the appeal is allowed.

11. In the result the appeal of the assessee is allowed.

ITA No. 7282/Mum/2017 for A.Y. 2013-14.

12. The assessee has raised following grounds of appeal:

> 1. The lower authorities, erred in upholding the adjustment of Rs. 13,36,12,349/- to the income of the assessee on account of royalty paid by the assessee to its associated enterprise.
> 2. The lower authorities, ought to have held that the royalty at 12% of the domestic sales is at arm's length.
> 2.1. The non-AE segment of the assessee has earned a segmental profit of 4.94% for the year under consideration, after paying royalty at 12% of the domestic sales. Thus, the profit before royalty is 16.94% for non-AE segment.
> 2.2. Further, no adjustment has been made by the lower authorities to the shipping price from assessee to AE and thus the same represents arm's length profit of 2.41 % attributable to manufacturing activity.

2.3. A margin of 3% has been granted by the TPO himself suo motu as the margin on the sales function undertaken by the assessee, in A Y s 2010-11, 2011-12 and 2012-13.

2.4. In view of the above, the royalty of 12% of sales is at arm's length. This is so since the total profit for the non-AE segment before royalty (16.94%), as reduced by the profit for manufacturing activity (2.41 %), and the profit attributable to sales function (3%), amounting to 11.53% (16.94% - 2.41% - 3%), would be comparable to the royalty paid at 12%.

3. The lower authorities, ought to have noticed that the above methodology meets the provisions laid down in Rule 10AB of the Income-tax Rules, 1962, read with section 92C(I)(f) of the Income-tax Act, 1961, and is the most appropriate method in the present facts.

4. The lower authorities, erred in not noticing that the above methodology also broadly corresponds with the provisions laid down in second proviso to Rule 10B(1)(d) of the Income-tax Rules, 1962, relating to Profit Split Method.

5. The lower authorities, erred in not noticing that the above methodology is also in accordance with Paragraph 6.139 of the revised 2015 OECD transfer pricing guidelines, and Paragraph 13 of the 1979 OECD transfer pricing guidelines.

6. The lower authorities, erred in not noticing that the Comparable Uncontrolled Price (CUP) method is not the most appropriate method, particularly in the facts of the case which involves royalty for manufacturing of capital goods / assets being injection stretch blow moulding machines.

7. The lower authorities, erred in applying the CUP method, even after their own findings that the comparables are not available particularly in light of Rule 10C(2)(c) of the Income-tax Rules, 1962, and hence CUP cannot be the most appropriate method in the facts of the present case.

13. Though, the assessee has raised multiple grounds of appeal, but in our considered opinion in sum and substances the grounds of appeal

related to TP adjustment are almost identical as raised by the assessee in appeal for AY 2012-13, which we have restored to the file of AO/TPO. Therefore, following the principle of consistency, the grounds of appeal raised by assessee is also restored to the file of AO/TPO with similar directions.

14. In the result, appeal of the assessee is allowed for statistical purpose.

Order pronounced in the open court on 22/07/2019.

Sd/-	**Sd/-**
MANOJ KUMAR AGGARWAL	**PAWAN SINGH**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai, Date: 22.07.2019
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Copy of the Order forwarded to :

1. Assessee
2. Respondent
3. The concerned CIT(A)
4. The concerned CIT
5. DR "K" Bench, ITAT, Mumbai
6. Guard File

BY ORDER,
Dy./Asst. Registrar
ITAT, Mumbai