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

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

I.T.As. No.3248, 3410/DEL/2012, 5856/Del/2010, 5315/Del/2011,52/Del/2013, 1567/Del/2014, 6741/Del/2014, 868/Del/2016 & 2511/Del/2018

Assessment Years: 2005-06, 2006-07, 2007-08, 2008-09, 2009-10, 2010-11, 2011-12

Samsung India Electronics Pvt. Ltd., 3rd Floor, Tower-C, Vipul Tech Square, Sector-43, Golf Course Road, Gurgaon.	vs.	Addl.CIT, Range-7 New Delhi.
TAN/PAN: AAACS 5123K		
(Appellant)		(Respondent)

Appellant by:	S/Shri Himanshu Sinha, Shri Bhuwan Dhooper, Adv. & Ms. Vrinda Tulsan, Adv.		
Respondent by:	Shri H.K. Choudhary, CIT-D.R.		
Date of hearing:	27	09	2019
Date of pronouncement:	04	10	2019

O R D E R

PER BENCH:

The appeals in ITA Nos. 3248/Del/2012, 5856/Del/10, 5315/Del/11, 52/Del/13, 1567/Del/2014, 6741/Del/2014, 868/Del/2016 & 2511/Del/2018 have been filed by the assessee in respect of the assessment years 2005-06 to 2011-12 respectively. Whereas, the appeal in ITA No. 3410/Del/2012 is a cross appeal filed by the Revenue for the AY 2005-06. Since the issues involved in all these appeals are common therefore, we

deem it fit and convenient to dispose-off these appeals by way of this consolidated order. We will take first the appeals for the A.Y. 2005-06.

2. The appellant assessee, Samsung India Electronics Pvt. Ltd. (SIEL), is a company incorporated in India under the Companies Act, 1956 and is primarily engaged in the business of manufacture and sale of consumer electronics and home appliances goods such as colour televisions, refrigerators, air conditioners, washing machines, microwave ovens, computer peripherals etc. The appellant company is a part of the Samsung group of companies. It is 100% subsidiary of Samsung Electronics Co. Ltd. Korea ('SEC'). One common ground permeating in all the years except for the appeal for AY 2006-07 is the ground pertaining to transfer pricing adjustment made on account of advertising and marketing promotion (AMP) expenditure incurred by the appellant, which shall be dealt firstly and subsequently, all other grounds shall be taken up.

AY 2005-06

3. Facts in brief for the AY 2005-06 are that, the appellant had filed its return of income on 31 October 2005, declaring a loss of Rs. 6,35,44,316. The assessing officer referred the case to the Transfer Pricing Officer – II (2), New Delhi (TPO) for determination of the arm's length price (ALP) of the international transactions entered into by the appellant with its associated enterprises. During the relevant assessment year, appellant had entered into new numerous international transactions with various associated enterprises (AEs). These international transactions were grouped under various segments and based on a transfer pricing study,

their arm's length price were determined. A summary of the international transactions and the appellant's approach in determining their ALP is summarised in the table below: -

Nature of International Transactions	Most Appropriate Method	Profit Level Indicator	SIEL's Profit Level Indicator	Comparables Profit Level Indicator
Class I – Manufacturing (Consumer Electronics, Home Appliances & Colour Monitors) Import of raw materials Import of spare parts Export of finished goods Purchase of samples Purchase of sales promotion material	Cost Plus Method (CPM)	Gross Profit / Input Cost	33.60%	23.78%
Class II – Distribution (Consumer Electronics, Home Appliances, Monitors and other IT & Telecom Products) Import of finished goods Import of spare parts Export of spare parts Purchase of samples Export of samples Payment for packing & R&D expenses Purchase of sales promotion material	Resale Price Method ('RPM')	Gross Profit/Sales	14.48%	6.45%
Class III – Sales and Post-sales support Service Income	Transactional Net Margin Method	Operating Profit / Total Cost	20.43%	6.12%

	('TNMM')			
Class IV – Contract Software Development Software development services	Transactional Net Margin Method ('TNMM')	Operating Profit / Total Cost	15%	13%
Class V Reimbursement of expenses	Comparable Uncontrolled Price Method ('CUP')	NA	NA	NA
Class VI Payment of royalty	Comparable Uncontrolled Price Method ('CUP')	NA	NA	NA
Class VII – Miscellaneous expenses/transactions Import of capital goods and spare parts Payment of IT related fees Payment of service expenses Payment of technical assistance fees Payment for service fee, training fees etc	Comparable Uncontrolled Price Method ('CUP')	NA	NA	NA

4. The dispute in the appeals for the A.Y. 2005-06 filed by the appellant and the cross appeal filed by the Revenue pertains to the international transactions grouped under Class-I (manufacturing) segment and Class-II (distribution) segment. There is no dispute in respect of the ALP of the international transactions in Classes III, IV, V, VI and VII, which are in respect of segments pertaining to post sale support services, software development service and other miscellaneous transactions, i.e., payment on royalty and reimbursement of expenditure.

5. In respect of Class -I (manufacturing) segment, following transactions have been grouped together by the appellant in its transfer pricing study prepared under rule 10B of the Income Tax Rules 1962 (Rules);

i) Import of raw-materials;
ii) Import of spare parts'
iii) Export of financial goods;
iv) Purchase of goods on sample basis;
v) Purchase of sales promotion material;

As stated above, assessee is engaged in the manufacturing of consumer electronic goods, home appliances and colour monitors. Cost Plus Method (CPM) was chosen qua this segment as the most appropriate method in its transfer pricing study. The profit level indicator taken was taken as gross profit/input costs. For the benchmarking exercise, an economic analysis was carried out in the TP study leading to identification of 11 uncontrolled comparable companies. Since appellant had earned gross profit margin of 36.6% which was much higher than the gross profit earned by the comparable companies, hence it was reported that the international transactions in which Class-I (manufacturing) segment were at arm's length price.

6. In Class-II (distribution) segment, assessee was engaged in the distribution of consumer electronic goods, home appliances, monitors, IT products and telecom products. For this segment, Resale Price Method (RPM) was chosen by the assessee as the most appropriate method to determine the ALP with Gross Profit margin (gross profit /sales) as the profit level indicator. The economic analysis carried out on the database showed 5 uncontrolled independent comparable companies whose mean

gross profit margin arrived at 6.45%. Since the gross profit margin of the appellant in the distribution segment was higher at 14.48%, hence it was concluded that the international transactions in Class-II segment were at arm's length.

7. The transfer pricing officer (TPO) rejected the most appropriate method adopted by the assessee and discarded the CPM for Class-I (manufacturing) segment; and RPM for the Class-II (distribution) segment. As per the TPO for both the segments, Transactional Net Margin Method (TNMM) was the most suitable method for determining of arm's length price. Under the TNMM, he selected operating profit margin on revenues (OP/OR; OP = operating profit/ OR = operating revenue) as the profit level indicator for both the segments. Further, the TPO while computing the PLI of the assessee for manufacturing and distribution segments increased the quantum of operating expenditure for computing the operating profit by Rs. 142.39 crores. The aforesaid amount of Rs. 142.39 crores had been received by the assessee during the relevant financial year from its parent company as a reimbursement under an assistance agreement referred to as Marketing Development Fund (MDF) Agreement. In terms of MDF agreement, the assessee had received the assistance from its parent company to conduct certain marketing activities. This amount has been shown as reimbursement in the Form 3CEB and in the transfer pricing study report and was reduced from the expenditure shown under the head "advertisement". Accordingly, in the profit and loss account of the financial statement under head "advertisement" expenditure only the net amount was shown, though the gross amount expended for advertisement was Rs 306.38 crores, on account of reimbursement received was Rs.

142.39 crores, the net amount of Rs. 306.38 (-) Rs.142.39 crores = 163.99 crores was shown as the net advertisement expenditure. The TPO concluded that this was an erroneous approach and was of the view that the entire amount of Rs. 306.38 crores incurred under the head "advertisement" should be taken into account to compute operating profit and the operating profit margin. This approach and calculation of the TPO was based on a similar approach adopted in the prior assessment years. Accordingly, while the operating expenditure under the head advertisement was increased from Rs. 163.99 crores to Rs. 306.38 crores leading to fall in operating profit and margin, the corresponding reimbursement of Rs. 142.39 crores received from the appellant's parent company was not included as part of the revenue. Based on this approach, the operating profit margin (OP/OR) of the manufacturing segment was determined at (-) 4.34% and the distribution segment at (–) 3.5%. The TPO further proceeded to undertake a fresh benchmarking analysis of the uncontrolled comparable companies and arrived at a set of 12 comparable companies for the Class-I manufacturing segment and set of 13 comparables for the Class-II distribution segment. The arithmetic mean of the operating profit margin (OP/OR) of these comparables for the manufacturing segment was computed at 1.25%. Similarly, the profit margin of the comparables in the distribution segment was carried out at (-) 0.447%. To compute profit level indicators of the comparable companies, the TPO used multiple years' data (current and two previous years to the extent of availability of data). The margins computed by the TPO are after making adjustments on account of working capital differences. Based on the above approach, the TPO worked out an adjustment to the arm's length price of the international transactions pertaining to

manufacturing segment at Rs.112,642,9851/- which was subsequently reduced to Rs.110,586,5807/- vide an order under section 154 dated 19/01/2009. In respect of distribution segment, the adjustment to the arm's length was worked out to be at Rs. 592,809,324/- which was subsequently reduced to Rs. 572,545,869/- vide aforesaid order dated 19/01/2009.

8. The TPO also carried out a secondary analysis, with respect to the Advertisement, Marketing and Promotion ("AMP") expenses incurred by the assessee company as he was of the view that the assessee has provided certain services in respect of creation of marketing intangibles, to its AE. The TPO was of the view that any AMP expenditure incurred by the assessee over and above the average AMP spentby the comparable companies was extraordinary in nature and incurred for the benefit of the AE which owned the "Samsung" brand. The TPO worked out the average AMP spend by the comparables at 1.05% of the Sales, whereas the assessee was at 7.71% of the Sales and treated the difference as the value for the brand promotion service which the assessee had provided to its AE. He accordingly proposed that, this amount should have been recovered by the assessee from its AE. The approach followed by the TPO in respect of this adjustment was as under:

Particulars	Amount (Rs.)
Total Income (A)	39,741,026,611
Advertisement and sales promotion expenses incurred (B)	3,063,811,643
AMP / Total Income of SIEL (C) = (B)/(A)	7.7094%
Bright Line (AMP/total income of comparables) (D)	1.05%
AMP as per bright line ('E) = (A)*(D)	417,280,779

Excess Amount Spent on Advertisement as compared to the comparables (F) = (B)-(E)	2,646,530,864
Less: Reimbursement received from its parent SEC	1,423,950,954
Adjustment proposed as per secondary analysis (Rs.) on protective basis	1,222,579,910

However, no addition was made by the TPO/AO in this respect and this analysis was meant to the used if the additions made under TNMM for Class I and II were deleted in appeal. This was an alternate and without prejudice analysis given by the TPO.

10. The AO incorporated the adjustment to the ALP made by the TPO and further made the following additions to total income:-

(a) Recruitment and training expenses of Rs. 1,72,98,334 was treated as capital expenditure and not allowable as a revenue expenditure u/s 37 of the Act;

(b) Loss arising on account of fluctuation of foreign exchange currency amounting to Rs. 7,79,52,000 was disallowed as being notional and contingent in nature. Subsequently, the Ld. AO passed an order (u/s 154) dated July 24, 2009 deleting the addition made on this account;

(c) Depreciation on UPS, printers and servers was restricted to 15% as against 60% claimed by the appellant leading to a disallowance of Rs. 3,21,617.

11. The assessee being aggrieved by the orders of the TPO and AO preferred an appeal before the Commission of Income Tax (Appeals)-XXIX, New Delhi (CIT(A)) contesting the aforesaid additions made to the total income of the assessee on various grounds.

12. The CIT (A) disposed off the appeal filed by the assessee vide his order dated 27th April 2012, partly allowing the appeal on following lines:

(a) CIT (A) held that the reference made by the AO to the TPO for determination of ALP of the international transactions did not suffer from any illegality and was a valid one;

(b) The CIT(A) held that TNMM should be adopted as the most suitable method for Class I and II Manufacturing and Distribution segments;

(c) Videocon International Ltd., being functionally different, cannot be taken as a comparable for Class I Manufacturing segment because this company is engaged in backward integration and indigenous manufacturing of components. The CIT(A) in this regard relied on the order of the prior assessment year 2004-05 whereby his predecessor while examining the suitability of this company as a comparable had rejected the same for the above reason. Since there was no change of facts and circumstances, the CIT(A) has followed the prior year's order;

(d) The CIT(A) ordered the exclusion of four companies, namely, Khaitan Electricals Ltd, Hotline Teletube& Components Ltd, Samtel India Ltd and Samtel Colour Ltd. from the list of comparables for the Class I Manufacturing segment as these companies had substantial related party transactions. The value of transactions as a percentage of sales was in excess of the generally accepted limit of 15%.;

(e) In the Class II segment, the CIT(A) ordered the exclusion of Control Print (India) Ltd. from the list of comparable companies

as in the prior assessment year 2004-05 on identical facts it had been held by his predecessor that this company is functionally dissimilar to the appellant's distribution business;

(f) Similarly, another company Gemini Communication Ltd. was also held to be incomparable to the appellant's Class II distribution business on account of functionally dissimilarity. This company was found to be engaged in end to end IT solutions and provision of services;

(g) The CIT(A) held that the TPO's approach of relying on three years' average data to determine the average profit margin of the comparables was not in accordance with law and it should be restricted to only current year data. While holding so, he once again relied on his predecessor's order of A.Y. 2004-05;

(h) As regards the issue of re-computation of profit margin of the appellant by treating the reimbursement received from its AE as operating expenditure while not treating the same as operating income, the CIT(A) held the same to be unjustified. He held that this approach of the TPO had been adopted in prior assessment years as well but the same had been negated by his predecessors in A.Yrs. 2002-03 to 2004-05. By relying on these prior years' orders, he held that the reimbursement of Rs. 142.39 crores was to be treated as operating income and profit as well.

(i) The CIT(A), however, approved the secondary analysis carried out by the TPO in respect of the AMP expenditure whereby he had made a protective assessment on account of "excessive" AMP expenditure incurred by the appellant to promote the "Samsung" brand. As per the TPO, since the appellant's combined AMP expenditure for this year at 7.7% of sales was

much higher than 1.05% of sales (the three years average AMP spend by the comparables in the manufacturing and trading segments), the excess of 6.65% (corresponding to Rs. 264.65 crores) represented a brand promotion service rendered by the appellant company to its parent which ought to have been received as reimbursement under the arm's length principle. However, the TPO had not proposed any separate addition on this account as he had taken a view that the reimbursement of marketing expenditure of Rs. 142.39 crores received by the appellant did not form part of the operating income while being part of the operating expenditure. On this basis an addition of Rs. 167.84 crores wasmade by the TPO which was incorporated by the AO in the assessment year. No further addition based on the secondary AMP analysis was made by the TPO and the AO. It was stated that this was only a protective assessment which would come into effect if on appeal the primary approach was deleted. Since the CIT(A) had negated the primary approach of treating the reimbursement of marketing expenses as expenditure but not as income, he examined the alternative approach based on which protective assessment had been made and held that the alternative approach was an acceptable method of determining the ALP of the excess AMP expenditure. He held as below:

> "*Now, since the ground of appeal regarding upward adjustment of TP has been allowed by taking a view that he reimbursement of marketing expenses shall form part of operating profits, the issue of excess of advertisement expenses has to be decided separately. The AO has not made separate addition on this account because this addition already stands included in upward adjustment of TP and therefore this addition was in effect eclipsed by the addition*

made on account of TP. Now since the eclipse caused by the TP addition has been removed, the addition on account of excess advertisement expenses becomes apparent. As it is not a new addition made by the AO on account of TP, no notice of enhancement is required to be given to the appellant. The appellant has not submitted any substantial argument on this issue and has simply argued that since the products that were advertised in India were not dealt with anyone else in India therefore benefit of such expenditure enures to no one else. TPO has already taken care of this argument. TPO has worked out excess advertisement expenses by making proper comparative analysis. I therefore hold that addition on account of excess marketing expenses stands confirmed to the tune of Rs. 122,25,79,910." (Page 31 of the impugned order).

(j) The CIT(A) held that the benefit of 5% provided in the *Proviso* to Section 92C(2) is not a standard deduction and if the difference between the transfer price and ALP exceeds 5%, the whole of such difference shall be treated as an adjustment.

(k) The CIT(A) computed the profit margin of the appellant at (-) 0.64% as against the comparables mean profit margin at (-) 7.37% using current year data for the Class I manufacturing segment leading to the deletion of the TP adjustment made in this segment. Further, the margin of the Class II Distribution segment of the appellant was worked out to be 0.21% as against the mean margin of the comparables at 0.38% leading to adjustment of Rs. 3,30,33,800 in this segment. The margins were computed after giving effect to the CIT(A)'s findings on treatment of reimbursement, exclusion of certain comparables and use of current year data for the comparables.

(l) As regards the disallowance pertaining to treatment of recruitment and training expenses as capital expenditure and not revenue expenditure, the CIT(A) deleted the disallowance by

relying on the decision of its predecessor in AY 2004-05, as well as the ITAT on this issue in appellant's case for A.Y. 1998-99. The CIT(A) observed that an appeal filed against the order of the ITAT has been dismissed by the Delhi High Court on 11/01/2010. Facts being same as in earlier years, he held that these expenses are fully deductible.

(m) The CIT(A) while examining the issue of depreciation on UPS, printers and servers, observed that this issue has been decided by the Delhi High Court in favour of the assessee in the case of CIT v. BSES Rajdhani Powers Ltd. (ITA No. 1266/Del/2010). While following the same, he held that depreciation is to be allowed @60% on these items.

(n) The ground relating to disallowance on account of loss arising from fluctuation of foreign currency was not pressed by the appellant as the AO had amended the assessment order dated July 24, 2009 u/s 154 to allow the claim of this loss.

13. Aggrieved by the order of the CIT (A), the assessee and Revenue have preferred the present appeals for AY 2005-06. The issues involved in all the appeals from AYs 2005-06 to 2011-12 are though several, however, one common issue permeating in all the appeals (i.e. AY 2005-06, 2007-08 to 2011-12), except for AY 2006-07, pertains to the transfer pricing adjustment on account of AMP expenditure which we will deal firstly, as it is one of the core issues contested by the parties before us. The remainder of the issues shall be dealt with appeal wise subsequently in this order.

Adjustment made in respect ofAdvertising and Marketing Promotion (AMP) Expenditure involved in Assessee's appeals for AY 2005-06 (Ground No. 3.1 to 3.6); 2007-08 (Ground No. 1.1 to 1.3); 2008-09 (Ground

No. 2.1 to 2.12); 2009-10 (Ground No. 1 to 12); 2010-11 (Ground No. 1 to 11); and 2011-12 (Ground No. 2 to 12)

14. Grounds 3.1 to 3.6 taken by the appellant in its appeal for AY 2005-06 are as below:

> **GROUND NO. 3.1:** *The AO/CIT(A) has erred by not providing reasons for rejecting the analysis undertaken by the appellant for benchmarking the international transaction pertaining to reimbursement of advertisement expenses.*
>
> **GROUND NO. 3.2:***The CIT(A) has erred in not providing an opportunity of being heard to the appellant and mechanically accepting the secondary analysis (of determining the arm's length price of marketing intangibles) undertaken by TPO in respect of reimbursement of advertisement expenses, thereby failing to pass a speaking order.*
>
> **GROUND NO. 3.3:** *The AO/CIT(A) has acted in excess of jurisdiction assigned under the Indian transfer pricing regulations by analyzing the advertisement expenditure of the appellant, in plain disregard of the fact of the same, being a domestic transaction undertaken by the parties, does not fall under the purview of Section 92 of the Act.*
>
> **GROUND NO. 3.4:** *The AO/CIT (A) has erred in concluding that the appellant has incurred excess advertising expenditure vis-à-vis comparable companies and should have accordingly, been reimbursed for the same.*
>
> **GROUND NO. 3.5:** *The AO/CIT (A) has erred in not appreciating that the advertisement expenditure was incurred exclusively for promotion of products of the appellant in India and was in the nature of business expenditure allowable as deduction.*
>
> **Ground NO. 3.6:** *The CIT(A) has erred in upholding the secondary analysis undertaken by the TPO when the arm's length price of the appellant's transactions with the AEs have already been tested under the transactional net margin method.*

The grounds and issues pertaining to AMP taken up by the appellant in other AYs are similar and are not being reproduced herein for the sake of brevity.

15. From AY 2005-06 to AY 2011-12 (except for AY 2006-07), the TPO has made similar adjustments on account of AMP expenses incurred by the assessee as he was of the view that the assessee had provided certain services in respect of creation of marketing intangibles to its AE. The TPO held that any AMP expenditure incurred by the assessee over and above the average AMP spend of the comparable companies (referred to as the "Bright Line" Test) was extraordinary in nature and incurred for the benefit of the AE which owned the "Samsung" brand. In AY 2005-06 (as in other years), the Ld. TPO applied the Bright Line Test (BLT) and worked out the average AMP spend of the comparables at 1.05% of Sales and that of the Appellant at 7.71% of Sales and treated the difference as the value of the service which the Appellant had provided to its AE. He accordingly held that the excess amount should have been recovered by the appellant from its AE and made an addition of Rs. 122,25,79,910/-.

16. Similar additions were made by the TPO for AY 2007-08 to AY 2011-12, wherein the TPO applied the BLT to benchmark the AMP expenditure.In AY 2007-08, the TPO made an addition on account of excess AMP expenditure of Rs. 131,13,25,080/- after applying a mark-up of 12%. In AY 2008-09, the TPO proposed an adjustment of Rs.454,94,35,445/- which was revised to Rs. 48,40,26,768/- by the Dispute Resolution Panel (DRP). In AY 2009-10, the TPO worked out the average AMP/Sales of the comparables at 3.66% as against 9.19% in the case of the Appellant (rectified to 9.03% of sales vide rectification order dated 06 March 2013) and considered this difference as the value of the service which the Appellant had provided to its AE and he proposed an adjustment of Rs. 455,53,39,101/-. In AY 2010-11,

the TPO proposed an adjustment of Rs.740,15,52,834/- (Rs. 102,15,61,275/- under the IT business and Rs. 637,99,91,559/- under the Non-IT business) with respect to AMP expenses. In AY 2011-12, the TPO proposed an adjustment of Rs.1188,41,38,456/- (Rs. 122,22,38,922/- under the IT business and Rs. 1066,18,99,534/- under the Non-IT business) which was reduced to Rs. 39,43,68,561/- (i.e. Rs. 31,31,05,771/- under the non-IT segment and Rs. 8,12,62,790/- under the IT segment) by the Ld. DRP.

17. On this issue, the Ld. Counsel for the appellant assessee right at the onset submitted that the approach adopted by the TPO and the CIT(A) in respect of the AMP expenditure has come to be known as the "Bright line test" which has been subject matter of extensive litigation before the ITAT and the High Courts. The Special Bench of this Tribunal in the case of ***L.G. Electronics [2013] 140 ITD 41*** had approved this approach and had held that excessive expenditure could be treated as a separate international transaction that could be subjected to arm's length exercise on its own. While holding so, the Special Bench had laid down extensive guidelines to determine the value of the international transaction and the ALP of the same. Subsequently, the Hon'ble Jurisdictional Delhi High Court in the case of ***Sony Ericsson [2015] 374 ITR 118***has held that the "Bright line test" was not a valid test of determining the ALP of the AMP transaction as it was not statutorily mandated. The High Court further laid down numerous guidelines and principles to determine the ALP of AMP transaction. Subsequent to this the Hon'ble Delhi High Court expanded the jurisprudence in this regard in the cases of ***Maruti Suzuki [2016] 381 ITR 117***, ***Whirlpool [2016] 381 ITR 154*** and ***Bausch &***

Lomb [2016] 381 ITR 227 by holding that existence of an international transaction merely on the ground of excess AMP expenditure cannot be presumed. It has to be shown to be existing based on mutual understanding or arrangement between the assessee and its associated enterprise. The Court further held AMP was a function and not a transaction.

18. It was also pointed out by the Ld. Counsel that Sony Ericsson's case (supra) was a batch of appeals dealing with assessees who were distributors; and the subsequent decisions of Maruti Suzuki and Whirlpool (supra) dealt with manufacturers and the two categories of assessee's stand on a different footing. The licensed manufacturers who operate as risk bearing entities cannot be examined under the so-called AMP framework as their investments in manufacturing and marketing are fully reflected in their profit margins and there cannot be a segregation of returns on manufacturing and returns on marketing as both go hand in hand and are inextricably linked. When goods are manufactured and marketed by the same Indian entity, it would be illogical for the Revenue to contend that such an entity should be treated in the same manner as an Indian distributor which distributes goods imported from a foreign manufacturer under a brand owned by an AE on the ground that by incurring "excessive" AMP expenditure, the brand-owner AE stands to gain at the expense of the Indian entity.

19. He submitted that Samsung is a globally well-known name in consumer goods industry and the strength of the brand enhances the sale of consumer goods by it in India, while competing with other domestic and global brands operating in the

Indian market. It is the assessee, an Indian Company, who is actually benefitted by being able to exploit the license for the use of brands granted by the licensor. Had the taxpayer sold these goods under an unknown brand name, products could not have stood in competition against other reputed brands in the market. The primary benefit is of the assessee who is selling the goods in India and the benefit obtained by the licensor is only incidental. As per the Ld. Counsel, after the decisions of Maruti Suzuki, Whirlpool and Bausch & Lomb (supra), there is no room for any confusion regarding the treatment of AMP expenditure as a separate international transaction. The Hon'ble Delhi High Court in these decisions has categorically held that for an international transaction to exist within the meaning of Section 92B, the Revenue has to show that there existed an agreement or understanding or arrangement, that the Indian entity would incur AMP expenditure for or on behalf of the AE which owns the brand. In the absence of such "action in concert", no international transaction can be said to exist. If the existence of international transaction cannot be established with any degree of certainty, the question of determining the ALP of the same would not arise.

20. The same principle has been upheld in numerous other judgments of the Delhi High Court as cited below:-

- Goodyear India Limited (ITA 77/2017 & CM Nos. 3072-73/2017, ITA 78/2017 & CM Nos. 3074-75/2017, ITA 79/2017 & CM No. 3076/2017)
- Amadeus India Pvt. Ltd. (ITA 154/2017)
- Casio India Company Private Limited (ITA 309/2016)
- Maruti Suzuki India Ltd (ITA No. 110/2014)

- Whirlpool of India Ltd. (ITA No. 610/2014)
- Honda Siel Power Products Ltd.(ITA No. 127/2017 & CM Nos. 4906-4907/2017 & 346/ 2015)
- Bausch & Lomb Eyecare India Pvt. Ltd. (ITA No. 643/2014).

21. The Ld. Counsel vociferously argued by applying the aforesaid principles in the instant case, where there was a marketing assistance agreement between the assessee and its parent under which it had received an assistance to the tune of Rs. 142.39 crores (in A.Y. 2005-06 and varying amounts in other years under appeal) for the marketing activities it had conducted, this reimbursement received under the MDF agreement was duly disclosed by the appellant in the list of international transactions in Form 3CEB and further its arm's length price (ALP) was also justified using Comparable Uncontrolled Price (CUP) method. The same has not been disputed by the TPO in any manner. These reimbursements are in respect of specific third party costs incurred for advertising and marketing undertaken by the appellant after obtaining the approval of the AE under a pre-agreed budget. He drew our attention to the relevant clauses of the MDF agreement under which the reimbursements were received. Accordingly, he submitted that as per the relevant terms of the MDF agreement, the assessee obtains prior approval under a capped budget set by the AE. It is a pure assistance or subsidy received by the appellant and does not arise from a service rendered by the appellant. The appellant as a matter of right cannot demand this assistance. The AE in its own discretion determines the annual budget and approves specific marketing activities for the appellant. Therefore, the only international

transaction with an ascertainable price is limited to the reimbursement received by the appellant under the MDF agreement. Not even a single rupee beyond the amount received as reimbursement can be treated as an international transaction.

22. The Ld. CIT (DR) Mr. Chaudhary, on the other hand, argued that the existence of the MDF agreement between the appellant and the AE clearly demonstrated that there existed an understanding between the two parties that AMP expenditure would be incurred by the appellant on behalf of the AE for the promotion of the brand owned by the AE. He further argued that on account of this agreement, the value of this international transaction cannot be limited to the amount of reimbursement received (Rs. 142.39 crores for AY 2005-06) but extended to the entire quantum of AMP expenditure incurred by the appellant during the year (Rs. 306.39 crores for AY 2005-06). He referred to the terms of the MDF agreement which provided for assistance in respect of marketing activities pertaining to the "Samsung" brand in print and electronic media. These obligations, in his view, showed that the appellant was acting in concert with its AE in respect of the brand promotion in India.

23. In rejoinder, the Ld. Counsel, Mr. Sinha submitted that it is an admitted position of the assessee that there is an understanding or arrangement under the MDF agreement in respect of AMP expenditure. However, such a transaction or arrangement is strictly limited to the value of reimbursement (Rs. 142.39 crore) received by the appellant under the agreement. These reimbursements have been received against pre-approved invoices under a budget/cap stipulated by the AE at the beginning

of the year. There is no tangible material or evidence to show that even a rupee beyond this amount was spent under an understanding or arrangement or action in concert with the parent AE. As per the ratio of Maruti Suzuki, Whirlpool (supra) and other decisions, no presumption can be made about the existence of an international transaction. It was also pointed out that the appellant has no right to demand any assistance or subsidy beyond the amount agreed under the MDF. In the absence of any such right, the value of the international transaction cannot be extended beyond the reimbursement amount which has already been disclosed in the list of international transactions in Form 3CEB. The Ld. Counsel then strongly relied upon the Sony Ericsson (supra) decision of the Hon'ble Delhi High Court where Bright line test has been categorically rejected by the Court as a method of determining the ALP of the AMP transaction. He drew the attention of the Bench towards Paras 127 and 135 of this decision to contend that it was not open for the Revenue to make a comparison of the average AMP expenditure of the comparable companies to arrive at a bright line of AMP expenditure beyond which it is presumed that the expenditure is for a service rendered to the brand-owing AE.

24. The Ld. Counsel also pointed out that even the official position of the Govt. of India in respect of the bright line test has changed as is evident from the India Chapter of the UN Transfer Pricing Guidelines. In the said chapter which contains the official position of the Indian Govt. on marketing intangibles, it has been clearly stated that instead of applying the bright line test, it would be better to focus on the marketing function of the Indian entity vis-a-vis the comparables chosen for benchmarking. He further

contended that the Hon'ble Delhi High Court in the decisions of Maruti Suzuki, Whirlpool (supra) and others has recognised the fact that AMP expenditure are incurred in respect to third party costs insofar as these represent amounts paid or payable to unrelated parties (media houses, advertising agencies, marketing bodies etc.) and cannot be treated as related party transactions merely because some incidental benefit is said to accrue to the AEs.

24. The Ld. Counsel also made a without prejudice argument regarding the quantum and composition of AMP expenditure taken by the TPO. The TPO while determining the value of international transaction of AMP and its ALP has taken into account expenditure which is purely selling and operational expenses and have no nexus with brand promotion or advertising in any manner. These expenses include purely operational expenses incurred in connection with dealers and sales promotion. The Hon'ble Delhi High Court in Sony Ericsson (supra) has held that selling costs cannot form part of the AMP transaction. Only those expenses which related to promotion of brand and advertising of brand can be taken. Sales related costs like dealer commission, discounts, sales promotions and trade event expenditures cannot be taken as part of the advertising costs. In this case, the TPO and the CIT (A) have erred in not distinguishing between the sales and brand promotion costs leading to a distorted picture. It was accordingly submitted that if at all the AMP expenditure was to be permitted to be taken as a separate international transaction, the value and ALP of the same has to be limited to the brand promotion related expenses and should exclude selling costs.The Ld. Counsel also submitted that for AYs 2007-08 to 2010-11, the

TPO has also erroneously considered rebates & discounts, in addition to sales promotion and selling expenditure, as a part of AMP. Further, the TPO himself for AY 2005-06 & 2011-12 did not include rebates and discounts as part of AMP. In this respect, the he contended that 'Rebates and discounts' and expenses in connection with sales do not lead to brand promotion and cannot be attributed to brand promotion as they represent 'point of sale' expenses.

25. The Ld. CIT(DR) in his reply contended that even selling costs should be included within the ambit of AMP expenditure as even these costs lead to creation of "marketing intangibles". In his view, the concept of marketing intangibles is wider than that of brand promotion and includes within its ambit marketing network, dealer and customer relationship and therefore all kinds of selling expenses should also form part of the AMP expenses.

26. By way of rejoinder, Ld. Counsel submitted that this issue is no longer *res integra* as the Hon'ble Delhi High Court in Sony Ericsson and the Special Bench in LG Electronics (supra) have decided this issue in a categorical manner in favour of the assessee by holding that it would not be fair and logical to include selling costs within the ambit of the AMP expenditure. A break-up of the total AMP expenses (operational and promotional expenses) for AY 2005-06, 2007-08 to 2011-12 was also submitted.

27. On the issue of application of Transaction Net Margin Method, the Ld. Counsel submitted that the Hon'ble Delhi High Court in Sony Ericsson (supra) has held that, once the profit margin of the manufacturing and distribution segments are tested

under TNMM, all the international transactions which are clubbed in the segment stand fully covered by the TNMM analysis. In such a situation, it would be illogical and incongruous to treat AMP expenditure as a separate transaction and subject the same to a Bright line test on a stand-alone basis. Under TNMM, the net margin of the segment is tested and since the net margin is computed after taking into account the entire AMP expenditure, the impact of AMP is fully captured in the TNMM analysis. Furthermore, he argued that the TPO has changed the comparables used in the TNMM benchmarking analysis which implies that he has applied his mind on the comparability of the companies chosen for the comparison under TNMM. The TPO not only had changed the comparables but had also changed the method of computation of the profit level indicator. The CIT (A) further had an occasion to examine both the aspects and has given his clear findings on both these aspects. Once the TNMM analysis has been subject matter of analysis at the hands of TPO and the CIT (A), it would serve no purpose in segregating the AMP expenditure as a separate transaction at this stage of second appeal.

28. The Ld. CIT (DR) submitted that despite having examined all the international transactions in a bundled manner under TNMM, the Ld. TPO and Ld. CIT (A) are justified in subjecting the AMP transaction to a Cost Plus Method on a standalone basis, because this expenditure has been incurred to benefit the brand "Samsung" which is owned by the Appellant's parent company and no remuneration for this brand promotion service has been received.

29. The Ld. Counsel then submitted that the Revenue has grossly erred in equating AMP expenditure with brand building and in alleging that "excessive" AMP expenditure beyond the bright line is a brand promotion service. He submitted that brand is a capital asset and it would be fallacious to treat any and all AMP expenditure as leading to brand building. Brand-building leads to enhancement of value of the brand and benefits the brand owner as much as it helps the brand-exploiter like a licensed manufacturer or a distributor. Brand-building is in the realm of capital and brand-promotion targeted towards sale of goods or services is in the realm of revenue transactions. Therefore, any distributor or licensed manufacturer like the assessee which incurs AMP expenditure for promoting the sales of its goods is not guided by the motive of enhancing brand value but purely by enhancing its sales. Increase in brand value happens slowly over a long period of time and there is no correlation between AMP expenditure and brand value. This is because brand value depends on numerous factors, most of which are not linked with AMP expenditure. The most important component of a brand is its reliability and quality and the reliability and quality of goods are not linked with AMP expenditure but on other expenses like R&D, quality control, after-sales services, customer services etc. AMP expenditure incurred by SIEL being revenue expenditure cannot be treated as contributing towards enhancement of value of the brand owned by the AE. There can be situations where AMP expenditure incurred by an Indian affiliate leads to enhancement of value of brand owned by an AE over a long period of time, but such a relationship cannot be presumed to exist for every assessee and for every year. It has to be specifically demonstrated that brand value has gone up over a long period of time and a portion of this

enhancement is attributable to successful AMP campaigns conducted by the Indian affiliate. Even in these situations, the benefit to the brand owner AE has to be treated as incidental and not a guiding force for the AMP expenditure incurred by the Indian assessee. The Ld. Counsel further submitted that if an assessee exercises long-term distribution and long-term licensing manufacturing rights, it is implicit that any investment in AMP whether high or low is towards its own sales. The return on investment is expected to be reaped over a period of time as SIEL as an exclusive distributor/licensed manufacturer in India is alone entitled to benefit from this investment.

30. The Ld. Counsel submitted that empirical and scholarly studies have shown that within a sector or industry there is huge variation of AMP expenditure among competitors. Various competitors place differing levels of importance on advertising and brand promotion depending upon their understanding and belief regarding the impact of advertising on sales. Empirical studies have shown that there is no positive correlation between advertising and increase in sales and no specific return on investment (ROI) can be inferred in respect of expenditure incurred on advertisement. To support this proposition he referred to a scholarly article authored by Justin M. Rao of Microsoft and Randall A. Lewis of Google titled "The Unfavourable Economics of Measuring the Returns to Advertising" published in The Quarterly Journal of Economics (2015) 1941-1973, Oxford University Press which contains a rigorous analysis of correlation between advertising spend and increase in sales. The conclusion drawn in this article is that it is not possible to quantify the extra sales that can be generated based on incremental AMP spend. It also

contains empirical data showing wide variation of AMP spend among competitors in the same sector or industry. Based on the above, it has been submitted that it is not possible to determine the impact of increased intensity of advertising function on profit margin, because the impact of advertising on sales cannot be determined and quantified. In the absence of a quantifiable measurement, it is not possible to make a "reasonably accurate" adjustment to the profit margins of the comparable companies as mandated under law.In view of the above, it was submitted that it would be erroneous to treat AMP as a separate international transaction and any attempt to benchmark such an imaginary transaction in any manner (whether as bundled transaction or on a stand-alone basis) would be an exercise in futility.

31. In his reply, the Ld. CIT (DR) fairly conceded that "bright line" test is no longer a valid and legal way of determining the existence of an international transaction pertaining to "excessive" AMP expenditure. However, he emphasised that in terms of the principles laid down by the Hon'ble Delhi High Court, existence of an international transaction in respect of AMP expenditure can be shown to exist if there is an arrangement between the assessee and its brand-owning AE to carry out brand promotion activities in India. He submitted that in the present case, the facts show that such an arrangement exists by way of an agreement (MDF agreement) between the Appellant and its AE. In this respect, he relied upon the ruling of this Tribunal in the case of **BMW India (P.) Ltd. v. DCIT [2017] 190 TTJ 717 (Delhi – Trib.),** wherein the question of AMP being an international transaction has been decided against the assessee and the determination of the ALP of the same has been remanded to the TPO in view of the principles

laid down in Sony Ericsson decision of the High Court (supra). In this case, in an agreement between BMW India and its AE BMW Germany, it was found that the BMW India represented the interests of BMW Germany. It was found that BMW India was responsible for the sale promotion and full utilization of the market potential for the Contract Goods in India. Further, it was found that BMW India undertook the performance of adequate advertisement and sales promotion as well as public and media relations activities for BMW Germany and not on its own volition. Under these circumstances, it was held that there is an Agreement between BMW India and BMW Germany for promoting BMW brand in India which constituted an international transaction. He further submitted that even in the present case there is an agreement between the assessee and its AE whereby the assessee is undertaking marketing and advertising activity at an extensive level and this activity is being carried out at the behest of the AE and the brand development benefit is solely derived by the AE itself. Such an arrangement, in his view, can be inferred from the terms of the agreement and the conduct of the assessee.

32. The Ld. Counsel for the Appellant in his rejoinder submitted that in the present case, there is no clause in the MDF agreement between the assessee and its foreign AE which shows that the assessee represented interests of the foreign AE in India. Further, the assessee has already disclosed the reimbursement of Rs. 142.39 crores in its Form 3CEB as an international transaction and has justified its ALP in the TP report using CUP method for AY 2005-06. Similar disclosures have been made in other years as well. The amount reimbursed is in the nature of assistance received against specific pre-approved invoices under a capped

budget specified in advance. The value of this international transaction cannot be extended or stretched beyond the amount reimbursed because the understanding between the appellant and its AE is limited to Rs. 142.39 under the terms of the MDF agreement itself. Accordingly, it was not possible to rely on this agreement to argue that the entire AMP expenditure (or the amount beyond the so-called bright line) be treated as a separate international transaction. It was also submitted that the Hon'ble Delhi High Court in the case of Whirlpool (supra) has held that a mere agreement providing for the involvement of the AE in the AMP function of an Indian assessee cannot be treated as a reason for presuming the existence of an international transaction. There has to be a clear common understanding or action in concert in respect of the AMP expenditure in India as being incurred at the behest or instance of the foreign AE.

33. The Ld. Counsel further relied on the following decisions of the Tribunal where existence of an international transaction of AMP expenditure has been negated:

- Nippon Paint India (P) Ltd v ACIT: [2017] 79 taxmann.com 8 (Chennai-Trib)
- Widex India (P)Ltd v ACIT: [2017] 78 taxman.com 348 (Chandigarh-Trib)
- MSD Pharmaceuticals(P) Ltd v ACIT: 2017] 88 taxmann.com 54 (Del-Trib)
- Philips India Ltd v ACIT: [2018] 90 taxmann.com 357 (Kolkata-Trib)
- CIT v Johnson & Johnson Ltd: [2017] 80 taxmann.com 269 (Bombay HC)

- ACIT v Colgate Palmolive (India) Ltd: ITA No. 6073/Mum/2014 (Mum-Trib).

34. The Ld. Counsel on a without prejudice basis, submitted that the Ld. TPO in AYs 2007-08 to 2011-12 has added a mark-up on the excess AMP expenses. He submitted that no mark-up must be charged on the same as the consumer electronics and IT hardware industry is highly competitive in nature, featured by aggressive marketing strategies undertaken by various players in the industry due to various factors such as price sensitivities, different preferences in urban and rural markets etc. to create/retain the customer base. It is extremely important for the players in this industry to undertake such strategies to create/maintain their market position. He contended that payments made to third parties such as advertisement agencies, printing press etc. should be excluded from the cost base while computing a mark-up and the same does not reflect the value addition/ efforts of the assessee and are merely third-party costs. In this regard, he has placed his reliance on ITAT decision in the case of **Cheil Communications India Private Limited (2011) 46 SOT 60.**

Protective Assessment in AY 2005-06

35. As regards the approach of the TPO to make a "protective assessment", the ld. Counsel submitted that such an approach is impermissible in law. Protective assessment cannot be made in the hands of the same assessee on an alternative basis. It has a limited application to cases where a single item of income is assessed in the hands of two distinct persons as the identity of the

real owner of income is not known or is not clear. In this regard he relied on the decision of the ITAT in the case of ***MSD Pharmaceuticals (P.) Ltd. v. ACIT [2018] 191 TTJ 702 (Delhi – Trib.).***The Ld. Counselalso placed reliance on the decision of Hon'ble Supreme Court in the case of ***Lalji Haridas v Income Tax Officer: [1961] 43 ITR 387*** wherein it was held that protective assessment can only be made in respect of two separate entities to ensure that income does not escape taxation. Ld. CIT(DR) relied on the order of the lower authorities.

DECISION

36. We have heard the rival submissions, perused the relevant findings given in the impugned orders as well as material referred to before us in respect of transfer pricing issue pertaining to AMP adjustment made by the TPO. We have already discussed in detail, the brief facts and background of the cases in the light of the material on record and as captured in the arguments placed by the parties. From the discussion made above, we will deal with various issues relating to AMP adjustment. The first issue for our consideration is:-

> *Whether AMP expenditure incurred by the assessee during the year is an international transaction? In the present context can the value of the AMP transaction be extended or expanded beyond the amount received as reimbursement under the MDF agreement*?

37. First of all, if assessee is a full fledged risk bearing manufacturer and is carrying out sales through the territory of India on its own with all the risks and rewards, then in our opinion, AMP expenditure incurred by an assessee is

demonstrative of its marketing and advertising function. This function is carried out by the assessee with the intention of driving its sales in India and resultant profit and loss. AMP expenditure incurred is meant to aid and facilitate the main sales function. The question before us is that, whether this function can be characterized as a transaction which falls under the ambit of an "international transaction" u/s 92B of the Act. Ordinarily, AMP expenditure is manifested in the form of third-party transactions by way of payments for advertisement and brand promotion activities. These transactions cannot *per se* partake the character of an "international transaction" within the meaning of Section 92B unless the conditions laid down in the provision are met. Section 92B covers transactions between AEs having cross-border element (i.e., involving a non-resident). Section 92B also contemplates existence of international transactions where the parties are not related to each other and don't qualify as AEs under Section 92A of the Act. These situations are those where though in form the transaction is entered into between unrelated parties the substance of the same is governed by an understanding or arrangement between AE of one party with another enterprise.Therefore, for any transaction of AMP entered into between the assessee and another enterprise which is not an AE u/s 92A of the Act, this understanding or arrangement has to be shown to exist. If the assessee denies having any such arrangement or understanding with its AE or when there is no apparent material on record to show that there exists any agreement, arrangement or action in concert between the two related parties, the onus rests on the Revenue to demonstrate the same before it can apply the provisions of Chapter X on the AMP expenditure. In the present case, the only ground on which the Ld.

TPO and the Ld. DRP have concluded that the AMP expenditure constitutes an "international transaction" is the "excessive" quantum of expenditure which is stated to be much above the "bright line" of the average AMP spend of the comparable companies. This approach, to our mind, is contrary to law and untenable.

38. Our view is bolstered by the various decisions of the Hon'ble Delhi High Court and coordinate benches of this Tribunal in this regard. In **Whirlpool of India Ltd. v. DCIT (2016) 381 ITR 154 (Del),** the following relevant principles have been laid down by the Court which have been reiterated/followed in other decisions as well:

(a) Sections 92B to 92F contemplate the existence of an international transaction as a pre-requisite for commencing the TP exercise. The Court observed that "*to begin with there has to be an international transaction with a certain disclosed price. The TP adjustment envisages the substitution of the price of such international transaction with the ALP*". (Para 33).

(b) The Court went to hold that, "*the TP adjustment is not expected to be made by deducing the difference between the excessive AMP expenditure incurred by the Assessee and the AMP expenditure of a comparable entity that an international transaction exists and then proceed to make the adjustment of the difference in order to determine the value of such AMP expenditure incurred for the AE. It is for this reason that the Bright line test has been rejected as a valid method for either determining the existence of international transaction or for the determination of ALP of such transaction. Although, under*

Section 92B read with Section 92F(v), an international transaction could include an arrangement, understanding or action in concert, this cannot be a matter of inference. There has to be some tangible evidence on record to show that the two parties have "acted in concert"". (Paras 34-35).

(c) The Court cited the Supreme Court decision of Daichi Sankyo v. J. Chiguripati (Civil Appeal No. 7148 of 2009) to emphasize that "action in concert" would necessarily entail a "shared common objective or purpose" between two or more persons. In the absence of such shared objective or purpose, no presumption of a transaction can be made.

(d) As regards the onus to show the application of TP provisions, the Court held that "*initial onus is on the Revenue to demonstrate through some tangible material that the two parties acted in concert and further there was an agreement to enter into an international transaction concerning AMP expenses*". (Para 37).

(e) As regards the presumption for imposing a transfer pricing adjustment in relation to AMP, the Court held that *"37. The provisions under Chapter X do envisage a 'separate entity concept'. In other words, there cannot be a presumption that in the present case since WOIL is a subsidiary of Whirlpool USA, all the activities of WOIL are in fact dictated by Whirlpool USA. Merely because Whirlpool USA has a financial interest, it cannot be presumed that AMP expense incurred by the WOIL are at the instance or on behalf of Whirlpool USA."* (Para 37)

(f) There is no machinery provision in the Act to bring an international transaction involving AMP expense under the ambit of transfer pricing provision if it cannot be shown that such an international transaction was entered into by the

assessee. In Court's words, "*It is in this context that it is submitted and rightly by the Assessee that there must be a machinery provision in the Act to bring an international transaction involving AMP expense under the tax radar. In the absence of clear statutory provision giving guidance as to how the existence of an international transaction involving AMP expense, in the absence of an express agreement in that behalf, should be ascertained and further how the ALP of such a transaction could be ascertained, it cannot be left entirely to surmises and conjectures of the TPO.*" (Para 39). The Court further held that after the invalidation of the Bright line test by the Delhi High Court in Sony Ericsson (supra), existence of an international transaction of AMP expenditure has to be established de hors the Bright line test.

39. It is also pertinent that the Hon'ble Court further held that as per the principles laid down by the Apex Court in ***CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC)*** and ***PNB Finance Ltd. v. CIT [2008] 307 ITR 75 (SC)***, in the absence of a machinery provision, bringing an imagined transaction to tax is not possible. If such a transaction with an ascertainable price is not shown to exist, Chapter X cannot be invoked. The aforementioned principles have also been applied by the Hon'ble Delhi High Court in the case of ***Valvoline Cummins Private Ltd. (ITA 158/2016)*** *wherein the Court observed as below:*

"17……. The mere fact that the Assessee was permitted to use the brand name 'Valvoline' will not automatically lead to an inference that any expense that the Assessee incurred towards AMP was only to enhance the brand 'Valvoline'. <u>The onus was on the Revenue to show the existence of any arrangement or</u>

agreement on the basis of which it could be inferred that the AMP expense incurred by the Assessee was not for its own benefit but for the benefit of its AE. That factual foundation has been unable to be laid by the Revenue in the present case. On the basis of the existing record, the TPO has found no basis other than by applying the BLT, to discern the existence of international transaction. Therefore, no purpose will be served if the matter is remanded to the TPO, or even the ITAT, for this purpose."

40. Therefore, the argument advanced by the Ld. CIT (DR) that the MDF Agreement should be viewed as an evidence to demonstrate the existence of an understanding and arrangement to carry out AMP in India at the behest of the AE needs to be examined in light of the above principles laid down by the Delhi High Court. In the present facts, we find that this transaction of having received assistance /reimbursement has already been shown by the assessee in its Form 3CEB as an international transaction. It has been contended by the Revenue that by virtue of this agreement, the entire AMP expenditure incurred by the assessee should be treated as an international transaction and subject to the provisions of Chapter X of the Act.

41. We find that the Appellant-assessee has entered into an understanding with its AE in respect of a portion of the AMP expenditure by way of the MDF agreement. Under this agreement, the AE of the assessee gives assistance to the assessee for carrying out certain advertising and marketing activities in India. Varying amounts have been received by the assessee from its AE under this agreement as reimbursements in all the assessment years impugned before us. The amounts received as assistance under this agreement in all these years have also been indisputably

disclosed and explained in the Form 3CEB and in the TP study. The question that requires our adjudication is whether by virtue of this agreement, the so-called "excessive" AMP expenditure of the assessee (which is much higher than the assistance received under the MDF agreement) can be treated as an international transaction u/s 92B. For this we need to advert to the terms of the MDF agreement. Relevant clauses of the MDF agreement applicable for A.Y. 2005-06 (the agreements pertaining to other years are materially similar) are extracted as below:

"Marketing Fund Agreement

THIS AGREEMENT made and entered into this 1st day of January, 2004 by and between Samsung Electronics Co., Ltd., a corporation duly organized and existing under the laws of the Republic of Korea, having its head office at Samsung Main Bldg, 250-2Ka Taepyung-Ro, Chung-Gu, Seoul, Korea (hereinafter referred to as "SEC") and Samsung India Electronics a corporation duly organized and existing under the laws of INDIA, having its principal office at 3rd, IFCI Tower, Nehru Place, New Delhi, INDIA (hereinafter referred to as "DISTRIBUTOR")

Article 1. Purpose

1.1 The objectives of this Agreement are to provide for terms and conditions of the Marketing Fund activities as set forth in Article 4.3 which shall be carried out by DISTRIBUTOR on behalf of SEC in the territory to further enhance Samsung corporate and brand images therein.

1.2 The Marketing Fund shall mean a strategic fund specifically reserved by SEC to support activities for upgrading corporate and brand images in the target markets and developing new opportunities to promote the sales of the target products therein.

Article 4. Scope of Reimbursement

4.1 The amount of reimbursement shall be the actual Marketing Fund related expenses DISTRIBUTOR incurs to carry out the pertinent activities as specified in Article 3 and 4.3 for the term of this Agreement and the yearly total amount of such reimbursement shall be limited to USD 30,000,000 assigned by SEC.

4.2 DISTRIBUTOR shall submit to SEC a detailed implementation plan pursuant to the annual Marketing fund schedule in writing at least two weeks in advance of the proposed implementation date for approval of said activities. DISTRIBUTOR shall be entitled to claim a reimbursement for the expenses hereof only when execution of such activities are pre-approved by SEC in a manner stated herein.

4.3 The extent of the Marketing Fund related activities to be reimbursed shall be limited to the following:

Category	*ACTIVITIES*
Advertising	*Broadcast media, print media, outdoor ad.* *Sponsor, intent ad PR*
Marketing infrastructure	*Market research, consulting, market data subscription database* *Other marketing infrastructure activities*
Promotion	*Sales promotion activities* *Dealer support activities (dealer convention, product training, incentive tour)* *Exhibition, trade, roadshow* *Sales kit and POP materials*
Shop display	*Samsung shop corner* *Rack & shop light box* *Other store display activities*

A perusal of the aforesaid terms of the MDF agreement shows that the reimbursement of a portion of the advertising and marketing expenditure incurred by the assessee by its AE is on a pre-approval basis and under an annual budget decided solely by the AE. The nature of reimbursement received is a form of assistance or subsidy and does not arise on account of any service rendered by the assessee. There is no obligation on the AE to approve any particular item of expenditure. It is solely on its own volition that the AE determines the activity it wants to finance/reimburse/assist. Therefore, it is not possible to infer the

existence of an international transaction beyond what has been reimbursed.

42. In a similar situation, coordinate Bench of this Tribunal has examined the issue of existence of an "international transaction" in the case of **PepsiCo India Holdings Pvt. Ltd. v. Addl. CIT** (I.T.As. No. 1334/CHANDI/2010, 1203/ CHANDI /2011, 2511/DEL/2013, 1044/DEL/2014 & 4516/DEL/2016) where the assessee, an Indian company had reimbursed a portion of the sponsorship expenditure (for international cricket events) incurred by the AE for the benefit of certain group companies including the assessee. The Revenue had contended that by virtue of this reimbursement the entire AMP expenditure of the assessee should be treated as an international transaction and subject to determination of arm's length price under Chapter X of the Act. This view was categorically repelled by the Coordinate Bench by observing as below:

> *"52……. In any case, if at all, ALP was to be determined then it should have been strictly circumscribed to the reimbursement of the cost aggregating to Rs.33,60,15,501/-. Further, the transaction of reimbursement of expenditure of Rs.33,60,15,501/- cannot be expanded to the entire expenditure of AMP of Rs.202.34 crores. The reason being, the amount of Rs.202.34 crores have been incurred by the assessee on its own volition and business requirement to be in competition with other big players in the field of aerated and non-aerated beverages and food products. It is acclaimed fact that industry in which assessee company is operating has to face stiff competition not only from the Indian companies but also from many multinational*

companies; and to remain in the competition as a lead brand it has to aggressively promote its product under the brand to remain in the competition and to augment its sale. All the necessary functions of strategizing, advertising and marketing activities, its implementation for market penetration in India is solely carried out by the assessee and there is no material on record to infer that there is any arrangement or agreement with the AE at any point of time that assessee is required to spent on AMP or it has been done at the behest of the AE. The reason adopted by the Revenue to conclude that the incurrence of AMP expenditure by the assessee for promoting the brands which is owned by its AE constituting a separate international transaction for the purpose of Section 92B which requires separate bench marking, does not has any legs to stand, because the Revenue has failed to show the existence of any agreement, understanding or arrangement between the assessee company and AE regarding the quantum of AMP spent or it was spent on behest of AE. The TPO has not recorded or identified any such separate arrangement or agreement that AMP expenses incurred by the assessee company are in pursuance of any agreement or arrangement. It is also not the case of the Department that the expenses which has been incurred by the assessee company during the course of its business have any bearing whatsoever on any other international transaction with the AE, other than reimbursement of expenditure of Rs.33.60 crores as discussed above.

53. Section 92B defines the international transaction in the following manner: - "(1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction"

means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to anyone or more of such enterprises.

From the plain reading of the aforesaid Section, it is quite clear that: (i) the transaction has to be between two or more associated enterprises either or both of whom are non-resident; (ii) the transaction is in the nature of purchase, sale or lease of tangible or intangible property or provision of services or lending or borrowing money; (iii) or any other transaction having bearing on the profits, income, loss or assets of such enterprises; (iv) all such nature of transaction described in the section will also include mutual agreement and the arrangement between the parties for allocation or apportionment or any contribution to any cost or expenses incurred or to be incurred in connection with benefit, services and facility provided to any of such parties. Relevant Explanation to Section 92B as inserted by the Finance Act, 2012 reads as under: - "i. the expression "international transaction" shall include— ..... (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises,

customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

Clause (ii) of the said explanation reads as followsii. the expression "intangible property" shall include— (a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;……."

Thus, under the expanded definition of the term 'international transaction' intangible property has been defined to include marketing related intangible assets such as trademark, trade name, brand name and logos, etc. This inter alia means that where two AEs engaged in the transaction which involved, purchase, sale, transfer, lease or use of intangibles rights then the same shall be classified as international transaction. From the above, definition, apart from transaction relating to purchase, sale or lease of tangible or intangible property, services lending or borrowing money, etc. functions having bearing on the profits, income, losses or assets is reckoned as international transaction. Besides this, if such a transaction is based on any mutual agreement or arrangement between the AEs for allocation or any contribution to any cost or expenditure incurred or to be incurred for the benefit, service or facility, then also such an agreement or arrangement is treated as international transaction.

Clause (v) of Section 92F reads as under: "92F (v). "transaction' includes an arrangement, understanding or action in concert, - (A) Whether or not such arrangement, understanding or action is formal or in writing; or (B) Whether or not such arrangement,

understanding or action is intended to be enforceable by legal proceedings." This definition of transaction has to be read in conjunction with the definition given in section 92B, which means that the transaction has to be first in the nature given in Section 92B (1); and then when such transaction includes any kind of arrangement, understanding or action in concert amongst the parties, whether in writing or formal, then too it is treated as international transaction. Here the conjoint reading of both the sections lead to an inference that in order to characterized as international transaction, it has to be demonstrated that transaction arose in pursuant to an arrangement, understanding or action in concert. Such an arrangement has to be between the two parties and not any unilateral action by one of the parties without any binding obligation on the other or without any mutual understanding or contract. If one of the party by its own volition is entering any expenditure for its own business purpose, then without there being any corresponding binding obligation on the other or any such kind of an arrangement actually existing in wring or oral or otherwise, it cannot be characterized as international transaction within the scope and definition of Section 92B (1).

Here, in this case, it has been vehemently argued from the side of the assessee that assessee-company had incurred expenditure on AMP to cater to the needs of the customers in the local market and such an expenditure was neither incurred at the instance or behest of overseas AE nor there was any mutual understanding or arrangement or allocation or contribution by the AE towards reimbursement of any part of AMP expenditure incurred by it for the purpose of its business. If no such understanding or

arrangement exists, then no transaction or international transaction could be said to be involved between the AE and the assessee which can be reckoned to be covered within the provision of Transfer Pricing Regulation. The incurring of expenditure by the assessee is in fact purely a domestic transaction by a domestic enterprise with a third party in India for its own business purpose. Even the reimbursement, as discussed above, by the assessee to its AE was in lieu of sponsorship fee paid to ICC which again was wholly and exclusively for the assessee's own business and was not at the behest or mandate of AE. This contention of the learned counsel on the face of record is liable to be accepted and in absence of any material or any kind of arrangement discovered or brought on record by the Revenue, remains unrebutted. The onus is on the Revenue to show that the twin requirement of Section 92B exists, that is, firstly, the transaction involved was between the AE, one of which is resident and other a non-resident was involved; and secondly, the transaction of AMP expenses has taken place between the two AEs (except for reimbursement of Rs.33.60 crore). Now it has been well settled by the Hon'ble Jurisdictional High Court in the case of Maruti Suzuki India Pvt. Ltd. (supra) that onus is upon the Revenue to demonstrate that there existed an arrangement between the assessee and its AE under which assessee was obliged to incur excess amount of AMP expenses to promote the brands owned by the AE. The relevant observation and the finding of the Hon'ble High Court in paragraph 60 reads as under:

"60……Even if the resort is had to the residuary part of clause (b) to contend that the AMP spend of MSIL is "any other transaction

having a bearing" on its "profits, income or losses" for a 'transaction' there has to be two parties. Therefore, for the purposes of the 'means' part of clause (b) and the 'includes' part of clause (c,) the revenue has to show that there exists an 'agreement' or 'arrangement' or 'understanding' between MSIL and SMC whereby MSIL is obliged to spend excessively on AMP in order to promote the brand SMC……

61……Even if the word 'transaction' to include 'arrangement', 'understanding' or 'action in concert', 'whether formal or in writing', it still incumbent on the revenue to show the existence of an 'understanding' or an 'arrangement' or 'action in concert' between MSIL and SMC as regards AMP spend for brand promotion. In other words, for both the 'means' part and the 'includes' part of Section 92B (1) what has to be definitely shown is the existence of transaction whereby MSIL has been obliged to incur AMP of a certain level for SMC for the purposes of promoting the brand of SMC." Same proposition has been upheld by the Hon'ble Jurisdictional High Court in the case of Whirlpool of India Ltd. vs. DCIT, Bausch & Lomb Eyecare India Pvt. Ltd. vs. ACIT (supra) and Honda Siel Power Products Ltd. vs. DCIT (supra)"

43. In the present case we find that the Revenue has not been able to place any material to record to show or suggest that the Appellant's AMP activity was carried out at the behest of its AE, beyond what was approved and reimbursed under the MDF Agreement. No understanding or arrangement or "action in concert" can be inferred from the terms of the MDF agreement or the conduct of the assessee to show that "excessive" AMP expenditure has been incurred at the behest of the brand-owning

AE. The appellant being one of the major players in the Indian market has carried out its AMP activity and function based on its own judgement and commercial realities. Revenue has not placed any material or evidence to show that there existed an understanding to incur "excessive" AMP expenditure. The arrangement and understanding were limited to the amounts agreed to be paid as assistance under the MDF Agreement. The amounts incurred as AMP expenditure by the appellant under the MDF Agreement have already been received as reimbursement/assistance and have indisputably been disclosed as an international transaction in Form 3CEB and form part of the transfer pricing study conducted under Rule 10D. The AMP expenditure which is outside the ambit of reimbursement received under the MDF Agreement, has been incurred by the appellant on its own volition as per its own requirements and without any interference of the AE and have been paid to third parties.

44. In view of the above, we hold that the scope and value of international transaction cannot be expanded beyond the reimbursements received under MDF agreement to cover the entire gamut of AMP expenditure incurred by the assessee during the year.

45. Now the second issue before us is, whether:

"Bright Line Test" a valid test that can be used by the TPO to determine the existence of an international transaction and also for the determination of its arm's length value?

In all the years under appeal, the TPO has applied the "Bright Line" Test to determine the "excessive" AMP expenditure incurred

by the Appellant. This “excessive” amount has been treated as a separate international transaction and subject to transfer pricing adjustment. The “bright line” test which was first approved by a Special Bench of this Tribunal in LG Electronics now stands rejected by the Delhi High Court decision in Sony Ericsson. In Sony Ericsson, the Hon’ble High Court examined the concept of “bright line” in the context of domestic law and international jurisprudence and arrived at a conclusion that such an approach is untenable and contrary to law and not sanctioned by international jurisprudence. The concluding remarks of the Hon’ble High Court are as below:

“127. We agree and accept the position in the portion reproduced above in bold and italics. The object and purpose of Transfer Pricing adjustment is to ensure that the controlled taxpayers are given tax parity with uncontrolled taxpayers by determining their true taxable income. There should be adequate and proper compensation for the functions performed including AMP expenses. Thus, we disagree with the Revenue and do not accept the overbearing and orotund submission that the exercise to separate 'routine' and 'non-routine' AMP or brand building exercise by applying 'bright line test' of non-comparables and in all case, costs or compensation paid for AMP expenses would be 'NIL', or at best would mean the amount or compensation expressly paid for AMP expenses. Unhesitatingly, we add that in a specific case this criteria and even zero attribution could be possible, but facts should so reveal and require. To this extent, we would disagree with the majority decision in L.G. Electronics India (P) Ltd. (supra).

135. It is, therefore, incorrect to suggest or observe that international tax jurisprudence or commentaries recognise "bright

line test" for bifurcation of routine and non-routine AMP expenditure, and non-routine AMP expenses is an independent international transaction which should be separately subjected to arm's length pricing."

45. In view of the above, we hold that the "bright line" approach is untenable in law either as a way to determine the existence of an international transaction or as a method to determine the ALP of an international transaction pertaining to AMP. No international transaction can be presumed to exist merely on the basis of "bright line" of expenditure incurred by comparable companies.

46. The third issue for our consideration is,

If TNMM has been adopted at segmental/entity level, then can individual component of AMP be segregated?

TNMM analysis entails comparison of net level profit margins of the assessee with that of the comparables. Net level margins are determined after reducing the entire operating expenses incurred by the business entity which necessarily includes AMP expenditure. Therefore, once a TNMM exercise is undertaken at entity level by subsuming the entire AMP expenditure as part of the operating expenditure, the arm's length nature of all the transactions that are accounted for within the net profit margin stand fully accounted for. In the present case, the reimbursement received by the Appellant from its AE under the MDF Agreement for a part of the AMP expenditure forms part of the operating income as well as expenditure which goes into the computation of the net profit margin (which is profit level indicator). Once a group of transactions pertaining to operating income and expenditure are

being tested under TNMM, it would not be open for the Revenue to segregate one item of expenditure/income for a separate benchmarking unless for cogent reasons it is of the view that a TNMM is not the most appropriate method to test all the international transactions together. In such a situation the Revenue would have to test each of the transactions separately and not leave any of the transactions untested leading to an incongruous situation. We are fortified in our view by the decision of the Hon'ble Delhi High Court in the case of Sony Ericsson (supra) wherein the Court observed as below:

> ***"101.*** *However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(1)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible."*

In the present facts, we find that the TPO has subjected various international transactions of the assessee to TNMM analyses under various segments and made transfer pricing adjustments on the basis of external comparables chosen by him. Several of these comparable companies included/excluded by him form subject matter of the present appeals. It implies that the TPO has applied his mind on the suitability of TNMM and made adjustments. Having adopted TNMM in a considered manner, it is not open for him to take up AMP as a separate transaction and subject to the same to a Cost Plus type of benchmarking because the entire AMP expenditure forms part of the operating expenditure that has been taken into account while computing the profit level indicator (net profit margin).

47. Next issue is, *Brand building exercise equivalent to incurring AMP expenditure?*

In our view, it would be erroneous to treat any and all AMP expenditure as being a brand building exercise. There is no basis to presume that there is a positive correlation between AMP expenditure and brand-value. Brand value is a far more complex concept than mere AMP expenditure. Brand is an intangible asset that encapsulates the reputation of an entity and a reputation is built over a long period of time primarily on the basis of trust it invokes. Year to year AMP expenditure may vary due to market conditions, but the brand value does not get altered in proportion to expenditure. AMP function itself is a complex activity involves several nuanced aspects of marketing management targeted towards increasing sales. Such an exercise is sometimes premised on product promotion and sometimes brand messaging and occasionally for brand familiarization. But the core of brand value

is not determined by the quantum of expenditure incurred but the overall level of trust inspired in the minds of the consumers. The Hon'ble Delhi High Court in the case of Sony Ericsson (supra) has examined this aspect in detail. The relevant observations are extracted below:

> ***"103.*** *Brand has been described as a cluster of functional and emotional values. It is a matter of perception and reputation as it reflects customers' experience and faith. Brand value is not generated overnight, but is created over a period of time, when there is recognition that the logo or the name guarantees a consistent level of quality and expertise. Leslie de Chernatony and McDonald have described "a successful brand is an identifiable product, service, person or place, augmented in such a way that the buyer or user perceives relevant, unique, sustainable added values which match their needs most closely." The words of the Supreme Court in Civil Appeal No.1201 of 1966 decided on 12th February, 1970 in Khushal Khenger Shah v. Mrs. Khorshedbanu, DabridaBoatwala, to describe 'goodwill', can be adopted to describe a brand as an intangible asset being the whole advantage of the reputation and connections formed with the customer together with circumstances which make the connection durable. The definition given by Lord MacNaghten in Commissioner of Inland Revenue v. Muller & Co' & Margarine Ltd. [1901] 217 AC 223 can also be applied with marginal changes to understand the concept of brand. In the context of 'goodwill' it was observed:*
>
> *"It is very difficult, as it seems to me, to say that goodwill is not property. Goodwill is bought and sold every day. It may be acquired. I think, in any of the different ways in which property is usually acquired. When a man has got it he may keep it as his own. He may vindicate his exclusive right to it if necessary by process of law. He may dispose of it if he will - of course, under the conditions attaching to property of that nature.....What is good-will? It is a thing very easy to describe very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However, widely extended or diffused its*

influence may be, goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may preponderate here and another element there. To analyse goodwill and split it up into its component parts, to pare it down as the Commissioners desire to do until nothing is left but a dry residuum ingrained in the actual place where the business is carried on while everything else is in the air, seems to me to be as useful for practical purposes as it would be to resolve the human body into the various substances of which it is said to be composed. The goodwill of a business is one whole, and in a case like this it must be dealt with as such. For my part, I think that if there is one attribute common to all cases of goodwill it is the attribute of locality. For goodwill has no independent existence. It cannot subsist by itself. It must be attached to a business. Destroy the business, and the goodwill perishes with it, though elements remain which may perhaps be gathered up and be revived again..... "

104. *"Brand" has reference to a name, trademark or trade name. A brand like 'goodwill', therefore, is a value of attraction to customers arising from name and a reputation for skill, integrity, efficient business management or efficient service. Brand creation and value, therefore, depends upon a great number of facts relevant for a particular business. It reflects the reputation which the proprietor of the brand has gathered over a passage or period of time in the form of widespread popularity and universal approval and acceptance in the eyes of the customer. To use words from CIT v. Chunilal Prabhudas& Co. AIR 1971 Cal 70, it would mean:*

'... It has been horticulturally and botanically viewed as "a seed sprouting" or an "acorn growing into the mighty Oak of goodwill". ... It has been historically explained as growing and crystallising traditions in the business. It has been described in terms of a magnet as the "attracting force". In terms of comparative dynamics, goodwill has been described as the "differential return of profit." Philosophically it has been held to be intangible, Though immaterial, it is materially valued. Physically and psychologically, it is a "habit" and sociologically it is a "custom". Biologically, it has been described by Lord Macnaghten in Trego v. Hunt, 1896 AC 7 as the "sap and life" of the business. It has been horticulturally and botanically viewed as "a seed sprouting" or an "acorn growing into the mighty Oak of goodwill".

It has been geographically described by locality. It has been historically explained as growing and crystallising traditions in the business. It has been described in terms of a magnet as the "attracting force". In terms of comparative dynamics, goodwill has been described as the "differential return of profit." Philosophically it has been held to be intangible, Though immaterial, it is materially valued. Physically and psychologically, it is a "habit" and sociologically it is a "custom". Biologically, it has been described by Lord Macnaghten in Trego v. Hunt, 1896 AC 7 as the "sap and life" of the business.'

105. *There is a line of demarcation between development and exploitation. Development of a trademark or goodwill takes place over a passage of time and is a slow ongoing process. In cases of well recognised or known trademarks, the said trademark is already recognised. Expenditures incurred for promoting product(s) with a trademark is for exploitation of the trademark rather than development of its value. A trademark is a market place device by which the consumers identify the goods and services and their source. In the context of trademark, the said mark symbolises the goodwill or the likelihood that the consumers will make future purchases of the same goods or services. Value of the brand also would depend upon and is attributable to intangibles other than trademark. It refers to infrastructure, know-how, ability to compete with the established market leaders. Brand value, therefore, does not represent trademark as a standalone asset and is difficult and complex to determine and segregate its value. Brand value depends upon the nature and quality of goods and services sold or dealt with. Quality control being the most important element, which can mar or enhance the value.*

106. Therefore, to assert and profess that brand building as equivalent or substantial attribute of advertisement and sale promotion would be largely incorrect*. It represents a coordinated synergetic impact created by assortment largely representing reputation and quality. There are a good number of examples where brands have been built without incurring substantial advertisement or promotion expenses and also cases where in spite of extensive and large scale advertisements, brand values have not been created. Therefore, it would be erroneous and fallacious to treat brand building as counterpart or to commensurate brand with advertisement expenses. Brand building or creation is a vexed and complexed issue, surely not just related to advertisement. Advertisements may be the*

quickest and effective way to tell a brand story to a large audience, but just that is not enough to create or build a brand. Market value of a brand would depend upon how many customers you have, which has reference to brand goodwill, compared to a baseline of an unknown brand. It is in this manner that value of the brand or brand equity is calculated. Such calculations would be relevant when there is an attempt to sell or transfer the brand name. Reputed brands do not go in for advertisement with the intention to increase the brand value, but to increase the sales and thereby earn larger and greater profits. It is not the case of the Revenue that the foreign AEs are in the business of sale/ transfer of brands.

107. *Accounting Standard 26 exemplifies distinction between expenditure incurred to develop or acquire an intangible asset and internally generated goodwill. An intangible asset should be recognised as an asset, if and only if, it is probable that future economic benefits attributable to the said asset will flow to the enterprise and the cost of the asset can be measured reliably. The estimate would represent the set off of economic conditions that will exist over the useful life of the intangible asset. At the initial stage, intangible asset should be measured at cost. The above proposition would not apply to internally generated goodwill or brand. Paragraph 35 specifically elucidates that internally generated goodwill should not be recognised as an asset. In some cases expenditure is incurred to generate future economic benefits, but it may not result in creation of an intangible asset in form of goodwill or brand, which meets the recognition criteria under AS-26. Internally generated goodwill or brand is not treated as an asset in AS-26 because it is not an identifiable resource controlled by an enterprise, which can be reliably measured at cost. Its value can change due to a range of factors. Such uncertain and unpredictable differences, which would occur in future, are indeterminate. In subsequent paragraphs, AS-26 records that expenditure on materials and services used or consumed, salary, wages and employment related costs, overheads, etc. contribute in generating internal intangible asset. Thus, it is possible to compute goodwill or brand equity/value at a point of time, but its future valuation would be perilous and an iffy exercise.*

108. *In paragraph 44 of AS-26, it is stated that intangible asset arising from development will be recognised only and only if amongst several factors, it can demonstrate a technical feasibility*

of completing the intangible asset so that it will be available for use or sale and the intention is to complete the intangible asset for use or sale is shown or how the intangible asset will generate probable future benefits, etc.

109. *The aforesaid position finds recognition and was accepted in CIT v. B.C. Srinivasa Setty [1981] 2 SCC 460, a decision relating transfer to goodwill. Goodwill, it was held, was a capital asset and denotes benefits arising from connection and reputation. A variety of elements go into its making and the composition varies in different trades, different businesses in the same trade, as one element may pre-dominate one business, another element may dominate in another business. It remains substantial in form and nebulous in character. In progressing business, brand value or goodwill will show progressive increase, but in falling business, it may vain. Thus, its value fluctuates from one moment to another, depending upon reputation and everything else relating to business, personality, business rectitude of the owners, impact of contemporary market reputation, etc. Importantly, there can be no account in value of the factors producing it and it is impossible to predicate the moment of its birth for it comes silently into the world unheralded and unproclaimed. Its benefit and impact need not be visibly felt for some time. Imperceptible at birth, it exits unwrapped in a concept, growing or fluctuating with numerous imponderables pouring into and affecting the business. Thus, the date of acquisition or the date on which it comes into existence is not possible to determine and it is impossible to say what was the cost of acquisition. The aforesaid observations are relevant and are equally applicable to the present controversy.*

110. *It has been repeatedly held by Delhi High Court that advertisement expenditure generally is not and should not be treated as capital expenditure incurred or made for creating an intangible capital asset. Appropriate in this regard would be to reproduce the observations in CIT v. Monto Motors Ltd. [2012] 206 Taxman 43/ 19 taxmann.com 57 (Delhi), which read:—*

> *"4. … Advertisement expenses when incurred to increase sales of products are usually treated as a revenue expenditure, since the memory of purchasers or customers is short. Advertisement are issued from time to time and the expenditure is incurred periodically, so that the customers remain attracted and do not forget the product and its qualities. The advertisements published/displayed may not be of relevance or significance*

after lapse of time in a highly competitive market, wherein the products of different companies compete and are available in abundance. Advertisements and sales promotion are conducted to increase sale and their impact is limited and felt for a short duration. No permanent character or advantage is achieved and is palpable, unless special or specific factors are brought on record. Expenses for advertising consumer products generally are a part of the process of profit earning and not in the nature of capital outlay. The expenses in the present case were not incurred once and for all, but were a periodical expenses which had to be incurred continuously in view of the nature of the business. It was an on-going expense. Given the factual matrix, it is difficult to hold that the expenses were incurred for setting the profit earning machinery in motion or not for earning profits."
(Also see, CIT v. Spice Distribution Ltd. [2015] 229 Taxman 400/54 taxmann.com 325 (Delhi) by the Delhi High Court on 19th September, 2014; and CIT v. Salora International Ltd. [2009] 308 ITR 199

***111.** Accepting the parameters of the 'bright line test' and if the said parameters and tests are applied to Indian companies with reputed brands and substantial AMP expenses, would lead to difficulty and unforeseen tax implications and complications. Tata, Hero, Mahindra, TVS, Bajaj, Godrej, Videocon group and several others are both manufacturers and owners of intangible property in the form of brand names. They incur substantial AMP expenditure. If we apply the 'bright line test' with reference to indicators mentioned in paragraph 17.4 as well as the ratio expounded by the majority judgment in L.G. Electronics India (P) Ltd case (supra) in paragraph 17.6 to bifurcate and segregate AMP expenses towards brand building and creation, the results would be startling and unacceptable. The same is the situation in case we apply the parameters and the 'bright line test' in terms of paragraph 17.4 or as per the contention of the Revenue, i.e. AMP expenses incurred by a distributor who does not have any right in the intangible brand value and the product being marketed by him. This would be unrealistic and impracticable, if not delusive and misleading. (Aforesaid reputed Indian companies, it is patent, are not to be treated as comparables with the assessed, i.e. the tested parties in these appeals, for the latter are not legal owners of the brand name/trademark.).”*

48. Placing reliance on the above extracts of the Sony Ericsson decision (supra), a coordinate bench of this Tribunal in PepsiCo (supra) held as below:

"60. Thus, the Hon'ble High Court after describing the concept of the "brand" had made a clear cut demarcation between development and exploitation of brand which is either in the form of trademark or goodwill which takes place over a passage of time by which its value depends upon and is attributable to intangibles other than trademark like, infrastructure, knowhow, ability to compete in the established market, lease, etc. Brand value does not represent trademark as asset and it is quite difficult to determine and segregate its value. Brand value largely depends upon the nature of goods and services sold, after sales services, robust distributorship, quality control, customer satisfaction and catena of other factors. The advertisement is more telling about the brand story, penetrating the mind of the customers and constantly reminding about the brand, but it is not enough to create brand, because market value of a brand would depend upon how many customers you have, which has reference to a brand goodwill. There are instances where reputed brand does not go for advertisement with the intention to increase the brand value but to only increase the sale and thereby earning greater profits. It is also not the case here that foreign AE is in the business of sale/transfer of brands. Their Lordships have also referred to Accounting Standard 26 which provides for computation of goodwill and brand equal value at a point of time but not its future valuation or how such an intangible asset will generate probable future benefit. Because, the value fluctuates from one moment to other depending upon reputation and other factors. Reputation of a brand only enhances the sale and profitability and here in this case is only benefitting the assessee company when 86 marketing its products using the trade mark and the brand of AE. Even otherwise also, the value of the brand which has been created in India by the assessee company will only be relevant when at some point of time the foreign AE decides to sell the brand, then perhaps that would be the time when brand value will have some significance and relevance. But to make any transfer pricing adjustment simply on the ground that assessee has spent advertisement, marketing expenditure which is benefitting the brand/trademark of the AE would not be

correct approach. Thus, this line of reasoning given by the TPO is rejected."

49. In PepsiCo (supra), this Tribunal, while examining the AMP issue examined the implications of the recent developments in transfer pricing spearheaded by OECD in its Base Erosion and Profit Shifting (BEPS) project and observed as below:

"61. *Further in the final report of Action 8-10 of Base Erosion and Profit Shifting Project (BEPS) of OECD titled as "Aligning Transfer Pricing Outcomes with Value Creation'. It has been suggested that no adjustment is required on AMP expenditure incurred by full-fledged manufacturers. The report contains various examples pertaining to manufacturer. The following passage from the report is quite relevant which for the sake of ready reference is quoted hereinbelow:*

"6.40 The legal owner will be considered to be the owner of the intangible for transfer pricing purposes. If no legal owner of the intangible is identified under applicable law or governing contracts, then the member of the MNE group that, based on the facts and circumstances, controls decisions concerning the exploitation of the intangible and has the practical capacity to restrict others from using the intangible will be considered the legal owner of the intangible for transfer pricing purposes.

6.41 In identifying the legal owner of intangibles, an intangible and any licence relating to that intangible are considered to be 87 different intangibles for transfer pricing purposes, each having a different owner. See paragraph 6.26. For example, Company A, the legal owner of a trademark, may provide an exclusive licence to Company B to manufacture, market, and sell goods using the trademark. One intangible, the trademark, is legally owned by Company A. Another intangible, the licence to use the trademark in connection with manufacturing, marketing and distribution of trademarked products, is legally owned by Company B. Depending on the facts and circumstances, marketing activities undertaken by Company B pursuant to its licence may potentially affect the value of the underlying intangible legally owned by Company A, the value of Company B's licence, or both.

6.42 While determining legal ownership and contractual arrangements is an important first step in the analysis, these determinations are separate and distinct from the question of remuneration under the arm's length principle. For transfer pricing purposes, legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by the MNE group from exploiting the intangible, even though such returns may initially accrue to the legal owner as a result of its legal or contractual right to exploit the intangible. The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed. For example, in the case of an internally developed intangible, if the legal owner performs no relevant 88 functions, uses no relevant assets, and assumes no relevant risks, but acts solely as a title holding entity, the legal owner will not ultimately be entitled to any portion of the return derived by the MNE group from the exploitation of the intangible other than arm's length compensation, if any, for holding title."

From the above quoted passage, it can be seen that the guidelines clearly envisage that legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by MNE group from exploiting the intangibles, even though such returns is initially accruing to the legal owner as a result of its legal/contractual right to exploit the intangible. The return depends upon the functions performed by the legal owner, assets it uses, and the risks assumed; and if the legal owner does not perform any relevant function, uses no relevant assets, and assumes no relevant risks, but acts solely as a title holding entity, then the legal owner of the intangible will not be entitled to any portion of the return derived by the MNE group from the exploitation of the intangible other than the Arm's Length compensation if any for holding the title."

50. In view of the above, we hold that in case of licensed manufacturers like the appellant who bear the full risks and rewards of manufacturing and selling their goods in the Indian market, the concept of brand promotion being for the benefit of the AE has no application at all. As regards brand building expenses

incurred by a distributor who does not own the brand, the same needs to be examined from a long-term perspective whereby the ability of the distributor to recover the advertising costs by way of increased sales for a reasonable period of time is to be judged. Once a distributor arrangement in place for a fairly long period of time (as in the present situation where the assessee is the distributor of "Samsung" products in India), expenses on advertising cannot be subjected to a stand-alone analysis as a "service" to its AE on a year to year basis. This question of compensating an Indian distributor would arise only if the parties prematurely terminate the distributorarrangement. In such an event, if the Indian distributor has been deprived of the opportunity of recovering its investment in AMP, it could be a valid reason for a transfer pricing adjustment because third parties would not agree to a premature termination of this kind without demanding compensation. Therefore, the question of compensating the taxpayer for any loss suffered due to excess AMP spend would arise only at the time of such premature termination and not during the pendency of the distributorship arrangement. Thus, in case of a routine distributor, disallowance/adjustment on account of AMP spend on the mere assumption that the supplier may terminate the agreement in the future is not sustainable. A taxpayer cannot be penalized on the presumption of a future event (which may not even occur) while ignoring the present facts and circumstances. It is also worthwhile to note that in the present case, the assessee has not paid any trade-mark or brand royalty to its AE for having used its brand.

51. Next issue before us is:

Whether it is permissible for the TPO to make a substantive and protective assessment on the same issue using two alternative approaches?

It is settled law that protective addition along with substantive addition of an item of income can be made only when the identity of the real owner of the income is unclear. The following observations made by the coordinate bench in MSD Pharmaceuticals Pvt. Ltd. (supra) make this amply clear:

> *"The very concept of protective addition is relevant only when an income is to be added in the hands of more than one taxpayer, in a situation in which there is an element of ambiguity as to in whose hands the said income can be rightly brought to tax. That's not the case before us. In our humble understanding, therefore, the concept of 'protective assessment', as is known to the income tax law, has no application in the cases like the one before us."*

52. The last issue before us is:

If AMP expenditure incurred by the Appellant is held to be an international transaction, can it include selling costs within its ambit? Further, would the Appellant be eligible to receive a mark-up on the AMP expenditure to capture the arm's return on the cost?

Since we have held that there is no international transaction in the nature of AMP expenditure which needs to be subjected to Chapter X analysis, these issues are rendered infructuous and academic.

53. Thus, in view of our finding given above we hold that, no adjustment can be made in the case of the appellant on account of AMP expenses and same is directed to be deleted.

OTHER GROUNDS IN ITA No. 3248/DEL/2012)AY 2005-06

GROUND NO. 4: *The CIT has erred in not appreciating that no adjustment is warranted in respect of transactions undertaken by the appellant with its AEs in Class II segment since the underlying difference between the transfer price and arm's length price does not exceed 5% of the latter and thus, the case is squarely covered by the proviso to section 92C (2) of the Act.*

54. In respect of Class II (Distribution of consumer electronics, home appliances and other IT and Telecom Products) segment, the Appellant had adopted Resale Price Method (RPM) and had chosen 5 comparables in its transfer pricing documentation with a mean margin of 6.45%. The Ld. TPO rejected RPM and chose TNMM as the most appropriate method. Further, the TPO also altered the set of comparables and adopted a set 13 comparables with a mean net profit margin of (-) 0.447%. The TPO also computed the net profit margin of the Appellant after giving effect to the MDF expenditure treatment to -3.50%. On appeal, the Ld. CIT (A) rejected 2 of TPOs comparables namely Control Print Ltd. and Gemini Communication Ltd. and applied current year data on the remaining comparables. The mean margin of the remaining comparables came to 0.38% as against 0.21% of the Appellant (after treating reimbursement for advertisement expenses as operating expense). The Ld. CIT (A) accordingly concluded that an adjustment of Rs. 3.3 crores is required to be done because the difference between ALP and the transfer price exceeds 5% of the ALP. The Ld. Counsel for the appellant submitted that the Ld. CIT (A) erred in making an incorrect calculation in this regard. The difference between the ALP and transfer price is within the permissible 5% range as shown in the computation below:

Particulars	**Reference**	**Amount (in Rs.)**
Sales	A	19,431,647,242
AE costs	B	9,205,413,953

Third Party costs	C	10,184,978,943
Total costs	D= B+C	19,390,392,896
Operating profit	E= A-D	41,254,346
Appellant's OP/Sales	F= E/A	0.21%
Arm's length OP/Sales	G	0.38%
Arm's Length OP	H=A*G	73,840,260
Shortfall in Appellant's OP	I=H-E	32,585,913
Arm's length AE costs	J=B-I	9,172,828,040
105% of Arm's length AE costs	K=J*1.05	9,631,469,442
TP adjustment (if any)	L=B-K	Nil

55. The Ld. Counsel submitted that no adjustment to the ALP could be made as under the *Proviso* to Section 92C(3), if the difference between the price recorded in the books and the ALP determined was less than 5%, no adjustment could be made. The Ld. CIT (DR) relied on the orders of the TPO and the CIT(A).

55. In view of the details submitted by the assessee which have not been disputed or controverted by the Ld. CIT(DR), it is apparent that by applying the permissible 5% margin under the *second Proviso* to Section 92C(2), no adjustment is warranted. Accordingly, this ground is allowed and the adjustment made by the Ld. CIT (A) is directed to be deleted.

56. GROUND NO. 5**:** This Ground has not been pressed by the assessee and is accordingly dismissed.

GROUNDS IN DEPARTMENT'S APPEAL (ITA No. 3410/Del/12) FOR AY 2005-06

GROUND NO. 1: *The Ld. CIT (A) has erred in excluding certain comparables while benchmarking international transactions*

under Class I – Manufacturing and Class II – Distribution Segment.

57. The Assessee is engaged in manufacturing of consumer electronics, home appliances &colour monitors (known as Class I- Manufacturing segment) which includes the import of raw materials, import of spare parts, export of finished goods, purchase of samples and purchase of sales promotion material. In the TP Study, the Assessee selected 11 comparables. The TPO proceeded to undertake a fresh analysis and arrived at a fresh set of comparables by accepting certain comparables of the Assessee and introducing certain new comparables. The comparables which were introduced by the TPO and thereafter rejected by the CIT (A) are under challenge by the Department in its appeal. The Department's appeal is in respect of two comparables, namely, Videocon Industries Ltd. and Samtel Colour Ltd.

58. **Videocon Industries Ltd (Class I- Manufacturing):** The company was included by the Ld. TPO in the final list of comparables by merely relying on its predecessor's order for AY 2004-05. On appeal by the Assessee, the Ld. CIT(A) excluded this comparable by relying on its predecessor's order for AY 2004-05 wherein it was held that the company is engaged in backward integration and indigenous manufacturing of components, hence it cannot be treated as an appropriate comparable.

59. Being aggrieved by the CIT (A)'s order, the Department is in appeal asking for inclusion of this comparable. The Ld. CIT (DR) argued that under TNMM broad level of function and product similarity is mandated and this company is engaged in manufacturing which is also the function of the tested party. He

vehemently argued that product similarity may not be exact and as long as there is a broad level of similarity, comparables should be accepted. In this case, he submitted that components of colour TVs are being manufactured by this comparable, which falls under the broad category of consumer goods. He also argued that prior years precedents should not be applied to questions of fact.

60. The Ld. counsel for the Assessee while supporting the order of the CIT (A) submitted that the company should not be taken as a comparable due to following reasons:

(a) Videocon did not form a part of SIEL's TP Study and the same was included by the TPO by merely relying on its own order for AY 2004-05 without conducting any functional analysis.

(b) It may be noted that Videocon was excluded as a comparable by CIT (A) in AYs 2003-04 and 2004-05 as well. Also, the Department did not file an appeal on this issue against the order of the CIT (A) for AY 2004-05. There is no change in the facts and circumstances of the case from AY 2004-05 and AY 2005-06. The functional description of this company and that of the appellant has remained the same and hence the decision of the prior year should be followed.

(c) The company is engaged in backward integration and indigenous manufacturing of components (glass shells) and derives sizeable portion of income from manufacture of glass shells, funnels and panels which are used in manufacturing of colour TV. Videocon enjoys cost benefits due to captive manufacturing of CTV shells. The Ld. Counsel relied on the decision of this Tribunal in the case of ***Sony India P. LTD V DCIT [2008] 114 ITD 448 (Del)*** in this regard where on similar facts Videocon was held to be incomparable to Sony

India, a company that was engaged in the manufacture of TVs and other consumer goods, on the ground that it undertakes manufacturing of components for CTV units which renders it functionally incomparable to companies which import the same parts.

61. We have analyzed the functional and product profile of Videocon and find that it is a component manufacturer, whereas the assessee's manufactured goods are in the category of finished goods. Though the components like glass shells and funnels are components of TV sets which are manufactured by the assessee, it would be wholly inappropriate to treat the two as comparables under TNMM as they operate in entirely different sectors. While components are sold to OEMs, finished goods are sold to end-customers and face entirely diverse market risks and dynamics. Furthermore, in the prior years this comparable has been rejected in first appeal by the CIT (A) and no appeal was preferred against the same. It is important to maintain consistency if there is no change in facts. We also note that the coordinate Bench has, under similar facts, examined the appropriateness of this comparable in Sony India (supra) and held it to be inappropriate. In view of the above, we dismiss this ground of appeal and hold that Videocon has been rightly excluded by the CIT (A) from the list of comparables.

62. **Samtel Colour Limited (Class I- Manufacturing):** Samtel was introduced by the Ld. TPO in the final list of comparables by merely relying on its predecessor's order for AY 2004-05. The company operates in only one segment i.e. manufacture of colour

picture tubes and electron gun. It has a Related Party Transaction (RPT) as a percentage of sales of 23.85%.

63. On appeal by the Assessee, the Ld. CIT (A) relied on the decisions of Sony India (supra) and ***Avaya India Pvt. Ltd (ITA No. 5150/Del/2010)*** wherein it was held that companies having more than 15% RPT should not be taken as comparable. Even for AY 2004-05, in Assessee's own case, Khaitan Electricals Ltd was excluded as it had RPT in excess of 15%. Based on above, Ld. CIT (A) excluded Samtel as a comparable.

64. Being aggrieved by the CIT (A)'s order, the Department is in appeal before this Tribunal for inclusion of this comparable. It is the Department's contention that RPT filter should be 25% instead of 15% as it is a reasonable threshold for comparability. The Ld. CIT (DR), further submitted that the Tribunal in numerous decisions has approved a 25% threshold and the same should be followed in this case as well.

65. The Ld. Counsel for the Assessee submitted that the company should not be taken as a comparable on the ground of consistency as the TPO in subsequent year i.e. AY 2006-07 has himself excluded companies having RPT in excess of 15%. Further, even after applying RPT filter of 15%, if sufficient number of comparable companies are available for determination of arm's length price, then such tolerance limit is proper.The Ld. Counsel for the Assessee placed reliance on ***LSI Technologies India Private Limited vs. ITO (IT (TP)A Nos.1380 & 1381/Bang/ 2010)*** and ***Textron India Pvt. Ltd. v. DCIT (IT(TP)ANo.1228/Bang/2010, etc)***.

66. We have heard the parties and also perused the relevant finding and the material referred to before us. The exercise of determination of arm's length price u/s 92 of the Act entails finding comparable uncontrolled transactions/entities for the purpose of comparison. If the levels of related party transactions are higher the "uncontrolled" nature of the comparable transaction or entity is diluted and the comparability is compromised. Therefore, in principle, lower the level of RPT, more accurate the result is likely to be. However, if sufficient number of comparables is not available due to paucity of data or comparables, the RPT threshold may have to be relaxed upwards for reasons of practicality. However, in situations where sufficient numbers of comparables are available by applying a lower threshold, the same should be preferred as the results are likely to be more accurate. The same view has been expressed by the coordinate Bench in the case of Motorola Solutions India Pvt. Ltd.[2014] 35 ITR(T) 546 (Delhi - Trib.) We accordingly hold that since in the given situation sufficient numbers of comparables are available even by following the lower level of threshold of 15%, the same should be followed. This ground is accordingly dismissed and the order of the Ld. CIT (A) is upheld.

67. Now we come to Class II-, which is DISTRIBUTION SEGMENT**:** The Assessee is engaged in distribution of consumer electronics, home appliances, colour monitors and other IT & Telecom products (known as Class II- Distribution segment) which includes import of finished goods, import of spare parts, export of spare parts, purchase of samples, export of samples, payment for packing & R&D expenses, purchase of sales promotion material. In

the TP Study, the Assessee selected 5 comparables. The TPO proceeded to undertake a fresh analysis and arrived at a fresh set of comparables. He accepted some of the comparables of the Assessee but also introduced 8 new comparables. Some of the comparables which were introduced by the TPO were thereafter rejected by the CIT (A) and the same are under challenge by the Department in its appeal as under. Ld. CIT (DR) submitted that the Revenue is aggrieved in respect of two comparables, namely Control Print (India) Ltd. and Gemini Communications Ltd.

68. **Control Print (India) Limited (Class II- Distribution):** This comparable was introduced by the Ld. TPO in the final list of comparables by merely relying on his predecessor's order for AY 2004-05. The company operates in only one segment and is engaged in coding, marking systems and development of digital printing systems for various markets & applications including packaging applications, specialty industrial applications, textile printing and security printing.

69. On appeal by the Assessee, the Ld. CIT (A) excluded this comparable by relying on his predecessor's order for AY 2004-05 wherein it was held that the company's functional/business profile of the company vis-à-vis the Assessee is dissimilar.

70. The Ld. CIT (DR) submits that the company has been taken as a comparable after conducting a detailed functional analysis and is functionally similar to the appellant. He emphasized that under TNMM broad level of product similarity is required and some degree of divergence is acceptable both in respect of product difference and functional difference.

71. The Ld. Counsel for the Assessee submitted that the company should not be taken as a comparable due to following reasons:

(a) _____The same was included by the TPO by merely relying on his own order for AY 2004-05 without conducting any functional analysis. This was excluded as a comparable by CIT(A) in AY 2004-05 as well. And the Department did not file an appeal on this issue against the order of the CIT(A) for AY 2004-05.

(b) _____The company is not a trader but a manufacturer cum assembler of solvents, ink-rolls, coding machines. It has a completely different functional profile as it is engaged manufacturing of marking and coding machines. Not only the activity is different, the products are also completely dissimilar.

72. We have perused the Annual Report of this company and we find that this company is engaged in manufacturing activity. The products are also very dissimilar to those traded by the assessee in its Class II segment. The financials of this company state that it has a single segment comprising of, "Coding and Marking Machines and Consumables thereof". It is quite obvious that this comparable is wholly unfit to be chosen as a comparable to the trading segment of the assessee as it is functionally dissimilar. In A.Y 2004-05, this comparable was ordered to be removed by the CIT (A) and no appeal was filed against his order. In these circumstances, we hold that the Ld. CIT (A)'s order in this regard is correct and justified and does not warrant any interference.

73. **Gemini Communications Limited (Class II- Distribution):** The Ld. TPO included this comparable by merely relying on its predecessor's order for AY 2004-05. The Ld. CIT (A) excluded this comparable by relying on his predecessor's order for AY 2004-05 wherein it was held that the functional/business profile of the company vis-à-vis the Assessee is dissimilar. It is a full-fledged and end-to-end IT solutions and service provider unlike the Assessee which is engaged in distribution operations only.

74. Before us, the CIT (DR) submits that the company has been taken as a comparable after conducting a detailed functional analysis and is similar to the appellant in several material respects.

75. The Ld. Counsel for the Assessee while supporting the order of the CIT (A) submitted that the company should not be taken as a comparable due to following reasons:

(a) _____Gemini is engaged in the business of providing solutions on networking and communications with products of companies like Cisco, Nortel, Avaya, etc.

(b) _____The same was excluded by the CIT (A) for AY 2004-05 but the Department did not file an appeal on this issue. Since, Department has accepted it as a comparable in one year, it cannot change its stand and challenge it in the subsequent year, if there is no change in the facts and circumstances of the case.

(c) _____Further, the major products dealt by it are 'communication equipment' and its major source of revenue is sale of network products as well

as network service solutions. It is a leading networking solutions and technical service provider.

76. We have perused the orders of the lower authorities and the Annual Report of this company. We find that this company is a leading networking solutions service provider. As part of the networking solutions it provides to its clients, it sells communication equipment as well. The solutions comprise of LAN and WAN designs, ITeS consulting solutions, data center design solutions, security consulting solutions etc. Entire revenue has been reported under a single segment of network products and services. These facts show that the CIT (A) has rightly ordered its exclusion on account of functional dissimilarity. The assessee in its Class II segment is engaged in pure trading/distribution of consumer electronics, home appliances, monitors and other products. The factors of comparability provided in Rule 10B (2) are not satisfied at all and accordingly we hold that the Ld. CIT (A) has rightly ordered its exclusion.

GROUND NO. 2: DISALLOWANCE OF EXPENDITURE ON RECRUITMENT AND TRAINING

77. The Ld. Counsel submitted that the said issue is covered by decision of Hon'ble Delhi High Court in Assessee's own case for AY 1999-2000, 2002-03 and AY 2003-04 wherein the Delhi High Court affirmed the decision of this ITAT of allowing the deduction of expenditure incurred on recruitment and training of employees. The Ld. AO erred in treating it as a deferred revenue expenditure on the assumption that recruitment expenses will result in long term benefit. He failed to appreciate that such expenditure was revenue in nature, incurred for the purpose of business and

therefore allowable under section 37(1) of the Act. Ld. CIT (DR) relied on the order of the CIT (A).

78. It has now been settled that recruitment and training expenses have to be treated as revenue expenditure and cannot be seen as leading to enduring benefit warranting any disallowance. We observe that similar disallowances were made in the prior years as well which have been deleted in appeal. The issue travelled up to the High Court and the Hon'ble Delhi High Court has affirmed the view taken by this Tribunal that these expenses are allowable in full in the year in which it is incurred. Orders dated 9.06.2013 and 15.05.2017 in the appeals for A.Yrs 1999-2000 and 2003-04 respectively of the Delhi High Court have been placed before us. Respectfully following the decision of the Delhi High Court we dismiss this ground of appeal.

AY 2006-07 (ITA No. 5856/DEL/10)

79. The facts and business model in the present Assessment Year i.e. 2006-07 are similar to the facts already stated for AY 2005-06. The appellant had filed its return of income on November 29, 2006, declaring an income of Rs. 36,26,44,434. A summary of the international transactions and the appellant's approach in determining their ALP is given in the table below:

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class I – Manufacturing (Consumer	Transactional Net Margin Method	OP/OR	2.22%	6	2.52%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Electronics, and Home Appliances) Import of raw materials, Import of stores and service parts, export of finished goods, payment of royalty, import of fixed assets	("TNMM")				
Class II – Trading (Consumer Electronics, and Home Appliances) Import of finished goods, import of stores and service parts, export of finished goods, payment of royalty, import of fixed Assets	Resale Price Margin ("RPM")	Gross Profit Margin ("GPM")	24.78%	12	23.16%
Class III – Manufacturing (Color Monitors) Import of raw materials, import of stores and service parts, export of finished goods, import of fixed Assets	TNMM	OP/OR	6.80	5	2.29%
Class IV – Trading (Color Monitors and other IT products) import of finished goods, import of	RPM	GPM	10.15%	9	8.69%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
stores and service spares, service income from hand held phones					

80. The dispute in the present appeal (ITA No. 5856/DEL/2010) filed by the appellant pertains to the international transactions grouped under Class-I and Class-III (manufacturing) segment and Class-II and Class-IV (trading) segments. There is no dispute with respect to Class V (contract software development and reimbursement of expenses) transactions.

81. In Class-I (manufacturing segment) the appellant was engaged in the manufacturing of consumer electronic goods and home appliances and in Class-III (manufacturing segment), the appellant was engaged in the manufacturing of colour monitors. Transactional Net Margin Method was chosen as the most appropriate method in its transfer pricing study for both these segments. The profit level indicator taken was operating profit/operating revenue. For the benchmarking exercise in Class-I and Class-III segments, an economic analysis was carried out in the TP study leading to identification of 6 and 5 uncontrolled comparable companies respectively. Since the appellant had earned profit margin of 2.22% and 6.8% in the Class-I and Class-III segments respectively which was within the ± 5% range of the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

82. In Class-II (trading segment), the appellant was engaged in the trading of consumer electronic goods and home appliances and in Class-IV (trading segment), the appellant was engaged in the trading of colour monitors and other IT products. For Class-II and Class-IV segments, Resale Price Method (RPM) was chosen as the most appropriate method to determine the ALP with Gross Profit margin (gross profit /sales) as the profit level indicator. The economic analysis carried out in the TP Study for Class-II and Class-IV segments resulted in identification of 12 and 9 uncontrolled independent comparable companies respectively. Since the appellant had earned gross profit margin of 24.78% and 10.15% in the Class-II and Class-IV segments respectively which was higher than the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

83. The TPO rejected the most appropriate method adopted by the assessee. He discarded the Resale Price Method for Class-II (trading) and Class-IV (trading) segment. As per the TPO, for both the segments Transactional Net Margin Method (TNMM) was the most suitable method for determining of arm's length price. Under TNMM he selected operating profit margin on revenues (OP/OR; OP = operating profit/ OR = operating revenue) as the profit level indicator for both the segments. Further, the TPO while computing the profit level indicator of the appellant for manufacturing and trading segments increased the quantum of operating expenditure taken into account to increase the operating profit by Rs. 86.22crores. The aforesaid amount of Rs. 86.22 crores had been received by the appellant during the relevant financial year from its parent company as a reimbursement under an assistance

agreement referred to as Marketing Development Fund (MDF) agreement. In terms of MDF agreement, as in prior years, the appellant had received the assistance from its parent company to conduct certain predefined marketing activities. This amount has been shown as reimbursement in the Form 3CEB and the transfer pricing study and was reduced from the expenditure shown under the head "advertisement". Accordingly, in the profit and loss account of the financial statement under head "advertisement" expenditure only the net amount was shown. Though the gross amount expended for advertisement was Rs 229.84 crores, on account of reimbursement received of Rs. 86.22crores, the net amount of Rs. 229.84-Rs.86.22 crores = 143.61 crores was shown as the net advertisement expenditure. The TPO concluded that this was an erroneous approach and was of the view that the entire amount of Rs. 229.84 crores incurred under the head "advertisement" should be taken into account to compute operating profit and the operating profit margin. This approach and calculation of the TPO was based on a similar approach adopted in the prior assessment years. Accordingly, while the operating expenditure under the head advertisement was increased from Rs. 143.61 crores to Rs. 229.84 crores leading to fall in operating profit and margin, the corresponding reimbursement of Rs. 86.22 crores received from the appellant's parent company was not included as part of the revenue. Based on this approach, the operating profit margin (OP/OR) of Class-I and Class-III manufacturing segments was determined at (-) 0.16% and 4.42% respectively. Further, the operating profit margin (OP/OR) of Class-II and Class-IV trading segments was determined at (-) 1.94% and (-) 3.36% respectively.

84. The TPO further proceeded to undertake a fresh benchmarking analysis of the uncontrolled comparable companies and arrived at a set of 5 comparable companies for the Class-I manufacturing segment, 3 comparables for the Class-II trading segment and 11 comparables for Class-IV trading segments. The arithmetic mean of the operating profit margin (OP/OR) of these comparables for the Class-I manufacturing segment was computed at 2.74%. Similarly, the profit margin of the comparables in the Class-II and Class-IV trading segments were carried out at 2.45% and 1.61% respectively. To compute profit level indicators of the comparable companies, the TPO used multiple years' data (current and two previous years to the extent of availability of data). The margins computed by the TPO are after making adjustments on account of working capital differences

85. Based on the above approach, the TPO worked out an adjustment to the arm's length price of the international transactions pertaining to Class-I manufacturing segment at Rs. 439,163,419/-. In respect of Class-II and Class-IV trading segments, the adjustment to the arm's length was worked out to be at Rs. 509,049,110 and Rs. 300,466,885 respectively. There was no adjustment made to the Class III and Class V segments.

86. The AO incorporated the adjustment to the ALP made by the TPO and also made the following additions to total income:

(a) _____Recruitment and training expense of Rs. 1,03,07,792 was treated as capital expenditure and not allowable as a revenue expenditure u/s 37 of the Act;

(b) _____Depreciation on UPS, printers and servers was restricted to 15% as against 60% claimed by the appellant leading to a disallowance of Rs. 7,72,086.

87. The assessee being aggrieved by the orders of the TPO and AO filed objections before the DRP, New Delhi contesting the aforesaid additions made to the total income of the assessee on various grounds. The Ld. DRP disposed off the objections filed by the assessee vide its directions under section 144C of the Income Tax Act, 1961 30th September 2010 and upheld the order of the TPO/AO.

88. In pursuance to the DRP Directions, the AO passed the final assessment order dated 19th October 2010. Aggrieved by the order of the AO (impugned order), the assessee has preferred the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL (ITA No. 5856/DEL/10) FOR AY 2006-07

GROUND NO. 1 & 2: These are general in nature.

GROUND NO. 3 & 4.1: These Grounds have not been pressed by the assessee. These grounds are accordingly dismissed as not being pressed.

GROUND NO. 4.2: *That on facts and in law, the TPO/AO has erred in rejecting Voltas Limited as a comparable company for benchmarking the international transactions under Class II (trading of consumer electronics and home appliances segment)*

89. The Ld. TPO has rejected Voltas Ltd. on the sole ground that the company is persistently making losses with declining net margins and the Ld. DRP has upheld the Ld. TPO's reasoning. The Ld. Counsel for the Appellant submitted that this comparable has been accepted by the Ld. TPO in AYs. 2004-05 and 2008-09. The Ld. Counsel submitted that Voltas has 4 segments i.e. Electro-mechanical Projects and Services, Engineering Products and Services, Unitary Cooling Products for Comfort and Commercial Use and Others. Voltas is not a loss-making company on an entity level, rather, losses are suffered only in one segment. However, the same segment is earning profits in future years and the loss is only in the current financial year and immediately preceding financial year. It has recorded a profit in the financial year 2003-04 and therefore it is factually incorrect to treat this company as a persistently loss-making company. Under Rule 10B(4) data of current year and two immediately prior years can be considered if the same has a bearing on the profitability of the company. This Tribunal in numerous cases held that to check whether a persistently loss company should be excluded, data of at least three years (current plus two prior years) have to be seen.

90. The Ld. Counsel argued that Voltas cannot be said to be categorized as a persistently loss-making entity because persistent loss-making entities imply that losses are suffered year after year leading to erosion of net worth. In the present case, a company suffering losses only in two years cannot be said to be persistent loss-making company. Further, it has been pointed out that turnover of the company has increased over the years, and it had no intention to close down its business and is in the market for the long run. The Ld. Counsel contended that the courts have

consistently held that if a company is functionally comparable, then it cannot be rejected merely on the basis that it is making losses. In this regard, the Ld. Counsel places reliance on the case laws below:

(a) _____In the cases of **DCIT vs. Exxon Mobil Company India Pvt. Ltd. (ITA No. 4389/Mum/2010)(Para 7)** and **Bobst India (P.) Ltd. v. DCIT (ITA No. 1380 (PN) of 2010)**, it has been observed that exclusion of a comparable merely on the ground that the comparable is incurring abnormal profit margin or persistent losses without considering the applicable law under Rule 10B of the Income Tax Rule, 1962 (Rules) is untenable under law;

(b) _____The Special Bench of Hon'ble Chandigarh ITAT held in the case of **DCIT vs. Quark Systems (P.) Ltd [2010] 38 SOT 307 (CHD.) (SB)** that if a company is functionally comparable and the turnover does not show declining trend, then merely on the basis that the comparable company is incurring losses, the comparable cannot be excluded. The Hon'ble Ahmedabad ITAT reiterated the above position by relying on Quark Systems *supra* in the case of **Erhardt+Leimer (India) Private Limited vs ACIT (ITA Nos. 3298/Ahd/2011 & 2880/Ahd/2012**;

(c) _____In the case of **Chryscapital Investment Advisors (India) Pvt. Ltd. Vs. DCITDelhi)/[2015] 376 ITR 183 (Delhi),** the Hon'ble jurisdictional High Court reiterated the same position *supra* that it is a settled law that comparables cannot be excluded

merely on the ground that it is making abnormally high profits or losses.

91. The Ld. Counsel further relying on **24/7 Customer.Com (P.) Ltd. v. DCIT [2013] 21 ITR (Trib) 514 (Bangalore)** submitted that when in a particular assessment year, if Arithmetic Mean Method has been applied, comparables with abnormal profits/losses cannot be excluded. This is for the reason that up until April 1, 2014, Indian transfer pricing regulations followed the Arithmetic Mean Method which took into account all comparables irrespective of their margin variance and calculates the average of all comparables for calculating the ALP. In contrast to this, post April 1, 2014, Indian transfer pricing regulations now employ the Quartile Method wherein, the companies that fall in the extreme quartiles (i.e. abnormally high profits/losses) get excluded and only those that fall in the middle quartile are retained for comparability. For the AY under consideration, Arithmetic Mean Method has been applied and thus, comparables with higher profits/losses cannot be excluded.

92. Further, the Ld. Counsel submitted that the exclusion of persistent loss-making companies has been in the context of IT companies which is a booming sector where the industry trend has been of growth and persistent losses is not normal. However, this approach cannot be *ipso facto* extended to other industries such as consumer electronics etc. which are very competitive industries as is evident from the low margins of the comparable companies.

93. The Ld. CIT (DR) relied vehemently on the orders of the Ld. TPO and DRP and submitted that two years of continuous losses

demonstrated that the company was in a downward trend and was experiencing a situation that was different from that of the appellant. On account of the extraordinary situation, this company cannot be taken as a comparable. The Ld. CIT (DR) further submitted that the Tribunal in various decisions has upheld the application of persistent loss making as a filter.

94. We have perused the orders of the lower authorities and examined the Annual Report of this company and seen the profitability trend as well. This company is indisputably a functionally comparable company and therefore the question that requires our consideration is whether it has shown persistent losses and whether persistent losses can be a ground for excluding a comparable. It is now settled that a mere loss-making or abnormally high loss/profit making company cannot be excluded unless it can be shown that extraordinary economic factors are present. It is also now settled that if a company has been exhibiting persistent losses for a long period leading to erosion of its net worth, it would be considered as facing an extraordinary economic situation and as not being representative of the economy/sector in which it operates. In the present facts we find that this comparable (Voltas) has shown an operating loss only in the current year and one prior year (F.Y. 04-05). In the financial year 2003-04, it is stated to have earned a positive profit margin of 4% in the relevant segment. It has also been contended that its net worth has not been rendered negative and has shown consistent increase in turnover from F.Y. 2003-04 onwards for five years in a row. In our view while examining whether a company can be excluded on the ground of persistent losses, a long term trend has to be seen and at least a period of 3 years (current year and two

prior years) is mandatory under Rule 10B(4). This is an exercise which has not been carried out by the TPO. We accordingly set aside this matter to the file of the TPO to determine whether Voltas had shown losses in the three years covered under Rule 10B (4) and whether its net worth had been rendered negative. If both the conditions are found to have been met, i.e., three years continuous losses leading to erosion of net worth, Voltas would have to be excluded. If it is found to have failed either or both of the conditions, it shall be retained as a comparable. While determining this, the TPO shall take into account only that segment of Voltas which is comparable to that of the assessee, i.e., cooling products. This ground is therefore disposed off in terms of the above directions.

GROUND NO. 4.3: *That on facts and in law, the TPO/AO has erred in considering* ***Bajaj Electricals Limited*** *as a comparable company while applying the transactional net margin method to benchmark the international transactions under Class II (trading of consumer electronics and home appliances segment)*

95. The Ld. TPO has included this comparable on ground that it is functionally similar and has been accepted as comparable by the Appellant in FY 2004-05. The Ld. DRP has upheld the Ld. TPO's reasoning. The Ld. Counsel for the Appellant submitted that Bajaj is engaged in manufacturing and distribution of various lighting, consumer durables, galvanized structures and other products. It has four segments as below:

- 'Lighting' includes Lamps, Tubes and Luminaries;
- 'Consumer Durables' includes Appliances & Fans;

- 'Engineering & Projects' includes Transmission Line Towers, Telecommunications Towers, Highmast, Poles and Special Projects;
- 'Others' includes Die-casting and Wind Energy.

96. The Ld. Counsel pointed out that the gross-profit margin of Appliance products were computed from the product schedule and used for Resale Price Method (RPM) computation in the TP report. However, when RPM was discarded in favour of TNMM by the TPO, the net profit margin of the entire consumer durables segment was selected for computation of net profit margin. It was also pointed out by the Ld. Counsel that the assessee applied RPM for this segment and computed the gross profit margin of the products appearing under the head 'Appliances' in the product schedule of the Annual Report. In the product schedule, there were two categories, appliances and fans in this segment of consumer durable. The Ld. TPO has rejected RPM and has adopted TNMM and used the net margin of the consumer durable segment which includes fans.

97. The Ld. Counsel contended that the Ld. TPO has committed a gross error in including the net profit margin derived from the manufacturing of fans as a part of the segmental profit margin taken for benchmarking the assessee's class II trading transaction.The Ld. Counsel has placed his reliance in this respect on **Adidas Technical Services (P.) Ltd. v. DCIT [2016] 69 taxmann.com 401 (Delhi - Trib.),** wherein it was held that, where segmental data is not available, the comparable is liable to be rejected.

98. The Ld. CIT (DR) relied vehemently on the orders of the Ld. TPO and DRP and submitted that the company was functionally comparable to the appellant and was rightly included in the list of comparables by the Ld. TPO. He further submitted that Bajaj Electricals was chosen by the assessee itself as a comparable and it cannot now ask for its exclusion. The Ld. CIT (DR) further submitted that fans as a product falls under the category of home appliances and though the assessee is not trading in fans, it is engaged in trading of other home appliances and under TNMM broad level of product similarity is required.

99. We have perused the order of the Ld. TPO and the DRP in this regard as well as examined the Annual Report of Bajaj Electricals. While it is correct that the assessee itself had selected Bajaj Electricals as a comparable, the same was done under Resale Price Method which requires comparison at gross profit level. Further, the assessee in its TP report had taken only the "Appliances" category as a comparable category and had excluded the gross profit margin earned from manufacturing of fans. Whereas, the TPO has discarded RPM and has adopted TNMM which is a comparison of net profit margins and the TPO has taken the net profit margin of the entire "consumer durable" segment of Bajaj Electricals which includes both Appliances and Fans. Most significantly the function in relation to fans in this segment is of manufacturing and not trading. From the Annual Report, it emerges that during the year, Bajaj Electricals had manufactured 537,000 pieces of fans. While the consolidated sales quantity of fans has been given at 1,784,000, the segmental break-up of manufactured fans and traded fans is not provided. In these

circumstances it is not possible to determine the net profit margin derived from the sale of traded fans. We also note that the range of traded products of the assessee does not include fans and is limited to consumer products like Colour TVs, Air conditioners, Washing Machines, Microwave ovens and refrigerators. We therefore order the exclusion of this comparable for determination of ALP of the international transactions of the segment pertaining to trading of consumer products of the assessee. This ground is accordingly allowed.

GROUND NO. 4.4: *That on facts and in law, the TPO/AO has erred in additionally identifying Control Print Limited and Gemini Communications Limited as a comparable company for benchmarking the international transactions under Class IV (trading of colour monitors and other IT products)*

100. The Ld. Counsel pointed out that this issue has already been decided in favour of the assessee by CIT (A) in prior years i.e. AY 2004-05 and 2005-06. He pointed out that no appeal has been filed by the Department before the ITAT on this issue in AY 2004-05. However, in AY 2005-06, the Department has filed an appeal on the same issues and the same has been covered in the submissions for AY 2005-06. The Ld. CIT (DR) relied on the orders of the Ld. TPO and DRP.

101. While adjudicating the appeal filed by the Dept. for A.Y. 2005-06, we have held that the Ld. CIT (A) was right in excluding these two comparables. In this assessment year as well, we find that the facts and circumstances relating to these two companies (Control Print and Gemini Communications) remain the same. A perusal of their Annual Reports shows that their functional and

product profile is unchanged. Control Print is a manufacturer of coding and marking machines and Gemini Communications is engaged in providing network solutions and as part of this exercise sells communication equipment. In order to maintain consistency with the approach approved by us in the prior year, in the absence of change of facts, we order the exclusion of these two companies.

GROUND NO. 5: *That on facts and in law, the TPO/AO has erred in law and facts by grossing up the advertisement and sales promotion expenses and not including the advertising reimbursements as part of income received by the appellant from its associated enterprises while computing the operating margins of the respective segments*

102. The Ld. Counsel for the Appellant contends that the Ld. DRP has merely stated that the reasons given by the TPO in his order are correct and has failed to take into account the decision rendered by Hon'ble ITAT in the case of **Sony India Private Limited 114 ITD 448** on this issue. The Ld. Counsel pointed out that after the Ld. DRP issued its directions, the Hon'ble ITAT rendered a decision on this issue in favour of the assessee in its own case for AY 2002-03 to 2004-05 wherein it was held that the assessee has a prior agreement for reimbursement of specific AMP expenses and genuineness or bona fide of the said agreement cannot be disputed. Further, it was held that based on evidence on record, the recoveries directly correspond to actual expenses incurred by the assessee and such expenditure was incurred in line with terms of aforesaid agreement.

103 Further, the CIT(A), in AY 2005-06 (as well as in the earlier years), based on merits of the case and placing reliance on ITAT

judgment in case of Sony India (P) Ltd *supra* decided the matter in favour of the assessee by treating AMP recovery as operating income at para no. 105.4 of the said order. It has been submitted that it has clearly been held that the prior agreement provided for reimbursement of specific AMP expenses and genuineness or bona fide of the agreement cannot be questioned. Also, there are evidences on record to prove that the expenses directly correspond to actual expenses incurred. The Ld. Counsel contends that the issue stands squarely covered in favour of the Appellant in its own case for three prior years by this Hon'ble ITAT.

104. Ld. DR argued that the Marketing Development Fund entered into by the appellant with its AE was for promotion of brand of the AE in India. Thus, action of the Ld. TPO of making an addition by treating AMP recovery as non-operating income and including the same as part of the operating expenses was correct. He also placed reliance on the DRP order wherein the DRP has upheld the action taken by the Ld. TPO on the same reasoning.

105. We have perused the orders of the TPO and the DRP as well as the appellate orders passed by this Tribunal on this issue in the prior years. We observe that a coordinate Bench of this Tribunal while deciding the appeals of the Appellant-assessee in A.Yrs 2002-03, 2003-04, 2004-05 has examined this issue in detail and has concluded that the approach of the TPO to treat the reimbursement received under the MDF agreement as non-operating income while treating the same as operating expenditure for computing the net profit margin is unjustified and contrary to law and principles of transfer pricing. In A.Y. 2005-06 as well, the TPO had adopted a similar approach which was held to be

impermissible by the CIT (A). No appeal was preferred by the Revenue before the Tribunal in respect of this issue. Respectfully following the orders of the Coordinate Bench on this issue, we hold that reimbursements received by the Appellant from its AE under the MDF agreement has to be taken into account both as operating income as well as operating expenditure while computing the net profit margin under TNMM analysis. This ground is therefore allowed.

GROUND NO. 6: *That on facts and in law, the TPO/AO has erred in not restricting the transfer pricing adjustment in proportion to the value of impugned international transactions with the associated enterprise vis-à-vis the total cost base of the various business segments which included the cost of uncontrolled transactions with independent third parties also.*

106. The Ld. Counsel argued that the Ld. TPO erred in not granting the proportionate adjustment to the Appellant. It is settled law that the adjustment is to be made only on international transactions and not on other unrelated transactions. He placed reliance on the following case laws for grant of proportionate adjustment:

(a) _____IL Jin Electronics (I) (P.) Ltd. v. ACIT ITA NO. 438/DEL/2008, [2010] 36 SOT 227 DELHI) (para 15)

(b) _____CIT v. Keihin Panalfa Ltd. ITA No. 11 and 12/2015 (Del HC) (para 12)

(c) _____CIT v. Thyssen Krupp Industries India (P.) Ltd. ITA No. 2201 OF 2013, [2016] 381 ITR 413 (Bombay) (paras 3 and 4)

(d) _____Tasty Bite Eatables Ltd. v. ACIT ITA NO. 1682/PN/2011 (para 37)

107. Ld. CIT (DR) relied on the order of Ld. TPO and DRP and contended that proportionate adjustment should not be given to the Appellant. Ld. TPO has allowed proportionate adjustment in AY 2014-15 & AY 2015-16.

108. It is now well settled that the transfer pricing exercise is strictly limited to the transactions with AEs and transactions with unrelated parties do not come within its ambit. It has also been brought to our notice that in A.Y. 2013-14 the DRP itself has issued directions to the TPO to confine the adjustments to the proportionate value of the international transactions with AEs. Accordingly, the TPO is directed to restrict the amount of adjustment, if any, made under Chapter X of the Act limited and proportionate to the value of the international transactions with AEs.

GROUND NO. 7: As this Ground has not been pressed by the assessee, it is dismissed.

GROUND NO. 7.1:*That on facts and in law, the AO has erred in holding that the benefit of expenditure on recruitment and training of employees is not restricted to one year and accordingly has to be apportioned over 6 years, accordingly, the AO has erred in disallowing expenditure of Rs. 1,03,07,792.*

GROUND 7.2: *That on facts and in law, the AO has erred in not allowing in the year under assessment, 1/6th of the expenditure on recruitment and training that was similarly disallowed in the preceding five assessment years*

109. The Ld. Counsel submitted that the said issue is covered by decision of Hon'ble Delhi High Court in Assessee's own case for AY 1999-2000, 2002-03 and AY 2003-04 wherein the Delhi High Court affirmed the decision of this Hon'ble Tribunal allowing the deduction of expenditure incurred on recruitment and training of employees. The Ld. Counsel submitted that the Ld. AO erred in treating it as a deferred revenue expenditure on the assumption that recruitment expenses will result in long term benefit. He failed to appreciate that such expenditure was revenue in nature, incurred for the purpose of business and therefore allowable under section 37(1) of the Act. Ld. CIT (DR) relied on order of the Ld. TPO and DRP.

110. We have already decided this issue under Ground no. 2 in the Dept's appeal for A.Y. 2005-06 (ITA No. 3410/Del/12) in assessee's favour relying on the orders of the Hon'ble Delhi High Court on this issue. Orders dated 9.06.2013 and 15.05.2017 in the appeals for A.Yrs 1999-2000 and 2003-04 respectively of the Delhi High Court have been placed before us. Respectfully following the decision of the Delhi High Court we allow this ground of appeal.

GROUND NO. 8.1: *That on facts and in law, the AO has erred in disallowing deduction in respect of depreciation on UPS amount to Rs. 7,72,086 by classifying them to be plant and machinery instead of computers*

GROUND 8.2: *That on facts and in law, the AO has erred in computing the amount of the depreciation disallowance.*

111. The AO allowed 15% depreciation on UPS stating that it is covered under the head 'plant and machinery'. Thus, 60%

depreciation claimed by the assessee was disallowed. In this aspect, the Ld. Counsel submits that this issue is no longer *res integra* as there are numerous decisions of the High Courts and Tribunal where it has been held that depreciation on UPS is to be allowed at 60% and not 15%. The Ld. Counsel contends that UPS were purchased for the purpose of running the computer uninterruptedly during power cuts and to prevent the loss of data in the computer due to sudden, frequent power cuts. He stated that UPS also controls voltage fluctuation and prevents the damage of computer system and its parts such as hard disk, memory etc. These UPS were connected to LAN, PCs, servers, routers, V Sats, etc. and these would not have functioned properly without support from the UPS. Thus, UPS form a vital component of the computer system and therefore, the applicable rate of depreciation on such UPS systems should be considered as 60 percent (same as that of computers) under the category of 'Computers'. The Ld. Counsel pointed out that 60% depreciation on UPS was allowed by the CIT (A) in assessee's own case for AY 2005-06. Ld. CIT (DR) relies on the order of the AO and the DRP.

112. We are in agreement with the Ld. Counsel of the Appellant that this issue is no longer *res integra* as this Tribunal has already taken a view that for depreciation purposes, UPS falls under the category of Computers being a computer peripheral. The law in this regard has been settled by various decisions, particularly the decision of the Hon'ble Jurisdictional High Court in the case of **CIT v. BSES Rajdhani ITA No. 1266/2010**. This ground is therefore allowed.

AY 2007-08 (ITA No. 5315/DEL/11)

113. The facts and business model in the present Assessment Year i.e. 2007-08 are similar to the facts already stated for AY 2005-06 and 2006-07. For the relevant assessment year, the appellant had filed its return of income on 31 October 2005 declaring an income of Rs. 104,57,52,771/- A summary of the international transactions in dispute and the appellant's approach in determining their ALP for these disputed transactions is given in the table below:

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class II –Trading – (Consumer Electronics and Home Appliances) Import of finished goods, Import of stores and service spares, Export of service spares, Service income from hand held phones	Resale Price Method ("RPM")	Gross Profit/Sales	24.15 %	10	23.08%
Class III - Manufacturing - (Colour Monitor) Import of raw material Import of stores and service spares, Export of raw materials and service spares, Import of fixed assets, Service	Transactional Net Margin Method ("TNMM")	OP/OR	0.17%	6	1.82%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
income from hand held phones					

114. The other international transactions pertain to Classes I (Manufacturing of Consumer Electronics and Home Appliances), Class IV (Trading of Colour monitors) and class V (Contract software development). There is no dispute in respect of these transactions. The dispute in the present AY (ITA No. 5315/DEL/2011) filed by the appellant pertains to the international transactions grouped under Class-II (Trading of Consumer Electronics and Home Appliances) segment and Class-III (Manufacturing of Colour monitors) segment.

115. In respect of Class -II (Trading of Consumer Electronics and Home Appliances) segment, the following transactions have been grouped together by the appellant in its transfer pricing study prepared under rule 10B of the Income Tax Rules 1962 (Rules);

i) Import of finished goods;
ii) Import of stores and service spares;
iii) Export of service spares;
iv) Service income from hand held phones.

The appellant is engaged in the trading of consumer electronic goods and home appliances. Resale Price Method was chosen as the most appropriate method in its transfer pricing study. The profit level indicator taken was gross profit/ sales. For the benchmarking exercise, an economic analysis was carried out in

the TP study leading to identification of 10 uncontrolled comparable companies. Since appellant had earned gross profit margin of 24.15% which was higher than the gross profit of 23.08% earned by the comparable companies chosen in the TP study, it was concluded that the international transactions in Class-II (Trading of consumer electronic goods and home appliances) segment was at arm's length price.

116. In Class-III (manufacturing of colour monitor) segment, Transactional Net Margin Method (TNMM) was chosen as the most appropriate method to determine the ALP with operating profit/ operating revenue as the profit level indicator. The economic analysis carried out in the TP study resulted in identification of 6 uncontrolled independent comparable companies. Since the appellant had earned profit margin of 0.17% which was within the ± 5% range of the profit margin earned by the comparables, it was concluded that the international transaction was at arm's length.

117. The transfer pricing officer rejected the most appropriate method adopted by the assessee. He discarded the Resale Price Method for Class-II (Trading of consumer electronic goods and home appliances) segment and adopted Transactional Net Margin Method (TNMM) as the most suitable method for determining of arm's length price. Under TNMM, he selected operating profit margin on revenues (OP/OR; OP = operating profit/ OR = operating revenue) as the profit level indicator. The TPO further proceeded to undertake a fresh benchmarking analysis of the uncontrolled comparable companies and arrived at a set of 3 comparable companies for the Class-II (Trading of consumer electronic goods and home appliances) segment and 2

comparables for the Class-III (Manufacturing of colour monitors) segment. The arithmetic mean of the operating profit margin (OP/OR) of these comparables for the Class-II (Trading of consumer electronic goods and home appliances) segment was computed at 4.59% and for Class-III (Manufacturing of colour monitors) segment was computed at 5.64%. Based on the above approach, the TPO worked out an adjustment to the arm's length price of the international transactions pertaining to Class-II segment at Rs. 310,027,372/-. In respect of Class-III segment, the adjustment to the arm's length was worked out to be at Rs. 291,019,708/-. The TPO also carried out an adjustment with respect to the Advertisement, Marketing and Promotion ("AMP") expenses incurred by the appellant company as he was of the view that the appellant has provided certain services in respect of creation of marketing intangibles, to its AE. The TPO was of the view that any AMP expenditure incurred by the Appellant over and above the average AMP spend of the comparable companies was extraordinary in nature and incurred for the benefit of the AE which owned the "Samsung" brand. The TPO worked out the average AMP spend of the comparables at 6.55% of Sales and that of the Appellant at 10.44% of Sales and treated the difference as the value of the brand promotion service which the Appellant had provided to its AE. He accordingly held that this amount should have been recovered by the Appellant from its AE. The approach followed by the TPO in respect of this adjustment is as follows:

Particulars	**Amount (Rs.)**
Total Income (A)	44,89,80,86,000
Advertisement and sales promotion expenses incurred (B)	469,10,06,942
AMP / Total Income of SIEL (C) = (B)/(A)	10.44%
Bright Line (AMP/total income of	6.55%

comparables) (D)	
AMP as per bright line ('E) = (A)*(D)	294,08,24,633
Excess Amount Spent on Advertisement as compared to the comparables (F) = (B)-(E)	175,01,82,309
Less: Reimbursement received from its parent SEC	57,93,56,345/-
AMP reimbursement that should have been made	117,08,25,964/-
Mark-up at 12%	14,04,99,115
Adjustment proposed on account of AMP (including mark-up)	131,13,25,080

118. The AO incorporated the adjustment to the ALP made by the TPO and also made the following additions to total income:

(a) Recruitment and training expenses of Rs. 1,20,69,362/- was treated as capital expenditure and not allowable as a revenue expenditure u/s 37 of the Act;

(b) Loss arising on account of fluctuation of foreign exchange currency amounting to Rs. 206,77,205/- was disallowed as being notional and contingent in nature;

(c) Depreciation on UPS, printers and servers was restricted to 15% as against 60% claimed by the appellant leading to a disallowance of Rs. 7,12,027/-.

119. The assessee being aggrieved by the orders of the TPO and AO filed objections before the DRP, New Delhi contesting the aforesaid additions made to the total income of the assessee on various grounds. The Ld. DRP disposed of the objections filed by the assessee vide its directions under section 144C of the Income Tax Act, 1961 30th August 2011 and upheld the order of the TPO/AO. In pursuance to the DRP Directions, the AO passed the final assessment order dated 19th September 2011. Aggrieved by the order of the AO (impugned order), the assessee has preferred

the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL (ITA NO. 5315/DEL/11) FOR AY 2007-08

GROUND NOs. 1 and 2: These grounds are general in nature.

GROUND NOs. 1.1 to 1.3: These grounds pertain to the AMP issue and are identical to those already adjudicated by us in ITA No. 3248/Del/2012 for A.Yr. 2005-06. These grounds are therefore allowed in line with our findings and observations given in respect of Grounds 3.1 to 3.6 of ITA no. 3248/Del/2012.

GROUND NOs. 1.4, 1.8 and 3: These Grounds are dismissed as not being pressed.

GROUND NO. 3.1: *That, on facts and in law, the Ld. TPO/ AO has erred in rejecting* ***Voltas Limited*** *as a comparable company for benchmarking the international transactions under Class II segment (trading of consumer electronics and home appliances segment)-*

120. The inclusion of this comparable came up for our consideration in the appeal no. ITA No. 5856/Del/2010 under Ground no. 4.2 (and has been discussed at length above). As the facts and circumstances of this year remain the same (and the arguments of the two parties remain the same), we hold that the direction given by us in the prior year would apply for this year as well. The examination of this comparable company is, therefore, remanded to the file of the TPO with a direction to determine whether the twin conditions of persistent loss for three years and erosion of net worth are met. If a clear three years' trend of persistent loss coupled with negative net worth is found, it can be

excluded from the list of comparables. This ground is therefore allowed in terms of the above directions.

GROUND NO. 3.2:*That, on facts and in law, the ld. TPO/ AO has erred in considering Bajaj Electricals Limited as a comparable company while applying the transactional net margin method to benchmark the international transactions under Class II segment (trading of consumer electronics and home appliances segment)*

121. An identical ground in respect of this comparable (Bajaj Electricals) came up for consideration in the appeal for A.Y. 2006-07 (ITA No. 5856/Del/2010) where we have already given our finding under Ground no. 4.3. The facts for this year are identical and the arguments advanced by the two sides are also identical. Therefore, our decision in this regard in ITA no. 5856/Del/2010 is to be followed. While deciding this ground in favour of the assessee we had directed the exclusion of this comparable as the segmental result taken into consideration includes manufacturing of fans and the assessee's activity is limited to trading of consumer products (but not fans). A perusal of this year's Annual Report shows that a similar situation exists in this year as Bajaj Electricals had manufactured 379,000 fans out of total of 21,78,000 fans sold by them. A bifurcation of profit margin of fans manufactured fans and traded fans are not provided. We accordingly allow this ground by following the earlier year's position in this respect.

GROUND NO. 4:*That, on facts and in law, the ld. TPO/AO has erred in rejecting PCS Technology Limited, Spice Limited and VXL Instruments as comparable companies for benchmarking the international transactions under Class III segment (manufacturing of color monitors)*

VXL Instruments

122. The Ld. Counsel contends that the TPO committed an error by rejecting VXL Instruments on the sole ground that it is a persistent loss-making company with declining net margins. The Ld. DRP upheld the order and reasoning of the TPO. The Ld. Counsel submits that it is factually incorrect that the said comparable is incurring persistent losses. As per the second proviso to Rule 10B (4), we should be checking losses in the current year and two prior years.

123. The Ld. Counsel pointed out that in subsequent years, turnover of VXL Instruments has increased and it continues to have operations. He contends that de-facto rejection of a negative margin company is not correct. He further contended that if a company is functionally comparable, then it cannot be rejected merely on the basis of suffering losses. In this regard, he has placed reliance on the following judicial decisions:

(a) **DCIT vs. Exxon Mobil Company India Pvt. Ltd. (ITA No. 4389/Mum/2010) (Para 7)** and **Bobst India (P.) Ltd. v. DCIT (ITA No. 1380 (PN) of 2010):** In both these cases, it was held that exclusion of a comparable merely on the ground that the comparable is incurring abnormal profit margin or persistent losses without considering the applicable law under Rule 10B of the Income Tax Rule, 1962 (Rules) is untenable under law;

(b) **DCIT vs. Quark Systems (P.) Ltd [2010] 38 SOT 307 (CHD.) (SB)**: In this case, it was held that if the company is functionally comparable and the turnover does not show declining trend then, merely on the basis that the comparable company is incurring losses, the comparable cannot be excluded;

(c) **Erhardt+Leimer (India) Private Limited vs. ACIT (ITA Nos. 3298/Ahd/2011 & 2880/Ahd/2012)**: Relying on the special bench decision in the case of Quark Systems (supra) the Hon'ble Tribunal has held as below:

> *"…consistent loss-making entities cannot be per se excluded merely in view of the negative income figures thereof."*

(d) **Chryscapital Investment Advisors (India) Pvt. Ltd. Vs. DCIT (ITA 417/2014): [2015] 376 ITR 183 (Delhi),** the Hon'ble jurisdictional High Court reiterated the same position *supra* that it is a settled law that comparables cannot be excluded merely on the ground that it is making abnormally high profits or losses.

124. The Ld. Counsel pointed out that in the present case, no extraordinary economic factor leading to persistent losses are evident from the annual report of VXL Instruments. The company is showing a steady increase of turnover on year-on-year basis except for a small dip in the F.Y. 2005-06 followed by a quick recovery in FY 2006-07 where there was a sharp increase in turnover. The trend analysis of the profit margin and the turnover as given below clearly shows that this company was passing through a temporary phase of losses from which it has recovered. Such losses are normal incident in the market and the purpose of providing for a computation of average under section 92C (2) of the Act, has been provided to account for profit as well as loss making companies. He submitted the Turnover and Net margin trend for different years:

Assessment Year	**Segmental Turnover (INR in**	**NPM**

	crores)	
AY 2004-05	49.48	0.96%
AY 2005-06	52.38	0.24%
AY 2006-07	40.26	-11.09%
AY 2007-08	72.81	-1.92%
AY 2008-09	93.43	-7.53%
AY 2009-10	80.38	2.14%
AY 2010-11	76.60	1.26%

125. Thus, he submitted that it can be seen from the trend analysis that there is no trend of persistent losses on a long-term basis. Further, the trend of sales on year-on-year basis shows that the company clearly has an upward trend. Therefore, it cannot be branded as a persistent loss maker.

126. The Ld. CIT (DR) vehemently argued that since VXL Instruments was persistently making losses, it was rightly rejected as a comparable by the Ld. TPO and the said rejection was rightly upheld by the DRP. He pointed out that this company has experienced losses in the current year, prior year and the subsequent year and on account of this trend it is evident that this company is a persistently loss-making company. He further submitted that this Hon'ble Tribunal has held in various judgments that a persistently loss-making company cannot be taken as a comparable.

127. While examining the suitability of another comparable, viz., Voltas Industries Ltd. in this appeal as well in the prior year's appeal, we have examined the issue of persistent loss making entities that are sought to be used as functionally comparable companies under TNMM. We have already held that a persistent loss trend has to be carefully gleaned from the facts of the case to

check whether this trend persists over a period of at least three years (current year and two prior years as specified in Rule 10B (4)). Furthermore, as loss and profit cycles are normal incident of the market, in order to check whether the persistent loss situation has arisen from an extraordinary economic situation which is not representative of the sector in which it operates, one has to see whether the net worth of the company has been eroded. If the twin conditions are fulfilled, the comparable can be excluded. In this case, though a chart of trend analysis has been furnished, it has not been examined by the TPO. The details of net worth are not placed before us. We accordingly remit this issue to the file of the TPO with a direction to apply the aforesaid principles to determine the suitability of this comparable. This ground is therefore disposed off in terms of the above observations.

PCS Technology Ltd.

128. Ld. Counsel contends that the TPO and the DRP committed an error in rejecting PCS Technology on the ground that it has a different financial year ending. He contends that different financial year is not a criterion to reject a comparable company. He contends that this company was accepted in AY 2006-07 by the TPO in which year too, the financial year of the company ended in June. The Ld. Counsel also submitted that the company's net profit margin for April-March can be extrapolated from the figures of the two overlapping years. He placed reliance on **DCIT vs. McKinsey knowledge Centre India private limited (ITA No. 195/del/2011), affirmed by the Hon'ble High Court of Delhi [TS-672-HC-2015(DEL)-TP]** to contend that extrapolated figures for the financial year has been approved by the Court.

129. Ld. CIT (DR) relied on the reasoning given by Ld. TPO and DRP and argued that since PCS Technology has a different financial year ending, it cannot be included in the list of comparables for the Appellant.

130. We have perused the reasoning given by the TPO and the Annual Report of this company (PCS Technology Ltd.). As per Rule 10B (4) current year data is to be primarily used for comparison under any of the specified methods. If the time period of comparison does not converge, the accuracy of comparison gets compromised. We do not agree with the contention of the Ld. Counsel that financial year ending is an irrelevant factor for the purpose of comparison under TNMM. In our view the law clearly stipulates the time period for which the data can be used for determination of ALP. It is only in certain situations where the company maintains and publishes quarterly results, the results for April-March period can be accurately extrapolated. In other situations where quarterly results are not available, any effort to derive at April-March results by extrapolating the figures on a proportionate basis would be fraught with the risk of inducing inaccuracy in the comparability process. The Hon'ble High Court's decision in Mckinsey Knowledge Centre (supra) was also rendered in the context of availability of quarterly results. In the present case, the extrapolated results submitted by the Ld. Counsel have not been drawn from published quarterly results but derived on a proportionate basis from the two overlapping years' financials. This approach is not tenable and is accordingly rejected. This ground in respect of PCS Technology Ltd. is, accordingly, dismissed.

Spice Mobile Ltd.

131. Ld. Counsel pointed out that the TPO erred in rejecting Spice Mobile Ltd. from the list of comparables on the ground that it is not clear from the financials if the company is performing manufacturing operations. The Ld. DRP upheld order of the TPO on the same reasoning. Ld. Counsel submitted that the company has 2 segments - IT segment and mobile segment. In the IT segment, the company is engaged in the business of manufacturing of computer systems and printers. Sales from computer systems and printers amount to Rs. 37.01 crore out of total sales of Rs. 52.1 crore in the IT segment. This works out to be 71% of the total revenue. The balance 29% is derived from trading, installation and networking. The calculated as submitted by the Ld. Counsel from the Annual Report is as below:

Particulars	**Amount in INR - thousands**
Turnover of IT segment	**521,912**
Passbook printers (manufactured)	234,423
Computer Systems (manufactured)	135,728
Sale from manufactured goods	**370,151**
Ratio of sales from manufacturing goods to turnover of IT segment	**71%**

132. The Ld. CIT (DR) submitted that Spice Mobile was rightly excluded from the list of comparables because it was not functionally comparable. Further, he contended that from the financials of the relevant segment, it was not clear if Spice Mobile was manufacturing comparable products.

133. We have perused the orders of the TPO and the Annual Report of Spice Mobile Ltd. This company has reported two segments – mobiles and Information Technology. In the IT segment it has significant operations in manufacturing of computer systems and peripherals which are comparable to the assessee's Class III segment wherein computer peripherals like monitors are being manufactured. However, the IT segment also has trading and installation revenues. The split between the manufacturing sales and other sales is 70:30 whereas break-up of operating costs between manufacturing and trading is not discernible from the report. In these circumstances, it is not possible to accept the inclusion of this company as a comparable. It is now well settled that if accurate segmental results are not available, the same cannot be used for TNMM benchmarking. We accordingly dismiss this ground pertaining to inclusion of Spice Mobiles Ltd.

GROUND NO. 5: *That, on facts and in law, the Ld. TPO/AO has failed to make appropriate adjustments to account for the differences in working capital employed by the appellant vis-à-vis the comparables, thereby disregarding the provisions of the Indian transfer pricing regulations and several judicial pronouncements on this subject*

134. The Ld. Counsel contends that appropriate adjustment to account for differences in working capital employed by the appellant vis-à-vis comparables ought to be allowed. He submitted that the TPO erred in not granting the working capital adjustment to the appellant to account for differences in working capital employed by the appellant vis-à-vis comparables. He argued that the TPO himself has allowed the working capital adjustments in

two preceding years, i.e., AY 2005-06 & 2006-07. He further submitted that working capital adjustments usually include adjustments for accounts payable, accounts receivable and inventory. These adjustments ensure that the absolute levels of the relevant balance sheet items are normalized by measuring them against the total cost. In respect of grant of working capital adjustment, the Ld. Counsel placed reliance on the following judicial decisions:

(a) _____Capgemini India Private Limited ITA No. 786/MUM/2011), [2013] 27 ITR(T) 74 (Mumbai - Trib.) (para 6)

(b) _____Demag Cranes & Components India Private Limited v. DCIT ITA No. 120/PN/2011, [2012] 144 TTJ 320 (Pune) (para 31)

(c) _____M/s Nevis Network (India) Pvt. Ltd v. ITO ITA No.338/PN/2012, [2015] 55 taxmann.com 519 (Pune - Trib.) (paras 11 and 13)

(d) _____Nortel Networks India Private Limited v. ACIT _____ ITA No. 4765/DEL/2011, [2015] 40 ITR(T) 102 (Delhi - Trib.) (para 11.8)

(e) _____M/s Motorola Solutions India Private Limited v. ACIT Circle-2 ITA No. 5637/Del/2011, [2014] 35 ITR(T) 546 (Delhi - Trib.) (para 162.1)

(f)_____Qualcomm India Pvt. Ltd. v. ACIT Circle 14(1) ITA No.5239/DEL/ 2010, [2014] 147 ITD 17 (Delhi - Trib.) (para 41)

(g) _____Mentor Graphics (Noida) (P) Ltd. (109 ITD 101)

135. The Ld. CIT (DR) relied on the orders of the lower authorities.

136. The issue of grant of adjustment for difference in levels of working capitals between the assessee and the comparable companies is now well recognized by this Tribunal and is no longer *res-integra.* Differences in inventory levels, credit period allowed by the suppliers and credit period given to its customers lead to capital being locked in circulation. The net profit margins do not reflect this difference. An entity which permits a longer credit period of realizing its sale proceeds would want to receive compensatory interest which is often inbuilt in the price of goods/services sold. Similarly, a customer who is paying the full price upfront would want a discount to account for the prompt payment that is made. Therefore, working capital adjustment is nothing but accounting for time value of money. The necessity and desirability of an adjustment for the same is advocated by the OECD and the UN guidelines on Transfer Pricing as well. Economic adjustment of this nature is also mandated by Rule 10B(3) and Rule 10B(1)(e)(iii). In light of this discussion, we allow this ground and hold that TPO should, while determining the net profit margins of the comparables should compute and allow suitable adjustments for differences in working capital. We also note that this is justified from the angle of consistency as well because the TPO himself had made working capital adjustments to the margins of the comparables in the two prior assessment years.

GROUND NO. 6: *That, on facts and in law, the Ld. TPO / Ld. DRP has erred in not restricting the transfer pricing adjustment in*

proportion to the value of impugned international transactions with the associated enterprise vis-à-vis the total cost base of the various business segments which included the cost of uncontrolled transactions with independent third parties also

GROUND NO. 6.1: *Without prejudice, the ld. AO / Ld. DRP has erred in holding that the value of international transactions is approximately 50% of the total cost and therefore the international transactions have significant effect on the total profitability which is not true for Class II transactions for which adjustment may be restricted in proportion to the value of international transactions*

137. This ground is identical to Ground no. 6 of ITA No. 5856/DEL/2010 for A.Y. 2006-07 which has been adjudicated in favour of the Appellant. Accordingly, following our own approach in prior year this ground is allowed.

GROUND NO. 8 & 8.1: *That, on facts and in law, the Ld. AO has erred in holding that expenditure on recruitment and training of employees' leads to enduring benefit to the appellant and in holding to allow only 1/6th of the total expenditure in the current year and deferring the balance to be allowed in next five years*

Without prejudice to the above, the Ld. AO has erred in not allowing in the year under assessment, 1/6th of the expenditure on this account that was similarly disallowed in the preceding five assessment years.

138. These grounds are identical to Ground no. 2 in ITA No.3410/Del/2012 for A.Y. 2005-06 and Ground nos. 7.1 and 7.2 in ITA no. 5856/Del/2010 for A.Yr.2006-07 and we have allowed these grounds in the two years by following the orders of the Hon'ble Delhi High Court in prior years. Following the same, these grounds are therefore allowed.

GROUND NO. 9: *That, on facts and in law, the Ld. AO has erred in not treating UPS connected to computers as 'computers' and instead regarding it as an item of general 'plant and machinery' for the purpose of allowing deprecation*

GROUND NO. 9.1: *Without prejudice to the above ground, the Ld. AO has also erred in not regarding said ups as 'electrical equipment being automatic voltage controllers', eligible for depreciation @80% under Item III(8)(ix)(e)(c) of Part A of Appendix I to the Income Tax Rules, 1962 ('the Rules')*

139. While deciding the appeal for A.Y. 2006-07 (ITA No. 5856/Del/2010), we have already allowed the ground no. 8.1 and 8.2 by holding that depreciation on UPS is to be allowed at 60% under the category of computers. Following the same, we allow this ground.

GROUND NO. 10: *That, on facts and in law, the Ld. AO has erred in holding that loss on exchange fluctuation amounting to Rs. 2,06,77,205 debited to P&L account is a notional loss and is not allowable as a deduction under the provisions of the Act*

140. The assessee in order to hedge itself against forex fluctuations which impacts its export proceeds and import price it has to pay in the course of business enters into forward foreign exchange contracts from time to time. These contracts which remain open and unexpired on March 31st are marked to the market as per generally accepted accounting principles. If there is loss on the open contract the same is debited to the P&L account and claimed as a deduction u/s 37 of the Act. The AO in his assessment order has held that the provisions of Act do not allow deduction of any such notional loss for which the liability has not

crystallized. Therefore, Marked to Market (MTM) losses on account of revaluation of forex forward contracts are only notional and are deductible as business losses under income tax provisions. For the purpose of taxation, MTM Losses should be considered as just notional losses which do not involve any actual outgo as the assessee is not liable to pay such losses. This view of the AO has been upheld by the Ld. DRP.

141. The Ld. Counsel for the appellant-assessee submits that the Ld. AO has erred in holding that loss on exchange fluctuation debited to P&L account on account of revaluation of open forward forex contracts is a notional loss for which liability is not crystallized or is contingent upon the actual settlement of forward contracts and is not allowable as a deduction under the provisions of the Act. The foreign exchange loss was incurred on the restatement of value of forward contracts which are executed in respect of underlying transactions of revenue nature i.e. trade payables/receivables and not for purchase of capital asset or any speculative purposes and, hence, the loss was claimed as deductible expense. It was explained that in a foreign exchange contract, there is a binding obligation to buy or sell a certain amount of foreign currency at a pre-agreed rate of exchange, on a certain future date. Due to binding nature of agreement, the liability of the Appellant accrued the moment it entered into forward contract. It was mandatory for the Appellant to measure the MTM losses on the unexpired forward contracts at the end of the year in accordance with the method of accounting consistently followed by it with respect to the effects of changes in foreign exchange rates. The Ld. Counsel stated that this issue is now well settled in view of the Hon'ble Supreme Court decisions of **CIT v.**

Woodward Governor India Private Ltd. 312 ITR 254 (SC) and **Bharat Earth Movers v CIT: [2000] 245 ITR 428(SC)**. He further submitted that in the assessee's own case in ITA no. 6508/Del/2012 this Tribunal has examined this issue and given a finding that such MTM losses are allowable u/s 37 of the Act.

142. We have heard both the sides and examined the orders of the lower authorities. We observe that the losses have been recognized in accordance with applicable accounting standards/consistent accounting policy. The Hon'ble SC judgment of **CIT v. Woodward Governor India Private Ltd. 312 ITR 254 (SC)** has settled the issue of allowability of forex losses recognised on the last date of Balance sheet u/s 37 of the Act arising on account of trading transactions. The Hon'ble Apex Court has categorically held that loss on account of exchange difference or mark to market losses as on the date of Balance sheet is not a notional or contingent loss and has to be allowed as ordinary principles of commercial accounting should be applied while deciding deductibility under the Act so long as they do not conflict with any express provisions of the Act. Further, in the case of **Bharat Earth Movers v CIT: [2000] 245 ITR 428(SC)**, the Hon'ble Apex Court had held that if a liability has definitely arisen in accounting year, deduction should be allowed although liability may have to be quantified and discharged at a future date but what should be definite is incurring of liability. The Ld. Counsel for the appellant has placed before us a copy of an order passed u/s 154 of the Act where similar forex losses in A.Yr.2005-06 has been allowed by relying on the Hon'ble SC judgement of Woodward Governor (supra). Further, this Tribunal has examined and adjudicated this issue in favour of the assessee in ITA No.

6508/Del/2012 in the case of Samsung Technology India Pvt. Ltd which had subsequently merged with the assessee. In view of the above discussion and respectfully following the authority laid down by the Hon'ble Supreme Court, this ground is allowed.

AY 2008-09 (ITA No. 52/DEL/13)

143. The facts and business model in the present Assessment Year i.e. 2008-09 are similar to the facts already stated for AY 2005-06, 2006-07 & 2007-08. The appellant had filed its return of income on November 30, 2008, declaring an income of Rs. 173,84,64,490/-. A summary of the international transactions of the appellant and the appellant's approach in determining their ALP is given in the table below:

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class I – Manufacturing (Consumer electronics and home appliances) Import of raw material, Import of stores and services spares, Export of raw material and services spares, Export of finished goods, Payment of Royalty, Import of fixed assets, Import of spares for repair and maintenance, Availing of technical services,	Transactional Net Margin Method ('TNMM')	Operating Profit / Operating Revenue	4.43%	7	2.77%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Reimbursement of marketing expenditure by AEs					
Class II – Trading (Consumer electronics, home appliances and mobile phones) Import of finished goods, Import of stores and service spares, Service income, Reimbursement of marketing expenses by AEs	TNMM	Operating Profit / Operating Revenue	2.22%	7	1.78%
Class III – Manufacturing (Colour monitors) Import of raw material, Import of stores and service spares, Export of raw material and service spares, Import of fixed assets, Reimbursement of marketing expenses by AEs	TNMM	Operating Profit / Operating Revenue	-1.55%	5	-2.50%
Class IV – Trading (Colour monitors and other IT products) Import of finished goods, Import of stores and services spares,	TNMM	Operating Profit / Operating Revenue	3.37%	9	-0.52%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Reimbursement of marketing expenses by AE					
Class V – Contract Software Development Services (Provision of contract software development services)	TNMM	Operating Profit / Operating Cost	17.60%	23	14.65%

144. The dispute in the present appeal (ITA No. 52/DEL/2013) filed by the appellant pertains to the international transactions grouped under Class-II (Trading of Consumer Electronics, Home Appliances and Mobile Phones) and Class-III (Manufacturing of Colour Monitors) segment. The other international transactions pertain to Classes I (Manufacturing of Consumer Electronics and Home Appliances), Class IV (Trading of Colour monitors and other IT products) and Class V (Contract software development services). There is no dispute in respect of these transactions.

145. In Class-II (Trading of Consumer electronics, Home Appliances and Mobile Phones) segment, the appellant was engaged in the trading of consumer electronics, home appliances and mobile phones and in Class-III (Manufacturing of Colour Monitors) segment, the appellant was engaged in the manufacturing of colour monitors. Transactional Net Margin Method was chosen as the most appropriate method in its transfer

pricing study for both these segments. The profit level indicator taken was operating profit/operating revenue. For the benchmarking exercise in Class-II and Class-III segments, an economic analysis was carried out in the TP study leading to identification of 7 and 5 uncontrolled comparable companies respectively. Since the appellant had earned profit margin of 2.22% and -1.55% in the Class-II and Class-III segments respectively which was higher than the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

146. The TPO rejected the economic analysis undertaken by the appellant and proceeded to undertake a fresh benchmarking analysis by accepting certain comparables of the appellant and introducing certain new comparables. The TPO arrived at a set of 7 comparable companies for the Class-II trading segment and 2 comparables for the Class-III manufacturing segment. The arithmetic mean of the operating profit margin (OP/OR) of these comparables for the Class-II trading segment was computed at 5.21%. Similarly, the profit margin of the comparables in the Class-III manufacturing segment was carried out at 2.94%. vide Order dated 14 October 2011, the TPO proposed an adjustment of Rs. 50,24,84,061/- pertaining to Class-II (trading segment) and Rs. 18,99,32,764/- pertaining to Class-III (manufacturing segment). Further, he proposed an adjustment of Rs. 454,94,35,445/- with respect to AMP expenses incurred by the appellant because he was of the view that the appellant has provided certain services in respect of creation of marketing intangibles, to its AE.

Computation of TP adjustment	**(In Rs.)**
Value of gross sales	55,784,998,000/-
AMP/Sales of the comparables	2.07%
Amount that represents bright line	1,154,749,458/-
Expenditure on AMP by assessee	5,542,768,817/-
Expenditure in excess of bright line	4,338,019,359/-
Mark-up at 15%	658,202,903/-
Reimbursement that assessee should have received	5,046,222,262/-
Reimbursement actually received	496,786,817/-
Adjustment to assessee's income	**4,549,435,445/-**

147. The assessee being aggrieved by the orders of the TPO and AO filed objections before the DRP, New Delhi contesting the aforesaid transfer pricing adjustments. The DRP disposed of the objections filed by the assessee vide its directions under section 144C of the Income Tax Act, 1961 dated 27 September 2012 and directed as follows:

(a) _____The DRP directed the exclusion of Spice Mobiles Ltd. as a comparable for Class II segment and arrived at a final list of 6 comparables. The arithmetic mean of the Net Profit Margin of these 6 comparables was calculated at 5.10% vis-à-vis 2.22% of the appellant. Thus, the adjustment for Classs-II segment was reduced to Rs. 48,40,26,768;

(b) _____The DRP also directed the TPO to exclude three companies i.e. Compuage Infocom Ltd., Redington India Ltd. and Computer Point Ltd. as comparables for determining the bright line of AMP expenditure. These companies were directed to be excluded because the amount incurred by these companies on marketing and selling was 'nil'. The DRP directed to exclude VXL Instruments Ltd. because it was a persistently loss-

making company. Further, to fix the Bright Line, the Ld. DRP directed to exclude cash discount for calculating AMP expenditure of the appellant as well as the comparables. Further, it directed to include other discounts and commission payments reflected in P&L account of comparables in the AMP expenditure to fix the Bright Line. A final set of 7 comparables was directed to be used for determining the bright line. The computation of AMP adjustment was revised as under:

Particulars	**Amount (Rs.)**
Value of Gross Sales	55,784,998,000
AMP/ Sales of the Comparables	2.95%
Amount that represents Bright Line	1,645,657,441
Amount actually spend on AMP Expenditure	5,54,27,68,817
Amount spent in excess of 'bright line' and on creation of marketing intangibles	3,89,71,11,376
Mark-up @15%	58,45,66,706
The amount by which Samsung India should have been reimbursed	4,48,16,78,082
Amount reimbursed	49,67,86,817
Adjustment (Rs.)	**3,98,48,91,265**

148. Based on the above directions, the TPO vide his rectified order dated 31 October 2012 made a final adjustment of Rs. 4,65,88,50,797 which comprised of (i) adjustment on account of AMP expenditure at Rs. 398,48,91,265/-, (ii) adjustment in respect of Class-II (trading segment) at Rs. 48,40,26,768/- and (iii) adjustment in respect of Class-III (manufacturing segments) at Rs. 18,99,32,764/-.

149. The AO incorporated the adjustment to the ALP made by the TPO and also made the following additions to total income:

(a) Recruitment and training expense of Rs. 2,07,83,696 was treated as capital expenditure and not allowable as a revenue expenditure u/s 37 of the Act;

(b) Foreign exchange fluctuation loss of Rs. 1,74,38,690 was not allowed as a deduction;

(c) Depreciation on UPS, printers and servers was restricted to 15% as against 60% claimed by the appellant leading to a disallowance of Rs. 7,24,741.

150. Aggrieved by the order of the AO, the assessee has preferred the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL (ITA NO. 52/DEL/13) FOR AY 2008-09

GROUND NO. 1 & 2: These grounds are general in nature.

151. **GROUND NO. 2.1 to 2.12:** These grounds pertain to the issue of AMP expenditure being treated as an international transaction and adjustment being made on the basis of the "bright line" test. We have already decided this issue in favour of the appellant in ITA no. 3248/Del/2012 for the A.Y. 2005-06 by examining this issue in detail. These grounds for this year are accordingly allowed and disposed-off on the lines of our findings and observations made while deciding Grounds no. 3.1 to 3.6 of ITA no. 3248/Del/2012.

GROUND NO. 3: *That on facts and in law, the Ld. AO/TPO erred in rejecting* ***Shyam Telecom Limited*** *as a comparable company for determining the ALP of international transactions under Class II*

segment (trading of consumer electronics, home appliances and mobile phones)

152. The Ld. TPO rejected Shyam Telecom for the sole reason that it was a persistently loss-making company. The Ld. DRP was of the view that the company was functionally different since the company has significant export income from trading and relevant segment considered by the appellant is not purely a trading segment but engaged in turnkey projects and trading.

153. The Ld. Counsel argued that Shyam Telecom is not a persistent loss-maker because on an entity basis, the company has shown positive operating profit year on year even though relevant segment incurred losses. He submitted that this comparable has been accepted by the Ld. TPO in subsequent 2 years and thus, the principle of consistency should be followed. He pointed out that the principle of consistency has been upheld in **Brintons Carpets Asia P. Ltd. v. DCIT (ITA 1296/PN/2010).** The Ld. Counsel submitted that Shyam Telecom operates under three business segments as stated in the table below:

Segment Name	Segment Description
Telecom Products & Services	The Telecom products & Services segment comprise of manufacturing and services in the related area.
Turnkey Projects and Trading	Turnkey Projects and trading services segment includes the turnkey projects and trading in telecom products.
Investments (including Dividend)	Investments are primarily in the subsidiaries which are dealing in telecommunication

	sectors.

He pointed out that over 99% income under Turnkey Projects and Trading Segment are attributable to trading income from sale of GSM handsets, accessories, communication systems and components. Revenue from GSM handsets & accessories is Rs. 157.08 crores which is 99% of total revenue from the Turnkey Projects and trading segment as is evident from the table below:

Particulars	**Amount (In INR) (In Lakhs)**
Total revenue from Turnkey projects and trading segment	15,893
Total revenue from traded goods	15,708
Ratio of traded goods to segmental revenue	99%

154. Ld. Counsel argued that in this case, no extraordinary economic factor leading to persistent losses are evident from the annual report of the company. Such losses are normal incident in the market and the purpose of providing for a computation of average under section 92C (2) of the Act, has been provided to account for profit as well as loss making companies.

155. The Ld. CIT (DR) vehemently relied on the order of the TPO and argued that Shyam Telecom was correctly excluded. He argued that since Shyam Telecom is a persistently loss-making company and it has a different functional profile, it cannot be included in the list of comparables to determine arm's length price. The Ld. CIT (DR) pointed out that the quantum of revenue derived

from turnkey project was INR 1.85 crores out of total segment revenue of INR 158.93 crores which was a material amount and cannot be ignored.

156. We have examined and perused the orders of the lower authorities and also the Annual Report of Shyam Telecom Ltd. While the basis of the claim that this company is a persistent loss-making one is not very clear, it is manifest that the product profile of this entity is very dissimilar to that of the assessee's. The relevant segment which is being sought to be taken for comparison is called the "Turnkey" segment. In this segment, predominant part of the revenues is derived from trading of GSM sets and communication network. Only a very small portion of revenue is derived from turnkey projects. However, the breakup of sales and profit margins of GSM phones and other equipment is not available in the Annual Report. In such a situation it would be an error to allow the inclusion of this comparable. This ground is accordingly dismissed.

GROUND NO. 4: *That, on facts and in law, the Ld. AO/TPO has erred in considering Bajaj Electricals Limited as a comparable company for determining the ALP of international transactions under Class II segment (trading of consumer electronics, home appliance and mobile phones).*

GROUND NO. 5: *That, on facts and in law, the Ld. AO/TPO has erred in rejecting PCS Technology Limited and VXL Instruments Limited as comparable companies for determining the ALP of international transactions under Class III segment (manufacturing of colour monitors).*

157. Ground no. 4 pertaining to Bajaj Electricals Ltd. is identical to the Ground no. 4.3 in ITA no. 5856/Del/2010 for A.Y. 2006-07 and Ground no. 3.2 in ITA no. 5315/Del/2011 for A.Y. 2007-08. As the material facts and circumstances and the arguments taken by both sides remain the same, this ground is decided on the findings and observations made in these two years. As in prior years, the material fact that needs to be seen is whether the segment of consumer products taken by the TPO includes manufacturing of fans. The Annual Report of Bajaj Electricals for the F.Y. 2007-08 reveals that in this year as well the company had manufactured 2,87,000 fans out of a consolidated sales quantity of 27,07,000 fans and the net profit margins of the manufactured and traded fans are not provided. In the absence of these details Bajaj Electricals Ltd cannot be taken as a comparable.

158. Ground no. 5 pertains to two companies which have been sought to be included as comparables – these are PCS Technology Ltd. and VXL Instruments Ltd. The suitability of these two companies as comparables for the Manufacturing Segment has already been examined by us in the appeal for A.Y. 2007-08, where identical questions and arguments had been raised by the two sides. In the said appeal (ITA No. 5315/Del/2011) while adjudicating Ground no.4 pertaining to these comparables, we have held that PCS Technology Ltd. is not a suitable comparable in the absence of accurate financials and for VXL Instruments, we have ordered a remand to the file of the TPO to determine whether the twin conditions of persistent loss (for current and two prior years) coupled with erosion of net worth are present. These directions would be equally applicable to these comparables for this year as well as the facts and circumstances remain the same.

Accordingly, Ground nos. 4 and 5 are partly allowed.

GROUND NO. 6: *That, on facts and in law, the Ld. AO/TPO has erred by not making appropriate adjustments to account for differences in working capital employed by the appellant vis-à-vis the comparables-*

GROUND NO. 7: *That, on facts and in law, the Ld. AO/TPO has erred in not restricting the TP adjustment in proportion to the value of international transactions with the associated enterprises vis-à-vis the total cost base of the various business segments which included cost of uncontrolled transactions with independent third parties as well*

159. Ground no. 6 pertains to the issue of allowability of economic adjustment to account for differences in working capital between the assessee and the comparables chosen for TNMM analysis and the same has already been adjudicated by us under Ground no. 5 for the appeal for A.Y. 2007-08 (ITA No. 5315/Del/2011). We have held that this issue of working capital adjustment is now no longer *res integra* and has to be allowed. This would be equally applicable for this year as well and this ground is accordingly allowed. The TPO is directed to compute the adjustment while determining the arm's length price under TNMM.

160. Similarly, Ground no. 7 pertaining to restricting the transfer pricing adjustment to the proportionate value of the international transactions has been decided by us under Ground no. 6 of ITA No. 5856/DEL/2010 for A.Y. 2006-07 and Ground no. 6 of ITA no. 5315/Del/2011for A.Y. 2007-08 by allowing the same. Our observations and order in this respect would apply to this Ground as well.

These two grounds 6 and 7 are accordingly disposed off in terms of the above observations.

GROUND NO. 8: This ground is dismissed as not being pressed.

GROUND NO. 9: *That, on facts and in law, the Ld. AO has erred in holding that expenditure on recruitment and training of employees leads to enduring benefit to the appellant and in allowing only 1/6th of the total expenditure in the current year and deferring the balance to be allowed in next five years and in doing so disallowing expense of Rs. 2,07,83,696*

GROUND 9.1: *Without prejudice to above, the Ld. AO has erred in not allowing in the year under assessment, 1/6th of the expenditure on this account that was similarly disallowed in the preceding five assessment years*

161. We have already adjudicated this issue in the appeals for prior years (A.Y. 2005-06, 2006-07 and 2007-08) and allowed the same. We have held that training and recruitment expenditure is fully allowable as revenue expenditure in the year in which it is incurred. There being no enduring benefit it cannot be treated as capital expenditure or deferred revenue expenditure. Ground no. 9 is therefore allowed and Ground no. 9.1 is dismissed as being infructuous.

GROUND NO. 10: *That, on facts and in law, the Ld. AO has erred in not treating UPS connected to computers as 'computer' and instead regarding it as an item of general 'plant and machinery' for the purpose of allowing depreciation and in doing so disallowed depreciation of Rs. 7,24,741*

162. We have already adjudicated this issue in the appeals for prior years (A.Yrs. 2006-07 and 2007-08) and allowed the same. We have held that it is now settled that depreciation on UPS

systems is allowable at the rate of 60% under the category of 'computer' and not at 15% under the category of 'plant and machinery'. Following the same, this ground is allowed.

GROUND NO. 11: *That, on facts and in law, the Ld. AO has erred in holding that loss on exchange fluctuation amounting to Rs. 1,74,38,690 debited to P&L account is a notional loss and in not allowable as a deduction under the provisions of the Act*

GROUND 11.1: *Without prejudice to the above ground, the Ld. AO has erred in not excluding Rs. 2,06,77,205 from the taxable income of current year being marked to market losses incurred in respect of foreign exchange contracts which were outstanding as on 31st March 2007 and written back during the year as same was not allowed as deduction in the assessment proceedings for AY 2007-08*

163. This ground pertains to allowability of loss arising from revaluation of forward forex contracts on the last date of the balance sheet on account of restatement of amounts payable and receivable in foreign exchange. This issue has already been decided by us in ITA No. 5315/Del/2011 for A.Y. 2007-08 under Ground no. 10 wherein we have allowed the ground in view of the law being settled by the Hon'ble Supreme Court in CIT v. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC) in this regard. Following the same, this Ground is allowed.

AY 2009-10 (ITA No. 1567/DEL/14)

164. The facts and business model in the present Assessment Year i.e. 2009-10 are similar to the facts already stated for AY 2005-06 to AY 2008-09. The appellant had filed its return of income on November 30, 2009, declaring an income of Rs.

143,10,59,696/-. A summary of the international transactions entered into by the appellant and the appellant's approach in determining their ALP is given in the table below:

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class I – Manufacturing (Consumer Electronics, Home Appliances and Mobile Phones) Import of stores and service spares, Import of raw material, Export of raw material and service spares, Export of finished goods, Payment of royalty, Import of fixed Assets, Import of spares for repair and maintenance, Availing of services, Reimbursement of marketing expenses by AEs	Transactional Net Margin Method ("TNMM")	OP/OR	4.13%	6	1.91%
Class II – Trading (Consumer Electronics, Home Appliances and Mobile phones) Import of finished goods, Import of	TNMM	OP/ OR	1.38%	8	2.14%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
stores and service parts, Export of finished goods, Services income, Reimbursement of marketing expenses by AEs					
Class III – Trading (Colour Monitors and other IT products) Import of finished goods, Import of stores and services spares, Reimbursement of marketing expenditure by AE	TNMM	OP/OR	1.42%	9	-0.41%
Class IV – Contract Software Development Services Provision of contract software development services	TNMM	OP/ OC	15%	21	14.33 %

165. The dispute in the present appeal filed by the appellant pertains to the international transactions grouped under Class-IV (Contract software development) segment. The other international transactions pertain to Classes I (Manufacturing of Consumer Electronics, Home Appliances and Mobile Phones), Class II (Trading of Consumer Electronics, Home Appliances and Mobile

Phones) and Class III (Trading of Colour monitors and other IT products). There is no dispute in respect of these transactions.

166. In Class-IV (Contract software development) segment, the appellant was engaged in the provision of contract software development services. Transactional Net Margin Method was chosen as the most appropriate method in its transfer pricing study. The profit level indicator taken was operating profit/operating cost. For the benchmarking exercise, an economic analysis was carried out in the TP study leading to identification 21 uncontrolled comparable companies having margin of 14.33%. Since the appellant had earned profit margin of 15% which was higher than the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

167. The dispute in the present appeal filed by the appellant primarily pertains to the transfer pricing adjustments made by the TPO vide order dated 30 January 2013 on account of: (a) alleged international transaction of Advertising, Marketing and Promotion (**AMP**) expenses; and (b) software development segment.

168. The first adjustment relates to adjustment made on account of **AMP expenses:** The TPO was of the view that the Appellant has provided certain services in respect of creation of marketing intangibles to its AE by spending huge AMP expenses and worked out the average AMP/Sales of the comparables at 3.66% as against 9.19% in the case of the Appellant (rectified to 9.03% of sales vide rectification order dated 06 March 2013) and considered this difference as the value of the service which the Appellant had provided to its AE. He accordingly held that this

excess amount should have been recovered by the Appellant from its AE or should have been compensated by its AE. The approach followed by the TPO in respect of this adjustment is as follows:

Particulars		**Amount as per original TP Order**	**Amount as per original rectified TP Order**
Advertisement and Sales Promotion	**A**	2,341,766,583	2,341,766,583
Rebates and discounts	**B**	5,100,380,243	5,100,380,243
Reimbursement of marketing expenditure – Class I transactions	**C**	271,038,677	271,038,677
Reimbursement of marketing expenditure – Class II transactions	**D**	97,935,129	97,935,129
Reimbursement of marketing expenditure – Class III transactions	**E**	39,419,164	39,419,164
Total Expenditure on AMP	**F = A + B + C + D +E**	7,850,539,796	7,850,539,796
Less: Cash Discounts*	**G**	(489,586,765)	(620,056,638)
AMP for this analysis	**H = F –G**	**7,360,935,031**	**7,230,438,158**

**While computing the total amount of AMP spent, cash discounts were accepted to be excluded from the computation*

Particulars	**TP adjustment as per original**	**TP Adjustment as per original**

		TP Order	rectified TP Order
Value of Gross Sales	**A**	80,092,644,000	80,092,644,000
AMP/ Sales of the Assessee (%)	**B**	9.19%	9.03%
Arm's length level of AMP (3.66% of sale)	**C**	2,931,390,770	2,931,390,770
Amount actually spent on AMP	**D**	7,850,539,796	**7,230,438,158**
Amount spent in excess of the 'bright line'	**E = D – C**	4,919,149,026	4,299,092,388
Mark up @ **15.46%**	**F**	760,500,439	664,639,683
Amount to be reimbursed by the AE	**G = E + F**	5,679,649,465	4,963,732,071
Amount already reimbursed by the AE	**H**	408,392,970	408,392,970
Amount of TP adjustment	**I = G – H**	**5,271,256,495**	**4,555,339,101**

169. Subsequently, the Appellant filed a rectification application under section 154 dated 19 February 2013 with the TPO. This application was for correct consideration of the cash discount at Rs. 620,056,638 as against Rs. 489,586,765. Accordingly, the TPO passed a rectified order dated 06 March 2013 and computed the AMP adjustment at Rs. 455,53,39,101 as against Rs. 527,12,56,496 in his original order.

170. For computation of the Bright Line, the TPO selected a list of 10 comparables which is as under:

S. No	Name of the company	AMP/ Sales (%)

1.	Home Solutions Retail (India) Ltd.	4.77%
2.	Vivek Ltd.	3.59%
3.	Infiniti Retail Ltd.	4.64%
4.	CCS Infotech Ltd.	0.72%
5.	Iris Computers Ltd.	0.44%
6.	Cellucom Retail India Pvt. Ltd.	8.16%
7.	General Sales Ltd.	10.18%
8.	Allied Photographics India Ltd.	0.49%
9.	VXL Instruments Ltd.	2.83%
10.	ACI Infocom Ltd.	0.79%
	Arithmetic Mean	**3.66%**

Further, for computation of the mark-up for computing the TP adjustment on AMP, the TPO selected two comparables as under:

S.No	**Name of the company**	**NCP (%)**
1.	Crystal Hues Ltd.	8.03%
2.	Cyber Media Research Ltd.	10.89%
	Arithmetic Mean	**9.46%**

This mean of NCP 9.46% has been increased by an ad-hoc 6% (i.e. half of 12%, being the nominal rate of interest to cover the return on the funds that has been blocked), thereby, arriving at a mark-up of 15.46%.

171. In so far as adjustments in the software development segment, the Appellant in its Transfer Pricing Report computed its margins at 15% NCP as against an ALP of 14.33% (arithmetic mean earned by 21 comparables companies). The TPO after making certain alterations to the quantitative filters adopted by the Appellant in its Transfer Pricing Report and further, adding a

few new quantitative filters, accepted 11 comparables forming part of the Appellant's Transfer Pricing Report, included 1 additional company, namely Blue Star Infotech at the behest of the Appellant and 6 additional companies from the accept/ reject matrix forming part of the Transfer Pricing Report. There by computing the ALP at 25%, being the arithmetic mean of 18 comparable companies. A representation of the final comparable set adopted by the TPO is tabulated below:

S.No	**Comparables**	**NCP (%)**
1.	Akshay Software Technologies Ltd.	7.99%
2.	Aztecsoft Ltd. (Consolidated)	27.37%
3.	Blue Star Infotech Ltd. (Consolidated)	17.64%
4.	Bodhtree Consulting Ltd.	69.80%
5.	Cat Technologies Ltd.	34.43%
6.	CG Vak Software & Exports Ltd.	2.7%
7.	Goldstone Technologies Ltd. (Seg)	10.28%
8.	Infosys Technologies Ltd.	40.74%
9.	Larsen & Toubro Infotech Ltd.	21.56%
10.	LGS Global Ltd.	17.55%
11.	Mindtree Ltd.	27.36%
12.	Persistent Systems Ltd.	37.77%
13.	R S Software (I) Ltd.	10.15%
14.	Sasken Communication Technologies Ltd.	22.67%
15.	Tata Consultancy Services Ltd.	31.44%
16.	Tata Elxsi Ltd.	16.89%
17.	Thinksoft Global Ltd.	16.56%
18.	Thirdware Solutions Ltd.	37.37%
Arithmetic Mean		**25.00%**

Based on the above set of comparables, the TPO computed the adjustment as under:

Particulars		**Amount (Rs.)**
Operating Cost	**A**	1,071,382,122
Arm's Length Margin @ 25%	**B = A*25%**	267,845,531
Arm's Length Price	**C = A + B**	1,339,227,653
Price charged by the Assessee	**D**	1,232,080,000
Adjustment proposed	**E = C - D**	**107,147,653**

172. The Ld. DRP passed its directions under section 144C of the Act dated 30 December 2013. Vide its directions, the Ld. DRP upheld the action of TPO with respect to the adjustment made on account of AMP expenses. However, for the adjustment made on account of software development segment, the Ld. DRP accepted arguments of the Appellant that the comparable 'Bodhtree Consulting Ltd.' had an exponential growth in revenue in the relevant assessment year and deleted the said comparable from the final list of comparables. Accordingly, the transfer pricing adjustment was reduced to Rs. 7,30,77,701 as the ALP of the 17 comparables was recomputed at 21.82%.

173. Pursuant to the directions of Ld. DRP, the AO passed the final assessment order dated 28 January 2014 incorporating the transfer pricing adjustment on account of AMP expenses of Rs. 455,53,39,101 and on account of software development segment of Rs. 7,30,77,701. The AO also made the following additions to total income:

(a) Recruitment and training expense of Rs. 4,61,16,829/- was treated as capital expenditure and not allowable as a revenue expenditure u/s 37 of the Act;

(b) Foreign exchange fluctuation loss of Rs. 2,99,52,597/- was not allowed as a deduction;

(c) Depreciation on UPS, printers and servers was restricted to 15% as against 60% claimed by the appellant leading to a disallowance of Rs. 2,87,820/-

(d) Denied deduction claimed under section 10A of the Act amounting to Rs. 27,74,04,907/-.

Aggrieved by the order of the AO (impugned order), the assessee has preferred the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL(ITA NO. 1567/DEL/14) FOR AY 2009-10

174. GROUND NO. 1 to 12: These grounds pertain to the issue of AMP expenditure being treated as an international transaction and adjustment being made on the basis of the "bright line" test. We have already decided this issue in ITA no. 3248/Del/2012 for A.Y. 2005-06 by examining the same in detail. These grounds for this year are allowed and disposed-off in favour of the appellant on the lines of our findings and observations made while deciding Grounds no. 3.1 to 3.6 of ITA no. 3248/Del/2012.

GROUNDS PERTAINING TO ADJUSTMENT ON ACCOUNT OF SOFTWARE DEVELOPMENT (13-23)

GROUND NO. 13: *The Ld. TPO/AO/DRP have erred in not accepting the economic analysis undertaken by the appellant in respect of international transaction pertaining to provision of*

contract software development services by the appellant to its AEs and computing adjustment of INR 7,30,77,701 to the total income of the appellant

GROUND NO. 14: *The Ld. TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'turnover less than INR 5 crores' as a comparability criterion*

GROUND NO. 15: *The Ld. TPO/AO/DRP have erred, in rejecting certain comparable companies identified by the appellant on account of showing diminishing revenues trend*

GROUND NO. 16: *The Ld. TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant for having different accounting year (i.e. having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months)*

GROUND NO. 17: *The Ld. TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'employee cost greater than 25 percent of total cost' as a comparability section*

GROUND NO. 18:*The Ld. TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'export earnings less than 75 percent of operating revenues' as a comparability criterion*

GROUND NO. 19:*The Ld. TPO/AO/DRP have erred in wrongly rejecting certain companies from and adding certain companies to the final set of comparables for the said transaction on an ad-hoc basis, thereby resorting to cherry picking of comparable for benchmarking*

GROUND NO. 20: *The Ld. TPO/AO/DRP have erred in selecting certain companies (which are earning supernormal profits) as comparable to the appellant to benchmarking the said transaction.*

GROUND NO. 21: The Ld. TPO/AO/DRP *have erred in treating gain arising from foreign exchange fluctuation as non-operating in nature while computing the profit margin of the appellant.*

GROUND NO. 22: The Ld. TPO/AO/DRP *have erred in not making appropriate adjustments to account for differences in working capital employed by the appellant vis-à-vis the comparable companies.*

GROUND NO. 23: The Ld. TPO/AO/DRP *have erred in not allowing appropriate adjustments to account for differences in risk profile of the appellant vis-à-vis the comparables.*

175. The Ld. Counsel submitted that in this segment, out of final set of 17 comparables, the appellant is aggrieved by 5 comparables (namely Cat Technologies Ltd., Infosys Tecnhologies Ltd, Thirdware Solutions Ltd, Tata Elxi Ltd, Tata Consultancy Services Ltd.). Further, the appellant is also aggrieved by the erroneous exclusion of 9 comparable companies (namely Ancent Software International Ltd, Helios and Matheson IT Ltd, Indium Software (India) Ltd, KPIT Cummins Info Ltd, Maars Software International Limited, Qunitegra Solutions Ltd, SIP Technologies and Exports Ltd, Softsol India Limited, Zylog Systems Limited). Further, the appellant has also raised grounds of appeal in respect of denial of adjustment for risk, denial of working capital adjustment, erroneous treatment of foreign exchange loss as non-operating in nature, erroneous use of filters while selecting comparables (export filter, employee cost filter, diminishing revenue filter, turnover filter), erroneous rejection of companies having different financial year and erroneous inclusion of comparables having super normal profits.

176. However, it has been submitted by the Ld. Counsel of the Appellant that if only two comparables (**Infosys Technologies Ltd and Tata Consultancy Services Ltd**) selected by the TPO and DRP held to be inappropriate and are excluded and working capital adjustment is allowed, the appellant's transaction value will be at arm's length and the rest of the grounds will not be required to be adjudicated and would be rendered academic in nature. Accordingly, we examine the validity of these two comparables and the claim of working capital adjustment. The Ld. Counsel made the following submissions and pleaded for exclusion of Infosys Technology Ltd and Tata Consultancy Services Ltd.

i) Infosys Technologies Limited

(a) The Ld. Counsel pointed out that there is a huge disparity in turnover between Infosys and the Appellant's software segment- INR 20,000 Cr approx. for Infosys vis-à-vis INR 125 Cr (approx.) for the Appellant. The Ld. Counsel also submitted the company was engaged in diversified and non-comparable services i.e. design development, re-engineering, infrastructure management services and it commands a huge brand value of approximately Rs. 31,900 Cr and, hence, could not be compared to the Appellant who is a captive service provider. He further submitted that the company has significant onsite revenue i.e. 51% of revenue is from on-site jobs whereas the comparables 'Maars Software International Ltd.' and 'Zylog Systems Ltd.' have been excluded by the TPO on the ground that they had onsite revenue of approximately 42%.

(b) The Ld. Counsel argued that since the company has significant R & D activities (i.e. 1.3% of revenue earned), has significant

intangible assets (patents filed by its R & D labs by the name of 'SET Labs' & brands) and has significantly large scale of operations i.e. it is an industry giant, this cannot be included in the list of comparables. He vehemently contended that there is a catena of judgments in which Infosys has been held to be an inappropriate comparable company. He listed out the judgments as follows:

- CIT vs. Agnity India Technologies Pvt. Ltd. (ITA 1204/2011 dated July 10, 2013)
- UT Starcom Inc. (India Branch) (ITA No.5848/Del./2011)
- Toluna India Pvt.Ltd. (ITA 393/2016 & ITA 394/2016)
- Sumtotal Systems India Pvt. Ltd. (I.T.T.A. NO.660 OF 2014)
- Adaptec India Limited (I.T.T.A. No.638 of 2014)
- Virtusa (India) Private Limited [ITA No. 1962/Hyd/2011]
- Telcordia Tech nologies India Pvt. Ltd [ITA No.7821 /Mum/2011]
- Agnity India Technologies Pvt. Ltd. v. DCIT TS-265-ITAT-2013(DEL)-TP
- Mercedes Benz Research & Development India Pvt. Ltd. [IT(TP)A No. 1222/Bang/2011]
- Transwitch India Pvt. Ltd. [IT(TP)A No. 948/Bang/2011]
- Yodlee Infotech Private Limited [ITA No. 1397/Bang/2010]
- Meritor LVS India (P) Ltd. [ITA No. 405/Bang/2011]
- Patni Telecom Solutions Pvt.Ltd.[ITA No. 1846/Hyd/2011]

- Sonata Software Ltd. [ITA No. 3514/Mum/2010]
- Agilent Technologies International Pvt. Ltd. [ITA No. 6047/Del/2012]
- Cincom Systems India P.Ltd. [ITA no. 761/Del/2012]
- Insilica Semiconductors India P. Ltd Vs. ITO [ITA No.1399/Bang/2010]
- Frost &Suvilian (I) Pvt. Ltd. [ITA No. 2073/Mum/2010]
- Adaptec (India) Pvt. Ltd. [ITA 1801/Hyd/2009]
- Genesys Integrating Systems (India) Pvt. Ltd. Vs. DCIT [ITA No. 1231/Bang/2010]
- Trilogy-E-Business Software India Pvt Ltd [TS-748-ITAT-2012-Bang]
- Bearing Point Business Consulting P. Ltd TS-758-ITAT-2012(Bang)-TP (AY:2007-2008)
- CSR PVT LTD Vs. ITO TS-68-ITAT-2013(Bang)-TP AY 2007-2008
- DCIT Vs. M/s Hellosoft India P. Ltd.TS-59-ITAT-2013(HYD)-TP 2005-06
- LG Soft India Private Ltd Vs. DCIT TS-64-ITAT-2013(BANG)-TP AY 2007-2008
- Autodesk India Pvt Ltd Vs DCIT TS-62-ITAT-2013(Bang)-TP 2006-2007
- HCL EAI Services Ltd V DCIT TS-133-ITAT - 2013(Bang)-TP 2006-2007
- NDS Services Pay-TV Technology Private Limited v ACIT TS-127-ITAT-2013-Bang-TP 2007-2008
- Logica Private Ltd v ACIT TS-131-ITAT-2013(Bang)-TP 2007-2008

- NTT Data India Enterprise Application Servico5es Pvt. Ltd. vs. ACIT [TS-293-ITAT-2013(HYD)-TP] (AY 2005-06)
- 3DPLM Software Solutions Ltd. (TS-359-ITAT-2013(Bang)-TP) (AY 2008-09)
- Hyundai Motors India Engineering Pvt. Ltd. [ITA.No.1850/Hyd/2012]
- App Labs Technologies Pvt. Vs DCIT [TS-316-ITAT-2013(HYD)-TP]

(c) The Ld. CIT (DR) submitted that the Ld. TPO retained this comparable for the reason that major revenue of this company was from software development and the revenue from software product was extremely low and that R&D of 1.3% of revenue was not significant. The Ld. DRP upheld action of the TPO for the reason that FAR profile of this company was akin to the Appellant.

ii) Tata Consultancy Services Ltd

(a) This company was introduced by the Ld. TPO and his action was upheld by the Ld. DRP for the reason that this company is functionally similar to the Appellant.

(b) The Ld. Counsel contended that this company fails the Related Party Transaction (RPT) filter applied by the TPO. He pointed out that the value of RPT (only revenues derived from related parties) is Rs. 12619.79 crore and the total revenue is Rs. 22,404 crores. Accordingly, the Ld. Counsel contended that the percentage of RPT as a ratio of total sales is 56.32% and fails the RPT filter of 25% applied by the Ld. TPO himself.

(c) The Ld. Counsel pointed out that the company has 42 patents registered and over 150 applications pending registration. Further, the company has huge employee base which gives it an access to variety of talent. It has significant R & D activities and has significantly higher assets of Rs. 2669.08 crores (Net book value as on 31 March 2009) as against Rs. 44.90 crores of the appellant.

(d) The Ld. Counsel also submitted that Tata has a significantly higher turnover of Rs. 21535.75 cras against Rs. 123.20 Cr. in the case of the Appellant i.e. 175 times more than the latter.

e) The Ld. Counsel contended that this company has to be rejected as a comparables also because it has on-site revenue of 51.19% of the total revenue. He submitted that the comparables 'Maars Software International Ltd.' and 'Zylog Systems Ltd.' have been excluded by the Ld. TPO in AY 2008-09 on the ground that they had on-site revenue of 42%.

f) The Ld. CIT (DR) vehemently opposed the exclusion of the said comparables. The Ld. CIT (DR) submitted that there is no correlation between branding and profit margin. Similarly, he contended that for service companies the turnover does not have a material bearing on the profit margin as long as the company is functionally similar, it should be retained as a comparable under TNMM because size, scale and brand name do not impact the profit margin though these aspects may affect the profit. He specifically pointed out that many companies without brands and operating at low turnover have high profit margins and companies with brands and high

turnover can have low margins. Therefore, these factors are not relevant for determination of ALP under TNMM.

g) The Ld. Counsel in his rejoinder submitted that the contentions raised by the CIT(DR) do not have any merit because application of TNMM does not mandate a positive correlation between a relevant economic factor (brand / scale/ turnover) and net profit margin. He pointed out that Rule 10B(1)(e) read with Rule 10B(2) mandate the following key aspects need to be taken into account while selecting comparables:

h) Apart from similarity of function, similarity of asset level and risks undertaken by the company sought to be taken as comparable has to be similar to that of the tested party. A company which is much bigger in size and has greater number of employees requires much different level of assets and undertakes much higher levels of risk as compared to a company which is smaller in size and lesser number of employees.

i) A company with a significant brand and other valuable trade intangibles has a distinct advantage in the market place over unbranded companies. It is also important to emphasize that branded and unbranded companies operate at different levels of the market and compete in different market segments. This is a relevant factor under Rule 10B(2).

j) In the real world, there can never be a positive correlation between two economic factors / indicators, specially while measuring the impact on profit margins it is not possible to judge the exact quantum of impact of any one factor on the profit margin because profit margin is impacted by numerous factors and reasons all of which cannot be documented and

quantified. It is for this reason that Rule 10B(1)(e)(iii) contains the words "***could*** *materially affect the amount of net profit margin in the open market*". Therefore, the statute does not mandate that an economic factor is relevant only if it is positively correlated with net profit margin but as long as there is a likelihood of impact, the conditions are fulfilled.

177. We have heard the two sides and perused the orders and material on record. We are examining the suitability of both these companies (Infosys Technology and Tata Consultancy Services) together as these two are similar in many respects. As per their profile, function and volume of scale, they are reckoned as the leaders of the Indian IT sector and are often considered to be the most prestigious brands in this space. The process of selection of appropriate comparables under TNMM is to be guided by Rule 10B (2) which lays down the factors of comparability. These factors are functions, assets and risks, nature of the services, contractual terms, level of the market and other relevant economic parameters which have a material effect on profitability. The 'OECD Transfer Pricing Manual 2017' in Para 3.43 and the 'UN Transfer Pricing Manual 2017' in Para B.2.3.4.40 also provide guidance in this respect, which for sake of ready reference are extracted below:

> *"3.43. In practice, both quantitative and qualitative criteria are used to include or reject potential comparables. Examples of qualitative criteria are found in product portfolios and business strategies.* ***The most commonly observed quantitative criteria are:***
>
> - ***Size criteria in terms of Sales, Assets or Number of Employees. The size of the transaction in absolute value or in proportion to the activities of the parties might affect the relative competitive***

positions of the buyer and seller and therefore comparability.

- ***Intangible-related criteria such as ratio of Net Value of Intangibles/ Total Net Assets Value, or ratio of Research and Development (R&D)/Sales where available: they may be used for instance to exclude companies with valuable intangibles or significant R&D activities when the tested party does not use valuable intangible assets nor participate in significant R&D activities.***

- *Criteria related to the importance of export sales (Foreign Sales/ Total Sales), where relevant.*

- *Other criteria to exclude third parties that are in particular special situations such as start-up companies, bankrupted companies, etc. when such peculiar situations are obviously not appropriate comparisons.*

- *The choice and application of selection criteria depends on the facts and circumstances of each particular case and the above list is neither limitative nor prescriptive."*

"B.2.3.4.40. Criteria commonly used for initial screening may include the following list. The relevance of the screening criteria below depends on the facts and circumstances of each particular case and the list here is purely indicative:

- *Geographic restrictions with respect to a country or region;*
- *A specific industry classification;*
- *Certain keywords;*
- *Elimination of those enterprises which may have substantial transfer pricing issues themselves and fail an independence screening;*
- *Inclusion or expulsion of specific functions such as research and development, production, distribution or holding of shares;*
- *Exclusion of companies which were only recently set up;*
- ***Consideration of diagnostic ratios such as turnover per employee, ratio of net value of***

intangibles/total net assets value or ratio of research and development/sales etc.; and

- *A focus on* ***sales volume, fixed assets or numbers of employees****."*

A perusal of the above principles along with the factors stipulated in Rule 10B(2) makes it amply clear that functions, assets and risks manifested in terms of scale, size, head-count, presence of valuable intangibles are very relevant considerations to be taken into account.

178. The exclusion/inclusion of Infosys Technology Ltd. as a comparable for captive software entities is an issue that has arisen in large number of cases (some of which have been cited above by the Ld. Counsel also). Infosys Technology Ltd. is one of India's leading IT companies have presence worldwide. Its turnover is in excess of Rs. 20,000 crore (as against Rs. 125 crore of the appellant) and its functions are highly diversified. One of the important attributes that sets Infosys apart from small captive IT companies is the presence of highly valuable IPRs by way of brand and software products which generate licensing revenues. It invests significant amounts in R&D and advertising every year. Its head count is significantly larger than that of the appellant company. The diversified nature of its business has been stated on Page 78 of the Annual Report – "*.end to end business solutions.. the solutions span the entire software life cycle encompassing technical consulting, design development, re-engineering, maintenance, systems integration, package evaluation and implementation, and testing and infrastructure management services. In addition, the Company offers software products for the banking industry*". A perusal of the Annual Report further reveals that it owns a well-

known proprietary product used by the banks called “Finnacle”. The Company generates licensing revenue from products like Finnacle. The Annual Report also states that its brand has been valued by the company at a staggering Rs. 31,900 crore. For these reasons, the functional, assets and risk profile of Infosys Technology Ltd. is very dissimilar to that of the assessee’s software development segment which operates as a risk mitigated captive entity. In large number of decisions of this Tribunal Infosys Technology Ltd. has been held to be incomparable to captive software developers who lack scale, size and heft of Infosys Technology Ltd. The Hon’ble Delhi High Court in the case of CIT vs. Agnity India Technologies Pvt. Ltd. (supra) has upheld the order of the Tribunal ordering its exclusion on the above grounds (vast difference in scale, size, functions, intangible assets and risk levels). In view of the above, we hold that Infosys Technology Ltd. should be excluded from the list of comparables.

179. The factual matrix pertaining to Tata Consultancy Services is quite similar. We have perused the Annual Report of this company and we find that its turnover is in excess of Rs. 20,000 crores. Furthermore, on Page 58 of the Annual Report it has been stated that the company has 42 registered patents and another 150 are pending registration. The head-count given on Page 23 of the Report indicates that it has more than 100,000 employees. Its asset base is in excess of Rs. 2500 crore (as against Rs. 45 crores of the Appellant). In these circumstances, it is vastly dissimilar and different that the software segment of the appellant, which is operating at a much smaller level and sans any ownership of IPRs. Furthermore, the details given on Page 144 of the Annual Report demonstrate that more than 50% of its revenues are derived from

related parties. It, accordingly, fails the RPT filter of 25% applied by the TPO. The reasons for excluding Infosys Technology are equally applicable to Tata Consultancy Services as well. We, therefore, hold that Tata Consultancy Services Ltd. is a wholly inappropriate comparable for the software development segment of the appellant.

Working Capital Adjustment

180. The Ld. TPO rejected the request for working capital (WC) adjustment to the margin of the comparables by stating that out of the 3 components of WC adjustment, only one component is affected by the subject transaction i.e. receivables. On this basis, he stated that it is not justified to allow WC on 3 components. The Ld. DRP upholding the action of the Ld. TPO directed that the working capital adjustment is difficult to make due to lack of accurate and reliable data. It held that the Appellant has failed to demonstrate that difference in working capital deployed is making difference in the margin earned by the taxpayer and the comparables.

181. The Ld. Counsel pointed out that detailed submissions and calculations have been submitted by the Appellant before the Ld. DRP. He argued that WC adjustment has been granted by the Ld. TPO in subsequent years i.e. AYs 2010-11 and 2011-12. He submitted that the difference in working capital position has a bearing on the ALP. Further, he drew our attention to rule 10B(1)(e) and rule 10B (3) which allows for making reasonably accurate adjustment to arrive at the ALP. The Ld. Counsel also placed reliance on the OECD Guidelines 2017, UNTP Manual 2017 and ICAI Guidelines in this regard.

182. Further the Ld. Counsel relied on the following judicial decisions where working capital adjustment has been held to be a permissible and desirable adjustment to improve comparability:

(a)_____TNT India Private Limited vs. Asst. Commissioner of Income tax, ITA No. 1442 (BNG)/ 08

(b)_____The Income-tax Officer vs. M/s Nextlinx India Pvt. Ltd., ITA No. 454/Bang/2011

(c)_____Bearing Point Business Consulting Private limited vs. The DCIT, ITA No. 1124/Bang/2011

(d)_____Nortel Network Vs ACIT [TS-65-ITAT-2014(DEL)]

(e)_____Cengage Learning Pvt. Ltd v ITO: [ITA No. 5926/Del/2010]

(f) _____AMD India (P) Ltd v DCIT: ITA No. 204 & 242/Bang/2015

(g)_____DCIT v M/s Kyocera Asia Pacific India Pvt Ltd ITA No. 1029/Del/2016

(h) _____M/s NCS Pearson India Pvt Ltd v DCIT: ITA No. 5561/Del/2014

(i) _____DCIT v Whirlpool of India Ltd: ITA No. 1609/Del/2013

(j) _____United Health Group Information Services Pvt Ltd v DCIT: ITA No. 419/Del/2014

(k)_____ITO v M/s H&S Software Development & Knowledge Management Centre Pvt Ltd: ITA No. 6662/Del/2014

(l) _____Transcend MT Services Pvt Ltd

(m) _____Accenture Services (P) Ltd v ACIT: ITA No. 7686/Mum/2012

183. The Ld. CIT (DR) relied on the orders of the lower authorities and reiterated that the appellant had failed to show the differences between the working capital levels.

184. We have perused the orders of the lower authorities and the material on record. We find that the WC adjustment figures were furnished by the appellant which were disregarded by the TPO. On the issue of allowability of this adjustment we find that this issued has been settled by this Tribunal in numerous decisions (some of which have been cited by the Appellant) in favour of the assessees. The desirability of making the WC adjustment has also been endorsed by the OECD and UN Guidelines. The relevant extracts are as below:

OECD Guidelines 2017

*"2.87 In those cases where there is a correlation between the credit terms and the sales prices, **it could be appropriate to reflect interest income in respect of short-term working capital within the calculation of the net profit indicator** and/or to proceed with a working capital adjustment."*

UN TP Manual 2017

*"…5.3.2.14. …x..x..Adjustment might be required to ensure consistency of accounting standards between the controlled transaction and the comparable. **Differences in the use of assets can be eliminated or reduced to a significant extent by making comparability adjustments on account of working capital** or capacity utilization."*

185. Further, the issue of allowability of economic adjustment to account for differences in working capital between the assessee and the comparables chosen for TNMM analysis has already been adjudicated by us under Ground no. 5 for the appeal for A.Y. 2007-08 (ITA No. 5315/Del/2011); and Ground no. 6 for the appeal for A.Y. 2008-09 (ITA No. 52/DEL/13). We have held that this issue of working capital adjustment is now well settled proposition and has to be allowed. This would be equally applicable for this year as well and this ground is accordingly allowed. The TPO is directed to allow the WC adjustment while determining the arm's length price of the international transactions in the software segment under TNMM. It would, however, be open to the TPO to verify the figures given by the assessee.

186. Since we have held that Infosys Technology Ltd. and Tata Consultancy Services Ltd are to be excluded from the list of comparables and working capital adjustment is to be allowed to the profit margin of the remaining comparables, the other grounds are rendered academic in nature as the value of international transaction in the software segment would fall within the arm's length range.

GROUND NO. 24: *The Learned AO/DRP has erred in holding that expenditure on recruitment and training of employees leads to enduring benefit to the appellant and in holding to allow only 1/6th of the total expenditure in the current year and deferring the balance to be allowed in next five years.*

GROUND NO. 25: *Without prejudice to the above, Learned AO/DRP has erred in not allowing in the year under assessment, 1/6th of the expenditure on this account that was similarly disallowed in the preceding five assessment years*

187. We have already adjudicated this issue in the appeals for prior years (A.Yrs. 2005-06, 2006-07, 2007-08 and 2008-09) and allowed the same. We have held that training and recruitment expenditure is fully allowable as revenue expenditure in the year in which it is incurred. There being no enduring benefit it cannot be treated as capital expenditure or deferred revenue expenditure. Ground no. 24 is therefore allowed and Ground no. 25 is dismissed as being infructuous.

GROUND NO. 26:*The Learned AO/DRP has erred in reducing the claim of depreciation on UPS without mentioning anything in the final assessment order and without assigning any reasons which is against the principle of natural justice*

GROUND NO. 27: *Without prejudice to the above ground, the Learned AO/DRP has erred in not treating UPS connected to computers as 'computer' and instead regarding it as an item of general 'plant and machinery' for the purpose of allowing depreciation.*

188. We have already adjudicated this issue in the appeals for prior years (A.Yrs. 2006-07, 2007-08 and 2008-09) and allowed the same. We have held that it is now settled that depreciation on UPS systems is allowable at the rate of 60% under the category of 'computer' and not at 15% under the category of 'plant and machinery'. Following the same, this ground is allowed.

GROUND NO. 29: *The Learned AO/DRP has erred in holding that loss on exchange fluctuation amounting to Rs. 2,99,52,597 debited to P&L account is a notional loss and is not allowable as a deduction under the provisions of the Act.*

GROUND NO. 30: *Without prejudice to the above ground, the Learned AO/DRP has erred in not excluding Rs 1,74,38,690 from the taxable income of current year being marked to market losses incurred in respect of foreign exchange contracts which were outstanding as on 31st March 2008 and written back during the year as same was not allowed as deduction in the assessment proceedings for AY 2008-09.*

GROUND NO. 31: *Without prejudice to the above ground, the Learned AO/DRP erred in not excluding Rs. 7,559,120 from the taxable income of current year being marked to market losses incurred by Samsung Telecommunications India Private Limited (now amalgamated with the appellant) in respect of foreign exchange contracts which were outstanding as on 31st March 2008 and written back during the year by the appellant as same was not allowed as deduction in the assessment proceedings for AY 2008-09.*

189. This ground pertains to allowability of loss arising from revaluation of open forward forex contracts on the last date of the balance sheet on account of restatement of amounts payable and receivable in foreign exchange under the marked to market (MTM) policy mandated under accounting norms. This issue has already been decided by us in ITA No. 5315/Del/2011 for A.Y. 2007-08 under Ground no. 10 and ITA No. 52/Del/2013 for A.Y. 2008-09 under Ground no. 11 and 11.1, wherein we have allowed the ground in view of the law being settled by the Hon'ble Supreme

Court in CIT v. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC) in this regard. Following the same, this Ground is allowed.

GROUND NO. 32:*The learned AO has erred in law and on fact in withdrawing a deduction of Rs 27,74,04,907 claimed by the appellant under Section 10A of the Act on the wrong pretext that mere shifting of undertaking from one location to another tantamount to non-fulfilment of conditions laid down in section 10A(2)(II)/(III) of the Act*

190. The Ld. Counsel submitted that this issue is covered in its favour by the order of this Tribunal in ITA No. 6508/Del/2012 in the case of Samsung Telecommunications India Pvt. Ltd. for AY 2008-09, which merged with the Appellant w.e.f. 1 April 2008. A copy of the order of this Tribunal in ITA No. 6508/Del/2012 dated 23/05/2017 has been placed before us. Our attention has been drawn towards Paragraphs 19-30 of this order where the Tribunal has examined this issue in detail and has concluded that re-location of an unit from one place to another in order to meet shortage of space and to effect expansion of business does not amount to splitting or reconstruction of an existing business and would not disentitle the assessee from claiming the benefit of Section 10A of the Act. This order of the Tribunal was subsequently confirmed by the Hon'ble Delhi High Court on this issue. Respectfully following the decision of the Tribunal and the Hon'ble Delhi High Court we allow this ground of appeal.

AY 2010-11 (ITA No. 6741/DEL/14)

191. The facts and business model in the present Assessment Year i.e. 2010-11 are similar to the facts already stated for AY 2005-06 to 2009-10. The appellant had filed its return of income on September 30, 2010, declaring an income of Rs.

7,52,20,73,240/-. A summary of international transactions entered into by the appellant and the appellant's approach in determining their ALP is given in the table below:

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class I – Manufacturing (Consumer electronics, Home Appliances, Mobile Phones and Colour Monitors) Import of raw material, Import of stores and service spares, Export of raw material, service spares and finished goods, Payment of royalty, Import of fixed assets, Import of spares for repair and maintenance, Availing of services, Provision of intra-group services, Reimbursement of marketing expenses by AEs	Transactional Net Margin Method ("TNMM")	Operating Profit/ Operating Revenue ("OP/ OR")	8.14%	10	1.26%
Class II – Trading (Consumer electronics, Home Appliances, Mobile Phones, Colour Monitors and other IT products) Import of finished goods, Import of stores and service spares, Export of	TNMM	OP/ OR	-0.05%	17	0.43%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
raw material, service spares and finished goods, Service income, Reimbursement of marketing expenses by AEs					
Class III – (Contract software development services) Provision of contract software development services, Reimbursement of expenses by AEs, Rental income	TNMM	Operating Profit / Operating Cost (OP/OC)	14.84%	4	15.78%

192. The dispute in the present appeal filed by the appellant pertains to the international transactions grouped under Class-III (Contract software development) segment. The other international transactions pertain to Classes I (Manufacturing - Consumer electronics, home appliances, mobile phones and colour monitors) and Class II (Trading - Consumer electronics, home appliances, mobile phones, colour monitors and other IT products). There is no dispute in respect of these transactions.

193. In Class-III (Contract software development) segment, the appellant was engaged in the provision of contract software development services. Transactional Net Margin Method was chosen as the most appropriate method in its transfer pricing

study. The profit level indicator taken was operating profit/operating cost. For the benchmarking exercise, an economic analysis was carried out in the TP study leading to identification 4 uncontrolled comparable companies. Since the appellant had earned profit margin of 14.84% which was within +/-5% of the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

194. The dispute in the present appeal filed by the appellant pertains to the adjustments made by the TPO vide order dated 30 January 2014 on account of: (a) alleged international transaction of Advertising, Marketing and Promotion (**AMP**) expenses and (b) software development segment.

195. **Adjustments made on account of AMP expenses:** The Ld. TPO proposed an adjustment of Rs. 7,401,552,834 (Rs. 1,021,561,275 under the IT business and Rs. 6,379,991,559 under the Non-IT business) with respect to AMP expenses incurred by the Appellant. He was of the view that the Appellant has provided certain services in respect of creation of marketing intangibles to its AE.

196. **ALP determination for Provision of Contract software development services (Class III):** In Class III (Contract software development services segment), the Ld. TPO proceeded to undertake a fresh benchmarking analysis of the uncontrolled comparable companies and arrived at a set of 17 comparables (rejected 2 out of 4 comparables of the Appellant and introduced 15 other comparables). The Appellant offered new comparables during the transfer pricing proceedings which were not accepted

by the TPO. Final set of comparable for benchmarking of international transaction are reproduced in the table below:

S.No.	Name of Comparable	Working capital adjusted NPM for AY 2010-11 (%)
1	Akshay Software Technologies Ltd.	-2.93%
2	e-Infochips	63.63%
3	Evoke Technologies Pvt Ltd	17.16%
4	E-Zest Solutions	12.30%
5	Infinite Data Systems Pvt. Ltd	82.23%
6	Infosys Ltd.	43.89%
7	Larsen & Toubro Infotech Ltd.	18.47%
8	LGS Global Limited	5.95%
9	Mindtree Ltd.	12.98%
10	R S Software (India) Ltd	8.66%
11	Sasken Communication Technologies Ltd	16.35%
12	Tata Elxsi Ltd.	15.52%
13	Thinksoft Global Services Limited	12.11%
14	Thirdware Solutions Ltd.	36.54%
15	Cat Technologies Limited	2.13%
16	Maveric Systems Limited	13.19%
17	Persistent Systems and Solutions Ltd.	10.33%
Arithmetic Mean (Page 61 of TP Order)		**21.68%**
NPM of Samsung India (Page 5 of TP Order)		**14.84%**
Adjustment (Rs.)		**109,395,995**

197. The Ld. DRP vide order dated 21 October 2014 upheld the action of TPO with respect to the adjustment made on account of AMP expenses. However, for the adjustment made on account of software development segment, the Ld. DRP directed the Ld. TPO to rectify arithmetical errors in margin computation of comparable companies. As a consequence, the Ld. TPO rectified the margin computation of one comparable namely Maveric Systems Limited from 13.19% to 12.75%, thereby reducing the arm's length margin from 21.68% to 21.65%. Consequently, the adjustment was reduced to INR 10,89,09,254/-.

198. Pursuant to the directions of Ld. DRP, the AO passed the final assessment order dated 5 November 2014. The AO while incorporating the transfer pricing adjustments made by the Ld. TPO on account of AMP expenses of Rs. 7,40,15,52,834 and on account of software development segment of Rs. 10,89,09,254, made further additions of:

(i) Rs. 3,01,54,176/- on account of recruitment and training expenses;

(ii) Rs. 4,86,59,085/- on account of forward exchange contracts classified under forex loss;

(iii) Rs. 2,18,19,987/- on account of deduction claimed under section 10A of the Act.

199. Aggrieved by the order of the AO, the assessee has preferred the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL(ITA NO. 6741/DEL/14) FOR AY 2010-11

200. **GROUND NO. 1 to 11:** These grounds pertain to the issue of AMP expenditure being treated as an international transaction and adjustment being made on the basis of the "bright line" test. We have already decided this issue in ITA no. 3248/Del/2012 for A.Y. 2005-06 by examining the same in detail. These grounds for this year are allowed and disposed-off on the lines of our findings and observations made while deciding Grounds no. 3.1 to 3.6 of ITA no. 3248/Del/2012.

ADJUSTMENT ON ACCOUNT OF SOFTWARE DEVELOPMENT

GROUND NO. 12: *The Learned TPO/AO/DRP have erred in not accepting the economic analysis undertaken by the appellant in respect of international transaction pertaining to provision of contract software development services by the appellant to its AEs and computing adjustment of INR 10,93,95,995 to the total income of the appellant*

GROUND NO. 13: *The Learned TPO/AO/DRP have erred, in rejecting certain comparable companies identified by the appellant for having different accounting year (i.e. having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months)*

GROUND NO. 14: *The Learned TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using turnover less than INR 5 crores' as a comparability criterion.*

GROUND NO. 15: *The Learned TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'export earnings less than 75 percent of operating revenues' as a comparability criterion.*

GROUND NO. 16: *The Learned TPO/AO/DRP have erred, in rejecting certain comparable companies identified by the appellant on account of showing diminishing revenues trend*

GROUND NO. 17: *The Learned TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'employee cost greater than 25 percent of total cost' as a comparability criterion*

GROUND NO. 18: *The Learned TPO/AO/DRP have erred in wrongly rejecting certain companies from and adding certain companies to the final set of comparables for the said transaction on an ad-hoc basis, thereby resorting to cherry picking of comparable for benchmarking*

GROUND NO. 19: *The Learned TPO/AO/DRP have erred in selecting certain companies (which are earning supernormal profits) as comparable to the appellant to benchmark the said transaction.*

201. At the outset, the Ld. Counsel submitted that out of 17 comparables retained by the TPO after the DRP directions, the assessee is aggrieved by the erroneous inclusion of 3 comparables (e-Infochips, Infosys, Infinite). Furthermore, the assessee is also aggrieved by the erroneous rejection of 10 comparables whose inclusion is being sought. These comparables are Caliber Point Business Solutions Ltd, CG-VAK software & Exports Ltd, Cigniti Technologies Ltd, Goldstone Technologies Ltd, Helios & Matheson Information and Technology Ltd, Quintegra Solutions Ltd, R systems International Ltd, Saven Technologies Ltd, Silver Line Technologies Ltd, Zylog Systems Ltd. However, it has been submitted by the Ld. Counsel that if only 3 comparables are excluded namely Infosys Technologies Ltd, E-infochips Bangalore Ltd and Infinite Data systems Ltd, then the assessee's international transaction would be at arm's length and the rest of the grounds will be rendered academic in nature. We therefore proceed to examine the validity of this claim.

202. The Ld. Counsel made following submissions with respect to rejection of the three comparable companies:

E-Infochips Bangalore Limited ("E-Infochips")

(a) The Ld. Counsel argued that E-Infochips is functionally dissimilar as the company is engaged in both software development and IT enabled services. He pointed out that in the Annual Report, segmental information is not available and he drew the attention of the Bench to Page No. 63 of the

Annual Report where this fact has been clearly stated and the segmental information in respect of software development and ITES has not been given.

(b) The Ld. Counsel submitted that the Ld. TPO included the said comparable by merely stating that this company cannot be said to be providing IT enabled services since its communication costs are very low and that merely having supernormal profits is not a criterion for rejection. The Ld. Counsel argued that that the Ld. TPO's conclusions are based on surmises and are contrary to the facts on record as evident from the Annual Report of the company. He further submitted that the exclusion of this company was sought not on the basis of super normal profits but on the basis of functional dissimilarity and absence of segmental information.

(c) The Ld. Counsel placed reliance on the judgment delivered by the coordinate Bench in the case of **Steria India Ltd. (ITA No.107/Del/2016)** wherein it has been held that the company is not functionally comparable as it is engaged in both software development and IT enabled services for which no bifurcation is available (as segmental information is not available). This judgment has also been upheld by the Hon'ble Delhi High Court **(ITA 762/2017).**

(d) The Ld. Counsel also placed reliance on the coordinate Bench ruling in the case of **Headstrong Services (India) Pvt. Ltd. (ITA No. 714/Del/2015).**

(e) The Ld. Counsel further placed reliance on the following judgments wherein E-Infochips has been held to be functionally dissimilar and non-comparable to a software development company:

- Pegasystems worldwide India Pvt Ltd. (ITA No. 1758/Hyd/2014)
- Intoto Software India Pvt. Ltd. (1921/Hyd/2014 & 25/Hyd/2015)
- Allscripts India Pvt. Ltd. (ITA No. 771/Ahd/2014)
- Freescale Semiconductor India Pvt Ltd (ITA No1263 /Del/2015)
- Headstrong Services (India) Pvt. Ltd. (ITA No.714/Del/2015)
- Stryker Global Technology Center Pvt Ltd v DCIT (ITA No. 6866/Del/2014)

204. The Ld. CIT (DR) emphasized the fact that the communication expenses of this company are at a very low level and accordingly, it is highly probable that this is not an ITES company because ITES companies typically incur substantial amount of communication expenses to deliver their services.

205. We have heard both the sides and perused the Annual Report of E-Infochips Bangalore. From the perusal of Page 63 of the Annual Report it is evident that this company has reported its results under a single segment which has been stated to be including Software as well as ITeS activities without any bifurcation being provided. It is a fundamental principle of transfer pricing that, functionally different spheres like software and ITeS segments are not to be treated as comparable functions. A company operating in one sector cannot be taken as comparable to another company in the other sector. Only if segmental profit margins for software and ITeS segments are separately provided in

the audited results, the results of the software segment can be taken for comparison with the software segment of the assessee. It is now well settled that in the absence of segmental margins, combined entity level results cannot be used for a TNMM analysis. In Headstrong Services (supra), this Tribunal while examining the comparability of E-Infochips Bangalore to a software company held as under:

> *12.2. After considering the rival submission and perused the relevant material on record, we find from the Annual Report of this company available on page 352 of the paper book that its P & L Account shows `Income from software services' as one unit at Rs. 43,04,66,481/-. Schedules 7 gives break up of this income with "Income from Software Services" at Rs. 37.13 crore and "Consultancy Charges" at Rs. 5.90 crore. Segmental information of this company is available on page 66 of its Annual Report which states that: "The Company is primarily engaged in Software Development and I.T. enabled services which is considered the only reportable business segment". This indicates that the revenue from Software Development and ITES has been clubbed by this company which also includes consultancy charges. No doubt Consultancy charges in relation to Software Development are part of overall Software Development, but the inclusion of ITES in the overall segment frustrates the comparability. We are currently dealing with the international transaction of `Provision of Software Development services' and the international transaction of ITES is separate which has also been benchmarked distinctly. In our considered opinion, e-Infochips Bangalore Ltd. having a pool of both software developments and ITES segments into the overall segment*

designated as `Software development', cannot be considered as comparable on entity level with the international transaction of `Software development' of the assesse. We, therefore, order for the exclusion of this company from the list of comparables."

206. We also do not find merit in the contention raised by the Revenue that since the communication expenses shown in the P&L account is at a low level, the Company should be presumed to be not be engaged in ITeS. Such a conclusion is not based on evidence but is a mere speculation. In the face of a clear disclosure in the Annual Report, a speculative approach is to be discarded. We, accordingly, hold that E-Infochips Bangalore is to be excluded from the list of comparables for the software segment.

Infosys Technologies Limited-

207. The Ld. Counsel submitted that the facts pertaining to this comparable and the Appellant remain the same as in the prior year i.e. A. Yr. 2009-10:

(a) As per the Annual Report, the Company provides end-to-end business solutions that leverage cutting-edge technology, thereby enabling clients to enhance business performance. The Company provides solutions that span the entire software lifecycle encompassing technical consulting, design, development, re-engineering, maintenance, systems integration, package evaluation and implementation, testing and infrastructure management services. In addition, the Company offers software products for the banking industry.

(b) The Ld. TPO/ AO included this company as a comparable for the reason that it is engaged in software development services. The Ld. DRP upheld order of the Ld. TPO/ AO.

(c) The Ld. Counsel pointed out that there are significant intangible assets and R & D activities leading to creation of IP for this company. R&D is conducted at the various Software Engineering & technology Labs (SET Labs) at Infosys. The SET Labs are engaged in R&D in various technologies, which *inter alia* includes:

- Next generation of software engineering
- Convergence of services, network and applications
- Text analysis, machinelearning, symbolic and quantitative approaches to Reasoning and Decision Making, and Task Oriented Knowledge Management Systems
- Virtualization, grid models for computing efficiencies and cloud computing.
- Application security requirements, etc.

The efforts of the SET Labs have led to creation of R&D and filing of patents

(d) The Ld. Counsel pointed out that Infosys has an established brand presence which is one of the most important intangible assets. The company itself accepts this in its Annual Report. He further pointed out that from a perusal of Infosys' Annual Report, it has claimed that it is the most reputed and admired company in India.

(e) The Ld. Counsel argued that Infosys was engaged in diversified services apart from software services income. Revenues is also derived from sale of software products & on-site services. As per the Annual Report, the Company provides end-to-end business solutions that leverage cutting-edge

technology, thereby enabling clients to enhance business performance. The Company provides solutions that span the entire software lifecycle encompassing technical consulting, design, development, re-engineering, maintenance, systems integration, package evaluation and implementation, testing and infrastructure management services. In addition, the Company offers software products for the banking industry.

208. The Ld. CIT(DR) relied on the orders of the Ld. TPO and DRP and contended that scale, size, brand may impact profits but not profit margins. He reiterated that there is no positive correlation between turnover and profit margin.

209. We have heard both the parties, perused the orders of the TPO and the DRP and analysed the Annual Report of Infosys Technologies Ltd. The facts pertaining to the assessee's software segment and the business results of Infosys remain the same as in prior year. In appeal of the prior A.Y. 2009-10 (ITA No.1567/Del/2014) we have analyzed the suitability of this company as a comparable to the appellant's software segment and held that it has to be excluded from the set of comparables. Following the same, we hold that Infosys Technologies Ltd is to be excluded.

Infinite Data Systems Private Limited

210. The Ld. Counsel argued that this company is functionally dissimilar to the Appellant. He pointed out that as per the Annual Report, the company is a full-fledged IT consulting organization and provides services in the nature of technical consulting, design and development of software, maintenance, systems integration,

implementation, testing and infrastructure management services. Further, revenue is primarily derived from technical support and infrastructure management services. The Ld. Counsel submitted that the Ld. TPO has accepted this company as a comparable merely on the basis that services provided by this company were in the nature of software development services. The Ld. DRP upheld the order of the Ld. TPO disregarding the disclosures made in the Annual Report of this company wherein it has been clearly mentioned that this is a highly diversified company. The Ld. Counsel also pointed out that there was exceptional growth in operations, revenue and profits. He submitted a year-on-year analysis for the period FY 2007-08 to 2009-10 which is as under:

Particulars	**FY 2007-08**	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**
Sales revenue	NIL	47,407,301	383,160,901	527,524,561
Year-on-year increase (%)		-	**708.23%**	37.67%
Employee remuneration	NIL	18,725,836	109,151,595	143,902,273
Year-on-year increase (%)		-	**482.29%**	31.83%
Profit before tax	(49,999)	9,851,316	157,310,476	337,737,471
Year-on-year increase (%)		-	**1496.85%**	114.495%
Debtors	NIL	50,097,205	131,326,992	225,170,269
Year-on-year increase (%)		-	**162.14%**	71.46%

The Ld. Counsel submitted that the fact that this company has witnessed widely fluctuating growth rates (as depicted above) is

indicative of the fact that the company was facing exceptional or peculiar circumstances and risks and cannot be said to be representative of the Indian software industry. In this regard, the Ld. Counsel placed reliance on the jurisdictional ITAT ruling in the case of **M/s. Stryker Global Technology Center Private Limited vs. DCIT, (ITA No.6866/Del./2014)** wherein the ITAT has examined the functional profile of Infinite Data Systems for AY 2011-12 and excluded it as a comparable. He also placed reliance on the jurisdictional ITAT ruling in the case of M/s Freescale Semiconductor India Pvt Ltd (ITA No1263 /Del/2015).

211. The Ld. CIT (DR) vehemently opposed the exclusion of the abovementioned comparable and supported the order of the TPO and the DRP. He submitted that though the nature of services is diversified many of the services rendered by this company fall under the broad category of software development.

212. We have heard the two sides and perused the orders of the TPO and the DRP. We have also perused the Annual Report of Infinite Data Systems Ltd. The business activity of the Company has been provided at Page 13 of the Annual Report as: *full-fledged IT consulting organization and provides services in the nature of technical consulting, design and development of software, maintenance, systems integration, implementation, testing and infrastructure management services.* The Annual Report further states that, "***Revenue is primarily derived from technical support and infrastructure management services***. *The company has entered into contracts with customers where the pricing is on* ***time and material basis***. *Revenues from these contracts are recognized as and when the related services are*

rendered and related costs are incurred. Revenue from the end of the last billing to the Balance Sheet Date is recognized as unbilled revenues." The fact that this company is deriving most of its revenue from technical support and infra management services make it clear that software development activity is a minor and subsidiary activity of this company. Further, the Annual Report does not contain segmental bifurcation of profitability between technical support segment and the software segment. Both the activities are clubbed together. In the decision cited by the Appellant in the case of Stryker Global Technology Center Pvt. Ltd. (supra), a coordinate Bench of this Tribunal has examined the validity of Infinite Data Systems Pvt. Ltd. as a comparable to a software company. The Tribunal ordered the rejection of this company on the ground of functional dissimilarity by observing as under:

> *"24. The comparability of Infinite was also examined in Sun Life India Service Centre (P.) Ltd. (supra) with Sun Life India Service Centre (P.) Ltd. which is a routine software development and service provider and held to be not a suitable comparable as it is a full-fledged IT consulting organisation and provides services in the nature of technical consulting, design and development of software, maintenance, system irrigation, implementation, testing and infrastructure management services. So, in view of the matter, we are of the considered view that Infinite is not a suitable comparable vis-à-vis assessee company, hence ordered to be excluded."*

In light of the aforesaid we order the exclusion of this company from the list of comparables.

213. The other grounds of the software segment are not being adjudicated as being academic in nature in view of the submission made by the Ld. Counsel regarding the international transaction of

software segment being at arm's length on the basis of deletion of the three aforesaid comparables, viz., Infosys Technologies, E-Infochips Bangalore and Infinite Data Systems.

GROUND NO. 25: *The Learned AO/DRP has erred in holding that expenditure on recruitment and training of employees leads to enduring benefit to the appellant and in holding to allow only 1/6th of the total expenditure in the current year and deferring the balance to be allowed in next five years*

GROUND NO. 26: *Without prejudice to the above, Learned AO/DRP has erred in not allowing in the year under assessment, 1/6th of the expenditure on this account that was similarly disallowed in the preceding five assessment years.*

214. We have already adjudicated this issue in the appeals for prior years (A.Yrs. 2005-06, 2006-07 and 2007-08, 2008-09 and 2009-10) and allowed the same. We have held that training and recruitment expenditure is fully allowable as revenue expenditure in the year in which it is incurred. There being no enduring benefit it cannot be treated as capital expenditure or deferred revenue expenditure. Ground no. 25 is, therefore, allowed and Ground no. 26 is dismissed as being infructuous.

GROUND NO. 27: *The Learned AO/DRP has erred in holding that loss on exchange fluctuation amounting to Rs. 4,86,59,085 debited to P&L account is a notional loss and is not allowable as a deduction under the provisions of the Act.*

GROUND NO. 28: *Without prejudice to the above ground, the Learned AO/DRP has erred in not excluding INR 29,952,597 from the taxable income of current year being marked to market losses incurred in respect of foreign exchange contracts which were*

outstanding as on 31st March 2009 and written back during the year as same was not allowed as deduction in the assessment proceedings for AY 2009-10.

215. This ground pertains to allowability of loss arising from revaluation of open forward forex contracts the last date of the balance sheet on account of restatement of amounts payable and receivable in foreign exchange under the marked to market (MTM) policy mandated under accounting norms. This issue has already been decided by us in ITA No. 5315/Del/2011 for A.Yr. 2007-08 under Ground no. 10, ITA No. 52/Del/2013 for A. Yr. 2008-09 under Ground no. 11 and 11.1 and ITA No. 1567/DEL/14 for A. Yr. 2009-10 under Ground no. 29-31 wherein we have allowed the ground in view of the law being settled by the Hon'ble Supreme Court in CIT v. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC) in this regard. Following the same, this Ground is allowed. Ground no. 28 being infructuous is dismissed.

GROUND NO. 29:*The Learned AO has erred in law and on fact in withdrawing a deduction of INR 21,819,987 claimed by the appellant under section 10A of the Act on the wrong pretext that mere shifting of undertaking from one location to another tantamount to non-fulfilment of conditions laid down in section 10A(2)(ii)/(iii) of the Act*

216. This issue has already been decided by us in ITA No. 1567/DEL/14 for A. Yr. 2009-10 under Ground no. 32 wherein we have allowed the ground. Following the same, this Ground is allowed.

AY 2011-12 (ITA No. 868/DEL/2016 and ITA No. 2511/DEL/2018 arising out of order passed u/s 154)

217. The facts and business model in the present Assessment Year i.e., 2011-12 are similar to the facts already stated for AY 2005-06 to 2010-11. The appellant had filed its return of income on November 29, 2011, declaring an income of Rs. 1,73,33,95,170/-. A summary of international transactions entered into by the appellant and the appellant's approach in determining their ALP is given in the table below:

Particulars	**Most Appropriate Method as per TP study**	**Profit Level Indicator (PLI) as per TP study**	**Margin earned by the Appellant as per TP study**	**No. of comparables considered as per TP study**	**Arm's Length Margin as per TP study**
Class I – Manufacturing (Consumer Electronics, Home Appliances, Mobile Phones and Colour monitors) Import of raw material, Import of stores and service spares, Export of raw material, Export of stores, spares and semi-finished goods, Payment of royalty, Import of fixed assets, Import of spares for repair and maintenance, Provision of intra-group services, Availing of services, Reimbursement of marketing expenses by AEs	Transactional Net Margin Method ('TNMM')	Operating Profit/ Operating Revenue (OP/ OR)	1.77	9	1.43%

Particulars	Most Appropriate Method as per TP study	Profit Level Indicator (PLI) as per TP study	Margin earned by the Appellant as per TP study	No. of comparables considered as per TP study	Arm's Length Margin as per TP study
Class II – Trading (Consumer electronics, Home Appliances, Mobile Phones, Colour Monitors and other IT products) Import of finished goods, Import of stores and service spares, Service income, Reimbursement of marketing expenses by AEs	TNMM	OP/ OR	1.39%	19	0.67%
Class III - Provision of contract software development services	TNMM	Operating Profit / Operating Cost (OP/OC)	15.01%	22	8.97%

218. The dispute in the present appeal filed by the appellant pertains to the international transactions grouped under Class-III (Contract software development) segment. The other international transactions pertain to Classes I (Manufacturing - Consumer electronics, home appliances, mobile phones and colour monitors) and Class II (Trading - Consumer electronics, home appliances, mobile phones, colour monitors and other IT products). There is no dispute in respect of these transactions. In Class-III (Contract

software development) segment, the appellant was engaged in the provision of contract software development services. Transactional Net Margin Method was chosen as the most appropriate method in its transfer pricing study. The profit level indicator taken was operating profit/operating cost. For the benchmarking exercise, an economic analysis was carried out in the TP study leading to identification 22 uncontrolled comparable companies. Since the appellant had earned profit margin of 15.01% which was higher than the profit margin earned by the comparables, it was concluded that the international transactions were at arm's length.

219. The dispute in the present appeal filed by the appellant pertains to the adjustments made by the TPO vide order dated 29 January 2015 on account of (a) alleged international transaction of Advertising, Marketing and Promotion (**AMP**) expenses and (b) software development segment.

220. **Adjustments made on account of AMP expenses:** The Ld. TPO was of the view that the Appellant has provided certain services in respect of creation of marketing intangibles to its AE. Therefore, he proposed an adjustment of Rs. 11,884,138,456 (Rs. 1,222,238,922 under the IT business and Rs. 10,661,899,534 under the Non-IT business) with respect to AMP expenses incurred by the appellant. The Ld. TPO applied the bright line test ("BLT") to compare the AMP/sales ratio of the appellant with that of the comparable companies and application of a mark-up equivalent to SBI's PLR.

221. **ALP determination for Provision of contract software development services (Class III):** In Class III (software

development services) segment, the Ld. TPO proceeded to undertake a fresh benchmarking analysis of the uncontrolled comparable companies by modifying the filters and arrived at a fresh set of comparables. He selected 11 out of the 26 comparables provided by the appellant (i.e. 22 comparables identified as per TP Study and 4 comparables identified by the assessee during the course of TP assessment proceedings) and introduced 8 additional comparables. The final sets of comparables for benchmarking international transaction are reproduced in the table below:

S.No.	Name of Comparable	Working capital adjusted NCP for AY 2011-12 (%)
1	Akshay Software Technologies Ltd.	3.63%
2	E-Infochips Limited	56.42%
3	Evoke Technologies Pvt Ltd	10.23%
4	E-Zest Solutions	38.19%
5	Infosys Technologies Ltd.	45.11%
6	Larsen & Toubro Infotech Ltd.	21.22%
7	LGS Global Limited	13.58%
8	Persistent Systems and Solutions Ltd (Merged)	22.80%
9	Persistent Systems Ltd.	24.10%
10	R S Software (India) Ltd	18.07%
11	Sasken Communication Technologies Ltd	26.68%
12	Wipro Technologies Services Ltd. (Merged)	55.37%
13	Celstream Technologies Pvt. Ltd.	15.27%
14	Acropetal Technologies Ltd. (Seg)	21.34%
15	Mindtree Ltd.(Seg)	11.22%

S.No.	Name of Comparable	Working capital adjusted NCP for AY 2011-12 (%)
16	Sankhya Infotech Limited(Seg)	24.13%
17	Tata ElxsiLtd(Seg)	13.34%
18	Thirdware Sol (Seg)	19.54%
19	Zylog Systems Limited	27.56%
Arithmetic Mean (Page 84 of TP Order)		**24.62%**
NCP of Samsung India (Page 5 of TP Order)		**15.01%**
Adjustment (Rs.)		**216,107,588**

220. The Ld. DRP vide order dated 23 December 2015 upheld adjustments made by the Ld. TPO and stated that incurring AMP expenses constitutes an international transaction. The Ld. DRP directed for exclusion of routine selling and distribution expenses while computing the AMP adjustment of comparables. The Ld. DRP also directed for imputing the said adjustment using AMP to gross profit ('GP') ratio and the mark-up on excessive AMP expense to be as per sub-clause (ii) to Rule 10(1)(c) i.e. the GP/Sales of comparable companies, thus selected. As a consequence, the Ld. TPO passed an order dated 28 January 2016, giving effect to the directions of the Ld. DRP, wherein the adjustment was reduced to Rs. 394,368,561 (i.e. Rs. 313,105,771 under the non-IT segment and Rs. 81,262,790 under the IT segment).

221. **ALP determination for Provision of contract software development services (Class III):** The Ld. DRP directed to exclude Infosys Ltd. and Sankhya Infotech Ltd. as a comparable for Class III segment. Accordingly, the Ld. TPO passed an order dated 28

January 2016, giving effect to the directions of DRP, wherein the adjustment was revised to Rs. 189,797,464, with a revised arm's length NCP of 23.45% as against 24.62% determined by the Ld. TPO earlier.

Accordingly, the total adjustments pursuant to Ld. DRP's directions are tabulated as under:

Particulars	**Amounts as per TP order (In Rs.)**	**Amounts pursuant to DRP directions (In Rs.)**
Adjustments made on account of AMP expenses	11,884,138,456	394,368,561
Adjustment on account of provision of contract software development services	216,107,588	189,797,464
Total	**12,100,246,044**	**584,166,025**

222. Pursuant to the directions of Ld. DRP, the AO passed the final assessment order dated 28 January 2015. The AO while incorporating the transfer pricing adjustments made by the TPO, made further additions of:

i) Rs. 143,127,352 on account of disallowance in respect of foreign exchange contracts classified under forex loss
ii) Rs. 889,984,961 on account of disallowance of deduction claimed under section 40(a)(i) of the Act.

223. The Ld. TPO initiated rectification proceedings suo-moto vide notices dated 6 April 2016 and 12 March 2018. In response to these notices, the Appellant filed submissions contesting the rectifications so proposed by the Ld. TPO dated 28 April 2016, 19 May 2016 and 22 March 2018. A rectification order dated 27

March 2018 was passed by the Ld. TPO ignoring the Appellant's contentions and enhanced the total adjustment amount as below:

224. **Adjustments made on account of AMP expenses:** The Ld. TPO enhanced the AMP adjustment from Rs. 394,368,561 (i.e. Rs. 313,105,771 under the non-IT segment and Rs. 81,262,790 under the IT segment) to Rs. 1,936,311,967 (i.e. Rs. 1,936,311,967 under the non-IT segment and 'nil' under the IT segment) on account of:

- Revision in the AMP/ Gross Profit ('GP') ratio of comparable companies to 13.14% from 22.47% [on account of revision in the AMP/ GP margins of two comparables namely Dynalog (India) Ltd. and Wep Peripherals Ltd. from (427.78%) and 21.36% to 3.65% and 7.48% respectively.]

- Revision in the AMP/ GP ratio of SIEL to 22.82% from 27.55%.

225. **ALP determination for Provision of contract software development services (Class III):** The Ld. TPO re-computed the operating margin of SIEL by treating foreign exchange gain as operating income instead of adjusting the same against operating expenses. In the re-computation of operating margins of comparable companies, he further treated foreign exchange gain and amounts written back as operating. Accordingly, the adjustment under this segment was enhanced from Rs. 189,797,464 to Rs. 220,348,249.

226. The AO passed an order dated 30 March 2018 incorporating the above revised adjustments made by the Ld. TPO vide his rectified order and enhanced the assessed income to Rs.

500,44,30,490. Aggrieved by the order passed by the AO, the Assessee has preferred the present appeal and has prayed for adjudication of the following grounds of appeal.

GROUNDS IN APPELLANT'S APPEAL (ITA NO. /DEL/16) FOR AY 2011-12

227. **GROUND NO. 1 to 12 and all the Grounds in ITA No. 2511/DEL/2018 arising out of order passed u/s 154):** These grounds pertain to the issue of AMP expenditure being treated as an international transaction and adjustment being made on the basis of the "bright line" test. During this year as well the "bright line" test has been used albeit in a slightly different manner. Instead of AMP/Sales ratio, the TPO has used AMP/GP ratio to overcome the hurdle posed by the Hon'ble Delhi High Court decision of Sony Ericsson (supra) where the "bright line" test has been held to be contrary to law and impermissible. In our view the approach by the TPO in treating the AMP expenditure as a separate international transaction based on a claim that "excessive" expenditure has been incurred remains the same as in prior years. Only the bright-line has varied from AMP/Sales to AMP/GP. We have already decided this issue in ITA no. 3248/Del/2012 for A.Y. 2005-06 by examining the same in detail. These grounds for this year are allowed and disposed-off on the lines of our findings and observations made while deciding Grounds no. 3.1 to 3.6 of ITA no. 3248/Del/2012.

ADJUSTMENT ON ACCOUNT OF SOFTWARE DEVELOPMENT

GROUND NO. 13: *The Learned TPO/AO/DRP have erred in computing adjustment of INR 18,97,97,464 to the total income of the appellant on account of adjustment in ALP of the international*

transaction pertaining to provision of software development services entered into by the appellant with its AE

GROUND NO. 14: *The Learned TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'export earnings less than 75 percent of operating revenues' as a comparability criterion*

GROUND NO. 15: *The Learned TPO/AO/DRP have erred, in law and on facts and circumstances of the case, by rejecting certain comparable companies identified by the appellant on account of showing diminishing revenues trend*

GROUND NO. 16: *The Learned TPO/AO/DRP have erred in rejecting certain comparable companies identified by the appellant using 'related party filter less than 25 percent of total cost' as a comparability criterion even though they satisfy the same on a consolidated basis*

GROUND NO. 17: *The Learned TPO/AO/DRP have erred, in rejecting certain comparable companies identified by the appellant for having different accounting year (i.e. having accounting year other than March 31 or companies whose financial statements were for a period other than 12 months)*

GROUND NO. 18:*The Learned TPO/AO/DRP have erred in selecting certain companies (which are functionally dissimilar or which are earning super normal profits) as comparable to the appellant to benchmark the said transaction*

GROUND NO. 19: *The Learned TPO/AO/DRP have erred in wrongly rejecting certain companies from and adding certain companies to the final set of comparables for the said transaction on an adhoc basis (including functional comparability), thereby resorting to cherry picking of comparable for benchmarking*

228. At the outset, the Ld. Counsel submitted that despite there being numerous grounds against the adjustment made in the software segment, the appellant was primarily aggrieved by the inclusion and exclusion of certain comparables by the TPO. However, if only 2 comparables are excluded namely E-Infochips Ltd and Wipro Technologies Services Ltd and 2 comparables are included namely, R Systems International Ltd and Caliber Point Business Solutions Limited, then the assessee's international transaction would be at arm's length and the rest of the grounds will be rendered academic. Accordingly, we proceed to examine the validity of these four comparables.

229. The Ld. Counsel made his submissions with respect to the following comparable companies:

E-Infochips Limited ("E-Infochips)

(a) The Ld. Counsel contended that E-Infochips should be excluded because the company fails TPO's filter of software service income to total income filter of at least 75% since the revenues from software development service accounts for 73.38% as evident from the below table:

Particulars	**Amounts (In INR)**	**Reference**
Income from software development (A)	192,109,661	Page no. 64 of annual report for AY 2011-12 (FY 2010-11)
Income from operations (B)	260,384,251	Page no. 33 of annual report for AY 2011-12 (FY 2010-11)
Revenue from comparable	**73%**	

segment (A/B)		

(b) The Ld. Counsel further submitted that the company fails TPO's filter of export income to total income filter of at least 75% - Revenues from export of software development service accounts for 62.77% as is evident from the table below:

Particulars	**Amounts (In INR)**	**Reference**
Income from export of software services (A)	163,443,751	Page no. 68 of annual report for AY 2011-12
Income from operations (B)	260,384,251	Page no. 33 of annual report for AY 2011-12
Revenue from comparable segment (A/B)	**62.77%**	

(c) The Ld. Counsel argued that E-Infochips incurred significant R & D expenses of 4.15% of the total cost during the year whereas the Appellant has not incurred any amount towards R&D in this segment. He further contended that the company is functionally dissimilar to the Appellant on account of undertaking diversified business operations since it has derived income from hardware and such income accounts for 15% of the total revenue. It is evident from the table below:

Particulars	**Amounts (In INR)**	**Reference**
Income from computer hardware(A)	39,248,562	Page no. 62 of annual report for AY 2011-12
Income from operations (B)	260,384,251	Page no. 33 of annual report for AY 2011-12
Revenue from	**15%**	

comparable segment (A/B)		

(d) He further pointed out that the company has reported only one segment despite undertaking diversified operations. He placed reliance on various judgments wherein it has been held that E-Infochips ought to be excluded as it is involved in products and no segmental data is available. The list of decisions are as below:

i) Saxo India (P.) Ltd. v. ACIT, Circle 22(2), also upheld by Hon'ble Delhi High Court in Pr. CIT v. Saxo India (P.) Ltd. (ITA No. 682/2016); ii) Intoto Software India Pvt. Ltd. (ITA No. 1196/HYD/2010); iii) Conexant Systems India Pvt. Ltd. (ITA No. 1429/HYD/2010 and 1978/HYD/2011); iv) Virtusa India Private Limited (ITA No. 1962/HYD/2011; v) EMC Software and Services (India) Private Limited (IT(TP)A No. 273/Bang/2016); vi)Philips India Ltd (ITA No.863 & 539/Kol/2016) wherein it was held that the company is not functionally comparable as it is engaged in diversified business (software development, hardware maintenance, IT consultancy), does not have segmental information (to carve out its ITeS), was involved in R&D, and had an exceptional year (grew at rate 5 times more than industry average).

230. Ld. CIT (DR) submitted that E-Infochips was included by the Ld. TPO for the reason that it is engaged in software development. The Ld. TPO was of the view that revenue from IT consultancy and software development taken together satisfy the service income filter. The Ld. CIT (DR) vehemently defended the

order of Ld. TPO/DRP and contended that E-Infochips was rightly included for the reasons mentioned in their orders.

231. We have heard both the sides and perused the material on record. We find that this company (E-Infochips) fails the filters applied by the TPO himself. The TPO has eliminated companies from his list of comparables whose service income constitutes less than 75% of its total revenues. Similarly, the export filter of 75% is also not met. The details extracted from the Annual Report have been examined by us and we agree that these filters are not met. We also note that this company derives a material part of its revenues from computer hardware which is commingled with the revenues from software and the Annual Report does not provide bifurcation of profitability between hardware and software development. In such a situation this company is not suitable to be taken up for a TNMM comparison.

232. We also draw strength from various decisions of the Tribunal in this respect where this comparable was held to be incomparable to a software service company for the reasons discussed above. These aspects have been discussed in detail in the decision of a coordinate bench of this Tribunal in Saxo India Pvt. Ltd. (supra) and Intoto India Pvt. Ltd. (supra). In view of the above factual aspects and the numerous decisions of this Tribunal, we hold that E-Infochips is not a suitable comparable and is directed to be excluded from the list of comparables.

Wipro Technologies Limited ("Wipro Technology")

233. The Ld. Counsel pointed out that, as per the Annual Report (Page No. 38) of Wipro Technology for AY 2011-12, Wipro Technology is engaged in providing IT software solutions /

maintenance and technology infrastructure support services to Citi Group entities globally. He contended that Wipro Technology is functionally dissimilar on account of undertaking diversified business operations comprising software related support services, primarily information technology software solutions / maintenance and technology infrastructure support services unlike the Appellant who is engaged in software development support services only. Reliance was placed by the Ld. Counsel on the following judgments that hold that in absence of segmental details, a company cannot be taken into account for comparability analysis:

- LG Soft India (P.) Ltd. Vs. DCIT (2014) 48 taxmann.com 237 (Bangalore-Trib.)
- M/s British Marine PLC-India Branch vs. DCIT(IT)-1(3)(2) (ITA No.1908/MUM/2016)

The Ld. Counsel further contended that Wipro has significant related party transactions. As per the annual report of the Wipro Technologies Ltd. of FY 2009-10, Wipro Limited, the holding company of the Wipro Technologies Ltd., has acquired all the interest held by Citigroup Inc. in Citi Technology Services Limited (Subsequently renamed as Wipro Technology Services Limited) with effect from 21 January 2009. On the same date, Wipro Limited entered a master service agreement with Citigroup Inc., erstwhile holding company of Wipro Technology for providing technology infrastructure services and application development and maintenance services for a period of six years. Therefore, all the transactions between Wipro Technologies Ltd and Citigroup Inc. would qualify as an international transaction within the

meaning of Section 92B(2) of the Act. The Ld. Counsel placed reliance on Saxo India Pvt. Ltd. (ITA No. 6148/Del/2015) which has further been upheld by the Hon'ble jurisdictional High Court vide order dated 28.09.2016 in ITA No. 682/2016 (Pr.CIT, Delhi-8 v. Saxo India Pvt. Ltd.): In this case, the relevant para is reproduced below for ready reference:

> *"16.5. Adverting to the facts of the instant case, we find that Wipro Technology Services Ltd. earned a revenue from Master services agreement with Citigroup Inc. for the delivery of technology infrastructure services. This agreement was, in fact, executed between the assessee's AE, Wipro Ltd., and Citigroup Inc., a third person. This unfolds that the transaction of earning revenue from software development support and maintenance services by Wipro Technology Services Ltd., is an international transaction because of the application of section 92B(2) i.e., there exists a prior agreement in relation to such transaction between Citigroup Inc. (third person) and Wipro Ltd. (associated enterprise). In the light of this structure of transaction, it ceases to be uncontrolled transaction and, hence, Wipro Technology Services Ltd., disqualifies to become a comparable uncontrolled transaction for the purposes of inclusion in the final list of comparables under Rule 10B(1)(e)(ii). We, therefore, direct removal of this company from the list of comparables."*

The Ld. Counsel also relied on the following decisions of the coordinate Bench of this Tribunal wherein exclusion of this comparable has been upheld in the case of a software development company:

- Intoto Software India Private Ltd. [2013] 35 taxmann.com 421 (Hyderabad - Trib.)
- M/s. FCG Software Services (India) Pvt. Ltd. Vs. ITO, I.T(T.P) A.No. 1242/Bang/2012
- Vodafone India Services Vs. DCIT, ITA No.7140 /Mum/2012
- Xander Advisors India Pvt. Ltd., Vs. ACIT, ITA No.5840/Del/2012
- NEC Technologies India P Ltd. (ITA No. 6283/Del/2015)

234. Ld. CIT (DR) has contended that the TPO included Wipro Technology as a comparable for the reason that it is providing specialized services within software development and is not selling products and thus, it is comparable to the Appellant. The Ld. CIT (DR) contended that the order of Ld. TPO was correct, and Wipro Technology was rightly included for the reasons mentioned in his order.

235. We have examined the facts relating to Wipro Technology Services and the contention raised by the two sides. We find that this company has been consistently held to be incomparable on account of the peculiar facts surrounding its history. This company was earlier a subsidiary of Wipro Ltd. and had a long term service contract with Citi group. Subsequently, it was acquired by Citi group and the long term service contract continued post acquisition. On these facts, the revenues earned by Wipro Technology Services from Citigroup acquire the dimension of “controlled” transactions between related parties within the

meaning of Section 92B(2) of the Act. This issue was first examined and adjudicated by a coordinate bench of this Tribunal in Saxo India Pvt. Ltd. wherein the Tribunal observed as below:

> *"16.5. Adverting to the facts of the instant case, we find that Wipro Technology Services Ltd. earned a revenue from Master services agreement with Citigroup Inc. for the delivery of technology infrastructure services. This agreement was, in fact, executed between the assessee's AE, Wipro Ltd., and Citigroup Inc., a third person. This unfolds that the transaction of earning revenue from software development support and maintenance services by Wipro Technology Services Ltd., is an international transaction because of the application of section 92B(2) i.e., there exists a prior agreement in relation to such transaction between Citigroup Inc. (third person) and Wipro Ltd. (associated enterprise). In the light of this structure of transaction, it ceases to be uncontrolled transaction and, hence, Wipro Technology Services Ltd., disqualifies to become a comparable uncontrolled transaction for the purposes of inclusion in the final list of comparables under Rule 10B(1)(e)(ii). We, therefore, direct removal of this company from the list of comparables."*

The view taken by the coordinate bench in Saxo India (supra) was subsequently approved by the Hon'ble High Court and followed in numerous other cases (listed above). In light of the peculiar facts which permeate during the year under consideration and respectfully following these precedents we hold that Wipro Technology Services Ltd. cannot be taken as a comparable as it is not an uncontrolled entity and accordingly fails the essential requirement of transfer pricing analysis.

236. **Caliber Point Business Solutions Limited ("Caliber") and R System International Ltd. (R System):** The Ld. TPO excluded Caliber and R System as comparables for the reason that these two companies adopt financial year ending in December and not in March. The Ld. DRP upheld order of the Ld. TPO.

237. The Ld. Counsel submits that different financial year ending is not a criterion to reject a comparable company. He pointed out that no adverse inference was made by the TPO in AY 2012-13 wherein Caliber was accepted as a comparable by the Appellant in its TP Study even though in that year too, the financial year of the company was December as in this year. The Ld. Counsel argued that a functionally comparable company cannot be rejected merely on the grounds of having different financial year if the data can be reasonably extrapolated. Reliance was placed by him on:

- DCIT vs. McKinsey knowledge Centre India private limited (ITA No. 195/DEL/2011), affirmed by the Hon'ble High Court of Delhi [TS-672-HC-2015(DEL)-TP]
- Mercer Consulting (India) Pvt Ltd [TS-664-HC-2016(P & H)
- Exevo India Pvt. Ltd. vs. ITO (I.T.A. No.907/Del/2016)
- SSL TTK (TS-887-ITAT-2016)
- Aegis Limited (ITA No. 7694/Mum/2014)

238. The Ld. Counsel submitted that extrapolated annual profitability of the comparable segment depicting March ending results for AY 2011-12 have been computed at 4.25% from annual reports for period December 2010 and December 2011. He placed reliance on the judgment delivered in the case of **Maersk Global Services Centre (I) Pvt Ltd (I.T.A. No.944/Mum/2016)** pertaining to inclusion of Caliber Point Solutions Ltd. as a comparable for AY 2011-12. As regards R Systems, the Ld. Counsel submitted that the extrapolated annual profit margin for the period ending March 2011 has been computed at 6.55% for the software development and customization service segment from

the quarterly statements filed by this company with the stock exchanges.

239. The Ld. CIT (DR) vehemently defended the order of Ld. TPO and contended that Caliber and R System were rightly rejected for the reasons mentioned in his order. He further submitted that the extrapolated annual figures are not reliable because these have been computed based on weighted average basis and not on actual quarterly results which are not available in the public domain.

240. The issue of different financial year ending in the context of rejection of comparables has been examined by us in ITA no. 5315/Del/2011 (appeal for A.Yr 2007-08) while determining the suitability of PCS Technology Ltd. as a comparable under Ground no.4. We have already held that it is mandatory under Rule 10B (4) to use current year data for purpose of comparison under TNMM. Use of data from different financial years would result in an inaccurate comparison and may erode the credibility of the benchmarking exercise. We had also taken note of the Tribunal decision in the case of McKinsey Knowledge Centre (supra) which was affirmed by the High Court wherein extrapolation of figures from quarterly statements was permitted. In the present situation, it has been submitted that the quarterly results of R System is available in public domain as it is a listed company and is required to file quarterly statements with the stock exchanges and regulators. However, the same has not been verified by the TPO. As regards Caliber it is not clear whether the quarterly statement of this company is available in the public domain. The extrapolated figures given by the appellant appear to be a weighted average mean. In our view this is not permissible. We accordingly

remand the determination of these facts to the file of the TPO who is directed to examine whether quarterly results of R System and Caliber is available in public domain so that their annual profit margin can be determined in an accurate way. If such information is available, the comparable can be included. If such information is not available, the comparable cannot be included merely on the basis of extrapolated figures derived from weighted average basis. This ground is disposed off in terms of our above directions.

GROUND NO. 23: *The Ld. AO/DRP has erred in law and in fact, in holding that loss on exchange fluctuation amounting to Rs. 143,127,352 debited to P&L account is a notional loss and is not allowable as a deduction under the provisions of the Act*

GROUND NO. 24: *Without prejudice to the above ground, the Ld. AO/DRP erred in not excluding Rs. 48,659,085 from the taxable income on the current year being marked to market losses incurred in respect of foreign exchange contracts which were outstanding as on 31st March 2010 and written back during the year as same was also not allowed as deduction in the assessment proceedings for AY 2010-11*

241. This ground pertains to allowability of loss recognized under accounting standards under marked to market (MTM) guidelines in respect of forward forex contract which are open and unexpired on the last date of the balance sheet on account of restatement of amounts payable and receivable in foreign exchange. This issue has already been decided by us in ITA No. 5315/Del/2011 for A.Y. 2007-08 under Ground no. 10, ITA No. 52/Del/2013 for A. Yr. 2008-09 under Ground no. 11 and 11.1, ITA No. 1567/DEL/14 for

A.Y. 2009-10 under Ground no. 29-31 and ITA No. 6741/DEL/2014 for A.Y. 2010-11 under Ground no. 27 & 28 wherein we have allowed the ground in view of the law being settled by the Hon'ble Supreme Court in CIT v. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC) in this regard. Following the same, this Ground is allowed.

GROUND NO. 25: *In the facts and circumstances of the case and in law, the Ld. AO/DRP has erred in making a disallowance/addition of Rs. 88,99,84,961 in terms of section 40(a)(i)/(ia) of the Act*

GROUND NO. 26: *The Ld. AO/DRP erred in disallowing Rs. 88,99,84,961 being the reversal of excess provision which was already disallowed in AY 2010-11*

GROUND NO. 27: *The Ld. DRP failed to acknowledge the facts that appellant had clearly submitted that reversal was of excess provision and accordingly, it erred in observing that the provisions have been reversed without clarifying whether payments were made or not and if made, the status of TDS on such payments*

GROUND NO. 28: *The Ld. AO/DRP has factually erred in stating that the appellant has not credited the profit and loss account in the current year with the amount of expenses of the previous years which have been so reversed, without appreciating that the reversal of provisions was made in the profit and loss account, by crediting the amount in respective heads of expenses and thereby increasing the income*

GROUND NO. 29: *The Ld. AO/DRP has erred in not appreciating that the said amount of Rs. 889,984,961 has already been disallowed in the preceding year, i.e., AY 2010-11 when it was*

debited to the P&L account, accordingly, the same has to be reduced in computing the total income when it is credited to the P&L account at the time of reversal in the current year, otherwise it would lead to double disallowance/taxation of the same amount

GROUND NO. 30: *The Ld. AO has erred on facts in observing that the reversal of expenses of Rs. 889,984,961 establishes the said expenses as prior period expenses which cannot be claimed in the current year, as he failed to understand that during the year under consideration the appellant had only reversed the said amount of Rs. 80,99,04,961 by crediting the P&L account*

242. Ground nos. 25 to 30 pertain to the issue of disallowance made by the AO u/s 40(a)(i)/(ia). The relevant facts in this respect are that, the assessee had created a year end provision of INR 3,396,650,580 for the year ending 31 March 2010. Out of this provision, INR 889,984,971 was in respect of vendors who could not be identified, and no TDS could be made. Accordingly, the assessee in its computation of income and in income tax return for A.Y. 2010-11 disallowed this amount of INR 889,984,971. During this year i.e. FY 2010-11 (AY 2011-12), the assessee reversed such provision in the books of accounts and credited the same in respect heads of expenses thereby reducing the expenses. This led to an increase of the total income to the extent of INR 889,984,971.The Ld. AO held that the assessee company has not deducted and deposited the tax deduction at source (TDS) and on a failure to deposit withholding taxes on this amount disallowed the same under section 40(a)(i)/(ia) of the Act. He further held that creation of provision is nothing but a strategy / tool for decreasing the income and taxes. The AO was of the view that the submission of the assessee that the expense was reversed in the

current year establishes that the prior period expense cannot be claimed in the current year especially when the assessee is following mercantile system of accounting. The AO observed that the legal fiction of section 40(a)(i)/(ia) is not available as the assessee has merely reversed the entries of expenses and has not actually deducted the tax and deposited the same. The Ld. DRP upheld the reasoning and action of the Ld. AO.

243. The Ld. Counsel for the appellant submitted that the reversal of the provision in the books of accounts of Rs. 889,984,971 was claimed as a deduction in computing the total income of AY 2011-12 because the same had already been taxed in the prior AY 2010-11. He further submitted that the action of the AO amounts of double taxation of the same amount. The Ld. Counsel pointed out that the deduction on account of reversal of the provision was mistakenly described as a deduction under section 40(a)(i) of the Act in the computation of income. This deduction was merely on the account of a reversal of a provision which had already been subject to tax in the prior year. The relevant details of reversal had been placed before the Ld. AO and have also been placed before us. The Ld. Counsel placed reliance on ***Johnson Matthey India Pvt. Ltd. [I.T.A. No. 4397/Del/2011]*** where in similar circumstances the Tribunal had deleted the disallowance made by the AO. It has been submitted by the Ld. Counsel of the appellant that as the said amount has already been disallowed in the preceding year i.e. AY 2010-11 when it was debited in the P&L account, the same is to be reduced in the computing the total income when it is credited to the P&L account at the time reversal in the current year i.e. AY 2011-12.

244. Ld. CIT(DR) relied on the orders of the AO and the DRP and contended that since no TDS had been deducted and deposited in this year, the disallowance made by the AO was justified because the same is mandated by Section 40(a)(i)/(ia).It has also been submitted that the reversal of provision made by the assessee in its books is in conformity with the generally accepted accounting principles consistently followed by the assessee to represent a true and fair view of the state of affairs of the financial statements and the same has been certified by the statutory auditors of the company as well.

245. We have heard both sides and examined the material on record. The computation of income for the prior year shows that the appellant on its own volition had added back an amount of Rs. 889,984,971to its income on account of a provision being created without any TDS being made. We find that during the relevant financial year, this provision was reversed and the corresponding heads of expenses to which the provision pertained were reduced correspondingly. This led to increase of income in the books of account. Since this amount had already been voluntarily disallowed in A.Y. 2010-11 and offered to tax, the impact of write-back in the books for the current year had to be reversed. The assessee claimed this as a deduction in its computation of income. We are in agreement with the submission of the assessee that this approach is consistent with the generally acceptable accounting practices.

246. In our view, Section 40(a)(i)(ia) of the Act comes into play only when an assessee claims any expense as a deduction without

deducting TDS on the same. However, in the present case, as the assessee has reversed the provision created in the previous year, the same has accordingly be reduced from the total income as it was already added back while computing the income of previous year. In this situation Section 40(a)(i) or (ia) has no application as there is no expense which has been incurred. The allowability of the reversal of the provision is a deduction that is claimed on the basis of alignment of the books of accounts with the taxable income. Therefore, the reasoning of the Ld. AO that as no tax has been deducted and deposited the said reversal of provision should not be allowed to be reduced from taxable income is on completely wrong footing because claim of the assessee pertains to reversal of excess provision created in preceding year for which vendors were not identifiable, and thus the question of deducting tax on the same does not arise.

247. Accordingly, we hold that the Ld. AO and the DRP have erred in not appreciating that in the preceding year at the time of creation of the said provision, the same was already suo-moto added back to the income under the head "Profits and Gains of business or Profession," for the reason that it is not allowable under the Act. Therefore, in the current year, on the reversal of the said amount, the same should be allowed to be reduced in computing the total income else it would lead to double taxation of the same. The decision of the coordinate Bench in the case of ***Johnson Matthey India Pvt. Ltd. [I.T.A. No. 4397/Del/2011]*** cited by the appellant is applicable to the present facts. In this case, the issue before the Tribunal was whether the reversal of provision (created in preceding years), which was disallowed in

those years, should be taxed in the year of reversal. The Tribunal while holding in favour of the assessee held as below:

"14. Each year the assessee has been making a provision for inventory in the books of account maintained by the company. While filing its return of income, this provision for inventory made in the books of account, is added back to the income under the head "Profits and Gains of business or Profession," for the reason that it is not allowable under the IT Act. In other words the provision for slow moving/obsolete inventory, which is created each year in the profits & loss account and balance sheet prepared in accordance with the Companies Act, 1956, has been specifically added back while computing taxable income under the IT Act, while filing the return of income of the respective year i.e. the assessee has not claimed deduction on the 'Provision' created in its accounts, in its income tax computation in the earlier years.

15. During the year under consideration the provision in question, in respect of slow moving/obsolete inventory was written back in the accounts of the company, on the ground that the said provision to the extent written back is no longer required. The assessee had sold the slow moving stock and disclosed the sale proceeds, in its sales account. The provision was written back as no longer required in the accounts and as the provision was not claimed as an expense in its income tax computation in the year in which it was created, the same need not be added back once again. The action of the AO is a double addition. A figure which was never claimed or allowed as a deduction in the earlier year was added back."

248. In another case involving a similar situation, this Tribunal has held that such reversal has to be allowed as a deduction. In

SPX India (P) Ltd. Vs. CIT (A) [(2014) 147 ITD 120 (Delhi)] wherein it was held that:

> *"…As far as quantification of the amount is concern, we find that assessee has made the provision for a sum of Rs. 2,61,540/-. The excess provision has been written back and a sum of rs. 1,05,989/- was offered for tax in the next year. Thus the exact amount paid without deducting the TDS is Rs. 1,55,551/-. The assessee has raised the plea before the AO but ld. AO has not assign any reason for not accepting this plea. If we confirmed the disallowance of the total amount then amount of Rs.1,05,989/- would suffer tax twice i.e. by way of disallowance in this year and in the next year when assessee has written back the provision. Therefore, we direct the AO to exclude this amount from the disallowance after verification that it was offered for tax in the next year."*

In view of the foregoing discussion and the authorities cited above, we allow this ground and direct the AO to allow this deduction.

249. In view of our discussion and our finding given above qua each year, all the appeals are treated as partly allowed.

Order pronounced in the open Court on 4th October, 2019.

Sd/-	Sd/-
[PRASHANT MAHARISHI]	**[AMIT SHUKLA]**
[ACCOUNTANT MEMBER]	**JUDICIAL MEMBER**

DATED: 4th October, 2019

PKK: