IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.1719/PUN/2018
निर्धारण वर्ष / Assessment Year : 2010-11

DCIT, Circle-1(1), Pune	Vs.	M/s. Carraro India Pvt. Ltd. (as a successor of Turbo Gears India Pvt. Ltd.,) B2/2, MIDC, Ranjangaon, Pune 412220 PAN : AAACC5292M
Appellant		Respondent

आयकर अपील सं. / ITA No.1720/PUN/2018
निर्धारण वर्ष / Assessment Year : 2010-11

Carraro India Pvt. Ltd. (as a successor of Turbo Gears India Private Limited) B2/2, MIDC, Ranjangaon, Pune 412220 PAN : AAACC5292M	Vs.	DCIT, Circle-1(1), Pune
Appellant		Respondent

Assessee by	Shri M.P. Lohia & Ms. Anjali Chaudhury
Revenue by	Shri T. Vijaya Bhaskar Reddy
Date of hearing	26-11-2019
Date of pronouncement	28-11-2019

आदेश / ORDER

PER R.S.SYAL, VP :

These two cross appeals – one by the assessee and the other by the Revenue - assail the correctness of the order passed by the

Commissioner of Income-tax (Appeals)-13, Pune on 21-08-2018 in relation to the assessment year 2010-11.

2. The first issue raised herein is against the confirmation of transfer pricing addition amounting to Rs.2.77 crore from the international transaction of 'Payment of Professional Fee'.

3. Succinctly, the factual panorama of the case is that the assessee is a wholly owned subsidiary of Gear World, SpA, which is further a wholly owned subsidiary of Carraro SpA. The assessee is engaged in the manufacturing and trading of Gears for construction equipment, utility and commercial vehicles, agricultural tractors and components for the automotive industry. It filed a return declaring total income at Nil. Certain international transactions were reported in Form No.3CEB. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of the international transactions. The TPO in his order u/s. 92CA(3) of the Income-tax Act, 1961 (hereinafter also called 'the Act') noticed that the assessee applied the Transactional Net Marginal Method (TNMM) for demonstrating that the international transaction of payment of Professional fees to the tune of Rs.2.79 crore was at ALP. The assessee chose

Foreign/Associated Enterprise as a tested party and certain foreign comparables, on the basis of which, it was claimed that the international transaction was at ALP. As per the TPO, the assessee did not produce any evidence before him supporting the receipt of services, quantum of services and the cost of the same in the open market. Applying the Comparable Uncontrolled Price method (CUP) as the most appropriate method, the TPO determined NIL ALP of the international transaction which followed an addition for the equal sum by the AO. The assessee contended before the ld. CIT(A) that out of total sum of Rs.2.77 crore, the assessee itself wrote back a sum of Rs.2,17,91,441/- as its income for the A.Y. 2012-13, which amount was actually not paid. The sustenance of disallowance to this extent was claimed to be amounting to double taxation. The assessee adduced further evidence to show that it did avail services. The ld. CIT(A) sent the additional evidence to the TPO calling for the remand report. In such a remand report, the TPO did not concur with the assessee's evidence by noticing that the e-mails put forth on behalf of the assessee did not prove any rendition of services by the AEs necessitating the making of payment. The ld. CIT(A), therefore, upheld the addition made by

the AO, against which the assessee has come up in appeal before the Tribunal.

4. We have heard the rival submissions and gone through the relevant material on record. It is seen that the assessee entered into the international transaction and accordingly debited a sum of Rs.2.79 crore on account of Payment of professional fee. The assessee submitted that a sum of Rs.2.17 crore and odd was written back in its accounts for the A.Y. 2012-13 and offered for taxation, leaving thereby the remaining debit in its accounts on this score to the tune of Rs.61,70,479/-, comprising of a sum of Rs.61,21,401/-, to GWS and Rs.49,078/- to Carraro International, SA.

5. In so far as the sum of Rs.2.17 crore and odd is concerned, which is claimed to have been written back by the assessee in its accounts for the A.Y. 2012-13 and offered for taxation, there can be no addition for this sum in the year under consideration, if the same has actually been written back. There is no finding of the authorities below that such an amount has been offered for taxation in a later year. The AO is directed to verify this contention of the assessee. In case it is found to be correct, then addition to this extent should be deleted in the year under consideration.

6. As regards the remaining amount, the major sum is Rs.61,21,401/- to GWS. The case of the assessee is that it did receive services from GWS, which fact has been wrongly denied by the TPO in the remand proceedings as well. We have perused a copy of the Advisory Service Agreement dated 5.11.2009 between Turbo Gears India Private Limited (the earlier name of the assessee) and Gear World, SpA (GWS), pursuant to which the assessee received advisory services on Manufacturing Strategy, Global sourcing and Quality Control, Sales and Marketing, Administration, Controlling and Human Resource, Logistic Support and other services connected or ancillary to the above cited services. This Agreement provides that such services shall be performed by Gear World for which it will charge at cost plus mark up. Percentages of mark up for different services have been given in Annexure-B. Page 964 of the paper book is a list of employees of GWS engaged in rendering such services to the assessee. Page 965 is a copy of e-mail from Mr. Franco Calvo of GWS to the assessee's customer in India, namely, Mr. Sanjay in connection with the business activity. From page 966 onwards, there are copies of several e-mails exchanged between the assessee/its customers on one hand and the employees of GWS on the other in connection with business

activities. The TPO has also accepted this fact in his remand report, relevant part of which has been reproduced on page 21 of the impugned order. The TPO admitted in para 8 of the remand report that "….. *After removing repetitive emails around 60 emails have been analysed. The email wise analysis is attached as Annexure "A". On the detailed analysis of these emails, it is seen that assessee has not proved that any service has actually been received from the AE. The payment of professional fee is also found to have not been linked to any specific service*". In para no. 10, the TPO noticed that "*The proof submitted in the form of the emails exchanges between the assessee's employee and Parent Company are nothing but the activities of the Shareholders*". Thus, the TPO admitted the factum of the email exchanges between the assessee/its customers and GWS. The TPO held that such e-mails were in the nature of Shareholder's activity, which position is not correct on noticing that the effect of such services also percolated to the assessee company, thereby excluding them from the ambit of shareholder's activity. Thus, it is amply established that the services were rendered by GWS to the assessee. It is a common submission that the position is similar in respect of the professional

services from Carraro International, SA for a minor sum of Rs.49,078/-.

7. Having held that the services were, in fact, rendered by the AEs to the assessee, the next question is the determination of the ALP of such services. It is seen that the assessee chose the TNMM as the most appropriate method and selected foreign/AE as a tested party and certain other comparables. As against this, the TPO applied the CUP method and treated Nil ALP of the international transaction.

8. The ld. AR fairly admitted that the benchmarking analysis of the international transaction may be carried out by treating the assessee itself as a tested party. In the absence of any data available on record deciphering the profit rate of the assessee from such transactions and that of the comparable companies in India, we are unable to determine or verify the ALP of the international transaction at our end. We, therefore, set-aside the impugned order on this score and remit the matter to the file of the AO/TPO for a fresh determination of the ALP of payment of professional fee for the remaining amount of Rs.61,70,479/- (Rs.61,21,401/- + Rs.40,078/-). This benchmarking would be done by taking the

assessee itself as a tested party and Indian comparables and then applying a correct method. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings.

9. The assessee reported certain other international transactions including Export of finished goods, Import of raw materials, Payment of surety charges, Payment of warranty charges and Reimbursement of expenses. The TPO noticed that the assessee in its original T.P. study documentation adopted the external TNMM as the most appropriate method for benchmarking such international transactions in an aggregate manner. During the course of the proceedings before the TPO, the assessee came out with a Supplementary report segregating such transactions. The benchmarking for Exports to AEs was done by adopting the Internal TNMM as the most appropriate method resulting in a *suo moto* transfer pricing adjustment of Rs.1,00,39,947/-. For the remaining transactions, the assessee applied other methods. The TPO rejected the assessee's supplementary report and stuck to the external TNMM as adopted by it in the original transfer pricing study documentation. He selected six companies as comparable with their

average Profit Level Indicator of OP/OR at 15.52%. The assessee's PLI, after the disallowance of Payment of professional services, was determined at (-)13.60%. This is how, the transfer pricing adjustment/addition of Rs.11.30 crore came to be made. The ld. CIT(A) rejected the assessee's version and sustained the addition.

10. We have heard both the sides and gone through the relevant material on record. The argument put forth on behalf of the assessee before us is confined to urging the application of the internal TNMM as the most appropriate method on aggregate basis of the international transactions under consideration instead of the external TNMM as applied by the TPO. In this regard, the assessee has submitted a working of percentage of profit/loss earned by it from transactions with AEs and non-AEs (both domestic and export) by calculating OP/TC from export to AEs and non-AEs uniformly at (-) 15.46% and from domestic sales to non-AEs at (-) 21.99%. Such a calculation has been placed at page 652 of the paper book. It was in the hue of such a calculation that the assessee contended that the internal TNMM of exports to non-AEs should be considered as a benchmark and consequently no transfer pricing addition was called for.

11. Rule 10B(1)(e) deals with the determination of the ALP under the TNMM. Clause (i) of Rule 10B(1)(e) stipulates that the net profit margin from an international transaction with an AE is computed in relation to cost incurred or sales effected or assets employed etc. Clause (ii) is material for the present purpose. It provides that the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base. On splitting clause (ii) into two parts, it divulges that the reference is made to internal and external comparables. One part of clause (ii) refers to 'the net profit margin realised by the enterprise .... from a comparable uncontrolled transaction' and the other part talks of 'the net profit margin realised .... by an uncontrolled enterprise from a comparable uncontrolled transaction'. It transpires that whereas the first part refers to the profit margin from internal comparable uncontrolled transactions, the second part refers to profit margin from an external comparable uncontrolled transaction. Ergo, it is discernible that what is to be compared under this method is the profit from a comparable uncontrolled transaction. The word 'comparable' may encompass an internal comparable as well as an external comparable. There is a cue in the rule itself as to the

preference to be given to internal comparable uncontrolled transactions *vis-à-vis* external comparable uncontrolled transactions. It is so because the delegated legislature has firstly referred to the net profit margin realized by the enterprise (internal) from a comparable uncontrolled transaction and, thereafter, it refers to the net profit margin realized by an unrelated enterprise (external) from comparable uncontrolled transaction. Thus where a potential comparable is available in the shape of an uncontrolled transaction of the same assessee, it is likely to have a higher degree of comparability *vis-a-vis* the comparables identified amongst the uncontrolled transactions of third parties. The underlying object behind the computation of the ALP of an international transaction is to find out the profit which such enterprise would have earned if the transaction had been with some third party instead of related party. When data is available showing profit margin of that enterprise itself as realized from a third party, it is advisable to have recourse to an internally comparable uncontrolled transaction. The reason is overt that various factors having bearing on the quality of output, assets employed, input cost etc. continue to remain, by and large, same in case of an internal comparable. The effect of difference due to such inherent factors on comparison made with the third parties,

gets neutralized when comparison is made with internal comparable. *Ex consequenti*, it follows that an internal comparable uncontrolled transaction is more noteworthy *vis-a-vis* its counterpart i.e. external comparable.

12. However, it is important to bear in mind that the internal cases constitute good comparable only if other things between the transactions with AEs and non-AEs are similar, such as, type of products or services dealt with, geographical locations, quantities sold and timing of sales etc. In case the nature of products or services dealt with in the transactions with the AEs and non-AEs are at variance, then the comparability cripples and the transactions with non-AEs shed credence even under the TNMM. In the otherwise scenario, that is, where the nature of products/services is similar, but there are differences due to geographical locations or timing of transactions or quantity dealt with etc., then the transactions with non-AEs can be considered as benchmark provided the effect of such differences can be removed by means of adjustment in the profit/price of non-AE transactions. In case, such effect of such differences cannot be properly off-loaded, then the internal comparable transactions cannot be considered for

benchmarking. The Hon'ble jurisdictional High Court in *Pr. CIT vs. Amphenol Interconnect India Pvt. Ltd. (2019) 410 ITR 0373 (Bom)* has held that the Comparable Uncontrolled Price (CUP) is not appropriate in case of geographical differences, volume differences, timing differences, risk differences and functional differences. In *CIT vs. J.P. Morgan India (P) Ltd. (2017) 99 CCH 382 MumHC (Bom): (2018) 161 DTR 398 (Bom),* the Hon'ble Bombay High Court has been held that the CUP can be used by making appropriate adjustments to rates charged by assessee from related and unrelated parties. Similar view has been taken by the Pune benches of the Tribunal in the context of the TNMM in the case of *Eaton Industrial Systems Pvt. Ltd. Vs. DCIT* (ITA No.505/PUN/2015) vide its order dated 25.11.2019.

13. The caveat to the rule of adopting internal cases as comparable is the computability of the correct profit margin from transactions with non-AEs. Where the assessee maintains separate books of account in respect of transactions with AEs and non-AEs, the benchmarking does not pose any serious problem as one can easily find out the profit margin of the non-AE transactions. But, the situation becomes a little tricky when the accounts are maintained in

a consolidated manner and thereafter an exercise of allocation/apportionment is done for ascertaining the profit margin from AE and non-AE transactions. In case the temptation to park more profits in the AE transactions by improper allocation of costs etc. is eschewed, such profit margins can also serve the purpose. However, in case the allocation of costs etc. is done by the assessee from consolidated accounts, it becomes incumbent upon the AO/TPO to satisfy himself as regards the application of appropriate keys for allocation of common operating costs and revenues.

14. Adverting to the facts of the instant case, the ld. AR has invited our attention towards page 652 of the paper book as per which it has computed profit (loss) margin from export transactions with AEs and non-AEs, uniformly, at (-) 15.46% by allocating the operating costs and revenues in certain percentages, the veracity of which has not been examined by the TPO. Since such a calculation of profit (loss) margin has not been verified by any authority, we set-aside the impugned order and remit the matter to the file of AO/TPO. In such fresh exercise, the TPO will firstly examine if the transactions with the non-AEs can be considered as comparable in terms of nature of products, geographical locations, timing and

quantities sold and the afore discussed parameters. In case, the transactions of export to the non-AEs are capable for comparison with the international transactions of export to the AEs, then the TPO will proceed to examine the veracity of calculation of the PLI from exports to the non-AEs *vis-à-vis* exports to the AEs as given on page 652 of the paper book. In case he gets satisfied, he will proceed to determine the ALP by adopting the internal TNMM as the most appropriate method. In case, the AO/TPO comes to conclusion that the working done by the assessee is not correct and further proper determination of PLI from exports to non-AEs is not possible, then he would be free to benchmark the international transactions as per law after allowing reasonable opportunity of hearing to the assessee.

15. In view of our decision, in principle, that the internal TNMM should be applied at the first instance unless the determination under this method becomes difficult, the other issues raised by both the sides emanating from the adoption of external TNMM by the TPO as the most appropriate method have been rendered infructuous and such grounds are, therefore, dismissed as having become academic in nature.

16. The last ground in the assessee's appeal against non-consideration of carry forward of business losses and unabsorbed depreciation amounting to Rs.37,22,81,779/- is directed to be considered by the AO as per law.

17. In the result, both the appeals are allowed for statistical purposes.

Order pronounced in the Open Court on 28th November, 2019.

Sd/-	Sd/-
(PARTHA SARATHI CHAUDHURY)	**(R.S.SYAL)**
JUDICIAL MEMBER	**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 28th November, 2019
सतीश

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr.CIT-V, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे
6. "**सी**" / DR 'C', ITAT, Pune;
   गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	26-11-2019	Sr.PS
2.	Draft placed before author	27-11-2019	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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