

THE INCOME TAX APPELLATE TRIBUNAL
"K" Bench, Mumbai
Before Shri Shamim Yahya (AM) & Shri Amarjit Singh (JM)

I.T.A. No. 203/Mum/2015 (Assessment Year 2010-11)

ACIT-19(2)(1) Room No. 204 Aayakar Bhavan M.K. Road Mumbai-400 020. (Appellant)	Vs.	M/s. Cherokee India Pvt. Ltd. Unit No. 95/95, SDF(III) Seepz-SEZ, Andheri(E) Mumbai-400 096. (Respondent)
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I.T.A. No. 410/Mum/2015 (Assessment Year 2009-10)
I.T.A. No. 411/Mum/2015 (Assessment Year 2010-11)

M/s. Cherokee India Pvt. Ltd. Unit No. 95/95, SDF(III) Seepz-SEZ, Andheri(E) Mumbai-400 096. (Appellant)	Vs.	DCIT-8(1) Room No. 204 Aayakar Bhavan M.K. Road Mumbai-400 020. (Respondent)
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PAN : AABCC5420G

Assessee by	Shri Ramesh Iyer
Department by	Shri V.K. Agarwal
Date of Hearing	29.08.2019
Date of Pronouncement	25.11.2019

ORDER

Per Shamim Yahya (AM) :-

ITA no. 410/Mum/2015 and ITA No. 203/Mum/2015. These are cross appeals by the assessee and for assessment year 2010-11 arising out of order of learned CIT(A) dated 17.10.2014.

2. ITA no. 411/Mum/2015 is appeal by the assessee for assessment year 2009-10 against the order of learned CIT(A) dated 17.10.2014.

Appeal by the revenue ITA no 203/Mum/2015

3. Grounds of appeal read as under :-

1. "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A), in respect of the addition of deemed dividend u/s 2(22)(e) of the Act amounting to Rs. 78 lakhs made by the Assessing Officer, was correct in giving directions of allowing relief amounting to Rs. 54 lakhs and sustaining disallowance only to the extent of Rs. 24 lakhs, without appreciating the position of law?"

2. "Whether the CIT(A) erred in restricting the addition u/s 2(22)(e) to Rs. 24 lakhs out of loans of Rs. 78 lakhs without appreciating the fact the lender company M/s. Pwertel India Pvt. Ltd. has accumulated profit of Rs. 1,08,48,212/- for the year?"

The appellant prays that the order of the CIT(A) on the above grounds above be set aside and that of the ITO/AC/DCIT be restored.

4. It transpires that tax effect in this appeal by the revenue is below the limit of rupees 50 lakhs fixed by the CBDT for filing appeals before the ITAT by circular No. 17/2019 dated 8.8.2019. It has not been shown to us that this appeal falls in any of the exceptions mentioned in the said circular. In this view of the matter appeal by the revenue stand dismissed in limine on account of tax effect.

5. One issue raised in assessee's appeal ITA No. 410/Mum/2015 for assessment year 2009-10 is that the learned CIT(appeals) has erred in taxing intercompany deposit as deemed dividend of the assessee who is neither a registered shareholder not a beneficial shareholder of the lender company.

6. At the outset on this issue learned counsel of the assessee stated that the above submission of the assessee was not considered by the learned CIT appeals as the necessary details about the shareholding patterns were not available at that time. However learned counsel of the assessee submits that now the details are available. Hence he pleads that the issue may be remitted to the file of assessing officer to consider the issue afresh.

7. Upon hearing both the counsel, in our considered opinion the interest of justice demands that this issue be remitted to the file of assessing officer. The assessing officer is now directed to consider the issue afresh in light of the details been submitted by the assessee.

8. One common issue raised in both the appeals relates to Transfer Pricing adjustment which enhanced the assessment.

9. The grounds raised in this regard are as under :-

A.Y. 2009-10 :

1. The learned CIT(Appeals) has erred in law and on facts and circumstances of the case in confirming the adjustment to the transfer price to the tune of ^ 2,48,75,146/- .

2. The learned CIT(Appeals) has erred on facts and in law in ignoring the fresh comparables provided by the appellant (at the request of the TPO) during the course of the TP audit for the relevant year and has instead subsequently gone on to uphold the comparables provided by TPO.

3. Without prejudice to Grounds of Appeal no.2 , the learned CIT (Appeals) has erred on facts and in law in not taking cognizance to the various inconsistencies in search done by TPO, which were pointed out by the appellant , and gone on to uphold the TPO's search to make the adjustment to the ALP.

4. Without prejudice to Grounds of Appeal nos. 1 to 3, the learned OT(Appeals) has erred on facts and in law in not appreciating the fact that the appellant is a low risk consignment manufacturer and that the comparables are full-fledged manufacturers.

5. Without prejudice to Grounds of Appeal nos. 1 to 3, the learned CIT(Appeals) has erred on facts and in law in applying the margins of full-fledged manufacturers without making any Working Capital or Risk adjustment to bring it in line with that of low risk consignment manufacturer.

6. The learned CIT(Appeals) erred in not considering the fact that from A.Y. 2005-06 onwards till A.Y. 2008-09, the TPOs and the CIT(Appeals) had calculated the profits at 6%.on the cost actually incurred by the appellant, and that in order to maintain consistency the same should have been followed for the relevant year too, especially considering that the facts and circumstances for the relevant year and earlier years were exactly the same.

A.Y. 2010-11 :-

1. The learned CIT(Appeals) has erred in law and on facts and circumstances of the case in confirming the adjustment to the transfer price to the tune of Rs. 4,42,96,836/- and enhancing the assessment accordingly.

2. The learned CIT(Appeals) has erred on facts and in law in upholding the comparables as taken by the TPO in the earlier year to be the comparables for the relevant year without conducting any fresh search for data of the relevant year.

3. The learned CIT(Appeals) has erred on facts and in law in upholding the comparables taken by the AO of the earlier year and hence carrying forward the inconsistencies of the earlier year which were pointed out by the appellant in the earlier year's search and which inconsistencies were not addressed by the TPO in the earlier year's order

4. The learned CIT(Appeals) has erred on facts and in law in upholding adjustment made by the AO to the Arm's Length Price by taking comparables of the earlier financial year and hence the same needs to be rejected Ab-initio

5. Without prejudice to Grounds of Appeal nos. 1 to 4, the learned CIT(Appeals) has erred on facts and in law in not appreciating that the appellant is a low risk consignment manufacturer and that the comparables are full-fledged manufacturers

6. Without prejudice to Grounds of Appeal nos. 1 to 4, the learned CIT(Appeals) has erred on facts and in law in applying the margins of full-fledged manufacturers and in the absence of any adjustment possible to the comparables based on the FAR of the appellant such comparables needs to be rejected.

7. The learned CIT(Appeals) erred in not considering the fact that from A.Y. 2005-06 onwards till A.Y. 2008-09, the TPOs and the CIT(Appeals) had calculated the profits at 6% on the cost actually incurred by the appellant, and that in order to maintain consistency the same should have been followed for the relevant year too, especially considering that the facts and circumstances for the relevant year and earlier years were exactly the same.

The learned CIT(Appeals) has erred on the facts and in law in taxing inter-company deposit as deemed dividend u/s 2(22)(e) in the hands of the appellant who is neither a registered shareholder nor a beneficial shareholder of the lender company

10. Since facts are identical we are referring to facts and figures from assessment year 2009-10.

11. The assessee was incorporated in 1984 as a wholly-owned subsidiary of US company. The prime goal of this undertaking was a fully integrated Indian

subsidiary capable of manufacturing and exporting assemblies and power suppliers for high-volume program to Cherokee international LLC Tustin USA. In the TP study the taxpayer showed following international transactions for the financial year 2008-09 with its associated enterprises (AEs).

Sr. No.	Nature of the transaction	Details of AE	Amounts (Rs.)	Method adopted by the assessee
1	Purchase of Raw Material (on free of cost basis)	Cherokee International Corporation & Cherokee China Power Supply	65,334,933	External IN MM
2	Sate of Finished Goods	Cherokee International Corporation Limited	98,337,700	External TNMM
3	Advances received against future sales	Cherokee International Corporation	722,764	CUP

TPO discussed the transfer pricing study report filed by the appellant before him. He quoted the Function, Asset and Risk Analysis of the assessee as per study report in paragraph 6 of his order. Discussing the methodology he observed that according to the TP Study Report, the OEGD guidelines state that the transactional profit method should ideally be applied on a transaction-to-transaction basis, but in appropriate situations transactions may be grouped or aggregated (see Rule 10A(d)/OECD at 1.42 to 1.44). Essentially, the relevant controlled transactions may best be aggregated if it is impractical to analyze the pricing or profits of each individual transaction, or if such transactions: are so interrelated that this is the most reliable means of benchmarking the outcome-of the transactions against an arm's length outcome. In light of this discussion, the assessee has grouped all its international transactions and has benchmarked them using external TNMM as the most appropriate method considering itself as a tested party. It has selected Operating Margin Ratio as the Profit Level Indicator (PLI) where $\text{Operating Margin Ratio} = \text{EBIT} / \text{Sales} * 100$ (EBIT does, not include Other Income, Non-recurring Income and Non-recurring expenses.) Further financial results of comparables have been considered for the test year i.e. 2007-08 (since data for the year 2008-09 was not available at the time of preparing this

Document). According to the study report, search was conducted on PROWESS. Following search criteria were followed.

Search criteria	No. of cos.	Reasons
On Company main activity	58	Companies engaged in the manufacture of Transformers
Data availability for the' period ended 31-3-2008	33	Companies not having data for the period under reference were rejected
Sales < Rs.50 crores	11	This is to weed out very big players and to provide more comparable companies.
Sales between Rs. 3 and Rs. 15 crores	03	To compare companies With a similar turnover range.

12. Final Set of Comparables :

Applying the above criteria, eliminations were carried out and finally 3 companies were considered as broadly comparable.

Company	Net Profit Rs. In Crores	Net Sales Rs. In Crores	PBDIT as a % of Sales	Net Profit %
Toyama Electric Ltd.	0.51	10.63	10.81	4.75
UMS Technologies Ltd.	0.24	4.06	25.69	4.4
XO Infotech Ltd.	-0.19	13.42	-1.12	-1.41
Average			11.79	2.58
CIPL			(9.3)	(10.45)

Even though the arithmetic mean of the operating margins of the final set of comparables was 2.58% against the operating loss of the assessee of (10.45)%, the assessee has concluded in its TP study report that all of its international transactions at arm's length price.

13. The assessing officer rejected the benchmarking of the assessee. According to the comparability analysis done by the Transfer Pricing officer the Transfer Pricing adjustment came to Rs. 2,48,75,146/-in the above. In the Transfer Pricing adjustment the assessing officer has rejected the following contention of the assessee for A.Y. 2009-10.

“as the assessee is a captive manufacturer of the parent company which supplies raw material to the assessee. Here the manufacturing activity has been shifted by the parent company to India to take advantage of the low labour cost and other manufacturing cost in India. Hence, the profit earned

by the parent company on account of locational savings should be attributable to the Indian entity. The profit of 6% on cost is as per the mutual agreement between the assessee and its associated enterprise. Now, assessee has agreed that its profit should be 6% of expenses incurred by it that is total cost less cost of a material. As assessee itself admits that the profits of the assessee should not be less than 6% of cost as it is the minimum markup assessee and its AE have agreed upon.”

14. The above Transfer Pricing adjustment was upheld by the learned commissioner of income tax appeals, upon assessee’s challenge to the same.

15. Against this order assessee is in appeal before the ITAT. We have heard both the counsel and perused the records. The learned counsel of the assessee reiterated the submissions as above, before the Assessing Officer. He submitted that there should be only 6% markup on the expenses incurred by the assessee. In this regard he referred to the mutual agreement between the assessee and its associated enterprise. In this regard on enquiry from the bench as to what is the agreement learned counsel of the assessee submitted that he is not in possession of any formal agreement. He submitted that the same was a mutual understanding, and that this ITAT has accepted the submission of the assessee for assessment year 2005-06.

16. We find that this ITAT for assessment year 2005-06 has held as under :-

7. We have carefully considered the rival submissions and perused the record. In our considered opinion, the initial burden is upon the assessee to prove the correctness of the method followed. In the instant case this burden was not discharged properly. As could be seen from Rules 10B to 10D of the I.T. Rules read with provisions of [section 92C](#) of the Act, the ALP in relation to an international transaction has to be determined by one of the prescribed methods, which is a most appropriate method in the circumstances of the case i.e., having regard to the nature of transaction, class of transaction, class of associated persons, functions performed for such performance and such other relevant factors as the Board may prescribe. Though the assessee has to prove that the method followed by it is the most appropriate method, it is not an unfettered choice on the tax payer and this is subject to following certain procedures. Apart from the reliability of the data of the uncontrolled transactions, it is mandatory to every person who has entered into an international transaction to keep and maintain such information and documents as may be prescribed and the Assessing Officer may require such person to furnish any such information or documentation within a particular period of time.

8. In the instant case, correctness of the method followed by the assessee hinges upon the nature of agreement entered into with AE. Though, the assessee claimed that it has applied a mark-up of 6% on the costs, as per TNMM, whether such mark-up can be based on an estimated cost is required to be proved by referring to the agreement whereas the assessee could not furnish the agreement and did not place sufficient proof to support his logic of arriving at "standard cost". Since assessee is a contract manufacturer and 5% of the raw materials are purchased on its own to manufacture the end-product, there is some element of risk involved, having invested on the plant and machinery, infrastructure etc., to carry on the activity of manufacture. While considering the reasonableness of the reward all these factors have to be cumulatively taken note of. As rightly pointed out by the tax authorities, in the case of a contract manufacturer it is unthinkable for a manufacturer to agree, in writing, to carry on the business so as to end up in losses. Assessee having not taken actual cost into consideration, TPO/Assessing Officer, as well as the learned CIT(A), have correctly noticed that either under TNMM or under cost- plus method the cost of goods supplied should be taken into consideration. It also deserves to be noticed that the mark-up of 6% has not been disputed by the tax authorities.

9. Learned Counsel, appearing on behalf of the assessee, submitted before us that in order to disregard the method followed by the assessee, the burden is upon the TPO to prove that the uncontrolled transactions are not comparable and in this regard he relied upon the decision of ITAT, Mumbai Bench in the case of C.A. Computer Associates Pvt. Ltd. (supra). In our opinion, the decision rendered in the aforesaid case is confined to the facts therein; since parameters prescribed in Rule 10B, vis-à-vis bad debts written off, were not taken into consideration the Tribunal correctly observed that the TPO was not justified in arriving at the arms length price by taking into account the bad debts written off. In the instant case, however, there is no dispute with regard to the method followed by the assessee except for the fact that the assessee has not proved satisfactorily as to why estimated 'standard-cost' has to be taken into consideration particularly when the transaction is with the principal who is holding 99.95% control over the assessee-company.

10. As could be noticed from paras 4.1 to 4.6 of the CIT(A)'s order, the main factor for disregarding the method followed by the assessee was due to non-furnishing of the so-called agreement with the AE. Since, we are in agreement with the detailed reasons given by the TPO/Assessing Officer as well as the CIT(A), we hold that the initial burden is upon the assessee to prove the reasonableness of the method followed by the assessee-company and in the absence of proving the same by producing any document/agreement with its principal highlighting the contractual terms of sharing cost, the learned CIT(A) was correct in holding that the special provisions of the Act have to be construed strictly and the method adopted by the tax authorities for making transfer pricing adjustments is reasonable in the circumstances of the case. We, therefore, affirm the Order of the learned CIT(A) and dismiss the appeal filed by the assessee."

17. Furthermore learned counsel of the assessee submitted that the above method was followed by this ITAT in the case of same assessee for assessment year 2009-10 on the principal of consistency. The tribunal held as under :-

2. The assessee company is engaged in the business of manufacturing, designing, developing and assembling of power supplies and related sim-custom design development of power supplies, transformers, toroidal cores, and current transformers control boards. It entered into following international transactions:

S.No.	Name of the AE	Nature of Transaction	Amount in Rupees for A.Y 2008-09	Method adopted
1.	M/s. Cherokee International, Tustin USA	Purchase of raw materials	9,09,54,952	TNMM
2.	-do-	Sale of finished goods	13,31,66,657	TNMM
3.	-do-	Purchase of Plant and machinery	NIL	TNMM
Total			22,41,21,609	

2.1 While determining the ALP the TPO has adopted a mark up of 6% on the on the cost incurred by the assessee which include purchase of raw material of Rs.9,09,54,952/-. The said raw material was supplied by the AE of the assessee free of cost. Thus, TPO calculated the TP adjustment of Rs.2,33,24,680/- as per following calculations:

ALP margin to be earned by the assessee	6%
ALP of the assessee	106% of the expenditure Rs 14,76,33,337/-
Arms Length price 106% x 147633337	15,64,91,337/-
Price received by the assessee	13,31, 66,657 /-
Shortfall being the adjustment u/s. 92CA	2,33,24,680/-

2.2 The TP adjustment made by the AO was agitated in an appeal filed before Ld. CIT(A). It was submitted that treatment adopted by the TPO for calculating 6% mark up on the cost is different from the treatment adopted by TPO in respect of immediate preceding year, wherein while calculating the cost the raw material supplied by AE free of cost was excluded. Ld. CIT(A) after going the submissions of the assessee found that for immediate preceding year i.e. for A.Y 2007-08 TPO while calculating 6% mark up had excluded the value of purchase of raw material and 6% mark up was calculated on the net cost of the assessee after excluding value of purchase of raw material. Thus, Ld. CIT(A) has allowed the relief to that extent to the assessee and has recalculated the TP adjustment as follows :-

ALP margin to be earned by the assessee	6%
Total Cost incurred by the appellant	Rs. 14,76,33, 337/-
Cost of raw material imported free of cost(A)	Rs.9, 10,00,0007-

The costs attributable to the appellant	Rs. 5,66,33, 337/-
Arms Length Price of the cost attributable to the appellant 106% of Rs. 5, 66,33,337/- (B)	Rs. 6,00,31, 337/-
Total Arm's length Price (C) = (A) + B	Rs. 15,10,31, 337/-
Price received by the assessee (D)	Rs.13,31, 66,657/-
Shortfall being the adjustment u/s.92CA (E) = (C) - (D)	Rs. 1,78,64,680/-

2.3 In the above manner adjustment made by the TPO was reduced to Rs.1,78,64,680/- from Rs.2,33,24,680/- by giving relief of Rs.54,60,000/-. The department is aggrieved and has raised aforementioned grounds of appeal.

3. Ld. DR relying upon the grounds of appeal submitted that Ld. CIT(A) has committed an error in granting relief to the assessee. Ld. DR submitted that value of the raw material supplied to the assessee free of cost by the AE could not be excluded for the purpose of 6% mark up and thus, relief given by Ld. CIT(A) is contrary to law and should be set aside. The adjustment made by the TPO should be upheld in its entirety.

4. On the other hand, Ld. AR of the assessee has produced before us copy of the TPO's order for A.Y 2007-08 which is dated 26/10/2010. It was submitted that the approach adopted by the TPO in the said year was exclusion of value of raw material received by the assessee from its AE which was free of cost. It was submitted that the TPO in the said year has adopted this approach after considering the submissions of the assessee and by way of a speaking order. It was further submitted by Ld. AR that assessee has accepted the view point taken therefore, did not file any appeal against the impugned order passed by Ld. CIT(A) by which addition of Rs.1,78,64,680/- has been upheld. Thus, it was submitted by Ld.AR that the order of Ld.CIT(A) being in accordance with the course of action adopted by Department in respect of immediate preceding year, (A.Y. 2007-09) should be upheld.

5. We have heard both the parties and their contentions have carefully been considered. We have carefully gone through the order passed by TPO in respect of A.Y 2007-08. Ld. CIT(A) has calculated the TP adjustment in accordance with the course of action adopted by the Department in respect of immediate preceding year i.e. for assessment year 2007-08. In our view Ld. CIT(A) did not commit any error in determining the arm's length price. The impugned transaction is in accordance with the view point taken in respect of A.Y 2007-08 as it is in accordance with the principle of consistency, which is applicable to the Income-tax cases as per decision of Hon'ble Bombay High Court in the case of [CIT vs. Gopal Purohit](#), 336 ITR 287(Bom), wherein their Lordships have held that there ought to be uniformity in treatment and consistency when the facts and circumstances are identical, particularly in the case of the assessee. In this case also, what Ld. CIT(A) has done is that he has brought uniformity in the treatment and consistency to bring the TP adjustment at par with the treatment adopted by the Department in respect of assessment year 2007-08. For the sake of completeness we may mention that in A.Y.

“Total cost as per Profit & Loss a/c.	Rs. 18,30,78,087/-
Less: Cost of goods received Free of Cost from parent company included in cost	Rs.12,01,51,762/-
Expenses incurred by assessee	Rs.6,29,,26,325/-
Profit calculated @ 6% on Rs.6,29,26,325	Rs. 37,75,579/-”

As it can be seen from the above the TPO in earlier year has excluded a sum of Rs.12,01,51,762/- being cost of goods received free of cost from parent company which was included in cost and has computed 6% margin on the balance cost of Rs. 629,26,325/-. In view of above discussion, we decline to interfere in the relief granted by Ld. CIT(A) and Departmental appeal is dismissed.”

18. Submitting the above learned counsel of the assessee stated that the issue now is covered by the ITAT order as above and the markup should be 6% on the total cost incurred by the assessee less cost of goods received from parent company included in cost.

19. Upon careful consideration we note that this is totally new facet of argument. Though a ground in has been raised in ground No. 6, in this regard in A.Y. 2009-10, no such ground is therefore A.Y. 2010-11. The contention was raised before the Assessing Officer in A.Y.2009-10, which was not accepted by the Assessing Officer. The mention of this type of argument that ITAT in earlier years, has accepted this aspect is also not there in the orders of the authorities below.

20. However, it is undisputed that in ITAT in orders as shown above has accepted this proposition. But in those years it was learned CIT(A)'s order which was upheld by the ITAT. In other words the 6% markup on cost was the proposition considered by learned CIT(A) which was accepted by the ITAT. In the present assessment year there is no mention whatsoever about this claim of the assessee in the order of learned CIT(A). All the assessee's arguments before learned CIT(A) were confined to selection of comparables and certain other adjustments. Learned CIT(A) has upheld the order of Assessing Officer

on the rejection of comparables of the assessee, and learned CIT(A) upheld the search and consequential computation by the Assessing Officer.

21. However, we agree that this contention of the assessee deserves consideration provided the facts for the present assessment year are in conformity with the earlier assessment years. Furthermore as noted above this aspect has not at all been considered at the level of learned CIT(A). In the interest of justice, we deem it appropriate to remit this aspect of assessee's contention to the file of learned CIT(A) to consider the same and give a finding thereupon. Needless to add the assessee should be granted opportunity of being heard.

22. As regards other grounds raised by the assessee challenging the learned CIT(A)'s order confirming the order for transfer pricing adjustment, we find that the adjudication on this aspect is dependent upon adjudication of the matter remitted by us hereinabove. Accordingly, we direct that other aspects may also be considered by learned CIT(A) consequential to his adjudication of the ground remitted by us.

23. In the result appeal by the revenue stand dismissed in limine on tax effect and assessee's appeals stand partly allowed.

Order has been pronounced in the Court on 25.11.2019.

Sd/-
(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-
(SHAMIM YAHYA)
ACCOUNTANT MEMBER

Mumbai; Dated : 25/11/2019

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai

6. Guard File.

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BY ORDER,

(Assistant Registrar)
ITAT, Mumbai