

INCOME TAX APPELLATE TRIBUNAL
[DELHI BENCH "I-1": NEW DELHI]
BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER
(Through Video Conferencing)

ITA No. 7801/Del/2017
(Assessment Year: 2013-14)

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| Keihin Automotive Systems Pvt. Ltd.[Now amalgamated & known as Keihin India Manufacturing Pvt. Ltd.,] Plot No. 663, Phase-5, Udyog Vihar, Gurgaon, Haryana – 122 016. PAN: AAECK4216F | Vs. | DCIT, Circle: 2 (1), Gurgaon. |
| (Appellant) | | (Respondent) |

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|-----------------------|-------------------------------|
| Assessee by: | Shri Pradeep Dinodia, C.A.; |
| Department by: | Shri Surendra Pal [CIT] – DR; |
| Date of Hearing | 10/03/2021 |
| Date of pronouncement | 08/06/2021 |

ORDER

PER PRASHANT MAHARISHI, A. M.

1. This appeal is filed by Keihin Automotive Systems Pvt. Ltd. for Assessment Year 2013-14 against the order passed by the Dy. Commissioner of Income Tax, Circle: 2 (1), Gurgaon,[The LD AO] . The Id. Assessing Officer's order under Section 143(3) read with Section 144C of the Income Tax Act, 1961 (the Act) dated 26.10.2017 pursuant to the direction of the Id. Dispute Resolution Panel-1, New Delhi, [The LD DRP] dated 22.09.2017 wherein the adjustment proposed by the Id. DCIT, Transfer Pricing 1(3)(1), New Delhi, [The LD TPO] per order passed under Section 92CA(3) of the Act on 20th October, 2016 was incorporated and assessee's assessed loss was determined at ₹ 31,814,920/- against the returned loss of ₹ 98,373,479/-.
2. The assessee has raised following grounds of appeal:-
 - 1 The Ld. AO DRP has erred in law and on facts and circumstances of assessee's case in making the additions/disallowances amounting to ' 6.65.58.555/- to the total income of the assessee. The additions/disallowances made are wholly illegal, erroneous and untenable in law and on the facts of the case of the assessee and are prayed to be deleted.
 - 2 The order of assessment is bad in law and on the facts of the case.

Grounds of Objections against Transfer Pricing Adjustments

3. The Ld. TPO and consequently the Ld. DRP AO has grossly erred in law and on facts and circumstances of the appellant's case in making a transfer pricing adjustment amounting to Rs. 6.23,19.555/- in respect of international transactions of the assessee u/s 92CA(3) of the Income Tax Act, 1961. The Id. AO/TPO DRP have erred in making such adjustment by:
 - 3.1. not providing opportunity of being heard to the appellant before passing the order u/s 92CA(3) of the Income Tax Act, 1961 and further the Ld. DRP has erred in law and on facts by accepting such order which is against the principles of natural justice.
 - 3.2. not accepting that only current year's data was to be used as prescribed under Rule 10B(4) of the Income Tax Rules, 1962 as against multiple year's data as was claimed during proceedings before him.
 - 3.3. not granting the capacity utilization adjustment carried out by the assessee in respect of personnel cost, being the first year of operations, which is in contravention with the provisions of Rule 10 B (3) of the Income Tax Rules, 1962.
 - 3.4. not granting the import duty adjustment carried out by the assessee on account of huge difference in import duty cost of assessee and comparables, which is in contravention with the provisions of Rule 10B(3) of the Income Tax Rules, 1962.
4. Without prejudice to the above grounds, the Ld. AO/TPO and consequently the Ld. DRP has erred in law and on facts and circumstances of the case of the assessee in computing the Transfer pricing adjustment by allocating the entire difference between the arm's length operating profit and actual operating profit to the controlled transactions of the appellant and not in the proportion in which the international transactions forming part of the cost base of the assessee bears to the total operating cost of the assessee.

Grounds of Objections against Corporate Tax Disallowance/ Additions

5. The Td. AO and consequently the Ld. DRP has erred in law and in facts in disallowing provision for doubtful debts, amounting 42,39,000/- u/s 37 of the Income Tax Act, 1961. without appreciating the factual & legal submissions of the appellant.
6. That the penalty proceedings initiated under Sec 271(1)(c) is on wholly illegal and untenable grounds since there was no concealment of an income nor submission of any inaccurate particulars of income, nor an default according to law by the assessee.
7. That the charging of interest u/s 234A, 234B and 234C is bad in law and is prayed not to be upheld.
8. That each ground is independent of and without prejudice to the other grounds raised herein. "

3. During the course of hearing on 10th March, 2021 assessee also preferred an additional ground of appeal which was omitted to be raised as under:-

“ 12. The Ld. AO has erred in law and in facts in proposing a disallowing under section 37 of the Income Tax At, 1961 of provisions for doubtful debts (Bad Debts) of Rs.42,39,000/- by treating the same as excess provision without appreciating the facts & legal submissions of the assessee company in this regard. “
4. This Ground of appeal was already before Ld. DRP but there is no adjudication on the same. This was not raised in original appeal memo but now raised.
5. Brief facts of the case shows that assessee is a company incorporated on 26th July, 2011 as joint venture of Keihin Corporation, Japan and Keihin Asia Bangkok Company Limited wherein Japan entity holds 70% equity and Bangkok company held 30%. It is engaged in the business of manufacturing of Compressed Natural Gas (CNG) assembly parts for the automotive industry. The Keihin group is engaged in the manufacturing of fuel injection and air-conditioning systems.
6. Assessee filed its return of income on 30.11.2013 declaring a loss of Rs. 16,15,22,376/-. It was revised on 25.11.2014 reducing loss to Rs. 9,83,73,479/-. Assessee has entered into several international transactions with its associated enterprises. Main international transaction was of purchase of raw-material of Rs. 18,19,76,837/-. Together with other transactions, it was bench-marked adopting Transactional Net Margin Method (TNMM) as Most Appropriate Method, adopting profit level indicator of operating profit /net sales, taking assessee itself as the 'tested party', wherein the margin of the comparable was 4.59%, compared with margin of the assessee at 13.13% and thus it was stated in the TP study report that international transaction entered into by the assessee of purchase of raw-material of Rs.18,19,76,837/- is at Arm's length.
7. The Id. Transfer Pricing Officer examined the computation of margins of the assessee. He found that assessee has shown the operating profit / operating revenue margin of 13.13% whereas it has incurred a loss of Rs. 9,41,94,573/-. Thus, computation of margin was examined. In Annexure 'C' of the TP study report, assessee has considered only some of the items as operating income and operating expenditure from the profit and loss account. Thus, assessee has ignored some of the revenue and some of expenses from computation of margins. The Id. TPO found that assessee has not considered as Operating expenses namely, (i) Cost of sales Rs. 1,29,94,274/-, (ii) Personnel expenditure Rs. 7,21,70,918/-, (iii) Depreciation Rs. 4,04,49,619/- and (iv) Finance cost Rs. 46,25,440/-. Therefore, the assessee has reduced the operating loss of Rs. 2,54,52,044/- from the total loss of Rs. 9,41,94,573/- which resulted into positive operating profit of Rs. 3,12,57,471/- showing the PLI of 13.13%. The Id. TPO questioned the non-inclusion of the above expenditure as operating expenditure. The assessee submitted that

- a. there is higher import content and other import related cost incurred by the assessee on consumption of raw material as compared to the small cost incurred by the comparables on consumption of raw material. It was stated that imported raw-material content is 89.65% of the total material consumed and, therefore, proportionate raw-material cost of Rs. 1,29,94,274/- is not an operating expenditure.
 - b. With respect to the personnel expenditure and depreciation, allowance it was stated that the personnel expenses compared to operating revenue of the assessee is 42.5% whereas of comparables it is only 12.17%. Therefore, the difference of the above margin of Rs. 7,21,70,918/- same is not considered as operating cost.
 - c. Similar is the case of depreciation. The average depreciation cost of comparable was stated to be 3.76% against depreciation of the assessee at 20.75%.
 - d. Finance cost was also excluded amounting to Rs. 46,25,414/- stating that only finance cost relating to working capital loss is considered as operating expenditure.
8. The Id. Transfer Pricing Officer noted that assessee has reduced 37% of its cost as idle cost without explaining the basis with the reasoning and not submitting the evidence in support of its claim. Thus, he rejected the claim of the assessee and computed the margin of the assessee at (-) 39.65%. He further observed that the assessee company being the tested party has made capacity utilization adjustment in its own account to make it as comparable to the comparable companies. He otherwise held that adjustment, if any, could be made in the accounts of the comparables only and not the tested party. He also held that in TNMM Method, lack of data of the comparable cannot be made as a basis for making an adjustment. Therefore, he considered the operating income of the tested party at Rs. 23,79,94,415/- and applied operating profit @ 4.59% resulting into a profit of Rs. 1,09,23,944/-. This was compared with the loss of the assessee at Rs. 9,43,57,340/- and an adjustment of Rs. 10,52,81,284/- was proposed as per order dated 20.10.2016. Assessee has also claimed Research & Development Expenses of Rs 1163223/- for testing expenses including material claimed as revenue expenditure. Ld AO held it to be capital expenditure and disallowed it. Consequent draft order was passed on 23/12/2016.
9. Against the draft order, assessee preferred objections before the Id. Dispute Resolution Panel. The Id. DRP issued its direction on 22.09.2017 wherein it gave direction as per para No. 3.5 stating that it is the first year of manufacturing activity and the claim of depreciation of the assessee is substantial as compared to comparables. Therefore, the TPO was directed to exclude depreciation from the operating expenses of the assessee as also that of comparables to re-compute the PLI of the assessee and average PLI of the comparables. With respect to the idle capacity adjustment, DRP did not approve the same as it was an ad-hoc adjustment of 37% of the cost of sales because of import duty and personnel cost. The DRP held that it is for the assessee to show that capacity utilization of assessee was 63% and that of the comparable is averaging at 100%. Therefore, fact cannot be assumed

in the name of comparability adjustment. With regard to the adjustment restricted to the AE transaction only the DRP held that as the Special Leave Petition of the Revenue in case of Fire Single International Ltd. is pending and further the ratio of transaction with the AE and the operating cost is substantial which goes into impacting the earning of the Revenue, this objection is rejected.

10. Consequently, the Id. TPO passed an order giving effect to the directions of the DRP on 12.10.2017 and computed the average PLI of comparable at 7.29%. He applied the above PLI to the revenue of the assessee and determined the Arm's length operating profit at Rs.1,73,49,793/-. The loss of the assessee of Rs.9,43,57,340/- was reduced by the depreciation amounting to Rs.4,93,87,578/- and adjusted loss was computed at Rs.4,49,69,762/-. Therefore, the adjustment was made of Rs.6,23,19,555/-. With Respect to disallowance of testing expenditure, Id DRP held it to be Revenue expenditure.
11. Consequently, the assessment order was passed making the above adjustment. There is one more corporate adjustment of disallowance of Rs. 42,39,000/- on account of provision for doubtful debts was made. The assessee did challenge the same before the Id. Dispute Resolution Panel but same was not adjudicate. In absence of any direction, above addition was also made by the Id. Assessing Officer in the final assessment order passed under Section 143(3) read with Section 144C of the Act dated 26.10.2017 and the income of the assessee was finally assessed at loss of Rs.3,18,14,920/- against the returned loss of Rs.9,83,73,479/-.
12. Ground Nos. 1 and 2 of the appeal are general in nature and no further arguments were advanced thereon, hence those are dismissed.
13. Ground No. 3 is challenging the overall transfer pricing addition.
14. Ground No. 3.1 was not pressed and hence the same is dismissed.
15. With respect to ground No. 3.2, the assessee submitted that the current year's data is only required to be considered for making any transfer pricing adjustment. The claim of the assessee is that for considering the adjustment of the transfer pricing the assessee as well as the Id. TPO both have proceeded based on the multiple year data. It was stated that due to practical difficulty for availability of current year's data relating to the comparables at the time of preparation of the TP study the assessee has adopted the current year's data as well as the data of preceding two years. It was stated that now the data of current year is available in public domain and, therefore, it should be used for working of the ALP of the international transaction. In the written synopsis submitted before us, assessee submitted the current year's data and arithmetical mean of the comparable PLI, which was 2.54 percentages. Therefore, it was stated that as mandate as per Rule 10B (4) of the Income Tax Rules, only current year's financial data should be used.
16. The Id. DR also accepted the above proposition.

17. In view of this, we direct the Id. TPO to verify the PLI of comparables and assessee by using the current year's data and then work out the ALP of the international transaction. Accordingly, ground No. 3.2 of appeal of the assessee is allowed with above direction.
18. Ground No. 3.3 is with respect to grant capacity realization adjustment carried out by the assessee with respect to the personnel cost being the first year of operation. Assessee submitted that it has not claimed any ad-hoc adjustment of 37% as claimed by the Id. DRP, but has explained the basis of computation of each of the specific adjustment made with respect to import duty, personnel cost, and depreciation demonstrated at page No. 144 – 146 of the transfer pricing study. According to the total of such cost as a percentage of total operating cost, it comes at 37%. AR further stated that as DRP has held that this is the first year of the manufacturing activity of the assessee and directed the TPO to reduce the depreciation, which was also made by the Id. TPO. Therefore, there is no reason that why on the same principle the personnel adjustment cost by the assessee should not be accepted. It was further claimed that comparable companies were existing since decades. AR further demonstrated that the average salary cost of the comparable companies is merely 13.52% of the total revenue of the comparables whereas in the case of the assessee it is 42.5%. Thus, apparently there is a higher personnel cost incurred by the assessee.
19. With respect to the higher cost of sales, assessee submitted that during the financial year 2012 – 13 the contention of imported raw material constituted 89.65% of the total raw material consumption. Whereas in case of comparable it was only 12.19% of the total Raw Material consumption on the weighted average cost of earlier three years. It was stated that the matter contention of the assessee was significantly higher than the comparables as it has incurred much higher duty cost and other imported related costs such as clearing and forwarding charges, delivery order charges, Demat charges etc. Because of severe competition in the market, assessee could not pass the import duty and other related cost to the end customer and was forced to bear the entire impact. Therefore, to improve the reliability of the results, assessee has adjusted the reported financial debt of assessee to eliminate the effect of high import duty and other related cost incurred by assessee. The learned authorised representative reiterated the same argument as was placed before the learned transfer-pricing officer and the learned dispute resolution panel.
20. The learned DR submitted that raw material consumption cannot be adjusted in such a manner as suggested by the assessee as whatever amount of goods have been sold, appropriate proportionate raw material consumption have been booked. Therefore, it cannot be said that assessee has borne higher imported material cost than its comparables.
21. Assessee also considered proportionate finance cost as non-operating, which is in the nature of interest on working capital loan. Assessee submitted that it has treated it as a non-operating as it cannot be said to have arising from the business operation of the assessee. The learned authorised representative reiterated the submissions made before

the lower authorities. He also relied on rule 10 TA of the safe Harbour rules wherein interest expenses is required to be excluded from the operating expenses.

22. The learned departmental representative submitted that safe Harbour rules do not apply to the assessee for this year and further the interest expenses are required to be excluded from the operating expenses only if they are then not the cost incurred in the normal operations. He submitted that assessee has incurred the working capital loan interest expenditure, which is part of the normal operations of the business of the assessee, and therefore it cannot be excluded from the operating expenses.
23. We have carefully considered the rival contentions and perused the orders of the lower authorities. Admittedly in the case of the assessee the learned dispute resolution panel has considered that it is the first year of the manufacturing activity and therefore the claim of proportion of depreciation which is substantial compared to comparables, directed the learned TPO to exclude depreciation from the operating expenses of the assessee as also that of comparables to recompute the PLI of the assessee and the average PLI of the comparables. However, with respect to the other expenditure it is stated that assessee has claimed ad hoc adjustment of 37% of the cost of sales. Therefore, it needs to be examined whether the assessee has claimed an ad hoc adjustment or has submitted the requisite details for claiming the above adjustment. We find it page number 310 of the paper book the assessee has submitted the complete details of the employees, part of who are also seconded by the associated enterprise to the assessee in India. The assessee has incurred the cost of such seconded employees amounting to ₹ 93,373,066/- and of its own employees of ₹ 98,908,439/-. In the seconded employees detail the assessee has shown that certain employees are for the development of the business and they are being paid higher amount of salaries looking at the other comparative salaries of the other employees. Therefore, it is apparent that assessee has not paid any ad hoc adjustment with respect to the salary payments being higher than the comparable but has given a listing of the employees, the designation, there are dictation qualification, nature of services performed by them, experience of the employees along with the details of the remuneration paid to them. Therefore, the lower authorities' observation that the same is claimed by the assessee on ad hoc basis is not correct. It is also a matter of record that the learned dispute resolution panel has categorically granted adjustment on account of the higher depreciation being the first year of the operation of the assessee, naturally therefore at least the claim of the assessee deserves to be examined that whether it has incurred higher cost of employee remuneration for development of the business or for the purpose of running operations and whether such remuneration paid to the employee should be considered as an operating expenses are not. This would also be evident when such expenditure of the assessee is dis-proportionate to the expenses incurred in the case of the comparable

companies, which are averaged out for three years; it needs proper examination about claim of the assessee.

24. The ground number 3.2 is with respect to the argument of the learned authorised representative that only the current year data are to be used which are prescribed Under rule 10 B (4) of the income tax rules as against the multiple year data. We are of the view that as the law mandates only the use of the current year data, only it should be utilized for working out the arm's-length price of the international transaction.
25. With respect to ground number 3.3 where the capacity utilization adjustment carried out by the assessee in respect of personnel cost being the first year of operation has not been granted by the lower authorities, we hold that as assessee has submitted complete details of the employees stating their name, designation, experience, educational qualification, role and responsibility and the amount of salary paid, more particularly when there is a disproportionate difference between the salary expenditure incurred by the comparable companies with the salary expenditure of the assessee and there are seconded employees who are necessarily deputed to the assessee for the purpose of development of the business, the claim the assessee needs to be re-examined with the details furnished. This is more so when learned dispute resolution panel accepted that there is a higher depreciation claim in the case of assessee compared to the comparable companies. In view of this we set aside ground number 3.3 of the appeal back to the file of the learned transfer pricing officer with a direction to examine the claim of the assessee that those expenditure on salary of the employees who are working for the development of the business and not for earning the operating profit for the year requires proper adjustment.
26. With respect to ground number 3.4 where the claim of the assessee is that the import duty adjustment carried out by the assessee on account of huge difference in import duty cost of the assessee as well as of the comparable should also be eliminated from the operating expenses of the assessee, we hold that as necessary consumption of the material is only booked in the profit and loss account for which the materials are imported for onward sale/manufacturing whose revenue has been booked in the profit and loss account, the above adjustment cannot be granted. This is so for the reason that the duty structure of the material imported by the assessee and the sale price of the assessee takes into consideration all these commercial aspects of the trading or operation of the business of the assessee. Naturally, if the import duty factor (rate) is higher when raw materials imported by the assessee naturally the sale price will reflect the recovery of those import duty also from the buyers.
27. In the result, ground number 3 of the appeal is partly allowed with above directions.
28. Ground number 4 is the claim of the assessee that adjustment on account of transfer pricing if any be made only proportionate to the value of control transactions in case of the assessee. We find that identical issue arose in the case of the assessee's own case for

assessment year 2004 – 05 and 2005 – 06 wherein in para number 12 this issue has been dealt with and decided in favour of the assessee that transfer pricing adjustment if any should be made only proportionate to the value of controlled transaction in case of the assessee. In view of the identical issue decided in favour of the assessee in assessee's own case for earlier years, we direct the learned assessing officer accordingly. We allow ground number 4 of the appeal.

29. The ground number 5 is with respect to the disallowance of provision for doubtful debts amounting to ₹ 4,239,000/- u/s 37 Of the Income Tax Act. This ground was raised before the learned dispute resolution panel also. The assessee has submitted a letter dated 31st of May 2017 before the learned dispute resolution panel stating that assessee has filed a reference on 24th of January 2017. After filing of the objections, the assessee realized that the assessee has inadvertently omitted to raise an objection against any addition made by the assessing officer in draft assessment order pertaining to disallowance of ₹ 4,239,000/- u/s 37 of the income tax act, which was booked as provision for doubtful debt since account books. It was stated that all the facts pertaining to this issue are available on record. Before the learned dispute resolution panel assessee submitted that assessee has claimed provision for doubtful debt of ₹ 7,758,872/- debited in the profit and loss account. During the course of assessment proceedings, the learned that AO had required the assessee to furnish the details of such provision for doubtful debts. In response to this assessee submitted that the assessee has made a provision for doubtful debts for receivable outstanding from Kehini Panlafa private limited in respect of said veteran it on sales. The assessee is a stated that the company has recovered a sum of ₹ 3,519,873/- out of ₹ 7,758,872/- in subsequent financial year 2013 – 14 and duly considered the same as income and pay taxes thereon and balance amount was transferred to the Kehiin Panlafa private limited on demerger in financial year 2014 – 15 and the same is shown Under the head other liabilities in financial statements of that company. Such details were submitted on 23rd 11 2016 and 23 December 2016. The learned assessing officer has considered the amount of ₹ 4,239,000/- as excess provision which is not been added back to the income in either current assessment year or in the succeeding assessment year, hence added the same to the income of the assessee u/s 37 of the act. The claim of the assessee is that any amount of provision for which the corresponding amount is reduced from the set-aside is of the balance sheet is treated as an actual right of he relied upon the decision of the honourable Gujarat High Court in case of CIT versus Vodafone Essar Gujarat Ltd (TS-330-HC-2017-GUJ] was wherein it has been held that if the assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtors account it would constitute a write off of an actual debt. Thus, the claim of the assessee is that the above sum is a bad debt only and not provision for doubtful debts. The learned authorised representative reiterated these arguments whereas the learned departmental

representative stated that no such arguments are dealt with by the learned dispute resolution panel and therefore the same should go back to the file of the learned assessing officer.

30. We have carefully considered the rival contention and perused the orders of the learned dispute resolution panel, we find that assessee did raise such an objection before the learned dispute resolution panel however; same was not at all dealt with in its direction. In view of this, we set-aside this issue back to the file of the learned assessing officer with a direction to the assessee to furnish the requisite information, the learned assessing officer after considering the claim of the assessee may decide the same in passing the fresh draft assessment order which would once again go before the learned dispute resolution panel. In view of this ground number 5 of the appeal is allowed accordingly.
31. Ground number 6 is with respect to the initiation of penalty proceedings, which is premature at this particular stage, and therefore this ground of appeal is dismissed.
32. Ground number 7 is with respect to the charge of interest u/s 234A, B and C, it is consequential in nature, and therefore it is dismissed.
33. In the result, appeal of the assessee is partly allowed with about directions.

Order pronounced in the open court on 08/06/2021.

-Sd/-
(AMIT SHUKLA)
JUDICIAL MEMBER

-Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Dated: 08/06/2021
MEHTA

Copy forwarded to

1. Appellant;
2. Respondent;
3. CIT
4. CIT (Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi