IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE

Before Shri George George K, JM & Shri B.R.Baskaran, AM

ITA No.2016/Bang/2018 : Asst.Year 2013-2014

The Joint Commissioner of Income-tax, LTU (OSD) Circle-1 Bangalore.	v.	M/s.Toyota Kirloskar Motors Private Limited, Plot No.1, Bidadi Industrial Area, Ramanagar, Dist., Bidadi Bangalore – 562 109. **PAN : AAACT5415B.**
(Appellant)		(Respondent)

ITA No.1972/Bang/2018 : Asst.Year 2013-2014

M/s.Toyota Kirloskar Motors Private Limited, Plot No.1, Bidadi Industrial Area, Ramanagar, Dist., Bidadi, Bangalore – 562 109.	v.	The Joint Commissioner of Income-tax, LTU (OSD) Circle-1 Bangalore.
(Appellant)		(Respondent)

Revenue by : Sri.Muzaffar Hussaain, CIT-DR
Assessee by : Sri.P.C.Kincha, CA

Date of Hearing : 11.08.2021		**Date of Pronouncement : 18.08.2021**

O R D E R

Per George George K, JM :

These are cross appeals directed against CIT(A)'s order dated 31.03.2018. The relevant assessment year is 2013-2014. We shall first adjudicate the assessee's appeal.

ITA No.1972/Bang/2018 (Asst.Year 2013-14)
(Assessee's appeal)

2. In this appeal, 13 grounds are raised. The general and T.P. adjustment grounds from 1 to 10, the learned did not press, hence, these grounds are dismissed. The surviving grounds, namely, ground Nos.11 to 13 read as follows:-

> ***"Grounds related to corporate tax (long term benefit):***
>
> *11. The CIT(A) has erred in confirming the action of the A.O. in :*
> *a. Disallowing provision towards employee long term service benefit liability on the ground that such provision is contingent and not accrued;*
>
> *b. Not appreciating that the provision for employee long terms service benefit is in accordance with provisions of Accounting Standard (AS) 15 – Employee benefit and based on actuary valuation; and*
>
> *c. Holding that employee long term service benefit liability has not crystallized nor has accrued.*
>
> ***Grounds related to corporate tax (Miscellaneous expenses)***
>
> *12. The learned CIT(A) has erred in allowing only 10% of Rs.73,91,476/- incurred towards construction the School Building, Installation of water purification Plant and Promotion of Japanese Language, without appreciating that the expenses are incurred to promote Toyota Brand and to create awareness about Toyota Products. Hence the expenses are wholly and exclusively for the purpose of business and are allowable.*
>
> ***Grounds related to corporate tax (MTM Loss / Gain)***
>
> *13. The learned CIT(A) has erred in confirming the action of the AO in :*
>
> *a. Disallowing a sum of Rs.1,76,80,000/-, being mark to market loss on outstanding derivative contracts on the ground that same is notional loss.*
>
> *b. Not appreciating that such mark to market loss is in accordance with provisions of applicable Accounting Standard and allowable as deduction in the facts and circumstances of the case."*

We shall adjudicate the above issues ground-wise as under:

Ground No.11

3. The assessee is engaged in the business of manufacturing and selling of multi utility vehicles. For the relevant assessment year, the assessee had filed return of

income by claiming deduction for provision towards long service benefit liability amounting to Rs.46,60,033. The Assessing Officer disallowed the provision stating that such liability has neither crystallized nor accrued during the year. The Assessing Officer also stated that there was no contractual obligation on the assessee and such amount constituted loyalty bonus subject to section 192 at the time of actual payment. The relevant observation of the A.O. reads as follow:-

> *"In the return of income the assessee made a claim of Rs.46,60,033 as provision for long service liability. In the course of assessment proceedings, it was explained that employees who complete 10 years of service are presented with mementoes in the form of gold. The liability that may arise on account of such employees in future is quantified and recognized over a period of time in accordance with accounting standard. It is clear from this explanation that the liability neither has crystallized nor accrued. There is no contractual obligation involved and such amounts which would constitute a loyalty bonus is subject to TDS u/s 192 at the time of actual presentation. Therefore, such income cannot be said to relate to the financial years constituting the 10 years span but is essentially one time expenditure during the financial year in which it is disbursed. Accordingly, provision made on such sums cannot be treated as an admissible expenditure. Accordingly, the sum of Rs.46,60,033 is disallowed and brought to tax."*

3.1 Aggrieved, the assessee preferred an appeal to the first appellate authority. Before the CIT(A) elaborate written submissions were filed, which are enclosed from pages 1067 to 1093 of the paper book filed by the assessee. The gist of the written submission is that the assessee is following mercantile system of accounting and the provision was made in compliance with the Accounting Standard (AS) – 15 and as per the actuary valuation report. Therefore, the submission of the assessee is that provision is based on the known liability and

since the estimation is reliable, the same is to be allowed as deduction. The CIT(A) rejected the contentions of the assessee by observing as under:-

> *"69. I have examined the issue. The appellant is having a scheme wherein it gives a gold coin weighing ten grams to an employee who has completed ten years during the Financial Year. As per the information furnished before me the scheme has started during the Financial Year 2011-12. The date for various years was asked which was furnished as shown in the table above.*
>
> *70. I asked a question to the appellant's representatives during the hearing as to what happens to an employee who has quit after completing nine years nine months in the organization. It was submitted that such an employee does not get a gold coin.*
>
> *71. The appellant in the para no.7.34 of the submission has claimed that in case of provision for employee long term service benefit liability, making of the company policy is the event which gives rise to the obligation. I do not agree with this claim.*
>
> *72. I find that the liability to pay to an employee accrues on the day employee completes ten years in the organization and not before that. In my view the appellant can create a provision (which will be allowable under IT Act) on the completion of ten years by an employee and not before that. The appellant can make payment when the employee completes eleven years, twelve years, or even later. Meaning thereby that the provision which is created on the tenth year is allowable. Thus, expenditure becomes due during the previous year in which the employee completes ten years, irrespective of the fact whether it is paid during the previous year or not. The expenditure does not become due even one day before completion of ten years.*
>
> *73. However, the appellant is creating provision for the employee who have completed one year, two years etc. by making some calculations which are not verifiable step by step. Thus, I find that the obligation of the appellant is not arising out of past or present obligation. Further, the obligation is future obligation and it therefore results in a contingent liability.*
>
> *74. I find that the decision of Hon.High Court of Karnataka Commissioner of Income-tax v. Micro Land Ltd. [2012] 18 taxmann.com 80 (Kar.) is relevant here. Hon.High Court has*

> *held that Deduction under section 37(1) can be allowed in respect of expenditure which is actually incurred or laid out in present and not an expenditure which is a future contingent expenditure which may or may not arise.*
>
> *75. Therefore, this ground of appeal is dismissed."*

3.2 Aggrieved by the order of the CIT(A), the assessee has raised this issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

3.3 The learned Departmental Representative supported the orders of the Assessing Officer and the CIT(A).

3.4 We have heard rival submissions and perused the material on record. It is an admitted fact that the assessee is following mercantile system of accounting. As per the mandate of Accounting Standard-15 (AS-15), the assessee is required to make the provision in the books of account towards future liability accruing to the employees who are in service but not yet completed 10 years duration to be eligible for memento. The assessee had engaged the services of actuary in order to determine the extent of provision to be made in accordance with AS-15. The actuary certified that as on 31.03.2013 (i.e. for the relevant assessment year under consideration), a sum of Rs.46,60,033 needs to be provided based on certain actuarial assumptions. A copy of the actuary valuation is placed at page 1221 of the paper book filed by the assessee. The AS-15 dealing with "employees benefits" defines the term "employees benefits" to include "other long term employee benefit". The extract of the Accounting Standard reads as follow:-

> *"(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing bonuses and deferred compensation; and"*

3.4.1 Therefore, if any company provides any long term service benefit to its employees, then the recognition, measurement and disclosure requirements laid out under AS-15 is required to be adhered to. The liability in this case might arise on account of employees completing 10 years of service in future, is therefore, required to be quantified and recognized over a period of time in accordance with the Accounting Standards. "Accrual" is one of the fundamental accounting assumption. The term accrue is not defined in the Act. As per AS-1 (Disclosure of accounting policies), Accrual presupposes that the financial statements are prepared on mercantile system of accounting. Under this system, the effects of transaction and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in financial statements the period to which they relate.

3.4.2 The Hon'ble Supreme Court in the case of Bharat Earth Movers v. CIT [2000] 112 taxman 61 (SC) had held if business liability has definitely arisen in the accounting year, then the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these

requirements are satisfied, it was held by the Hon'ble Supreme Court that the liability is not a contingent one and the liability is in praesenti though it will be discharged at a future date. It was further held by the Hon'ble Supreme Court that it does not make any difference if the future date on which the liability shall have to be discharged is not certain. The Hon'ble Supreme Court was considering a case where the assessee company had floated beneficial schemes for its employees for encashment of leave. The officers were entitled to earned leave calculated at the rate of 2.5 days per month, i.e., 30 days per year. The staff (other than officers) was entitled to vacation leave calculated at the rate of 1.5 days per month, i.e., 18 days in year. The earned leave / vacation leave could be accumulated up to 240/126 days maximum and the same could be encashed subject to the ceiling limit of 240/126 days. The taxpayer, in the case considered by Hon'ble Supreme Court, made provision for meeting the liability to the extent of entitlement of the officers and staff to accumulate earned vacation leave subject to ceiling limit of 240/126 days as might be applicable, and claimed that provision as deduction. The Tribunal held that the taxpayer was entitled to such deduction. The High Court, on the basis of the reasoning that the liability would arise only if an employee might not go on leave and instead would apply for encashment, held that the provision for accrued leave salary was a contingent liability and, therefore, was not a permissible deduction. The Hon'ble Supreme Court reserved the Hon'ble High Court's conclusion by observing as above.

3.4.3 Therefore, taking into account the judicial pronouncements and the AS-15, we hold that if the liability is an known liability and the estimation of liability is reliable, the provision made for the relevant assessment year cannot be stated to be a contingent liability. In this case, the actuary valuation for claiming provision of Rs.46,60,033 for the relevant assessment year is placed on record at page 1221 to page 1233 of the paper book filed by the assessee. On perusal of the same, it is not clear as regards the basis of arriving of the above stated provision. In simple terms, if the assessee had made a provision on proportionate basis, i.e., taking into account 10% on an year to year basis for gifting the memento on completion of 10 years of service, we could have understood the valuation report is based on some reasonable basis. Further, when the employee leaves the assessee-company prior to completion of ten years, how the provision is reduced on year to year basis, is also not explained. Before us, no explanation was offered as regards how the provision of Rs.46,60,033 is arrived at. Therefore, in the facts of the given case, the assessee has to prove before the A.O. the scientific basis for creating a provision for Rs.46,60,033. For this purpose, the issue raised in ground No.11 is restored to the files of the A.O. with the above directions. It is ordered accordingly.

3.5 In the result, ground No.11 is allowed for statistical purposes.

Ground No.12

4. The Assessing Officer had disallowed a sum of Rs.73,91,476 u/s 37 of the I.T.Act, being the expenditure related to construction of school at Bidadi, promotion of Japanese language and construction of basic civil structure for water purification plant at Ramanagaram on the ground that they are not incurred for the benefit of business. The relevant finding of the A.O. reads as follow:-

"Date	*Narration*	*Amount*
19.07.2012	*Construction of school building*	*783903*
19.07.2012	*Construction of school building*	*788611*
26.07.2012	*Promotion of Japanese language in Bangalore University*	*411001*
09.09.2012	*Construction of school building*	*788611*
30.09.2012	*Construction of school building*	*719900*
28.03.2013	*Construction of basic civil structure for water purification plant at Ramanahalli*	*474927*
28.03.2013	*Construction of basic civil structure for water purification plant at Ramanahalli*	*474927*
30.03.2013	*Construction of basic civil structure for water purification plant at Ramanahalli*	*503800*
30.03.2013	*Construction of basic civil structure for water purification plant at Ramanahalli*	*503800*
30.03.2013	*Promotion of Japanese language*	*402781*
31.03.2013	*Construction of school building*	*1539215*
		7391476

5.2 Opportunity was provided to the assessee to explain the allowability of these specific items during the hearing on 27.10.2016. The items of expenditure are no way related to the business of the assessee and are also not expenses in nature of revenue. Moreover, the assessee is not able to explain how these expenses benefited him in his business. Hence, they are considered as not for the purpose of business and added back to the income u/s 37."

4.1 Aggrieved, the assessee preferred an appeal to the CIT(A). Before the CIT(A), elaborate written submissions were filed. Copy of the same is placed on record at pages 1094 to 1115 of the paper book filed by the assessee. The gist of the submission as regards expenditure incurred for improving

Government School in Manchanayakanahalli Village, it was submitted that the expenses were for the purpose of business, for the following reasons:-

(a) Help its employees' children in getting quality education facilities;

(b) Ensure that its employees do not migrate in search of better educational facilities;

(c) Uplift the morale of the employees and make them more productive;

(d) Improve the brand image of Toyota in Manchanayakanahalli and nearby villages.

4.2 As regards the expenditure incurred for installation of water purification plant Byramangala Village, which is 2.5 kms. away, it was submitted that the construction of water purification plant would ultimately benefit assessee's employees and families in getting quality health and it ensure more efficiency at work. It was stated that the expenditure incurred for installation of water purification plant is wholly and exclusively for the purpose of business for the following reasons:-

(a) Help its employees and their families in getting quality drinking water;

(b) Uplift the morale and health of the employees and make them more productive; and

(c) Improve the brand image of Toyota in Byramangala and nearby villages.

4.3 As regards the assessee's payment amounting to Rs.8,13,782 to Bangalore University, it was stated that the assessee has inter-company transfer policy, wherein its employees are transferred to its parent company, Toyota Motor Corporation, Japan. As the English speaking population is very less in Japan, the employees who are selected for inter-company transfers had to attend Japanese language learning course for a period of 3 months. It was stated that there was a requirement to develop Japanese language learning centre in Bangalore, which would ultimately benefit the employees who are enrolled for the course, hence, the payment made amounting to Rs.8,13,782 is an allowable business expenditure.

4.4 The CIT(A) held that considering the benefit of assessee's employees, 10% of the amount, i.e., Rs.7,39,147 is to be allowed as a deduction under the Income-tax Act and balance disallowance made by the A.O. was confirmed. The relevant finding of the CIT(A), reads as follow:-

> *"82. I have considered the details and the submissions made by the appellant. From the point of view of the society and environment the appellant has definitely done good work. However, the same is not incurred for the purpose of business. Considering the benefits to its employees 10 per cent of this amount i.e. 7,39,147 is being held as allowable under the Income Tax Act and the balance disallowance is confirmed. This ground is accordingly partly allowed."*

4.5 Aggrieved, the assessee has raised the above issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

4.6 The learned Departmental Representative supported the findings of the CIT(A).

4.7 We have heard rival submissions and perused the material on record. Majority of the expenses incurred by the assessee amounting to Rs.73,91,476 is incurred in villages very near to assessee's manufacturing plant. It is the claim of the assessee that the workers and their family has benefitted from the above expenditure. This fact has also accepted by the CIT(A) by allowing as deduction 10% of the total expenditure. The amount of Rs.8,13,782, expended for promotion of Japanese language will also ultimately benefit the employees of the assessee. Taking the overall view and to put a quietus to the issue, we hold that 30% of the total expenditure would have benefitted the employees of the assessee-company. Accordingly, we allow a sum of Rs.22,17,441 out of the total expenditure of Rs.73,91,476. It is ordered accordingly.

4.8 In the result, ground No.12 is partly allowed.

Ground No.13

5. During the year under consideration, the assessee had planned to increase the overall capacity of the plant from 2,10,000 units to 3,10,000 units. The assessee, therefore, required funds to make investment in plant and machinery. The assessee approached bankers and availed Buyers Credit Loan facility from BTMU, Citi Bank and SCB Banks for investment in plant and machinery. The loan facility extended by BTMU, Citi Bank and SCB banks were denominated in Foreign Currency and the interest rate was benchmarked

against LIBOR. To protect against fluctuations in foreign currency exchange rate and LIBOR, the assessee entered into hedge transaction with respective banks from whom it had borrowed under buyer's credit. The hedging transaction entailed the following:

> (a) Floating LIBOR interest rate with fixed interest rate; and
>
> (b) Eliminated foreign exchange rate fluctuation on interest / principal payments using suitable currency hedge / swap contract.

Though this hedge, the loan was converted into equivalent rupee loan without any interest rate fluctuation risk and foreign exchange fluctuation risk. As a result, liability for repayment of loan and interest payment was fixed and there is no impact of forex fluctuation while repayment / settlement.

5.1 During the course of assessment proceedings, it was submitted that on the principle of prudence and transparent accounting practice, the assessee provided for losses in respect of all outstanding derivative hedge contracts at the balance sheet date by marking them to market. Accordingly, during the year under consideration, the assessee ascertained mark-to-market value in respect of Swap Contract based on confirmation obtained from the respective bankers and debited MTM losses to Profit & Loss account to the extent of Rs.1,76,80,000 during the relevant A.Y. 2013-2014.

5.2 The Assessing Officer has disallowed the MTM loss of Rs.1,76,80,000 for the following reasons:

> (a) MTM losses claimed by the assessee prior to settlement are on notional losses and cannot be allowed as deduction;
>
> (b) MTM losses claimed by the assessee prior to settlement are on notional losses which has to be treated as speculative loss in terms of section 43(5) of the I.T.Act and cannot be allowed as deduction.

5.3 The relevant portion of the assessment order, reads as follow:-

> *"7.6 As such, in the instant case, 'marked to market losses' claimed by the assessee on notional basis prior to the date of settlement has to be treated as speculative loss in terms of section 43(5). At this juncture it is pertinent to note that the assessee cannot place reliance on the decisions of the Hon'ble Supreme Court in the cases of Woodward Governors (supra) & ONGC (322 ITR 180) in view of the following reasons:*
>
> > (i) The issue before the Supreme Court in the case of Woodward Governor India Pvt. Ltd. (supra) (312 ITR 254) was whether the additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes could be allowed as a deduction u/s 37(1) in the year of fluctuation in the rate of exchange or whether the same could be allowed in the year of repayment of loans. In this regard, the Hon'ble Supreme Court has held that any difference i.e. loss of gain arising on conversion of the outstanding liability relating to forex transaction on revenue account at the end of the year should be recognized in the P&L account for the reporting period.
> >
> > (ii) In view of this, it is clear that the Hon'ble Supreme Court has not adjudicated or decided the issue with respect to mark to market loss on forward contract. Therefore, this decision is not applicable to the facts of the case on hand.
>
> *7.7 Accordingly, in the light of the Board's instruction, it is held that the `marked to market losses' claimed by the*

assessee on account of restatement of receivables at the end of the financial year on the basis of forward contracts are not allowable as revenue expenditure. Hence, the entire loss claimed by the assessee of Rs.1,76,80,000 is disallowed and added back to the income of the assessee."

5.4 On further appeal, the CIT(A) confirmed the view taken by the Assessing Officer. The relevant finding of the CIT(A), reads as follow:-

"87. The original loan is a variable interest loan. It is linked to LIBOR. Further, there is a risk of fluctuation of currency. The appellant through hedging transaction converted the variable interest loan in fixed interest loan and fixed the rate of rupee to dollar as that of on the date of transaction.

88. The appellant has already claimed the mark to market losses in the accounts and this claim has been allowed by the AO. For example, a loan is taken by the appellant on 26.11.2012 amounting to US$ 40,004,345. On 26.11.2012 the US$ to Rupee conversion rate is 54.93. On 31.03.2013 the US$ to Rupee conversion rate is 54.30. This has already been claimed and allowed by the AO.

89. Thus, I find that the AO has followed the judgment of Hon'ble Supreme Court in CIT v. Woodward Governor India P. Ltd. [2009] 312 ITR 254 reiterated in Oil and Natural Gas Corporation Limited v. CIT [2010] 322 ITR 180 and CIT v. Maruti Udyog Ltd [2010] 320 ITR 729 in letter and spirit. The unrealized loss due to foreign exchange fluctuation on the last date of the accounting year in respect of loans taken for revenue purposes has been allowed as deduction by AO to the assessee.

90. However, the assessee wants that the restatement of this hedging transaction should be allowed as revenue expenditure. This claim of assessee is not allowed as per the Income-tax Act. Hon'ble Supreme Court has also not gone into the allowability of losses on the hedging transaction in these decisions. Therefore, the reliance of the assessee on the above Supreme Court decisions for allowance of losses on hedging transaction is misplaced and cannot be accepted.

91. This ground of appeal is therefore dismissed."

5.5 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR relied on the submissions made

before the CIT(A) (page 1116 to1143 of the paper book filed by the assessee).

5.6 The learned DR supported the order of the CIT(A).

5.7 We have heard rival submissions and perused the material on record. The unrealized loss due to foreign exchange fluctuation on the last date of the accounting year in respect of loans taken for revenue purposes had been allowed as deduction by the A.O. The assessee, however, wants that restatement of the hedging transaction should be allowed as revenue expenditure. This claim of the assessee is not mandated as per the judgment of the Hon'ble Supreme Court relied on by the A.O. as well as the provisions of the Income-tax Act. As rightly pointed out by the CIT(A), the A.O. had in letter and spirit followed the judgment of the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India P. Ltd. [(2009) 312 ITR 254 (SC)], reiterated in the case of Oil and Natural Gas Corporation Ltd. v. CIT [(2010) 322 ITR 180 and in the case of CIT v. Maruti Udyog Limited [(2010) 320 ITR 729]. Further, underlying reason for availing the foreign loans are for purchase of plant and machinery, which is admittedly is on the capital front and cannot be allowed as a revenue expenditure. Therefore, the CIT(A)'s order confirming the assessment order on this issue is in accordance with law and no interference is called for. It is ordered accordingly.

5.7 In the result, ground No.13 is dismissed.

ITA No.2016/Bang/2018 (Asst.Year 2013-14)
(Revenue's appeal)

6. The grounds raised in Revenue's appeal read as follow:-

"1. The order of the Ld.CIT(A) is opposed to law and facts of the case.

2. Whether CIT(A) is right in law in excluding M/s. Tata Motors Ltd. as comparable, since it has passed the RPT filter.

3. Whether the Hon'ble CIT(A) right in fact and in law in allowing liabilities and provisions written back as operative which would result into abnormal adjustment and would make the profit earned within the permitted range even if no operating profit is earned.

4. Whether the Hon'ble CIT(A) erred by not upholding the approach of the TPO in treating liabilities and provisions written back as non-operative as the determination of ALP is based on current year data.

5. Whether the Hon'ble CIT(A) right in fact and in law in allowing working capital adjustment whether positive or negative would result into abnormal adjustment and would make the profit earned within the permitted range even if no operating profit is earned.

6. Whether the Hon'ble CIT(A) erred by not upholding the approach of the TPO in limiting the working capital adjustment to the average cost of capital of the comparable companies.

7. Whether on facts and in the circumstances of the case and in law, the CIT(A) is justified in restricting the adjustment only in International transactions where the assessee has selected TNMM and applied the same on entity level because presumption underlying arms length principle is that uncontrolled are at arm's length and therefore the overall margins are less than arm's length margins, the short fall must be on account of AE transactions only and not on pro rata basis.

8. Whether, on the facts and circumstances of the case and in law, the CIT(A) is justified in directing to confine the TP adjustment to the value of International transactions alone.

9. Whether the Hon'ble CIT(A) erred in not considering the fact that whatever is the reduction in the margin of the assessee viz a viz comparables is on account of sales to AE at

> *a lesser price and the same gets considered when ALP is calculated by applying TNMM.*
>
> *10. Whether the Hon'ble CIT(A) right in fact and in law in directing TPO to take net sale of as denominator for determination of ALP on royalty transaction.*
>
> *11. Whether the Hon'ble CIT(A) erred by not upholding the approach of the TPO in determination of ALP on royalty transaction.*
>
> *12. For these and such other grounds that may be urged at the time of hearing."*

We shall adjudicate the above grounds as under:

Ground No.2 – Inclusion of Tata Motors Limited

7. The assessee in its TP study, applied 25% RPT filter whereby companies having related party transactions (income transactions plus expenses transactions) in excess of 25% of sales were rejected as comparables. The assessee rejected Tata Motors Limited and Maruti Suzuki India Limited as comparable companies by holding that these companies was having RTP in excess of 25%. The TPO selected the above two companies as comparables. The TPO in his order relied on Tribunal's order in the case of Support Soft India for assessment year 2005-2006 in IT(TP)A No.1372/Bang/2011.

7.1 Aggrieved, the assessee preferred an appeal to the first appellate authority. According to the assessee, TPO had applied 25% filter, but there is no discussion in the order passed u/s 92CA of the I.T.Act whether the said filter has been applied by aggregating both income and expenses transactions or has been applied separately for both income and expenses transactions. The CIT(A) requested for remand

report from the TPO. The TPO in his remand report dated 21.03.2018, computed RPT ratio of both Tata Motors Limited and Maruti Suzuki India Ltd. According the AR, the TPOs tabulation of RPT ratio is individually for income and expenses transactions (RPT income / total sales and RPT expenses / total expenses) instead of tabulating the same on aggregate basis. The assessee filed a rejoinder to the remand report submitting that the RPT should be computed on aggregate basis. The CIT(A) directed the AO / TPO to exclude Tata Motors Limited from the list of comparable companies. The relevant finding of CIT(A) reads as follow:-

> *"18. The appellant in the rejoinder to the remand report has submitted that total RPT for Tata Motors Limited is Rs.14,386.32 crores whereas total revenue FY 2012-13 is Rs.46,853.92 crores. Therefore, the appellant contends that the RPT percentage for Tata Motors is 30.70 per cent. Similarly, the appellant has calculated RPT for Maruti Suzuki at 34.67%. Therefore, I find that both the comparables Tata Motors Ltd. and Maruti Suzuki India Ltd fail related party transaction filter of 25% on sales. Accordingly, I direct these comparables to be excluded from the set of final comparables."*

7.2 Aggrieved, the Revenue is in appeal before the Tribunal. The learned DR submitted that the CIT(A) has erred in excluding Tata Motors Limited as a comparable since it has passed the RPT filter. According to the DR, RPT ratio has been calculated consistently across the board for all the comparables, and therefore, the CIT(A)'s exclusion of Tata Motors Ltd. is not justified.

7.3 The learned AR submitted that RPT has been calculated on aggregate basis taking into the ratio of RPT income plus RPT expenses by sales. The said position has been

consistently adopted by the Revenue in the past years, in assessee's own case. It was further submitted by the learned AR that the TPO in order to retain two companies as comparables has deviated and adopted new mechanism for computing RPT ratio.

7.4 We have heard rival submissions and perused the material on record. There is nothing on record to suggest how RPT ratio has been calculated for all the comparable companies. The learned AR has argued that the TPO in order to retain Tata Motors Ltd. and Maruti Suzuki India Limited has deviated and adopted a new mechanism for computing RPT ratio. On a query from the Bench how RPT ratio has been calculated for other comparables, the learned AR has unable to point out the same. The RPT ratio has to be consistently calculated on an aggregate basis taking the ratio of RPT income plus RPT expenses by sales. The said position was adopted by the Revenue in the past years. In this regard, the TPOs order in assessee's own case for assessment year 2007-2008 has been placed on record. A perusal of the same it is clear that RPT ratio has been calculated taking both RPT income transactions plus RPT expenses transactions on aggregate basis. On the facts of this case, it is not clear how RPT ratio has been calculated for Tata Motors Limited vis-à-vis other comparable companies. Therefore, this issue is restored to the files of the A.O. The A.O. is directed to calculate RPT ratio on an aggregate basis taking the ratio of RPT income plus RPT expenses by sales across the board for all the comparable companies (including Tata Motors Ltd. and Maruti Suzuki India Limited.

7.5 Therefore, ground No.2 is allowed for statistical purposes.

Ground Nos.3 and 4 – Provision Written back – Operating in Nature

8. The assessee had written back provision of Rs.18.48 crore that was no longer required. The same was credited to the profit and loss account. While computing the margin, the assessee treated the same as operating in nature. The TPO treated the same as non-operating in nature (however, there was no reasoning given by the TPO in adopting such a stand).

8.1 Aggrieved, the assessee preferred an appeal to the first appellate authority. Before the first appellate authority, it was submitted that reversal of provision is in relation to marketing expenses, general expenses and material provision which are no longer required. It has further submitted that since in the year of creation these provisions are treated as operating in nature, the reversal of the same is also to be treated as operating in nature. The CIT(A) by placing reliance on the order of the Delhi Bench of the Tribunal in the case of Sony India (P) Ltd. v. DCIT 114 ITD 448 (Delhi) and the order of the Bangalore Bench of the Tribunal in the case of Logica Private Limited v. ACIT 36 taxmann.com 374 (Blr.) held that the provisions written back should be treated as operating in nature.

8.2 The Revenue being aggrieved has raised this issue before the Tribunal.

8.3 We have heard rival submissions and perused the material on record. The assessee has reversed the provision of Rs.18.48 crore, which were no longer required. In the year of creation of this provision, the same were treated as operating in nature and reversal of the same should also be treated as operating in nature. This view has been consistently held by the judicial pronouncements relied by the CIT(A).

8.4 Therefore, ground Nos.3 and 4 are rejected.

Ground Nos.5 and 6 – Working capital adjustment)

9. The assessee had provided the working capital adjustment computation and requested the TPO to grant such adjustment. The TPO did not grant working capital adjustment. There is no discussion on this aspect in the TPO's order.

9.1 Before the CIT(A), the assessee made detailed submissions why the working capital adjustment be granted. The CIT(A) requested for remand report from the TPO on this issue. In the remand report the TPO submitted that the working capital adjustment should not granted. The assessee filed a rejoinder and made detailed submissions. The CIT(A) accepted the submissions of the assessee and directed the AO / TPO to provide for both positive and negative working capital adjustment.

9.2 Aggrieved, the Revenue has raised this issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

9.3 We have heard rival submissions and perused the material on record. The working capital adjustment is an accepted adjustment. In the following judicial pronouncements, it has been held that working capital adjustment has been provided for the purpose of better comparability.

> (a) Swiss Re Global Business Solutions India (P.) Ltd. v. DCIT [2020] 116 taxmann.com 716 (Bangalore – Tribunal)
>
> (b) Maxim India Integreated Circuit Design Pvt. Ltd. v. DCIT [IT(TP)A No.1573/Bang/2017 dated 02.11.2020.

9.4 In view of the above judicial pronouncements, we hold that the CIT(A) is justified in directing the AO to grant working capital adjustment. It is ordered accordingly.

9.5 Therefore, ground Nos. 5 and 6 are allowed.

Ground Nos. 7 and 8 - TP adjustment should be restricted to AEs transactions.

10. The assessee submitted before the AO / TPO that out of the total transactions which it had entered into, only 52.07% of the transactions are with its AEs, whereas, balance transactions are undertaken with third parties. The assessee requested the TPO to restrict the TP adjustment to only AEs

transaction. The TPO, however, did not accept the contention (there is no discussion on this aspect in the order of the TPO).

10.1 Aggrieved, the assessee preferred an appeal to the first appellate authority. Before the CIT(A), the assessee filed detailed submissions why TP adjustment should be restricted to AEs transactions. The CIT(A) requested for a remand report from the TPO on this issue. The TPO submitted a remand report by stating ALP should be calculated on entity level. The assessee filed a rejoinder. The CIT(A) accepted the submissions of the assessee and directed the TPO to restrict the TP adjustment to the transaction it had entered with its AEs, alone.

10.2 Aggrieved, the Revenue has raised this issue before the Tribunal. The learned Departmental Representative relied on the order of the AO / TPO.

10.3 The learned AR, on the other hand, submitted that in assessee's own case for assessment year 2003-2004, the Bangalore Bench of the Tribunal had accepted that the TP adjustment is to be restricted only to the transaction assessee had entered with its AE. Copy of the order of the Bangalore Bench of the Tribunal in assessee's own case for assessment year 2003-2004 is placed on record.

10.4 We have heard rival submissions and perused the material on record. For assessment year 2003-2004 in assessee's own case the Bangalore Bench of the Tribunal had accepted that TP adjustment has to be restricted to AEs

transactions alone. Following judicial pronouncements has also held the TPO adjustment has to be restricted to the international transaction the assessee had entered with its AEs.

(a) CIT v. Keihin Panalfa Ltd. (Del HC-TS-474-HC-2015

(b) CIT v. Tara Jewels Exports (P) Ltd. [2017] 80 taxmann.com 117 (Bombay).

10.5 In view of the above judicial pronouncements, we hold that the CIT(A) has correctly directed the AO / TPO to restrict the TP adjustment to the AEs transaction.

10.6 Accordingly, ground Nos.7 and 8 are rejected.

Ground Nos.10 & 11 – Royalty Benchmarking

11. The assessee had adopted TNMM at the entity level in which process royalty payment is considered as closely linked transaction and part of operating cost. The TPO rejected the above stand of the assessee and benchmarked the royalty transaction as per the ALP computation of assessment year 2012-2013.

11.1 Before the CIT(A), the assessee reiterated the submissions made and filed a detailed objection against the analysis of TPO. The CIT(A) called for a remand report. In the remand report, the TPO rejected the claim of the assessee by referring to the order of the Tribunal in assessee's own case for assessment year 2005-2006. The assessee filed a rejoinder to the remand report. The CIT(A) partly allowed the ground of the

assessee by holding that TPO has to follow consistent approach and should adopt net sales as denominator for the purpose of comparing royalty in case of comparables and the assessee.

11.2 Aggrieved, the Revenue has raised this issue before the Tribunal. The learned DR supported the order of AO / TPO.

11.3 The learned AR reiterated the submissions made before the Income Tax Authorities.

11.4 We have heard rival submissions and perused the material on record. The AO /TPO had made TP adjustment for shortfall in margins as well as royalty. The royalty adjustment has been made despite royalty being part of operating cost, although the royalty adjustment is held by the TPO as subsumed within the margin adjustment. We are of the view that once the net profit margin is tested on touchstone of arm's length price, it pre-supposes that the various components of income and expenditure considered in the process of arriving at the net profit are also at arm's length. In taking the above view, we rely on the order of the ITAT in assessee's own case for assessment year 2007-2008 in IT(TP)A No.1315/Bang/2011, wherein the Tribunal had held that the royalty payment made by the assessee are at arm's length price. The relevant finding of the Tribunal reads as follow:-

> *"48. On the issue whether the TPO can come to a conclusion that the ALP of an international transaction is nil because no services were rendered or that the assessee did not derive any benefit from the AE for which payments were made, we have considered the submissions of the learned counsel for the assessee. This issue is purely academic because we have*

already held that the conclusions of the TPO/DRP that the trading and manufacturing segment of the Assessee are distinct and not inter related warranting combined transaction approach is not correct and that a combined transaction approach has to be adopted and that on the basis of combined transaction approach the price paid for the international transaction is at Arm's Length. We may also that legally the TPO should adopt the ALP as nil. On similar approach by TPO adopting ALP at Nil the ITAT, Bangalore Bench, in the case of M/s.Festo Controls Pvt. Ltd. vs. DCIT in ITA No.969/Bang/2011 (AY: 2007-08) dated 4-1-2013, the Tribunal examined the question as to whether the TPO can determine the ALP at nil on the ground that no services were rendered. The Tribunal, on the above issue followed the decision of the Mumbai Bench of the ITAT in the case of Castrol India Ltd. v. ACIT in ITA No.3938/MUM/2010 dated 14.09.2012 wherein it was held that it was incumbent upon the TPO to work out the ALP of the relevant transactions by following some authorized method and the entire cost borne by the assessee cannot be disallowed by taking the ALP at Nil. The Tribunal also referred to the decision of the Hon'ble Delhi High Court in the case of CIT v. EKL Appliances Ltd., ITA No.1068/2011 dated 29.03.2012. In the aforesaid decision, the assessee entered into an agreement pursuant to which it paid brand fee/ royalty to an associated enterprise. The TPO disallowed the payment on the ground that as the assessee was regularly incurring huge losses, the know-how/ brand had not benefited the assessee and so the payment was not justified. This was reversed by the CIT (A) & Tribunal on the ground that as the payment was genuine, the TPO could not question commercial expediency. On appeal by the department, the Hon'ble Delhi High Court held that the "transfer pricing guidelines" laid down by the OECD make it clear that barring exceptional cases, the tax administration cannot disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterprises. The guidelines discourage re-structuring of legitimate business transactions except where (i) the economic substance of a transaction differs from its form and (ii) the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner. The OECD guidelines should be taken as a valid input in judging the action of the TPO because, in a different form, they have been recognized in India's tax jurisprudence. The Hon'ble Court held that it is well settled that the revenue cannot dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur (Eastern Investment Ltd 20 ITR 1 (SC), Walchand & Co 65 ITR 381 (SC) followed). Even Rule 10B(1)(a) does not authorise disallowance of expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same. In light of the aforesaid decisions, we are of the view that the stand taken by the assessee in this regard deserves to be accepted. It is clear from the decisions referred to above that the TPO has to work out the ALP of the international transaction by applying the methods recognized under the Act. He is not competent to hold that the expenditure in question has not been incurred by the assessee or that the assessee has

not derived any benefits for the payment made by the assessee and therefore he cannot consider the ALP as NIL. We hold accordingly.

49. Besides the above, even on facts the determination of ALP at NIL in respect of royalty payments cannot be sustained. In this regard, it was brought to our notice by the ld. counsel for the assessee that similar payment made in A.Y. 2009-10, the DRP in its directions dated 19.11.2013 was pleased to hold that the payment of royalty was supported by the services rendered by the AE and was justified. The aforesaid order of the DRP was considered by the CIT(A), LTU, Bangalore in A.Y. 2005-06 and in her order dated 20.3.2014, the CIT(A) held as follows:-

> "10.3 The above mater had come up for adjudication before the DRP in the appeals for other years also. For AY 2006-07 I find that the DRP has confirmed the TPO's determination of ALP of royalty at 'nil' through order dt. 30.09.2010. In this order, however, at page 10 while recording its directions, the DRP mentions the TPO's admission that in view of the time barring situation he was unable to examine the objections raised by the assessee. After independently studying these objections, the DRP cryptically approved the TPO's position of 'nil' ALP. In AY 2009-10 however, the DRP has discussed in elaborate detail the assessee's objections on similar grounds and has arrived at the conclusion that the assessee not only received the technology support as well as the related intangibles in terms of production processes, but has also benefitted from these technological practices, standards and know-how which were not created locally by itself. The Toyota Production System, standardized on a world-wide basis, has also been studied for its operational efficiency by premier academic institutions. I am inclined to agree with this conclusion after examining the facts of the appellant's case and the evidences available. The TPO's argument that no benefit was derived by the appellant from the technology for which royalty was paid is not supported by facts and evidences. The fact that the royalty rate was within the permissible limit specified by the Govt. of India and approved by the RBI is an additional argument in support of the legitimacy of the said payment.
>
> 10.4 In view of the above discussion, the TPO's determination of the ALP of the royalty payment at 'nil' cannot be supported. For such ALP determination, a proper analysis of comparables is required to be performed for FY 2004-05 and the TPO is directed to identify suitable comparables and, after providing adequate opportunity to the appellant to determine the appropriate ALP of royalty payment. For statistical purposes, the grounds raised in this regard are treated as allowed."

50. The facts and circumstances remain the same in the present assessment year as it prevailed in the earlier assessment year decided by the CIT(A)/DRP referred to above. We are of the view that the findings of the CIT(A)/DRP have to be upheld and is accordingly upheld. In view of the above, we are of the view that Gr.No.22 to 24 has to be allowed, though it is only academic.

> *51. In view of our conclusions on Gr.No.12, 22 to 24, we are of the view that the other issues raised by the assessee in the various grounds of appeal do not require any adjudication and are left open."*

11.5 We also place reliance on the judgment of the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India v. ACIT 55 taxmann.com 240. In view of the aforesaid reasoning and the judicial pronouncements, we hold that the CIT(A) was correct in partly allowing the assessee's ground by holding that the TPO has to follow a consistent approach and adopt net sales as denominator for the purpose of comparable royalty in the case of comparables and the assessee.

11.6 Therefore, ground Nos.10 and 11 are rejected.

12. In the result, the appeal filed by the Revenue and assessee are partly allowed for statistical purposes.

Order pronounced on this 18th day of August, 2021.

Sd/-	**Sd/-**
(B.R.Baskaran)	**(George George K)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Bangalore; Dated : 18th August, 2021.
Devadas G*

Copy to :
1. The Appellant.
2. The Respondent.
3. The CIT(A)-9, Bangalore
4. The Pr.CIT (LTU), Bangalore.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore