

आयकर अपीलीय अधिकरण “के” न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
“K” BENCH, MUMBAI

माननीय श्री छल्ला नागेन्द्र प्रसाद, न्यायिक सदस्य एवं
माननीय श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष।
BEFORE HON’BLE SHRI C.N. PRASAD, JM AND
HON’BLE SHRI MANOJ KUMAR AGGARWAL, AM
(Hearing Through Video Conferencing Mode)

1. आयकरअपील सं./ I.T.A. No.7844/Mum/2019
(निर्धारण वर्ष / Assessment Year: 2015-16)

Firemenich Aromatics Production (India) Pvt. Ltd. (successor to Firemenich Aromatics (India) Pvt. Ltd.) 9 th floor, Plot No. 4, Survey No. 20, MIDC, Behind Majas Bus Depot, Jogeshwari East, Mumbai-60.	बनाम/ Vs.	ACIT – 9(3)(1), R. No. 215, 2 nd floor, Aaykar Bhavan Maharshi Karve Road, Marine Lines Mumbai-400 020
स्थायीलेखासं ./जीआइआरसं ./PAN/GIR No. AABCF-1120-G/AAACF-1621-M	:	
(अपीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

Assessee by	:	Ms. Hirali Desai & Shri Kiresh Shivkar – Ld. ARs
Revenue by	:	Shri Sunil Deshpande– Ld. Sr.DR

सुनवाई की तारीख/ Date of Hearing	:	21/09/2021
घोषणा की तारीख / Date of Pronouncement	:	26/10/2021

आदेश / ORDER

Manoj Kumar Aggarwal (Accountant Member)

1 Aforesaid appeal by assessee for Assessment Year 2015-16 arises out of final assessment order passed by Ld. AO u/s 143(3) r.w.s. 144C(13) on 25/10/2019 pursuant to the directions of Ld. Dispute Resolution Panel-1, WZ, Mumbai (DRP) u/s 144C(5) dated 22/08/2019. The grounds raised by the assessee read as under: -

i. Ground No. i: Transfer Pricing ('TP') adjustment in relation to export of finished products

1.1. On the facts and circumstances of the case, and in law, the Hon'ble DRP has erred in upholding the action of the Ld. AO/TPO in determining the Arms' Length Price ('ALP') of the international transaction of export of finished products at Rs. 8,34,22,404 instead of Rs. 7,59,14,928 thereby, computing a TP adjustment of Rs. 75,07,476.

1.2. While doing so, the Hon'ble DRP/ Ld. AO/ Ld. TPO erred in:

(a) Disregarding the aggregation approach adopted by the Appellant thereby, rejecting the application of entity level Transactional Net Margin method ('TNMM') as the Most Appropriate Method ('MAM');

(b) Applying Comparable Uncontrolled Price ('CUP') Method as the MAM vis-a-vis the products sold to both Associated Enterprises ('AEs') and Non-AEs; and

(c) Applying two methods i.e., CUP and TNMM at the same time for benchmarking the impugned international transaction.

1.3. Without prejudice to point 1.1. and 1.2., while applying CUP, the Hon'ble DRP/ Ld. AO/ Ld. TPO erred in ignoring the differences on account of geographical market, volume of transactions, functional and risk profile and level of market while comparing the impugned international transaction with the comparable uncontrolled transaction.

1.4. On the facts and circumstances of the case, and in law, the Hon'ble DRP/ Ld. AO/ Ld. TPO has erred in not following the order of the Hon'ble Income Tax Appellate Tribunal (TTAT') for AY 2013-14 and AY 2014-15.

The Appellant prays that the aforesaid adjustment of Rs. 75,07,476 be deleted.

2. Ground No. 2: Transfer Pricing ('TP') adjustment in relation to payment of royalty for availing technical know-how

2.1. On the facts and circumstances of the case and in law, the Hon'ble DRP has erred in upholding the action of the Ld. AO/ TPO in determining the ALP of royalty paid to AE for technical know-how at Rs.23,08,81,950 instead of Rs. 26,37,95,683 thereby, computing a TP adjustment of Rs.3,29,13,733.

2.2. While doing so, the Hon'ble DRP/ Ld. AO/ Ld. TPO erred in:

(a) Disregarding the fact that payment of royalty is inextricably linked to entrepreneurial operations of the Appellant and therefore, it should have been benchmarked on an aggregation basis by applying TNMM as the MAM; and

(b) Applying CUP method as the MAM to determine the ALP of the impugned international transaction.

2.3. Without prejudice to point 2.1. and 2.2., while applying CUP, the Hon'ble DRP/ Ld. AO/ Ld. TPO erred in:

(a) Inappropriately accepting the royalty agreement which is not comparable to the royalty agreement of the Appellant; and

(b) Inappropriately rejecting the royalty agreements which are comparable to the royalty agreement of the Appellant.

2.4. On the facts and circumstances of the case, and in law, the Hon'ble DRP/ Ld. AO/ Ld. TPO has erred in not following the order of the Hon'ble ITAT for AY 2012-13, AY 2013-14 and AY 2014-15-

The Appellant prays that the aforesaid adjustment of Rs. 3,29,13,733 be deleted.

3. Ground No. 3: Transfer Pricing ('TP') adjustment in relation to payment of interest on External Commercial Borrowing ('ECU')

3.1. On the facts and circumstances of the case and in law, the Hon'ble DRP erred in upholding the action of the Ld. AO/ TPO in determining the ALP of the international transaction of payment of interest on ECB at Rs. 48,53,007 instead of Rs. 1,06,58,345, thereby computing an adjustment of Rs. 58,05,338.

3.2. While doing so, the Hon'ble DRP/ Ld. AO/ Ld. TPO erred in:

- (a) Not following a structured/ methodical search process in selecting the comparable companies for arriving at the arm's length interest rate;
- (b) Not appreciating the fact that the interest paid by the Appellant on ECB loan is as per the circular issued by Reserve Bank of India ('RBI'); and
- (c) Disregarding the fact that the effective rate of interest paid by the appellant is lower than the SBI Prime Lending rate ('PLR') for the relevant year.

3.3. On the facts and circumstances of the case, and in law, the Hon'ble DRP/ Ld. AO/ Ld. TPO has erred in not following the order of the Hon'ble ITAT for AY 2013-14 and AY 2014-15.

The Appellant prays that the aforesaid adjustment of Rs. 58,05,338 be deleted.

4. Ground No. 4: Transfer Pricing ('TP') adjustment in relation to payment of Information System ('IS') charges

4.1. On the facts and circumstances of the case and in law, the Hon'ble DRP erred in upholding the action of the Ld. AO/ Ld. TPO in determining the ALP of the international transaction of payment of IS service charge at Rs. 9,41,68,816 instead of Rs. 11,08,02,230 thereby disallowing the claim pertaining to internal cost of IS charge amounting to Rs. 1,66,33,414.

4.2. While doing so, the Hon'ble DRP/ Ld. AO/ Ld. TPO grossly erred in:

- (a) Determining the ALP of the international transaction of payment of internal cost of IS charge as 'Nil' purportedly applying 'Other method' as per the provisions of Rule 10AB of the Income-tax Rules, 1962; and
- (b) Ignoring that the Appellant had supported the claim with appropriate evidences.

4.3. On the facts and circumstances of the case, and in law, the Hon'ble DRP/ Ld. AO/ Ld. TPO has erred in not following the order of the Hon'ble ITAT for AY 2012-13, AY 2013-14 and AY 2014-15-

The Appellant prays that the aforesaid adjustment of Rs.1,66,33,414 be deleted.

5. Ground No. 5: Initiating penalty proceedings under section 271(1)(c) of the Act

5.1. On the facts and circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act for furnishing inaccurate particulars of income.

6. Ground No. 6: Levy of interest under section 2346 and 234C of the Act

6.1. On the facts and circumstances of the case and in law, the Ld. AO erred in levying interest under section 2346 and 2340 of the Act.

2. The Ld. AR, at the outset, placed on record ground-wise chart to submit that substantial issues are squarely covered by earlier orders of Tribunal in assessee's own case for AYs 2012-13 (ITA No.2590/Mum/2017 dated 23/07/2018); 2013-14 (ITA No.7330/Mum/2017 dated 22/02/2019); 2014-15 (ITA

No.6081/Mum/2018 dated 07/06/2019). The copies of the orders have been placed on record. Though Ld. DR justified the assessment framed by Ld. AO, however, this position could not be controverted by the revenue. In the said background, our adjudication to the appeal would be as given in succeeding paragraphs.

3. For ease of reference, the assessee's grievance could be tabulated in the following manner: -

No.	Nature of Addition	Adjustment (in Rs.)
1.	TP adjustment on Export of finished products	Rs.75.07 Lacs
2.	TP adjustment against payment for technical know-how	Rs.329.13 Lacs
3.	TP adjustment against payment of interest on ECB loan	Rs.58.05 Lacs
4.	TP adjustment against payment of IS services	Rs.166.33 Lacs

4. The assessee being resident corporate entity is stated to be engaged in manufacturing of various types of chemicals / compounds / ingredients / derivatives etc. Since the assessee carried out certain international transaction with its Associated Enterprises (AE), the same were referred u/s 92CA(1) to Ld. Transfer Pricing Officer [TPO] for determination of Arm's Length Price (ALP). The Ld. TPO, vide its order dated 24/10/2018, proposed certain adjustments which are the subject matter of appeal before us. These adjustments were incorporated by Ld. AO in draft assessment order dated 21/12/2018 which was subjected to objections before Ld. DRP. The Ld. DRP issued directions on 22/08/2019 pursuant to which the final assessment order was passed by Ld. AO on 25/10/2019 which is under challenge before us.

5. TP adjustment on Export of finished products

5.1 The Ld. TPO noted that the assessee was into manufacturing and marketing of industrial flavors, fragrances and chemical specialties. Its AEs were in the business of production and the distribution of flavors and fragrances for use in products in the beauty, household, pharmaceutical and food and drink industries with the support of centralized extensive research and development.

5.2 During the year, the assessee exported finished goods of Rs.759.14 Lacs to its AEs. The assessee benchmarked the transactions of import of raw material, export of finished goods, payment of royalty, commission received & purchase of raw material (domestic) using entity level Transactional Net Margin Method (TNMM). Taking assessee as the tested party and using Profit Level indicator (PLI) as Operating profit to operating income, the assessee arrived at mean margin of 4.55% of 5 comparable entities as against assessee's own margin of 7.74%. Accordingly, no Transfer Pricing (TP) adjustment was proposed by the assessee in its TP study report.

5.3 However, rejecting the same, Ld. TPO directed assessee to provide Comparable Uncontrolled Price (CUP) data since common goods were sold to AEs as well as non-AEs entities. The same was opposed by the assessee on the ground that there were multiple factors which leads to non-applicability of internal CUP viz. level of market, functional differences, risk differences, volume difference, geographical difference etc. At the same time, the assessee benchmarked the transactions under CUP method also.

5.4 The Ld. TPO, after considering CUP method, arrived at TP adjustment of Rs.75.07 Lacs which has been attached by way of annexure to Ld. TPO's order. It could be seen that product-wise average sale rate to AE has been compared with average sale rate to non-AEs and adjustment has been arrived at. This adjustment, upon confirmation by Ld. DRP, is in further challenge before us.

Our findings and Adjudication

6. We find that this issue has been dealt with by coordinate bench of Tribunal in assessee's own case for AY 2013-14, ITA No.7330/Mum/2017 dated 22/02/2019 wherein the bench held as under:-

7. We have considered rival submissions and perused material on record. As far as the primary facts are concerned, there is no dispute that out of the sales turnover of finished products sold to the AE amounting to Rs.10,13,28,211, benchmarked by the assessee applying TNMM, the Transfer Pricing Officer has accepted a major part of the sales of finished products to the AEs to be at arm's length. He has only raised objections in respect of the turnover relating to specific finished products sold both to AEs and non-AEs. Upon verifying the price charged for such products to AEs and non-AEs, he has observed that the price charged to non-AEs is more than the price charged to AEs. Thus, he has made an upward adjustment of ` 73,04,480, to the price charged to AEs for sale of finished products. On a perusal of Annexure-1 to the order passed by the Transfer Pricing Officer, wherein, he has made comparative analysis of price charged to AEs and non-AEs for common products, it is noticed that he has short listed eight common products which were sold both to AEs and non-AEs. On a critical examination of the details mentioned in Annexure-1, it is noticed that except one non-AE in U.A.E., all other non-AEs are located in India. Whereas, the AEs are located outside India. Even, in respect of price charged to the solitary non-AE situated outside India, the Transfer Pricing Officer has compared it to the price charged for similar product to an AE in India. Therefore, in strict sense of the term, this particular sale of product Lemocello to the AE in India cannot be termed as an international transaction. Be that as it may, from a perusal of Annexure-1, it becomes factually clear that sale of similar products made to both AEs and non-AEs are in different geographical locations. While the AEs are located in foreign countries the non-AEs are located in India. Therefore, the price charged to non-AEs in India cannot be used as a CUP for determining the arm's length price of the sales of finished products made to overseas AEs. One of the conditions of rule-10B(2) of the I.T. Rules, 1962, is, while considering the issue of comparability with an uncontrolled transaction, the conditions prevailing in the markets in which the respective parties to the transaction operate including the geographical location along with other factors have to be examined. Therefore, geographical location of the party to whom sales were made is a crucial factor to be weighed in while making comparability analysis. Undisputedly, in the facts of the present appeal, the Transfer Pricing Officer has compared the price charged to

non-AEs located in India with the price charged to AEs in foreign countries. Therefore, the AEs and non-AEs being situated in different geographical locations, there may be various factors/reasons which could have influenced the price charged by the assessee to the AEs and non-AEs. Hence, the price charged to non-AEs cannot be considered to be a CUP to determine the arm's length price of the price charged for sale of finished products to the AEs.

8. The Co-ordinate Bench, while deciding an appeal relating to assessee's sister concern viz. Firmenich Aromatics Production (India) Pvt. Ltd., in ITA no.7145/Mum./2017, dated 13th November 2018, had an occasion to deal with identical issue relating to comparability of the price charged to AEs and non-AEs situated in different geographical locations. The Tribunal held that in such circumstances CUP cannot be applied as the most appropriate method. In this regard, the detailed finding of the Co-ordinate Bench is reproduced hereunder:-

XXXXX

9. The principle/ratio laid down by the Co-ordinate Bench in the aforesaid decision squarely applies to the facts of the present appeal as well. Therefore, we hold that CUP method applied by the Transfer Pricing Officer to determine the arm's length price of the price charged for sale of finished products to the AEs is invalid. Accordingly, accepting assessee's claim we delete the addition made by the Assessing Officer. Ground raised is allowed.

In the above decision, the bench has rejected the application of CUP method. The aforesaid decision has subsequently been followed by another coordinate bench in AY 2014-15, ITA No.6081/Mum/2018 order dated 07/06/2019 (para nos. 10-11). It has been held that while considering the issue of comparability with an uncontrolled transaction, the condition prevailing in the market in which the respective parties to the transaction operate, including the geographical location along with other factors would be relevant to decide which method would be suitable for benchmarking the transactions. Finally, the application of CUP method has been rejected by the bench and the adjustment has been deleted. Respectfully following the consistent stand of Tribunal, we reject application of CUP method and delete the impugned adjustment as proposed by Ld. TPO. This ground stand allowed.

7. TP adjustment against payment for technical know-how

(Royalty)

The assessee paid royalty for use of technical know-how to its AE @ 5% on local sale and @ 8% on export sales. It was stated that technical know-how owned by the AE was in the nature of secret formulae, trade secrets, manufacturing procedure, methods and other technical information relating to the manufacturing, compounding, quality control, testing and servicing of the licensed products. The assessee benchmarked the same applying TNMM method. However, Ld. AO adopted the benchmarked royalty rate of 4% as against effective rate of 4.57% paid by the assessee and proposed an adjustment of Rs.329.13 Lacs. This adjustment, upon confirmation by Ld. DRP, is in further challenge before us.

Our findings and Adjudication

8. We find that similar adjustment was proposed by Ld. TPO in earlier years. In AYs 2012-13 & 2013-14, Ld. TPO disallowed the royalty payment on *ad hoc* basis and benchmarked the transactions using CUP method. However, Tribunal deleted the adjustment on the premises that Ld. TPO was bound to determine the ALP by following any one of the prescribed method and determination of ALP on *ad hoc* basis could not be sustained. It was also held that CUP method could not be applied since comparable agreements were between entities located outside India. In AY 2014-15, Ld. TPO applied CUP method to benchmark the transactions. However, the coordinate bench, in its order for AY 2014-15, held that CUP was not most appropriate method for benchmarking the transactions because of geographical differences. We find that in this

year, Ld. TPO has followed same methodology as in AY 2014-15 and applied CUP method which has already been rejected by Tribunal in AY 2014-15. Therefore, following consistent view of Tribunal, we delete this adjustment. The ground thus raised stands allowed.

9. TP Adjustment against payment of interest on ECB Loan

The assessee obtained loan in the nature of External Commercial borrowings (ECB) from its AEs for the purpose of setting up new premises for corporate office and purchasing of the capital assets. The ECB Loan was taken on 10th June 2012 vide RBI approval at interest rate of 6 months USD LIBOR rate + 350 basis points. The assessee benchmarked the same relying upon RBI circular No. 12/2012-13 which allow ECB loan on automatic route at those rates. However, Ld. TPO computed benchmarking rate of LIBOR+143.62 basis points as per the Bloomberg database. Therefore, the differential of 206.38 basis points (350 bps – 143.62 bps) was considered as excess payment and TP adjustment of Rs.58.05 Lacs was proposed. This adjustment, upon confirmation by Ld. DRP, is in further challenge before us.

Our findings and Adjudication

10. We find that this issue is covered by Tribunal's order for AY 2013-14 (para-24) wherein it has been held that ALP of such transaction could be more accurately determined by following rate of interest fixed by RBI in respect of ECB loan. This decision has subsequently been followed in AY 2014-15. The assessee has followed the same RBI rate to benchmark the transactions in this year. Therefore, respectfully following earlier stand of Tribunal, we delete the impugned adjustment. The grounds thus raised stand allowed.

11. TP adjustment against payment to AE for Software charges

11.1 The assessee paid sum of Rs.11.08 Crores for software usage during the year. Accordingly, assessee was asked to substantiate the use of software and actual services provided by the AE and basis for allocation of cost to the taxpayer, cost incurred by its AE and evidence for third party payments made by the AE. The assessee submitted that during financial year 2010-11, it switched over from old accounting software, stock maintenance software and software for other purposes into S3-ERP being SAP software. The software was developed / acquired by its AE namely Firmenich SA, Switzerland for all the Group entities around the world. Previously, the assessee was using three different software i.e. accounting software, stock maintenance software and software for other purposes and it switched over to combine S3-ERP being SAP software for all purposes. The cost of development of such software was substantial and would require regular up-gradation for its successful usage. Moreover, assessee's entire business was run, controlled and managed by computer system with the help of application software and therefore, such expenditure was necessary. For the said purpose, the assessee entered into "Information Systems Service Agreement" on 14th October, 2011 for implementation of S3-ERP being SAP software and availing services pertaining to Information System (IS) service from Firmenich SA. According to the terms of agreement, the assessee was required to pay two (2) charges namely, IS charge (a recurrent service fee for regular recurrent services) and S3 charge (a specific service fee for development /acquiring and implementation of

"S3 ERP Program"). The details of intra-group invoices of Rs.11.08 Crores towards IS and S3 services was submitted before Ld. TPO.

11.2 Regarding IS charges, the details of employees of AE which rendered the services were furnished. It was submitted that during the year, the assessee employed approximately 190 plus employees who were availing IS services in different departments. The cost relating to IS services was paid only up-to 30th June 2014. In support of the cost of IS services, the assessee submitted the third party audit certificate certifying the number of users availing services. Merely 2.8% of total cost was allocated to the assessee as IS charges on the basis of number of IS users and it pertained to period 1st July 2013 to 30th June 2014 only.

11.3 The other charge viz. S3 charge pertained to SAP software cost which was allocated on the basis of SAP licenses. The software was installed at the server of its AE who maintained, controlled and managed the same. Accordingly, proportionate costs were allocated to the assessee on actual basis. In support of cost allocation, the assessee furnished third part audit certificate along with sample third party invoices raised by the vendors on its AE.

11.4 In support of benefits, the assessee submitted a flowchart of the manufacturing operations, depicting the inter-linkage between the manufacturing operation and application provided /services received as part of IS and S3 services. The details of the same have been extracted in the order of TPO. It was also submitted that the cost benefit analysis was never questioned or litigated before the tax authorities in earlier years. Therefore, the assessee justified the said amount and relied on the Tribunal's order in its own case for Assessment Year 2012-13.

11.5 The Ld.TPO, after considering assessee's submissions, accepted the S3 charge to be at Arm's Length Price but proposed adjustment of Rs.166.33 Lacs being IS charges paid by the assessee since the assessee could not submit substantial evidence in this regard. This adjustment, upon confirmation by Ld. DRP, is in further challenge before us.

Our findings and Adjudication

12. We find that IS charges were paid by the assessee for obtaining access to ERP software and for regular recurrent services and such charges were paid in earlier years also. In AY 2012-13, similar adjustment proposed by Ld. TPO was deleted by coordinate bench on the premises that Ld. TPO was duty bound to determine ALP by following any one of the prescribed methods and determination of ALP on adhoc basis could not be sustained. It was also observed that the assessee had submitted substantial evidences in support of the claim. This order was followed subsequently in AY 2013-14. In AY 2014-15, Ld. TPO allowed external cost but did not allow cost allocated to the assessee on the ground that the claim was unsubstantiated. This adjustment was also deleted by the Tribunal. Therefore, we find that this issue is recurring in nature. The charges have been paid pursuant to the agreement and the assessee has already placed on record third part audit certificate along with sample third party invoices raised by the vendors on its AE. In support of benefits, the assessee submitted a flowchart of the manufacturing operations, depicting the inter-linkage between the manufacturing operation and application provided /services received as part of IS and S3 services. Therefore, Ld. TPO, in our

opinion, was not justified in denying this cost to the assessee. Respectfully following earlier view of Tribunal, we delete this adjustment and allow the relevant grounds of appeal.

13. The remaining ground are consequential or pre-mature in nature which would not require any specific adjudication on our part.

Conclusion

14. The appeal stands partly allowed in terms of our above order.

Order pronounced on 26th October, 2021.

Sd/-

(C. N. Prasad)

न्यायिक सदस्य / **Judicial Member**

मुंबई Mumbai; दिनांक Dated : 26/10/2021

Sr.PS, Dhananjay

Sd/-

(Manoj Kumar Aggarwal)

लेखा सदस्य / **Accountant Member**

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकरआयुक्त(अपील) / The CIT(A)
4. आयकरआयुक्त/ CIT– concerned
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकरअपीलीयअधिकरण, मुंबई / ITAT, Mumbai.