IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

IT(TP)A No. 713/Bang/2017
Assessment year : 2012-13

M/s. Continental Automotive Components (India) Pvt. Ltd., Plot No.53B, Bommasandra Industrial Area, Hosur Road, Attibele Hobli, Anekal Taluk, Bangalore – 560 099. **PAN: AAKCS 9578C**	Vs.	The Assistant Commissioner of Income Tax, Circle 2(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri T. Suryanarayana, Advocate
Respondent by	:	Ms. Neera Malhotra, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	29.09.2021
Date of Pronouncement	:	24 .11.2021

O R D E R

Per Chandra Poojari, Accountant Member

This appeal by the assessee is directed against the order of the ACIT, Circle 2(1)(1), Bangalore dated 31.1.2017.

2. The assessee company is a wholly owned subsidiary of Continental Automotive GmbH, Germany. It operates in the following segments:-

(i) Manufacturing segment

The assessee is engaged in the manufacture of auto-electrical components which include instrument clusters, engine systems,

speed sensors, airbag controllers, anti-lock braking system etc. for the automobile industry.

(ii) Trading segment

The assessee's operations in this segment primarily relate to the trading of dashboard instruments, tachographs, sensors and other allied components for the automobile industry.

(iii) Services segment

In the services segment, the assessee renders application / specific services to its Associated Enterprises ("AEs") with regard to development of software.

3. During the AY 2012-13, several international transactions took place between the assessee and its AEs, including purchase of raw materials for the manufacturing segment and the aforesaid provision of SWD services and in the course of assessment, the AO made a reference to the TPO for examination of the arm's length price of the aforesaid transactions.

4. On such reference, the TPO passed an order dated 25.01.2016 under Section 92CA of the Income-tax Act, 1961 ("the Act") determining the TP adjustment with respect to manufacturing segment as Rs. 89,85,85,564/- and the TP adjustment with respect to software development services ["SWD services"] segment at Rs.11,77,20,997/- totalling to Rs.101,63,06,561/-.

5. In the draft assessment order dated 28.03.2016 the aforesaid TP adjustment was incorporated, apart from the additions on account of disallowance of provision for warranties and R&D expenses.

6. Aggrieved, the assessee filed its objections before the DRP which, vide its directions dated 30.12.2016, partly accepted the assessee's contentions with regard to the TP adjustments made by the TPO were concerned. As regards provision for warranty, the DRP allowed the

expenses to the extent incurred by the assessee of Rs. 2,62,34,907/- and R&D expenses to the extent of Rs. 26,39,28,539 as a deduction on the ground that the same has been considered a part of the operating cost for computing the margin for manufacturing segment.

7. Pursuant to the directions of the DRP, the AO passed the final assessment order dated 31.01.2017 in which the TP adjustment was reworked to Rs. 50,68,91,405/-. Aggrieved, the assessee has preferred this appeal before this Tribunal.

8. **Ground Nos. 1 to 3** are general in nature which do not require adjudication.

MANUFACTURING SEGMENT

9. **Ground No. 4** is that the DRP erred in not granting an adjustment for underutilisation of capacity.

10. The details of the appellant's international transactions are as follows:-

Sl. No.	Particulars	Amounts (in Rs.)
1.	Purchase of raw material and components	77,90,18,698
2.	Payment towards technical know-how fee	43,08,67,934
3.	Sale of automotive components	21,77,46,807
4.	Payment towards Research and development fees	23,60,81,090
5.	Payment towards services availed	56,66,07,292
6.	Purchase of capital assets	7,65,63,855
7.	Purchase of automotive components for trading	1,68,51,69,923
8.	Services revenue	1,04,36,85,278
9.	Interest on loan paid	1,98,12,390
10.	Reimbursement of expenses	9,52,04,249
11.	Recovery of expenses	1,25,66,823
12.	Trade Payables	2,06,64,81,202

13.	Advances Paid	7,89,02,537
14.	Trade receivables	12,68,84,128
15.	Research and Development expenses	2,78,47,449
16.	Production support services	2,64,51,066
17.	Shared services	51,23,08,777
18.	Unearned revenue	2,16,15,648
19.	Capital advance	1,34,33,652

Net mark-up on cost earned by the Appellant

As per the TP study:

Operating Income	Rs. 484,00,60,000/-
Operating Cost	Rs. 453,33,80,000/-
Operating Profit (Op. Income – Op. Cost)	Rs. 30,66,80,000/-
Net mark-up (OP/OR)	6.34%

As reflected in the TP Order:

Operating Income	Rs. 483,10,60,000/-
Operating Cost	Rs.539,43,70,000/-
Operating loss (Op. Income – Op. Cost)	Rs.-56,33,10,000/-
Net mark-up (OP/OR)	-11.66%

11. In the assessee's TP study, the following adjustments were made to the operating cost:

- costs associated with unutilised capacity.
- costs on account of high customs duty

12. On making the above mentioned adjustments, the assessee arrived at a margin of 6.34% as against -11.66% arrived at by the TPO. Though the TPO accepted the comparables selected by the assessee, he did not grant an adjustment for under-utilisation of capacity and an adjustment for expenses incurred towards customs duty. The TPO also treated amortization of goodwill as an operating expense while computing the margin of the Appellant.

Filters applied by assessee in its TP study:

Step	Description
1.	Companies for which the latest data available was for a period ended prior to 31.03.2010 – rejected
2.	Companies reporting net sales >Rs. 1 crore – selected
3.	Companies with positive net worth – selected
4.	Companies reporting average manufacturing income/average net sales>50% - selected
5.	Companies which were functionally comparable – selected
6.	Companies with related party transactions less than 10% of sales – selected

Comparables selected by assessee and their arithmetic mean:

Sl. No.	Name of the company	Weighted Average Margin (%)
1.	Automotive Stampings & Assemblies Ltd	3.06
2.	Bajajsons Ltd	4.87
3.	Bharat Gears Ltd	6.94
4.	JMT Auto Ltd	10.69
5.	M&M Auto	8.03
6.	Rambal Ltd	8.07
7.	Rasandisk Engineering Inds. India Ltd	5.30
8.	Triton Valves	7.78
9.	Wheels India Ltd	5.48
10.	Mubea Suspension India Ltd	5.34
11.	Ring Plus Aqua Ltd	10.83
Average		6.94

13. The TPO accepted the above companies chosen by the assessee and the computation of arm's length price and the adjustment made by him are as follows:-

Operating Revenue ("OR")	4,83,10,60,000
Operating Cost ("OC")	5,39,43,70,000
Operating Profit ("OP")	-56,33,10,000
OP/OR	-11.66%
OP/OC	-10.44%
Arm's length OP/OR	6.94%

Arm's length OP	33,52,75,564
Arm's length cost	4,49,57,84,436
Adjustment (OC – arm's length cost)	89,85,85,564

14. In arriving at the above adjustment, the TPO imposed the adjustment on an entity level, rather than restricting the adjustment to the proportion of international transactions to total cost in the segment.

15. The DRP upheld the order passed by the TPO holding that the adjustment for unutilised capacity and customs duty was unwarranted and upheld the treatment of goodwill as an operating expense while computing the margin of the assessee. The DRP also did not accept the contention of the assessee that there must be an adjustment to the margin of the assessee on account of foreign exchange fluctuation, on the basis that the treatment by the TPO of foreign exchange loss as non-operating took care of the differences arising on account of foreign exchange fluctuation. The DRP did not also agree with the contention of the assessee that the adjustment, if any, should be restricted to the international transactions of the assessee. The DRP, however, directed that depreciation be considered for the comparable companies at the same percentage of the operating cost as in the case of the assessee.

16. Now we will take up the grounds of appeal which are argued by the assessee before us.

Ground No.4 : Capacity utilization

17. Before us, the ld. AR submitted that the assessee was not able to operate at its optimum capacity and could not recoup its fixed costs due to industry slowdown, leading to lesser demand and high depreciation cost, since the economy had faced global recession and the industry meltdown had hit the automotive industry and affected the opportunity of the

assessee to acquire new customers. This resulted in underutilization of the production capacity in the factory, resulting in low utilization of the available capacity for the FY 2011-12 to manufacture the products. The assessee operated at 40.39% of its installed capacity whereas the comparable companies chosen by the assessee operated at an average of 77.42%. It is evident from the capacity utilization of 40.39% that the assessee had under-utilized its capacity considering low demand for its products. Hence, the assessee could not manufacture at optimal capacity and recoup the fixed expenses for the year and the adjustment for under-utilization of capacity is warranted.

18. The ld. AR submitted that the TPO did not grant an adjustment for capacity utilization on the ground that that the adjustment would have to be made to the comparable companies and not the tested party and that the capacity utilisation of each of the comparable companies has not been considered. The TPO held that the data considered by the assessee to compute the adjustment pertained only to 6 out of 11 companies and that the capacity utilisation for FY 2011-12 of the tested party is taken for the comparable companies, such data for the earlier years have been considered. Since the data relates to two different periods, proper comparison cannot be made. It was also observed that under-utilization of capacity is not only for the assessee but had affected the entire industry. Therefore, its comparable companies also have the same effect as the assessee.

19. He further submitted that firstly, from a harmonious reading of sub-clause (iii) of clause (e) of Rule 10B and sub-rule (3) of 10B, it is evident that for a comparability analysis of an international transaction with the uncontrolled transaction, reasonable and accurate adjustment is permitted to eliminate any difference which materially affects the price or costs or the

profit arising from such transaction in the open market. Nowhere does the Rule suggest that such adjustment should be made only to the uncontrolled transaction, that is, comparable companies and not to the 'tested party' whose transaction is being compared. It is submitted that the adjustment can be made either in the case of the 'tested party' or the comparable companies so that the difference which could materially affect the amount of net profit margin is removed. More so, in practical situations there may be absence of reliable data in the case of the comparable companies for which such material difference is to be analysed or examined. In certain cases there may arise some difficulty when the reliable data for particular cost or profit may not be available and, therefore, a reasonable accurate adjustment in the hands of the tested party may throw fruitful result. This view has been upheld by the ITAT in the case of *Pangea3 & Legal Database Systems Pvt Ltd v ITO* reported in [2017] 79 taxmann.com 303 (Mumbai - Trib.). This Tribunal has also allowed adjustments in the case of tested party in the following cases:

- Skoda India Pvt. Ltd. v. ACIT reported in [2009] *30 SOT 319 (Pune)*
- Kirloskar Motors Pvt. Ltd. v. ACIT reported in *[2012] 28 taxmann.com 293 (Bangalore)*

20. Further, it is submitted that in the case of Haworth India *(supra)*, this Tribunal had held that the adjustment, if any, can be made to eliminate the material differences between the assessee and its comparable companies to the extent these adjustments are reasonably accurate. Such adjustment can be allowed only in a case where assessee is able to furnish accurate and credible evidence in this regard. In the relevant case law, since Haworth India had not been able to furnish credible and accurate information with regard to capacity utilization, the adjustment was not

allowed. However, in the assessee's case, it has provided all information practically possible. Sufficient evidence has been provided in the form of capacity data of comparable companies as well as industry average from the Federation of Indian Chambers of Commerce & Industry ("FICCI") survey report. Hence principally capacity utilization adjustment should have been granted. The assessee also relies on the following judicial precedents in this regard:-

- Global Vantedge P. Ltd. v. DCIT reported in *[2010] 37 SOT 1 (DELHI)*
- ITO v. CRM Services India (P) Ltd reported in *[2011] 14 taxmann.com 96 (Delhi)*
- CIT v. Petro Araldite Pvt. Ltd reported in *[2018] 93 taxmann.com 438 (Bombay)*.
- Transwitch (India) Pvt. Ltd. v. DCIT reported in *[2012] 21 taxmann.com 257 (Delhi - Trib.)*
- Capgemini India Private Limited v. ACIT reported in *[2013] 33 taxmann.com 5 (Mumbai - Trib.)*
- ACIT v. Fiat India (P.) Ltd. [IT Appeal No.1848 (Mum) of 2009, dated 30-04-2010]
- Amdocs Business Services (P.) Ltd. v. DCIT reported in *[2012] 26 taxmann.com 120 (Pune)*

21. Without prejudice to the above contentions on producing relevant data wherever practically possible by the assessee, since the revenue is of the opinion that the data provided by the assessee is unreasonable and inaccurate, the ld. AR submitted that the AO can exercise his powers under Section 133(6) of the Act to collate the information on capacity details of the comparable companies such as actual capacity in units, installed capacity, break up of fixed and variable cost, product wise segmental profitability (if any) and provide the assessee an opportunity by sharing the details so obtained on the comparable companies, and accordingly grant the adjustment for capacity under-utilized. Similar contentions have been upheld by this Tribunal in the case of *IKA India Private Limited v. ACIT* reported in *[2019] 101 taxmann.com 276 (Bangalore).* It was therefore

submitted the adjustment for capacity utilisation as made by the assessee in its TP study be upheld. In the alternative, as submitted above, since the respondent-revenue is well within its powers to call for details from the comparable companies, such course may be adopted and the adjustment be granted.

22. The ld. DR submitted that the DRP relied upon the decision of the Tribunal, Mumbai Bench in *Petro Araldite P Ltd. (ITA No.3782/Mum/2011 dated 24.7.2013)* and held that allowing depreciation in the case of comparable companies at the same rate of the operating cost (as that of the tested party) would take care of the differences with regard to under-utilization of capacity. She submitted that the DRP also relied upon the decision in *Haworth India Private Limited (FA No.5341/Del/2010)*wherein it was held that the decisions in the case of *ACIT vs. Fiat India Pvt. Ltd. [Hon'ble Mumbai Tribunal (ITA No.1848/ Mum/2009)]; Skoda Auto India (P) Ltd. Vs. ACIT [Hon'ble Pune Tribunal (122 TT) 699)] ; E-Gain Communication (P) Ltd. Vs. ITO [Hon'ble Pune Tribunal (118 TTJ 354)] and Global Vatedge Pvt. Ltd. Vs DCIT [Hon'ble Delhi Tribunal (ITA Nos.2763 & 2764/De1/2009)]* are not applicable considering the fact that the expression "net profit margin realized" means the net profit margin actually realized and actual cost incurred and sale affected and thus, there is no room for any assumption for taking the profit margin which has been realized. In the case of the tested party (assessee), it is not permissible to deviate from the book results on the ground of capacity utilization and observing that "*The perusal 'of the above provision will reveal that every person who is entered into an international transaction is under an obligation to keep and maintain the information and document with respect to the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arms length price. The TPO in his report has observed that assessee did not submit any evidence for assuming the capacity utilization of the*

comparables and whatever data relied upon by the assessee for seeking capacity utilization adjustment was either unreliable or incorrect. When fixed cost itself is incurred only for a part of the year the same cannot be adjusted for differential capacity utilization".

23. Further, the ld. DR relied on the order of the Tribunal in the case of F*linth Group (India) Pvt. Ltd. v. ITO in IT(TP)A No. 3285/Bang/2018 dated 31.10.2019* wherein it was held as under:-

> "5. We have perused submissions advanced by both sides in the light of records placed before us.
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> Indian transfer pricing regulations and OECD guidelines requires adjustment to be made in case of material differences in transactions or enterprise being compared, so as to arrive at a more reliable margin. And any adjustments as per Rule 10B(3) requires to be made in case of uncontrolled transaction. However, in a case where appropriate adjustment cannot be made to uncontrolled transaction due to lack of information/data, then in order to read provisions of transfer pricing regulations in harmony, adjustments should be made in case of tested party.
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> 5.1 On perusal of decision of Co-ordinate Bench of this Tribunal in India Pvt. Ltd. vs DCIT (supra), it is observed that has been considered by observing as under:
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> > "The Indian transfer pricing regulations, OECD Guidelines and the US transfer pricing regulations call for an adjustment.to be made in case of material differences in the transactions or the enterprises being compared so as to arrive at a more reliable arm's length price/ margin. While the Indian transfer pricing regulations refer to the adjustments on uncontrolled transactions, however the same has to be read with Rule 10B(3) of the Rules which clearly emphasizes the necessity and compulsion of undertaking adjustments. Hence in case appropriate adjustments cannot be made to the uncontrolled transaction, due to lack of data, then in order to read the provisions of transfer pricing regulations in harmony, the adjustments should be made on the tested party. In the

following decisions it has been held that adjustment to the profit margins have to be made on account of underutilization of capacity:

(i) In the case of Mando India Steering Systems (P.) Ltd. v. Asstt. CIT [2014] 45 taxmann.com 160/ 149 ITD 284 (Chennai Trib) the Tribunal upheld the contention of the taxpayer for making a suitable adjustment on account of idle capacity for the purpose of margin computation. The relevant extract is reproduced as below:

> "10. We are of the considered view that under-utilization of production capacity in the initial years is a vital factor which has been ignored by the authorities below while determining the ALP cost. The TPO should have made allowance for the higher overhead expenditure during the initial period of production."

(ii) In the ruling of Dy. CIT v. Panasonic AVC Networks India Co. Ltd. 12014] 42 taxmann.com 420/ 63 SOT 121 (URO) (Delhi - Trib.) it was held that:—

> "5. ……. Capacity underutilization by enterprises is certainly an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits. Of course, the fundamental issue, so far as acceptability of such adjustments is concerted, is reasonable accuracy embedded in the mechanism for such adjustments, and as long as such an adjustment mechanism can be found, no objection can be taken to the adjustment."

(iii) In the case of Biesse Mfg. Co. Ltd. v. Asstt. CIT 12016] 69 m 428 (Bang. - Trib.) the Tribunal held as follows:

> "10.4.1 We have heard the rival contentions and perused and carefully considered the submissions made and material on record; including the judicial pronouncements cited. The issue for consideration is whether adjustment for under-utilisation of capacity is allowable in the case on

> hand and if so, the manner of computation thereof and the quantum of adjustment …….
>
> 10.4.5 In the above cited case of the Mumbai Tribunal i.e. Petro Araldite P. Ltd. (supra), the Tribunal has upheld the principle that adjustment for capacity underutilisation can be granted. ……. Following the decision of the ITAT, Mumbai in the case of Petro Araldite P. Ltd. (supra), we hold that any adjustment for capacity underutilisation can be granted "

(iv) In the recent case of GE Intelligent Platform (P.) Ltd. (IT(TP)A No. 148/Bang/ 2015 and 164/Bang/ 2015) for AY. 2010-11 was held as follows:-

> "8 ……. now the law is quite settled to the extent that once there is unutilized capacity or men power, such underutilization impacts margin and therefore, the adjustment should be made while computing the ALP …….. If the underutilization is more than average underutilization of the industry then necessary adjustment is required to be made to the margin of computing ALP "

29. Moreover, the above argument of the assessee for grant of capacity utilisation adjustment is also supported by the following decision of Bangalore ITAT in the case of Genisys Integrating Systems (India) (P.) Ltd. v. Dy. CIT 12012] 20 tcvcmann.com 715/ 53 SOT 159. Relevant extract of the decision is under:—

> "15.2 We agree with this contention of the counsel for the assessee. All the comparables have to be compared on similar standards and the assessee cannot be put in a disadvantageous position, when in the case of other companies adjustments for under utilization of manpower is given. The assessee should also be given adjustment for under utilization of its infrastructure. The all consider this fact also while determining the ALP and TP adjustments. With these directions, the appeal of the disposed of."

30.1 The reliability and accuracy of adjustments would largely depend of reliable and accurate data. For certain types of adjustments, relevant data for comparables may either not be available in public domain or may not be reliably determinable based on information available in public domain, whereas, it may be possible to make equally reliable and accurate adjustments on the tested party (whose data would generally be easily accessible).

31. In such a scenario, one has to resort to the provisions of Rule 10B(3)(ii) which provides for making "reasonably accurate adjustments" for eliminating any material differences between the two transactions being compared. The purpose or intent of the comparability analysis is to examine as to whether or not, the values stated for the international transactions are at ALP i.e., whether the price charges is comparable to the price charges under an uncontrolled transaction of similar nature. The regulations don't restrict or provide that the adjustments cannot be made on the results of the tested party. Therefore, keeping in mind the aforesaid objective, the net profit margin of the tested party drawn from its financial accounts can be suitably adjusted to facilitate its comparison with other uncontrolled entities/ transactions as per sub-clause (i) of rule 10B(1)(e) of the Rules itself The absence of specific provision in Rule 10.13(1)(e)(iii) of the Rules does not impede the adjustment of the profit margin of tested party. The above view has also been. upheld in the following decisions:—

- Capgemini India Pvt. Ltd. v. Asstt. CIT 12014 33 taxmann.com 5/120141 147 ITD 330 (Mum. - Trib.)

- Demag Cranes & Components (India) (P.) Ltd. v. Dy. CIT 12014 17 taxmann.com 190/49 SOT 610 (Pune)

32. As far as data of comparable companies on capacity utilization being not available in public domain is concerned, it is practically not possible to obtain data on capacity utilization of comparable companies and consequently compute adjustment on the comparable companies, the operating cost of the tested party is adjusted for capacity utilization adjustment.

33. The assessee has under-utilized capacity during the subject AY and is accordingly factually and legally eligible to an adjustment for the same. Therefore, such a benefit cannot be denied to the assessee only for the reason that the data about comparable companies is not available. Requiring the assessee to produce such a data which is not public domain would tantamount to requiring the appellant to perform an impossible task. The only way to get the data in the current case, would be where the TPO collates the same from the comparable companies by exercising his powers under section 133(6) of the Act. The relevant extracts of the section are as under:—

> "(6) require any person, including a banking company or any officer thereof, to furnish info, (nation in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act :"

34. In this regard, we find that the Mumbai ITAT in case of M/ s Jt. CIT v. Kiara Jewellery P. Ltd. (2014) 45 taxmann.com 548//2015] 152 ITD 891 (Mum. Trib.) has directed the to obtain the exact details of capacity utilization of comparable companies, if not available in public domain. The relevant extract of the aforesaid decision is as under:—

> "11. Keeping in view the decision of the Tribunal in the case of Petro Araldite (P) Ltd (supra) laying down the guidelines on the issue of capacity utilization, we consider it appropriate to restore this issue relating to adjustment on account of capacity utilization in the case of assessee company to the file of AO/ TPO for deciding the same afresh keeping in view the said guidelines. If the exact details of capacity utilization of the comparable companies are not available in the public domain, the AO/ TPO is directed to obtain the same directly from the concerned parties and to decide this issue afresh after giving assessee an opportunity of being heard."

(Emphasis Supplied)

35. Accordingly, we direct the TPO to exercise powers under section 133(6 • the Act to call for information on capacity utilization of the companies such as —

- Installed Capacity,
- Actual production in Units,
- Break up of Fixed Cost and Variable Cost;
- Segmental/ product wise information, if any.

36. Post obtaining the information, he is requested to provide the assessee an opportunity by sharing the details so obtained, and accordingly, grant the adjustment for capacity under-utilized. Ground No. 7 is decided accordingly.

Respectfully following aforestated observations, we direct Ld.TPO to exercise powers under section 133(6) of the Act and call for relevant information on capacity utilisation in case of comparables finally selected. Needless to say that details so collected by Ld.TPO shall be provided to assessee and then to provide consider the issue as per law.

Accordingly this ground raised by assessee stands allowed for statistical purposes."

24. We have heard both the parties and perused the material on record. In this case, the exact details of capacity utilisation of comparable companies was not made available to the TPO. It was alleged that the TPO should obtained it by exercising his powers u/s. 133(6) of the Act so as to compare the capacity utilisation of the comparables with the assessee company. In our opinion, it is appropriate to remit the issue relating to adjustment on account of capacity utilisation of the assessee to the file of the AO/TPO for deciding the same afresh keeping in view the OECD guidelines. If the exact details of capacity utilisation of comparable companies are not available in the public domain, the AO/TPO is directed to obtain the same directly from the comparable companies and decide the

issue afresh, after affording opportunity of being heard to the assessee. Accordingly, this issue is remitted to the AO/TPO.

Ground No.5 : Customs Duty Adjustment

25. The grievance of the assessee by this ground is that the DRP erred in not granting adjustment towards custom duty expenses. The assessee has incurred significant customs duty charges which are proportionately much greater than that of the comparable companies leading to a lower profitability for the assessee. The comparable companies have not incurred any significant custom duty expense as they primarily manufacture using materials available indigenously within India. It is submitted that the assessee is still in the process of localizing its manufacturing process. To meet the quality standards and to overcome technological challenges, the assessee imports raw materials from its AEs. Therefore, it becomes necessary for the assessee to import raw materials from its AEs which is not the case for the comparable companies, thus, putting the assessee in a comparative disadvantage vis-a-vis the comparables. The TPO rejected the adjustment sought for the reason that the decision to import is a conscious decision taken by the assessee and in the absence of any external factors, beyond the control of the Assessee necessitating imports, no adjustment can be made. The TPO also observed that the import duty is a part of the cost of material which is always included at the time of pricing of the product and also that the assessee ought to have considered the customs duty component payable while negotiating the price at which the raw materials are imported.

26. The DRP has upheld the non-grant of customs duty adjustment on the basis that the arithmetic mean of margins under the TNMM method takes care of such difference.

27. The assessee submits that the import of raw materials is not a commercial decision but on the other hand is necessitated for reasons beyond the assessee i.e., by lack of capacity to localize the procurement which the assessee is still in the process of doing. Reliance is placed on the following decisions in support of the Appellant's contentions.

- Skoda India Pvt. Ltd. v. ACIT reported in [2009] *30 SOT 319 (Pune)*
- Putzmeister Concrete Machines Private Limited v. DCIT reported in *[2014] 49 taxmann.com 436 (Panaji - Trib.)*
- Toyota Kirloskar Motors Pvt. Ltd. v. ACIT reported in *[2012] 28 taxmann.com 293 (Bangalore)*

28. In this connection, the assessee's import consumption vis-à-vis the imports of comparable companies and the assessee are as below:-

Sl. No.	**Name of the company**	**Imports/Total purchases (%) (3 year average)**
1.	Automotive Stampings & Assemblies Ltd	0.57
2.	Bajajsons Ltd	5.92
3.	Bharat Gears Ltd	2.62
4.	JMT Auto Ltd	1.54
5.	M&M Auto	0.53
6.	Rambal Ltd	2.10
7.	Rasandisk Engineering Inds. India Ltd	4.61
8.	Triton Valves	10.81
9.	Wheels India Ltd	8.63
10.	Mubea Suspension India Ltd	0.02
11.	Ring Plus Aqua Ltd	4.75
	Average import consumption	3.83

29. The ld. DR relied on the order of the TPO and submitted that arithmetic mean of the margins of the comparables under TNMM takes care of such differences and she further submitted that the adjustments were rejected on the following reasons:-

> a. Adjustments are to be made to the margins of the comparable companies to account for differences which could materially affect the amount of net profit margin in the open market. In the case of the assessee, it is the business model by which the assessee imports most of its raw materials from its AEs. The assessee company manufactures goods and sells in India out of raw materials procured from its AEs. This import duty is not a onetime cost which would affect the company's margin as an extraordinary event.
>
> b. Import duty per se does not call for an adjustment. It requires to be seen whether the import is necessitated by certain factors beyond the control of the assessee company. If it is the normal business model of the assessee to import goods, it is not an extraordinary event affecting its margin.
>
> c. The higher percentage of import content in the assessee's production is a conscious decision taken by the assessee keeping in mind all commercial considerations including the obvious benefits of better quality which is bound to reflect in higher sales margin.
>
> d. Import duty is part of the cost of material which is always taken into account in pricing a product. If the individual elements of cost were to be separately adjusted for differences between the tested party and the comparables, then the profit margin of all the companies would become uniform.
>
> e. The assessee company ought to have considered the customs duty component payable while negotiating the

price at which the raw materials were imported from the AEs.

30. This issue came up for consideration before the Chennai Tribunal in the case of *Gates Unitta India Company (P.) Ltd. v. DCIT, 84 taxman.com 69* wherein it was held as follows:-

"5. Before us, ld. A.R submitted that 90% of the raw materials of the assessee are imported as such customs duty adjustments to be made and it includes Rs. 4.31 crores pertained to the customs duty in the manufacturing segment. In principle the customs duty adjustments is allowed in view of the Co-ordinate Bench decision in the case of Motonic India Automotive (P.) Ltd. v. Asstt. CIT [2016] 73 taxmann.com 235 (Chennai - Trib.) wherein held that:

'6.1 At this stage, it is pertinent to mention the finding of the Pune Bench in the case of Demag Cranes & Components (India) Pvt. Ltd. v. DCIT (supra) dated 4.1.2012 in ITA No.120/PN/2011, which is as follows :

"37. We have heard the parties and perused the available material on records in the light of the second limb of the ground 4(b). It is relevant mentioned that we have already analysed the relevant provisions of Income Tax rules vis a vis the scope of the adjustments in the preceding paragraphs in the context of the adjustments on account of the 'working capital'. In principles, our findings on the issue remain applicable to the adjustments on account of the import cost mentioned in ground 4(b) too. The difference between the AL Margin before and after the said adjustments on account of 'import cost' works out to 0.57% (7.18%-6.61%). Revenue has not disputed the said working of the assessee. In these factual circumstances and in the light of the scope of adjustments discussed above, in our opinion and in principle, the assessee should win on this ground too. One such decision relied upon by the assessee's counsel supports our finding relates to the decision of this bench of the Tribunal in the case of Skoda

Auto India p Ltd 122 TTJ 699 (Pune) dated March 2009 wherein, it is held (in para 19 of the order) that,-

"No doubt , a higher import content of raw material by itself does not warrant an adjustment in operating margins, as was held in Sony India (P) Ltd.'s case (supra), but what is to be really seen is whether this high import content was necessitated by the extraordinary circumstances beyond assessee's control. As was observed by a Co-ordinate Bench of this Tribunal in the case of E-Gain Communication (P) Ltd. (supra) "the differences which are likely to materially affect the price, cost charged or paid in, or the profit in the open market are to be taken into consideration with the idea to make reasonable and accurate adjustment to eliminate the differences having material effect". We do not agree with the AO that every time the assessee pays the higher import duty, it must be passed on to the customers or it must be adjusted for in negotiating the purchasing price. All these things could be relevant only when higher import content is a part of the business model which the assessee has consciously chosen but then if it is a business model to import the SKD kits of the cars, assemble it and sell it in the market, that is certainly not the business models of the comparables that the TPO has adopted in this case. The adjustments then are required to be made for functionally differences. The other way of looking at the present situation is to accept that business model of the assessee company and the comparable companies are the same and it is on account of initial stages of business that the unusually high costs are incurred. The adjustments are thus required either way. It is, therefore, permissible in principle to make adjustments in the costs and profits in fit cases. We also do not agree with the authorities below that the onus is on the assessee to get all such details of the comparable concerns so as to make this comparison possible. The assessee cannot be expected to get the details and particulars which are not in public

> domain. In such a situation, i.e. when information available in public domain is not sufficient to make these comparisons possible, it is inevitable that some approximations are to be made and reasonable assumptions are to be made. The argument before us was that it was first year of assessee's operations and complete facilities ensuring a reasonable indigenous raw material content was not in place. The assessee's claim is that it was in these circumstances that the assessee had to sell the cars with such high import contents, and essentially high costs, while the normal selling price of the car was computed in the light of the costs as would apply when the complete facilities of regular production are in place. None of these arguments were before any of the authorities below. What was argued before the AO was mere fact of higher costs on account of higher import duty but then this argument proceeded on the fallacy that an operating profit margin for higher import duty is permissible merely because the higher costs are incurred for the inputs. That argument has been rejected by a Co-ordinate Bench and we are in respectful agreement with the views of our esteemed colleagues. This additional argument was not available before the authorities below and it will indeed be unfair for us to adjudicate on this factual aspect without allowing the TPO to examine all the related relevant facts. We, therefore, deem it fit and proper to remit this matter to the file of the TPO for fresh adjudication in the light of our above observations."

38. The perusal of the impugned orders shows that the above cited guidelines by way of decision of this bench of the Tribunal in the case of Skoda Auto India p Ltd (supra) were not available to the revenue authorities. Therefore, we are of the opinion, the issue should be set aside to the files of the TPO with direction to examine the claim of the assessee relating to the import cost factor and eliminate the difference if any. However, the TPO/AO/DRP shall see to it that the difference in question is 'likely to materially affect' the price/profit in the open market as envisaged in

> sub rule (3) of Rule 10B of the Income tax Rules, 1962. Accordingly, ground 4(b) is allowed pro tanto.'
>
> Accordingly, we direct the A.O. to give suitable adjustment against the custom duty component while determining the ALP.'
>
> Hence, to bring uniformity, the customs duty was to be eliminated from the comparable price also to arrive at correct PLI. Accordingly, we remit the issue to the file of AO for fresh consideration."

31. In view of the above finding of the Tribunal in *Gates Unitta India Company (P.) Ltd. (supra)*, we are inclined to remit this issue to the AO/TPO with similar directions.

32. **Ground No. 6 raised by the assessee is with regard to aadjustment for foreign exchange fluctuations**. It was submitted that the assessee imports a considerable amount of raw material for undertaking the manufacturing operations in India. As a rule, import prices are significantly impacted by the foreign exchange rates, which is the case for the assessee as well. Hence, foreign exchange fluctuation will be one of the significant factors impacting the import costs and in turn influencing the profitability. The assessee's claim for an adjustment for such fluctuations was negatived by the DRP stating that the TPO had considered foreign fluctuation as non-operating in the case of the assessee and the comparables and that therefore, the same takes care of the differences on account of foreign exchange fluctuations.

33. It is submitted that the above mentioned foreign exchange gain/loss arises on account of change in foreign exchange rate at the time of realisation or otherwise, i.e., after booking the transaction at a different exchange rate. This does not affect the transaction which has already taken place. Further, it is submitted that the foreign exchange gain or loss

and hedging cost will vary depending on the risk management policy and on the hedging cost a company is willing to bear. The foreign exchange fluctuation computed as per Accounting Standards ("AS") 11 takes into account the realization loss/gain (fluctuation due to differences between invoice and payment exchange rates) and revaluation loss/gain (translation of closing balances at the year-end exchange rate). However, such exchange fluctuation does not take into account any adverse exchange fluctuation due to depreciation of Indian currency on a year-on-year basis. The adjustment now being sought for by the assessee is on account of the foreign exchange fluctuation loss which is embedded in the raw material import cost. It is submitted that due to stricter quality norms and necessity for adherence to the global quality standards, the assessee had to import from its group affiliates/foreign unrelated suppliers and therefore localisation of such high quality raw materials had not occurred during the assessment year in question due to several factors.

34. The significant imports made by the assessee are in Euro, USD and Yen. While accounting, the same is converted to INR based on the foreign exchange rates communicated by the Continental Group. During the relevant years, the INR depreciated considerably vis-à-vis most of the other major currencies and imports became costlier for the assessee. The fluctuation in the value of Euro and USD vis-a-vis INR for a 10 year from FY 2008-09 to FY 2017-18 is as under:

Financial year	**Euro to INR rate**	**% depreciation/ appreciation**	**Average depreciation/ appreciation**
2008-09	65.45	-	(3.95%)
2009-10	67.37	2.94%	
2010-11	60.06	(10.85%)	
2011-12	**66.29**	**10.37%**	**10.37%**
2012-13	70.03	5.64%	1.42%
2013-14	80.66	15.18%	

2014-15	78.15	(3.11%)	
2015-16	71.78	(8.15%)	
2016-17	73.77	2.77%	
2017-18	75.08	1.77%	

Financial year	**USD to INR rate**	**% depreciation/ appreciation**	**Average depreciation/ appreciation**
2008-09	46.48		
2009-10	47.67	2.57%	(0.98%)
2010-11	45.51	(4.54%)	
2011-12	**47.86**	**5.16%**	5.16%
2012-13	54.19	13.23%	
2013-14	60.33	11.34%	
2014-15	61.03	1.15%	5.26%
2015-16	65.36	7.10%	
2016-17	67.12	2.68%	
2017-18	64.48	(3.94%)	

35. The ld. AR submitted that during the FY 2011-12, there was an abnormal depreciation in the value of Euro and USD as against the average movement for the preceding periods. This has resulted in a higher outflow of INR for the same value of Euro and USD which was transacted in the previous year. Although there was no significant increase in the price of imports as compared to the previous year, the foreign exchange rate fluctuations has also contributed towards increased material costs. Therefore, an adjustment for the abnormal impact due to foreign currency fluctuation during the year has to be considered on the value of import purchases made during the year. He highlighted the following points that necessitate the adjustment to the Appellant's cost on account of foreign exchange fluctuations:

Higher Import Content of the assessee vis-à-vis comparable companies:

36. As stated above, the assessee imports a considerable amount of raw materials for undertaking the manufacturing operations in India unlike

the comparable companies selected in the transfer pricing documentation by the assessee and also the comparable companies selected by the TPO.

37. It is submitted that in comparison to the assessee, the comparable companies who are established players in the automobile market, have negligible import content due to indigenization of materials required for production. The assessee contends that due to stricter quality norms and necessity for adherence to the global quality standards, the assessee had to import from its group affiliates/foreign unrelated suppliers and therefore localisation of such high quality raw materials had not occurred during the assessment year in question due to several factors. In this connection, the assessee's import consumption vis-à-vis the imports of comparable companies selected by the TPO and the assessee are as below for the FY 2011-12.

38. The ld. DR submitted that the assessee incurred foreign exchange loss of Rs.284.98 million which is considered by the TPO as non-operating. The TPO has also considered the foreign exchange fluctuation as non-operating in the case of comparables. This takes care of the differences with regard to foreign exchange fluctuation. Accordingly no further adjustment on this count was required.

39. This issue was also considered by the Chennai Tribunal in the case of *Gates Unitta India Company (P.) Ltd. (supra)* and it was held as under:-

> **"7.** We have heard both the parties and perused the material on record. In our opinion, forex fluctuations loss in the operating cost of the assessee and also forex gains in the operating income of assessee, both to be excluded from the operating expenses as well as operating income respectively in view of the Order of Tribunal in the case of *Motonic India Automotive (P.) Ltd.* (*supra*) in for assessment year 2009-10 vide order dated 17.08.2016 wherein held that:—

> "9. We find force in the argument of the ld. AR. It is normal that exchange rate is subject to fluctuation due to economic conditions. While determining the ALP, one has to consider these factors, more so, our view is fortified by the decision of the Tribunal in the cases of *Honda Trading Corp. India Pvt. Ltd.* v. *ACIT* in ITA No.5297/Del/2011 for the assessment year 2007-08 and *DHL Express (India) Pvt. Ltd.* v. *ACIT* in ITA No.7360/Mum/2010 for the assessment year 2006-07. Accordingly, we direct the TPO to provide considerable exchange fluctuation adjustment while determining the ALP. Accordingly, this issue is remitted to the file of the TPO for determining the ALP after considering the above three components i.e. customs duty adjustment, air freight adjustment and foreign exchange fluctuation adjustment."
>
> Accordingly, this issue is remitted to the file of AO for fresh consideration."

40. Following the aforesaid decision of the Tribunal, we remit this issue to the AO/TPO with similar directions for fresh decision.

41. **Ground No.7 is regarding treatment of amortisation of goodwill as operating expenditure**. The facts of this issue are that the assessee had purchased the automotive components business of Siemens Limited pursuant to a business purchase agreement dated 23.11.2007. The sale consideration for the said purchase was Rs. 1,700 million. The assessee had accounted for the tangible and intangible assets based on the fair value of these assets as determined by an external valuer appointed by the company. Thereafter, an amount of Rs. 1226.70 million was accounted as goodwill and amortized over a period of 5 years. An amount of Rs. 245.60 million was amortized in FY 2011-12 and the assessee has considered the said expenses as non-operating in nature and the same was not included in the cost base for determination of operating margin of the manufacturing segment for transfer pricing purposes.

42. It is submitted that for the purpose of net margin computation, only the income and expenditure in connection with the business operations of the company is to be considered. In the present case, goodwill has resulted on account of an extra-ordinary circumstances involving merger of an automotive components business of Seimens Limited and amortization of goodwill is due to such extraordinary circumstances. Hence, amortization of goodwill should not be considered as operating expenses. Detailed submissions in this regard are placed at pages 224-225 and 1604 of the paperbook.

43. Reliance in this regard is placed on the decision of the Delhi Bench of this Tribunal in *ST Ericsson India Pvt Ltd v. DCIT (order dated 03.07.2018 in ITA No. 609/Del/2015)* where it was held that amortization of goodwill is an extraordinary item and is not pertaining to the regular operations of the assessee, and hence non-operating in nature.

44. The ld. DR submitted that the DRP has already held that depreciation of the comparables should be brought to same rate of depreciation of the operating cost of the assessee company and the same cannot be faulted with. She relied on the orders of lower authorities.

45. We have heard both the parties and perused the material on record on this issue. This issue was considered by the Tribunal in the case of *ST*-Ericsson India Pvt. Ltd. v. DCIT in IT(TP)A No.609 & 168/Del/2015 dated 3.7.2018 and it was observed as follows:-

> "15. Assessee has challenged the findings returned by TPO/DRP treating amortization of goodwill as not extra ordinary in nature. It is the case of the assessee that goodwill is on account of acquisition of units through slump sale under Business Transfer Agreement and in these circumstances, amortization of goodwill is an extra ordinary item and is not pertaining to the regular operation of the taxpayer, hence non-operating in nature.

> 16. Ld. AR for the assessee contended that ld. DRP in assessee's own case in AYs 2011-12 and 2012-13 and ld. TPO in AY 2013-14 ITA No.168/Del./2015 has already amortized goodwill as extra ordinary in nature by excluding the same by computing operating margin of the taxpayer and order thereof is available at pages 2681 to 2695, 2696 to 2713 and 2718 and 2764 of the paper book. It is also not in dispute that there is no change in the facts of AYs 2010-11, 2011-12, 2012-13 and 2013-14. Perusal of the order passed by ld. DRP available at page 2681 relevant portion at page 2691, shows that amortization of goodwill is an extra ordinary item and is not pertaining to the regular operation of the assessee, and hence non-operating in nature. So, in these circumstances, we direct the TPO to verify the facts and treat the amortization of the goodwill as non-operating expenditure in order to compute the operating margin of the assessee. So, ground no.7 is determined in favour of the assessee."

46. Following the above cited decision of the Delhi Tribunal, this issue is decided in favour of the assessee.

47. **The next ground (no. 9) is with regard to the adjustment, if any, should be restricted to proportionate value of international transaction of the assessee**.

48. Without prejudice to the above, the ld. AR submitted that the transfer pricing adjustment (if any) should be restricted only to the international transaction pertaining to purchase of raw materials from its AEs and other related transactions. The DRP did not accept this contention of the assessee despite various decisions of this Tribunal in favour of the assessee. It was submitted that the mandate in Chapter X of the Act is only to re-determine the consideration received or given to arrive at income arising from an International Transaction with Associated Enterprises. In respect of transactions with non-AEs, Chapter X of the Act has no role to

play and therefore to make an adjustment including the non-AE transactions is erroneous and contrary to the provisions of the Act. Reliance is placed on the following decisions in support of the above contention of the Appellant:

- IL Jin Electronics (I) (P.) Ltd v. ACIT reported in *[2010] 36 SOT 227 (DELHI)*
- M/s Tupperware India Private Limited (ITA No. 2140/Del/2011 and 1323/Del/2012)
- IKA India Private Limited v. ACIT reported in *[2019] 101 taxmann.com 276 (Bangalore)*.
- CIT v. Alstom Projects India Limited reported in *[2017] 88 taxmann.com 465 (Bombay)*
- Alstom Projects India Limited v. CIT reported in *[2013] 36 taxmann.com 130 (Mumbai - Trib.)*
- CIT v. Thyssen Krupp Industries (P) Limited reported in *[2016] 70 taxmann.com 329 (Bombay)*
- Claas India Pvt. Ltd., - ITA No.3883/Del/2010
- CIT v. Petro Araldite Pvt. Ltd reported in *[2018] 93 taxmann.com 438 (Bombay)*
- Kyungshin Industrial Motherson Limited v. DCIT reported in *[2015] 57 taxmann.com 166 (Delhi - Trib.)*
- Emersons Process Management India (P) Ltd v. ACIT reported in *[2011] 13 taxmann.com 149 (Mumbai)*
- DCIT Vs Starlite reported in *133 TTJ 425 (Mum)*
- Gillete India Ltd v. ACIT reported in *[2014] 44 taxmann.com 133 (Jaipur - Trib.)*
- Phoenix Mecano (India) Private Limited v. ITO reported in *[2014] 42 taxmann.com 469 (Mumbai - Trib.)*
- Penfort (Israel) Limited v. Deputy Director of Income-tax reported in *[2013] 36 taxmann.com 499 (Mumbai - Trib.)*
- ACIT v. Super Diamonds reported in *[2012] 26 taxmann.com 101 (Mum.)*

49. It was submitted that the percentage of international transactions to the total operating cost would be at 37.31%, as demonstrated below and therefore, the adjustment if any should be restricted to such percentage alone:-

Nature of international transactions	Reference	Amount in INR
Purchase of raw materials and components less of returns	A	77,90,18,698
Payment of Technical Knowhow	B	43,08,67,934
Payment of royalty	C	23,60,81,090
Availing of services	D	2,78,47,449
Production Support Service	E	2,64,51,066
Shared support services	F	51,23,08,777
Total value of international transactions	**G=SUM(A:F)**	**2,01,25,75,014**
Total adjustment under manufacturing segment	**H**	**38,91,70,408**
Total Operating Cost (from TP Order)	**I**	**5,39,43,70,000**
Adjustment restricted to international transactions	**J=(H*G)/I**	**14,51,94,831**

50. Hence, based on the above, without prejudice to the other arguments of the assessee, it is submitted that the transfer pricing adjustment (if any) should be restricted to the international transaction of the assessee.

51. The ld. DR submitted that it is an undisputed fact that the TPO has accepted the TNMM as the most appropriate method applied by the assessee with regard to the manufacturing segment. The TPO has also accepted the comparables selected by the assessee. He only modified the margin based on the use of data relevant to the financial year. The following international transactions are part of operating cost and operating revenue, with regard to the manufacturing segment:-

Operating cost	
Purchase of raw materials and components	77,90,18,698
Technical knowhow	43,08,67,934
Research and development licence fees	26,39,28,539
Payment towards services availed	56,66,07,292
TOTAL	204,04,22,463
Operating revenue	
Sale of automotive components	21,77,46,807

52. Thus, in the manufacturing segment, the international transactions related to the expenses are to the extent of 204,04,22,463 and in respect of revenue are to the extent of 21,77,46,807. The object of applying the TNMM at the manufacturing segment level, by considering the comparable engaged in the manufacturing function, is to find out the negative influence on the assessee company due to the international transactions related to cost and revenue by comparing the margin of the segment with the mean margin of the independent comparables. Therefore, it is not appropriate to restrict the adjustment to the AE cost or revenue. In the case of the assessee, the ALP margin has been worked out by the TPO at 6,94% and by applying that margin, he arrived at the conclusion that the operating cost should have been at 2449,57,84,436 as against the operating cost which works out to 2539,43,70,000 based on segmental information, which makes it clear that the international/ transaction related to cost of 2204,04,22,463 adversely influenced the profit margin of the manufacturing segment of the assessee company to the extent adjustment works out under TNMM. Hence, restricting the adjustment to the AE's cost amounts to holding that non-AE cost has also impacted the profit margin of the manufacturing segment, will defeat the very purpose of transfer pricing

analysis. Hence, reliance placed by the assessee on the decisions is rejected by the revenue authorities.

53. We have considered the rival submissions. This issue was considered by the Hon'ble Supreme Court in the case of *CIT v. Hindustan Unilever Ltd., 99 taxman.com 134 (SC)* wherein it was held that while determining the ALP of international transactions, benchmarking has to be done only on Associated Enterprises transactions and not for the entire turnover. In view of this, we find force in the argument of the ld. AR that the TP adjustment should be restricted only to international transactions pertaining to purchase of raw materials from AEs and other related transactions only. With these observations, we allow this ground of the assessee.

SOFTWARE SEGMENT

54. Only ground Nos. 22 to 24 are pressed before us.

55. The additional ground 24A reads as follows:-

> "24A. The learned AO/learned TPO/learned DRP erred in treating the amortization of goodwill arising out of the purchases by the Appellant from Siemens Limited pursuant to the purchase of business by the Appellant from Siemens Limited pursuant to the Business Purchase Agreement dated 23 November 2001 as operating in nature for the purpose of margin computation of the Appellant's services segment."

56. Application for admission of additional ground is filed submitting that this ground was raised in ground No.7 in the manufacturing segment before the lower authorities and the Tribunal, however, due to oversight the same was not raised specific to services segment, which is a *bona fide* mistake and the same may be admitted. We have considered the rival submissions, perused the record and are of the view that the additional ground now

raised before us requires no fresh investigation into facts and is borne out of material available on record. *Accordingly, following the Hon'ble Supreme Court judgment in the case of M/s National Thermal Power Co. Ltd. Vs. CIT, 229 ITR 383 (SC)*, the additional ground is admitted for adjudication.

57. Now we take up ground No.7 along with additional ground 24(a). It is submitted that the TPO, whilst computing the margin of the assessee for the services segment, treated amortization of goodwill as operating in nature and consequently computed the margin for the segment as 5.31% as against 8.35% computed by the assessee in its TP study. As stated above whilst dealing with ground no. 7 under the manufacturing segment, it is submitted that for the purpose of net margin computation, only the income and expenditure in connection with the business operations of the company is to be considered. In the present case, goodwill has resulted on account of an extra-ordinary circumstances involving merger of an automotive components business of Seimens Limited and amortization of goodwill is due to such extraordinary circumstances. Hence, amortization of goodwill should not be considered as operating expenses. Detailed submissions in this regard are placed at pages 224-225 and 1604 of the paperbook.

58. Reliance in this regard is placed on the decision of the Delhi Bench of this Tribunal in *ST Ericsson India Pvt Ltd v. DCIT (order dated 03.07.2018 in ITA No. 609/Del/2015)* where it was held that amortization of goodwill is an extraordinary item and is not pertaining to the regular operations of the assessee, and hence non-operating in nature.

59. The ld. DR submitted that this issue may be remitted to the lower authorities for consideration as they had no occasion to examine it.

60. This ground is allowed as held as held in paras 45 to 46 of this order.

61. Ground No.23 is regarding exclusion of comparables.

Larsen and Toubro Infotech Ltd. ('L&T') & Persistent Systems Ltd.

62. The ld. AR submitted that L&T is incomparable to its SWD service segment and thus ought to be excluded from the list of comparables. He objected to the inclusion of L&T on the grounds that it is functionally incomparable and has significant brand value. However the contentions of the Appellant have been rejected by the TPO and the same has been upheld by the DRP.

63. He submitted that L&T is a global IT services and solutions provider. It is involved in a diverse range of activities from analytics and information management, application development, architectural services, cloud computing, consulting, enterprise integration, infrastructure management services, integrated engineering services, mobility services, oracle services, SAP services etc., none of which are comparable to the Appellant's SWD services. Further, L&T owns several intangibles and enjoys significant brand value (intangibles of 18.56% of its asset base). As a result of this high brand value, the company enjoys a high bargaining power in the market. The company is also into development of products. It owns proprietary software products which are developed in-house such as Unitrax and Accurusi. The company has also incurred significant expenses in foreign currency amounting to 40.38% of its total expenditure which suggests that is engaged in provision of onsite services. Hence, it operates on a business model different from that of the Appellant and is thus incomparable to it. It is further submitted that L&T is functionally not comparable as it is a market leader and thus enjoys significant benefits on

account of ownership of marketing intangibles and intellectual property rights. L&T has been consistently excluded from the final list of comparables in the cases of assessees similar to the Appellant Accordingly, the Appellant submits that the company is a product company having significant intangibles and is thus not comparable to captive software service providers such as the Appellant. Detailed submissions in this regard are made at pages 320-327and pages 642-645 of the paperbook. He submitted that the DRP, however, failed to properly appreciate the assessee's submissions in this regard and thereby upheld its inclusion in the list of comparables.

64. Reliance in this regard is placed on the decision of this Tribunal in *EMC Software and Services India Private Limited v. ACIT ITA 523/Bang/2017 (Order dated 03.07.2019)* wherein L&T was excluded from the final list of comparables. Reliance is also placed in the case of an Assessee placed similar to the assessee in *CGI Information Systems & Management Consultants (P.) Ltd. v. ACIT [reported in (2018) 94 taxmann.com 97 (Bangalore - Trib.)]* wherein, the company was directed to be excluded. Thus, it is submitted that L&T Ltd. ought to be excluded from the final list of comparables.

65. The ld. DR submitted that that the company cannot be excluded by application of upper turnover filter as the ground relating to the same has been rejected by the revenue authorities. Further, the related party transactions are less than 25%, and the DRP upheld the application of 25% related party transaction filter applied by the TPO. Therefore the objection in this regard is also not acceptable. With regard to the functions, on perusal of the Annual Report it is noticed that the company is only engaged in software development and therefore functionally comparable with the assessee. The other differences are not significant and the influence of

such differences, if any, is taken care of while computing the mean margin of the comparable companies. Accordingly, the objection with regard to the above company is not acceptable, and the selection of the same by the TPO is accordingly to be upheld.

66. With regard to margin computation, the difference is due to non-consideration of 'provision no longer required for doubtful debts' and 'provision for doubtful debts' as operating in nature. In this regard, he submitted that such provisions are not made in all the cases. Hence, there is no rationale to consider such provision as operating in nature, Even otherwise, for the comparability analysis, such provisions are excluded from the tested parties as well as the comparable, the error in the margins of the relevant year are taken care of. This view also finds support from several decisions of the Hon'ble ITAT, including in the case of *M/s Telcordia Technologies India Pvt. Limited 22 taxmann.com 96/ 137 ITD 1 (Mum)*, in which it was decided that the provision for doubtful debt cannot form part of operating cost. Further, in the case of *Thyssen Krupp Industries India Pvt. Ltd., [2013] 33 taxmann.com 107*, the Mumbai Tribunal held that the provision for doubtful debts is to be considered as non-operating in nature because it is only a provision. While working out the operating profit, only items of receipts and expenditure, which have direct relation for determining the profit have to be taken into account. In the case of *Four Soft Ltd. vs. Dy, CIT [2011] 142 TTJ 3581[2012] 16 ITR (Trib.) 73 (Hyd.).* Therefore, there is no error in considering such provisions as non-operating in nature. However, with regard to reduction of foreign exchange loss of Rs.28,11,75,063 and 'interest and finance expenses' of Rs.7,68,51,641 from the operating expenses of Rs.2340,08,18,255, it was pointed out that from the following extracts of the statement of P & L account that the operating expenditure does not include Finance cost

(including foreign exchange loss) which is provided in Note P(i) and P(ii) of the Annual Report:-

EXPENSES		
Employee benefit expenses	O(i)	17,700,804,103
Operating expenses	O(ii)	2,233,789,603
Sales, administration and	O(iii)	3,466,224,349
		23,400,818,255
Operating profit		6.284,714,851
Finance Cost		358,026,704

P. FINANCE COST	
P(I) Interest paid on	
Fixed loans	909,998
On others	75,544,203
Lease finance charges	397,440
	76,851,641
P(ii) Exchange loss on borrowings (net)	281,175,063
Total finance cost	358,026,704

67. She therefore submitted that there is a mistake in computing the operating margin of L & T Infotech Ltd. with regard exclusion of finance cost and foreign exchange loss. Accordingly, the DRP has directed the AO to rectify the mistake, after due verification, while giving effect to the directions of its order.

Persistent Systems Ltd. (Persistent)

68. As regards Persistent Systems Ltd., the ld. AR submitted that this company is functionally dissimilar and ought to have been excluded from the final list of comparables. The assessee has objected to the inclusion of Persistent on the ground that Persistent is engaged in SWD services as well as development of software products. The company also owns

Intellectual Properties and has significant onsite revenues. However, the same was rejected by the TPO and upheld by the DRP.

69. It is submitted that Persistent is engaged in outsourced software product development services and Intellectual Property Led Solutions. Persistent also renders export services and is also engaged in development of software products. Persistent made significant investments towards R&D and also in intellectual property led solutions. Further, Persistent owns several IP solutions such as eMee, KLISMA etc. It reports its segmental details on the basis of type or class of customers and geography and not on the basis of services rendered. Therefore, in the absence of segmental details with respect to its software development services segment being available, it cannot be held as a comparable to the assessee. In addition, during the year under consideration, Persistent acquired the software marketing and development business of a company based in France which contributed to its strategic thrust in the life sciences and healthcare markets and helped expand its business for which no adjustment can be made to eliminate the material effects of the said differences between it and the assessee. Further, during the year under consideration, two of the company's subsidiaries viz., Persistent e-Business Solutions Ltd. and Persistent Systems and Solutions Ltd merged with the company which are peculiar to this company during the year. Detailed submissions in this regard are made at pages 330-340 and pages 645-650 of the paperbook.

70. Reliance in this regard is placed on the decision of this Tribunal in *EMC Software and Services India Private Limited v. ACIT ITA 523/Bang/2017 (Order dated 03.07.2019)* wherein the company was excluded from the final list of comparables. Reliance is also placed on the decision of this Tribunal in *CGI Information Systems & Management*

Consultants (P.) Ltd. v. ACIT (reported in [2018] 94 taxmann.com 97 (Bangalore - Trib.) and PCIT v. Cash Edge India P. Ltd reported in TS-262-HC-2016(DEL)-TP (order dated 04.05.2016) wherein, in the case of assessees placed similar to the assessee, this company was directed to be excluded. Consequently, it is submitted that Persistent is incomparable to the assessee and ought to be excluded from the list of comparables for the above and following reasons.

> The turnover of Persistent Systems is significantly higher than the assessee and hence, Persistent Systems has to be rejected based on the application of the upper limit of turnover criteria.
>
> Persistent Systems fails related party transaction ("RPT") filter and therefore, it should be rejected.
>
> The Company has the presence of extraordinary events during the year.
>
> The learned Transfer Pricing Officer ("TPO") has erred in computation of markup of the Company.

71. The ld. DR submitted that this company was rejected on application of upper turnover filter and upheld the application of the related party transaction filter applied by the TPO. Hence, the contention regarding the turnover and related party transaction filter are not acceptable. With regard to the functions, on perusal of page no.164 of the Annual Report, it is noticed that "*the company is predominantly engaged in outsource software product development services, the company offers complete product life cycle*" which is further evident, from Note 21 to the financial statements, according to which the entire revenue is from sale of software services.

72. With regard to the extraordinary event, it is noticed from page no.195 of the Annual Report that Persistent e-Business Solutions Ltd., engaged in software development, consultancy and system integration; and

Persistent System and Solutions Ltd., engaged in software development services, have been amalgamated, with effect from 01/04/2011, with the assessee company, the profit of 4.46 million and 89.08 million respectively of the above companies have been included in the profit and loss of the assessee company. However, both the above companies were mainly engaged in software development services, we are of the view that the work related to consultancy and system integration, in the case of Persistent e-Business Solutions Ltd., has not resulted in increase of profit of the company selected as comparable, considering the fact that profit of Persistent e-Business Solutions Ltd. is '44 lakhs, which works out to only 2.54% of the operating profit of 217.32 crores computed by the TPO. Accordingly, we do not find any infirmity in selection of the above company as a comparable.

73. With regard to erroneous computation of margin, the ld. DR submitted that the TPO has considered provision for bad debts and provision for doubtful debts as non-operating in nature In this regard, our direction with regard to L & T Infotech Ltd. is equally applicable. The TPO has also considered the foreign exchange fluctuation as non-operating, in respect of which the directions have been issued in paragraph No.2.3 of the DRP order.

74. These comparables i.e., L&T and Persistent were considered as not comparable in the case of *CGI Information Systems & Management Consultants (P.) Ltd. v ACIT, 94 taxmann.com 97 (Bangalore Trib.)* wherein it was held as under:-

> "29. We have considered the rival submissions. In the case of Agilis Information Technologies India (P.) Ltd. (supra), this Tribunal considered the comparability of the 3 companies which the Assessee seeks to exclude from the final list of comparable companies chosen by the TPO. The functional profile of me

Assessee and that of the Assessee in the case of Agilis Information Technologies India (P.) Ltd. (supra), is identical inasmuch as the said company was also involved in providing SWD services to its AE and the TPO had chosen some comparable companies which were also chosen by the TPO in the case of the Assessee for the purpose of comparability. In the aforesaid decision the Tribunal held on the comparability of the 3 companies which the Assessee seeks to exclude as follows:

(a) * ….. * …… *

(*b*) Larsen & Tourbro Infotech Ltd., was excluded from the list of comparable companies by relying on the decision of the Delhi Bench of ITAT in the case of *Saxo India (P.) Ltd.* v. *Asstt. CIT* [2016] 67 taxmann.com 155 (Delhi - Trib.). The discussion is contained in paragraphs 4.8 to 4.10 of the Tribunal's order. The Tribunal held that L & T Infotech Ltd., was a software product company and segmental information on SWD services was not available. The Tribunal also noticed that the appeal filed by the revenue against the tribunal's order was dismissed by the Hon'ble Delhi High Court in ITA No.682/2016.

(*c*) Persistent Systems Ltd., was excluded from the list of comparable companies on the ground that this company was a software product company and segmental information on SWD services was not available. The Tribunal in coming to the above conclusion referred to the decision rendered by ITAT Delhi Bench in the case of *Cash Edge India (P.) Ltd.* v. *ITO* ITA No.64/Del/2015 order dated 23.9.2015 and the decision of Hon'ble Delhi High Court in the case of *Saxo India Pvt. Ltd.* (*supra*). The findings in this regard are contained in Paragraphs 4.14 to 4.16 of its order.

30. Respectfully following the decision of the Tribunal we hold that the aforesaid 3 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins. In this regard we are also of the view that the plea of the learned DR for a remand of the issue to the DRP on the ground that the DRP has not given any reasons in its directions cannot be accepted. The DRP bas endorsed the

view of the TPO in its directions and therefore the reasons given by the TPO should be regarded as the conclusions of the DRP."

75. In view of the above decision of the Tribunal, taking a consistent view, we direct exclusion of these two companies from the final list of comparables.

Inclusion of comparables

76. Vide **ground No.21**, the ld. AR submitted that the assessee seeks inclusion of Akshay Software Technologies Ltd., Evoke Technologies Ltd and Technosoft Engineering Projects Ltd.

Akshay Software Technologies Ltd.

77. It was submitted that this company was proposed by the assessee as an additional comparable before the TPO and came to be rejected on the basis that the company's functions are more in the nature of IT Enabed Services [ITeS]. The exclusion of this company came to be upheld by the DRP on the basis that the company is engaged in professional services and ERP services and segmental details for the same were not available. In this regard, the ld. AR submitted that firstly, perusal of the functions of the company listed in its annual report shows that the company is functionally similar to the assessee. Akshay is primarily engaged in provision of software development services. It derives 99.74% of its income from provision of software services. The website of the company states that the company is engaged in rendering IT services, which are in the nature of SWD and caters to the needs of corporate bodies, banks and financial institutions. Further, it is submitted that the income from commission and sale of software licenses constitutes a meagre 0.2% of the total revenues and therefore the same would not have any impact on the profitability of the company. Further, Akshay was selected by the TPO as well as the

assessee as a comparable for the assessment year 2009-10. It is submitted that that there is no change in the facts pertaining to the company, and therefore Akshay ought to be included in the final list of comparables. Detailed submissions in this regard are placed at pages 358-364 of the paperbook.

78. The ld. DR submitted that from the Director's report, it was noticed that the company is engaged in professional services and ERP services. However, the entire revenue has been shown as income from software services in the absence of segmental information with regard to two functions performed by the company, it cannot be retained as a comparable, hence the rejection is accordingly to be upheld.

79. We have heard both the parties and perused the material on record on this issue. The assessee has filed financials of Akshay Software Technologies Ltd. The revenue from operations is shown as follows:-

NOTES FORMING PART OF THE FINANCIAL STATEMENTS

	For the year ended March 31, 2012 ₹	For the year ended March 31, 2011 ₹
Note 19-Revenue From Operations		
Income fom Software Services	14,66,94,500	11,39,21,048
Sale of software licences	3,82,800	8,01,279
	14,70,77,300	**11,47,22,327**

(Source: Page 27 of the AR 2012)

Extracts from the Directors' Report and Notes forming part of the Financial Statements from the Annual Report emphasize on the facts that Akshay Software is predominantly engaged in providing IT related services.

i. The operations of the company being IT related require normal consumption of electricity. However the Company is taking every necessary step to reduce the consumption of energy.

(Source: Page 5 of the AR 2012)

80. This company was considered as comparable in the case of Arowana Consulting Ltd. v. *ITO* in IT(TP) A No. 235/Bang/2015, order dated 29-6-2015, wherein it was held as under:-

> "12.3 We have considered the rival submissions as well as the relevant material on record. As regards the decision of the co-ordinate bench in the case of Arowana Consulting Ltd. v. ITO (supra), the Tribunal has dealt with only one objection of employee cost in paras 8 & 9 as under :
>
> > 8. What is left for consideration is assessee's grievance regarding M/s. Akshay Software Technologies Ltd. DRP directed exclusion of the said company for a reason that its employee cost was more than 89% of its total operating expenditure. We find that assessee had employee cost in excess of 90% of its operating expenditure. In our opinion, it is normal to have a high percentage of employee cost in a software development company, especially so, when the company is involved in development of software for clients at the site of the clients. Reason given by the DRP, in our opinion, was not correct. Higher employee cost is a normal feature for a software development company for the simple reason that it is a skill oriented business. The skill-set required for the employees in the case of the assessee, required knowledge of Arabic also, making it all the more scarce. In any case, for A.Y. 2009-10, M/s. Akshay Software Technologies Ltd. was considered as a proper comparable and not excluded. In his order dated 07-1-2015 for A.Y. 2009-10, after applying the onsite revenue filter of 50%, TPO himself had considered M/s. Akshay Software Technologies Ltd., as a proper comparable. As to the argument of the Ld. DR that Related Party Transaction, volume of M/s. Akshay Software Technologies was not provided by the assessee, leading to its rejection, we find that assessee had at paras 5.172 and 5.173 of its objections before DRP, submitted that RPT of the said company was 4.33% only, compiling the figures from previous years data available in Annual Report of Financial Year 2010-11 of the said company. This working stands unrebutted. We are, therefore of the opinion that the assessee has to succeed in its claim that M/s. Akshay Software Technologies Ltd, is a proper

> comparable. We direct the TPO to include the said company as a comparable along with the two comparables, namely, M/s. R. S. Software (India) Ltd. and M/s. Thinksoft Global Services Ltd, and rework the mean PLI. ALP adjustment, if any, required shall be based on such mean PLI, after considering the working capital adjusted. Ordered accordingly. Ground 12 of the assessee is allowed."

81. In view of the above decision of the Tribunal, the AO/TPO is directed to consider Akshay Software Technologies Ltd. as a comparable.

Technosoft Engineering

82. The ld. AR submitted that this company was proposed by the assessee as an additional comparable before the TPO and was rejected on the ground that the functions of the company were more in the nature of engineering design services. Before the DRP, the assessee demonstrated that the company was engaged in software designing services. However, the DRP upheld the order of the TPO on the ground that it was unclear whether the company renders software development services. In this regard, it is submitted that a perusal of the annual report of the company would demonstrate that the company is engaged in software designing which is nothing but software development. The website extracts of the company also support the said submission. It is therefore submitted that the company is functionally comparable and that it passes all the filters applied by the TPO. Detailed submissions in this regard are placed at pages 376-386 of the paperbook.

83. The ld. DR submitted that the assessee failed to furnish the complete Annual Report to establish that the company is functionally comparable. Even from the reading of the extract of the Annual Report produced by the assessee, it is noticed that the company is engaged in software designing activity and allied services, from which it is not clear as

to whether such services are in the nature of software development. Further, the assessee failed to substantiate that the company qualifies all the filters applied by the TPO. Accordingly, the rejection of the above company is to be upheld.

84. We have both the parties on this issue. The textual information (14) relating to this company at page 377 of the PB is as follows:-

Textual information (14)

Disclosure in auditors report relating to maintenance of cost records

According to the information/explanations given to us and the books & records examined by us, since the company is carrying out of Computer Software designing activity and other allied services during the year therefore Maintenance of cost records Under Section 209(1)(d) of the Companies Act, 1956 is not applicable to the company.

[100200] Statement of profit & loss

Unless otherwise specified all monetary values are in INR

	1.4.2011 to 31.3.2012	1.4.2010 to 31.3.2011
Statement of profit & loss (Abstract)		
Disclosure of revenue from operations (Abstract)		
Disclosure of revenue from operations for other than finance company (Abstract)		
Revenue from sale of products		
Revenue from sale of services	13,31,10,444	11,95,52,334.63
Other operating revenue	1,93,24,552	1,79,90,616
Total revenue from operations other than finance company	15,24,34,996	13,75,42,950.63
Total revenue from operations	15,24,34,996	13,75,42,950.63

85. However, the allegation of the ld. DR is that the complete financials are not made available to the AO/TPO. In our opinion, if the data is not in the public domain, the AO can exercise his powers u/s. 133(6) of the Act to obtain the financials of this company and decide the issue accordingly. Hence this issue is remitted to the AO/TPO.

Evoke Technologies Ltd.

86. This company was proposed by the assessee as an additional comparable before the TPO and was rejected by him on the ground that the company fails the different year ending filter applied by him and that no data is available in the public domain as regards the company. Before the DRP, the assessee demonstrated that the financial year ending of the company was 31st March 2012 as in the case of the assessee and also that data was available. The DRP however rejected the company on the basis that the reserves and surplus and borrowings of the company were substantial as compared to its share capital and that therefore, its financials were unreliable. It also held that the functions of the company are not comparable to the assessee.

87. The ld. AR submitted that the aforesaid conclusions of the DRP are erroneous inasmuch as the mere fact that the reserves and surplus and borrowings of the company are substantial does not indicate that the financials of the company are unreliable. The functions of the company as evident from the annual report are software development services and the company earns its entire revenues from software development activity alone. Although the DRP lists out various activities as being performed by the company, the same are not evident from the annual report. In any event, the services listed out are in the nature of software development services and therefore, the conclusion that the company is not functionally comparable is erroneous. Detailed submissions in this regard are at pages 388 to 391 of the paperbook.

88. It is also submitted that for assessment year 2011-12, the said company is in the final list of comparables chosen by the TPO for assessees rendering software development services and there is no change in the facts pertaining to the company for AY 2012-13. It is

therefore submitted that the company ought to be included in the final list of comparables.

89. The ld. DR submitted that in addition to the reasons recorded by TPO and assessee failed to contradict the finding of TPO, on perusal of the Annual Report, it is noticed that against the share capital of a small sum of Rs.2,18,180, the reserve and surpluses are to the extent of Rs.14,98,93,187 and borrowings to the extent of Rs.2,55,08,763, which makes the financials of the company unreliable. Also the company offers end-to-end IT services that can be quickly built and deployed to suit their clients unique industry requirements. The company's core IT service include:-

- Oracle Consulting Service
- Microsoft Consulting Services
- Java Consulting Services
- IT Staffing Solutions
- QA and Testing Services
- Mobility Services
- BPM Consulting Services
- Open Source Services
- Big Data & Analytics Solutions

90. The above functions are not comparable to the software development services rendered by the assessee and therefore the rejection of the above company from the comparables is to be upheld.

91. We have heard both the parties on this issue and perused the material on record. In this case, the company has earned revenue from software development charges which is clear from the Notes forming part of the accounts as follows:-

EVOKE TECHNOLOGES PRIVATE LIMITED
Notes forming part of Accounts

Note No: 14 Revenue From Operations — Amount Rs

Particulars	For the Year 2011-12	For the Year 2010-11
Software Development Charges	300,485,323	144,869,912
Total	300,485,323	144,869,912

92. Being so, Evoke Technologies Ltd. is a comparable company. Accordingly, we remit the issue to the AO/TPO with a direction to go through the financials of this company and decide the issue accordingly.

Corporate Tax issues

93. Ground No. 25 is with regard to disallowance of provision for warranty of Rs. 5,21,33,004. During the year, the assessee had created a provision for warranty amounting to Rs. 7,83,67,911 which was claimed as deduction. The provision for warranty has been created by the assessee on scientific basis based on past experience.

94. The AO disallowed the provision for warranty contending the same to be contingent liability/ created on estimate basis. The DRP held that the assessee is not following a scientific method, following its earlier directions for the AY 2011-12. However it directed the AO to allow the actual expenses of Rs. 2,62,34,907/- on warranty incurred during the assessment year and has accordingly disposed of the objections raised by the Appellant.

95. The ld. AR submitted that it supplies dashboard sensors and other allied auto components to various automotive manufacturers like TVS, Hyundai, Tata, etc. The Appellant provides warranty of 24 months on its

products to the customers. The Appellant creates two kinds of provision for warranty, they are:

a. **General Provision for warranty** – The assessee creates general provision for warranty on a scientific basis towards the expected liability that could arise during such warranty period. The Appellant creates provision for warranty on the percentage of sale for each product. The quality department based on past experience and historical trend of the performance of each product arrives at a percentage based on which provision for warranty is created.

b. **Additional provision for warranty** – Bearing in mind the nature of industry of that of automobile components manufacturer, the assessee needs to create additional provision for warranty based on the circumstances and specific cases. During the year under consideration, additional provision for warranty amounting to Rs. 7,07,03,390/- was created for sales made to Tata, Mondo (Glovis) and Ford. The defects that occurred in sales to each customer is as follows:-

Customer Name	Defect
Tata	The LED lights are not working
Mondo (Glovis)	There is a flux issue in the Electronic Controller Unit for steering
Ford	Cracks found on the top crystal on the visible radius

96. Out of the provision amount of Rs. 7,07,03,390/-, an amount of Rs. 6,33,00,008/- has been actually incurred towards actual warranty claims over a period of the next two years and balance has been reversed. The details of the additional/special warranty provision created during FY 2011-12 and the actual payments in the subsequent years is available at pages 418-419 of Volume 2 of the paperbook.

97. The movement in provision for warranty as accounted for by the Appellant for the year under consideration is as under**:-**

Particulars	General Warranty	Specific Warranty	Total
Opening balance	1,39,86,741	3,02,01,581	4,41,88,322
Provision created	76,64,521	7,07,03,390	7,83,67,911
Provision utilized against actual payment/debit by customer	-	-	(2,62,34,907)
Closing balance	-	-	9,63,21,326

98. It was submitted that the assessee has created the provision for general warranty as per the policy of the company based on scientific method and also the company has created provision for additional warranty based on circumstances. It has followed the below mentioned method for creating provision for general warranty:-

a) The quality department of the company maintains the record/data for goods returned from the customers for the purpose of warranty claims.

b) The compilation would have details relating to each product for which warranty has been claimed and the month in which such products are manufactured.

c) Based on this data, the company would arrive at a percentage of warranty that needs to be created for each product.

99. As the warranty provided by the assessee is for 24 months, the company considers the data relating to past 24 months. Thus, the company

considers the sale for the past 24 months and the goods returned for the purpose of warranty claims during that period. Based on these actual data, percentage of likely warranty claim is arrived at. This percentage is applied for the purpose of creating provision against sales of each month. Thus after following the said method, the company has created the provision for general warranty. The summary of the provision for warranty is available at pages 2294-2409 of the paperbook.

100. The difference between the provision amount and the utilization amount is not the benchmark that is required to be considered. What needs to be seen is whether the provision created is on scientific basis. It is submitted that the amount of provision is a factual outcome of the methodology followed in creating provision and utilization would be the actual expenditure incurred against the warranty claims. In the present case, the assessee has followed the scientific methodology based on which provision amount is arrived at.

101. The assessee follows the specific methodology of creating provision for warranty consistently over the years. The said methodology has been submitted before the AO during the course of assessment proceedings. It creates provision for warranty on a scientific basis.

102. Reliance is placed on the following decisions in support of the above contentions: -

- Rotork Controls India Private Limited [2009] 180 Taxman 422 (SC)
- *Nokia Siemens Networks India Private Limited Vs. CIT*[2011] 14 Taxmann.com 84 (Karnataka High Court)*;*
- *Micro Land Ltd* [2012] 18 taxmann.com 80 (Karnataka High Court)*;*
- *Toyota Kirloskar Motors (P.) Ltd. v CIT*[2013] 30 taxmann.com 294 (Karnataka High Court)*;*
- *Hewlett Packard India Sales (P.) Ltd. v CIT*[2014] 49 taxmann.com 166 (Karnataka High Court)*;*

- *Motor Industries Co. Ltd. v CIT*[2015] 55 taxmann.com 377 (Karnataka High Court)*;*
- *Denso Kirloskar*[2013] 34 taxmann.com 238 (Karnataka High Court)*;*
- *Ericsson Communications Pvt. Ltd v CIT*[2009] 318 ITR 340 (Delhi High Court).

103. Based on the above discussion, the ld. AR submitted that the expenses incurred by it towards warranty expense are allowable under section 37 of the Act. In assessee's own case for AY 2009-10 and AY 2010-11, the DRP directed the AO to delete the disallowance in respect of provision for warranty. Also, it is submitted that for the assessment years 2008-09 and 2011-12 the issue has been remanded for fresh consideration by this Tribunal.

104. On the other hand, the ld. DR submitted that similar objections was rejected by the DRP by observing as under:-

> "we peruse paragraph 9 of the draft assessment order, from which, it is noticed by us that the A.O. made the disallowance on the reason that the assessee failed to furnish the scientific basis on which the provision is made.
>
> It is also noticed by us from the order of the DRP for A.Y. 2010-11, that the actual expenses incurred during the year was Rs. 1,95,00,000/- as against the provision for warranty of Rs. 87,38,000/- was made. It is also noticed by us from the order of the DRP for A.Y. 2009-10, that the DRP has given the contradictory finding, in one side the DRP directed to allow the claim of provision of warranty of Rs.1,09,46,000/- and on another side, directed that Rs.98,67,981/- being the actual claim of warranty should be allowed"
>
> It is also evident from the orders of the DRP for A.Y. 2009-10 that the difference in the actual expenditure and the provision was marginal, whereas, in 2010-11, the actual expense incurred was more than the provision made. In the year under consideration, the actual expense is Rs.1,66,77,339/- whereas, the provision for warranty made during the year is Rs.5,28,64,672/-. These facts

> makes us clear that no scientific method was followed for making the provision for warranty and in such circumstances, the judicial pronouncements on which the reliance has been placed by the assessee including the decisions of the DRP, are not of any help to the assessee. In such circumstances, we are of the view that A.O. was justified in allowing the actual expenses of Rs.1,66,77,339/-, the above objections are accordingly rejected."

105. She submitted that the above finding of the DRP for the AY 2011-2012 makes it clear that the assessee was not following a scientific method. The fact narrated by the AO in the draft assessment order for the assessment year, at para-8, that the provision is not based on a scientific method and therefore the decision of the Hon'ble Supreme Court, on which reliance has been placed, is not applicable. The movement in provision for warranty account as under also makes it clear that the warrant provision is not made on a scientific basis:

Amount in INR

Particulars	General Warranty	Specific Warranty	Total
Opening balance	13,986,741	30,201,581	44,188,322
Odd: Provision created during the year (debited to P & L A/c)	7,664,521	70,703,390	78,367,911
Less : Actual warranty claims	-	-	(26,234,907)
Closing balance			96,321,326

106. She further submitted that, however, the DRP noticed that in all the above assessment years, the actual expenses incurred has been allowed, but the Assessing Officer, in the draft assessment order, has not even allowed the actual expenditure incurred during the year and also no reason has been given for not allowing the same. Hence the DRP directed the Assessing Officer to allow the actual expenses incurred during the assessment year.

107. We have heard both the parties and perused the material on record. This issue was considered by the Hon'ble Supreme Court in the case of *Rotork Controls India (P.) Ltd. v. CIT, 314 ITR 62 (SC)* wherein it was held as under:-

> "16. The question which arose for determination was : whether during the assessment years 1949-50, 1950-51, 1951-52 and 1952-53 the assessee-company was entitled to claim deduction of the yearly premium from its profits under section 10(2)(xv) of the Income-tax Act, 1922. It was held that the provision in the policy for surrendering annuity and the provision in policy for return of premium was not entitled to deduction as the payment made to the trustees by the assessee-company was towards a contingent liability or towards a liability depending on a contingency, namely, the life of a human-being. It was held that putting aside of money which may become expenditure on the happening of an event is not an expenditure under section 10(2)(xv) of the 1922 Act. It was held on facts that the money was placed in the hands of trustees and/or the insurance company to purchase annuities, if required, but to be returned if the annuities were not purchased. Therefore, it was a case of setting apart of the money and consequently the assessee was not entitled to deduction under the said section.
>
> 17. At this stage, we once again reiterate that a liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate is possible of the amount of obligation. As stated above, the case of Indian Molasses Co. (P.) Ltd. (supra) is different from the present case. As stated above, in the present case we are concerned with an army of items of sophisticated (specialised) goods manufactured and sold by the assessee whereas the case of Indian Molasses Co. Ltd. (supra) was restricted to an individual retiree. On the other hand, the case of Metal Box Co. of India Ltd. (supra) pertained to an army of employees who were due to retire in future. In that case the company had estimated its liability under two gratuity schemes and the amount of liability was deducted from the gross receipts in the profit and loss account. The company had worked out its estimated liability on actuarial valuation. It had made provision

for such liability spread over to a number of years. In such a case it was held by this Court that the provision made by the assessee-company for meeting the liability incurred by it under the gratuity scheme would be entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The same principle is laid down in the judgment of this Court in the case of Bharat Earth Movers (supra). In that case the assessee-company had formulated leave encashment scheme. It was held, following the judgment in Metal Box Co. of India Ltd.'s case (supra), that the provision made by the assessee for meeting the liability incurred under leave encashment scheme proportionate with the entitlement earned by the employees, was entitled to deduction out of gross receipts for the accounting year during which the provision is made for that liability. The principle which emerges from these decisions is that if the historical trend indicates that large number of sophisticated goods were being manufactured in the past and in the past if the facts established show that defects existed in some of the items manufactured and sold then the provision made for warranty in respect of the army of such sophisticated goods would be entitled to deduction from the gross receipts under section 37 of the 1961 Act. It would all depend on the data systematically maintained by the assessee. It may be noted that in all the impugned judgments before us the assessee(s) has succeeded except in the case of Civil Appeal Nos. 3506-3524 of 2009 - Arising out of S.L.P.(C) Nos. 14178-14182 of 2007 - Rotork Controls India (P.) Ltd. v. CIT, in which the Madras High Court has overruled the decision of the Tribunal allowing deduction under section 37 of the 1961 Act. However, the High Court has failed to notice the "reversal" which constituted part of the data systematically maintained by the assessee over last decade.

18. For the above reasons, we set aside the impugned judgment of the Madras High Court dated 5-2-2007 - Rotork Controls India (P.) Ltd.'s case (supra) and accordingly the civil appeals stand allowed in favour of the assessee with no order as to costs."

108. In view of the above judgment, we direct the AO to examine the assessee's past record and allow the provision for warranty in the same proportion as compared to the sales as in the earlier assessment years.

For this purpose, the AO may consider the data of the immediate past five assessment years and decide the issue accordingly.

109. **Ground No. 26 is with regard to disallowance of annual licence fee of Rs. 2,75,76,144**. During the year under consideration the assessee debited expenses amounting to Rs. 29,15,04,683/- to profit and loss account under the head "R&D". The break-up of the total R&D expenses is as under:-

Sl. No.	Nature of expenses	Amount in INR
1	License fees to group companies	26,39,28,539
2	Payment of R & D Cess	2,83,62,813
3	Third party and others	(7,86,669)
Total		**29,15,04,683**

110. He submitted that the above expense being incurred for the purpose of business, has been claimed as deduction u/s. 37 of the Act. The AO disallowed the same contending it to be capital in nature and also that it is not a genuine expenditure while passing the draft order, on the contention that no evidences were submitted supporting the same. The DRP has upheld the disallowance proposed by the AO and rejected the assessee's objections in this regard. However, the DRP directed that to the extent of Rs. 26,39,28,539/-, as the same has been considered as part of the operating cost for computing the margin with respect to the manufacturing segment in the TP order, the same could not be disallowed once again u/s. 37. Pursuant to above, the AO has passed the final order as per the directions of the DRP making - a disallowance of Rs. 2,75,76,144/- (Rs. 29,15,04,683/-- Rs. 26,39,28,539/-).

111. In this regard, the Assessee submitted as follows:-

Expenditure incurred is allowable under section 37 of the Act:

a. Annual License Fee:

112. The assessee incurred Rs. 26,39,28,539/- towards payment of Annual License Fees to its parent company and its sister concern ("Continental Global" for short) under the following agreements:

Agreement A ***(page no. 1125 to page no. 1137 of the paper book)*** The assessee has entered into a License Agreement effective from 1st January 2009 with Continental Automotive GmbH, Germany ("CA GmbH").

- Under this agreement, CA GmbH grants a non-exclusive, non-transferable license to use intellectual property owned by it as well as the technical information, to the Appellant for development, manufacturing and sale of automotive products.
- Compensation for the aforementioned license has been agreed to be paid by the Appellant as an annual royalty of 3% of net sales on account of use of intellectual property generated from basic R&D and 2% on net sales (which shall decrease by 0.25% during every calendar year after 2009) on account of use of intellectual property generated from old application R&D. [Basic R&D is Product related research and development for the general benefit of the company in manufacturing of the automotive products and Application R&D is Customer specific product related research and development].

Agreement B *(page no. 2241 to page no. 2251 of the paper book)*: The Appellant has entered into a License and Technical Assistance Agreement effective from 1st January 2009 with Continental Teves AG & Co. OHG, Germany ("CT AG").

- Under this agreement, CT AG grants license to use technical information for development, manufacture and sale of sensors.
- Compensation for the aforementioned license has been agreed to be paid by the Appellant as an annual royalty fees of 6% of net sales of sensoric products per year

113. The term "R&D" was just a nomenclature used by the Appellant for the purpose of accounting such expenditure and the nature of expense as clearly laid out in the aforesaid agreements was royalty.

Claim of annual license fees as revenue expenditure under section 37(1)

114. The ld. AR submitted that the annual license fee incurred by it was for the use of technology of the Continental Group for manufacturing and sales of the products. Such expenditure should be allowed under section 37(1) of the Act based on following submissions:

i. Section 37 of the Act is a residual clause for claiming deduction for any expenditure incurred for the purposes of the business.
ii. For the purpose of claiming deduction under section 37 of the Act, the following conditions should be fulfilled:
    - The expenditure must be revenue in nature and should not be covered by any express deductions under sections 30 to 36 of the Act.
    - The expenditure should not be personal in nature.
    - The expenditure should be incurred wholly and exclusively for the purposes of the business or profession.
iii. The annual license fee is payable for making use of licensed intellectual property and/ or technical information owned by the Continental Group.

iv. Such payments are made only towards "access" to technical knowledge and not absolute transfer of technical knowledge or information.

v. Such expenses were incurred by the Appellant for increasing profitability relating to products manufactured by the Appellant by applying new methods of manufacture/ technology provided under the aforementioned agreements.

vi. The object of the aforementioned agreements was to obtain the benefit of technical knowledge available with the licensors, for running the business of the Appellant.

vii. Further, the license fee is calculated as a percentage of sales, hence, it is recurring in nature and there is no enduring benefit derived by the Appellant in this regard. Accordingly the same should be considered as revenue in nature and should be allowed as deduction under section 37(1) of the Act, since it satisfies all the aforementioned conditions.

viii. In this regard, reliance is placed on following decisions:

- *Kanpur Cigarettes (P.) Ltd. v. CIT*147 Taxman 428 (Allahabad High Court)
- *CIT v. Kirloskar Tractors Ltd [1998] 231 ITR 849 (Bombay HC)*
- *Alembic Chemical Works Co. Ltd. v. CIT*[1989] 43 Taxman 312 (SC)
- *J.K. Synthetics Ltd. v. CIT[2009] 176 Taxman 355 (Delhi High Court)*
- *DCIT v. Honda SIEL Power Products Ltd I.T.A .No. 1579/DEL/2017 (A.Y 2012-13) & S. A No. 217/Del/2017 in ITA No. 1579/Del/2017*

ix. Based on above judicial decisions, the factors to be considered and conditions to be satisfied are summarized below:-

Factors to be considered	**Conditions to be satisfied**
License period and termination	The license is granted for a limited period and not exclusive. The parties have a right to terminate the license
Restriction on creation of	The licensee has restricted rights to create further rights/ assign the license in favor of third parties

further rights/ assignment	
Confidentiality	The arrangement prohibits parting with confidential information
Degree of transfer	The license does not transfer all the 'fruits of research' of the licensor, "once for all"
Nature of royalty	Royalty paid as a percentage of sales is linked to sales achieved by the assessee and hence, is considered as cost in earning the same

115. He submitted that in the case of the assessee, the agreements under which the annual license fees was paid, satisfies the aforementioned conditions as under:-

Factors under consideration	**Whether the conditions are satisfied?**	**Clause reference in the Agreements A and B**
License period and termination	Yes. Both the licenses are granted for a limited period. The agreements can be terminated at the discretion of both parties.	• Agreement A - 6.1.2 • Agreement B - 7.1 and 7.2
Restriction on creation of further rights/ assignment	Yes. The Appellant can sub-license only on receipt of prior written approval from the Licensor.	• Agreement A - 2.2 • Agreement B - 3.1
Confidentiality	Yes. The Appellant is obligated to hold in confidence all the information provided under the agreement.	• Agreement A - 8 • Agreement B - 6.1 to 6.5
Degree of transfer	Yes. The scope of the license is only to grant right to use licensed intellectual property. There is no transfer of absolute ownership of any intellectual property.	• Agreement A - 2.1 • Agreement B - 3.1
Nature of royalty	Yes. Royalty was paid based on a percentage of net sales as provided in the agreements	• Agreement A - 5.1 • Agreement B - 4.1

116. It is submitted that for the above expenses, the assessee receives a wide array of assistance, services, support and guidance on a recurring basis. It can be said that these royalty payments made are commensurate to the benefits obtained by the Appellant on a year on year basis. The broad key areas of support/ assistance/ service provided by Continental global to Appellant is described below in detail:-

Standard Practices:

a) Continental global provides access to standard procedures, methodologies, best practices, knowledge updates, etc. relating to manufacturing process of a product. These are provided largely through software platforms used by Continental group on a standardized basis across the world. These are continuously updated and the latest versions of the same are made available through portals/tools.

b) The global team works on the upgradation of current technologies and products. It also avoids parallel work of a similar kind among the group entities. The sharing of best practices on technical know-how, manufacturing processes and techniques is the foundation for Continental group's business as an organization as they aim to serve the customer's requirements in a standardized manner. The Appellant being part of the group benefits out of such knowledge sharing and technical guidance and support.

c) Some of the key benefits out of the above support to the Appellant includes timely business planning, optimum resource utilization, and meeting customer's requirements where the expectation is always to deliver as per global standards, gaining competitive advantage, and running the business smoothly and efficiently.

d) Corporate Project Management Manuals and Standards – CPMMs and CPMS provided by Continental global aid in project management. Further, the Appellant refers to the standard document provided by Continental global in planning introduction of a new product, which provides basic guideline for innovation introduction. Continental group provides the latest updates relating to development of key manufacturing technologies. This helps the Appellant to upgrade its business including the manufacturing process to the latest available technology.

117. Relevant Snapshots of the manuals, emails and standard documents demonstrating the rendering of these services are produced before this Tribunal under an application for additional evidence. It is submitted that adopting standard practices is key to the assessee's business without which it would not be in a position to produce high quality automobile products as per global standards.

- **Access to various tools/platforms**

a) There are numerous tools/ software platforms that are made available by Continental global to the Appellant for the purpose of its business. These tools are developed in-house by Continental global or developed by third party and customized for use by Continental group. These tools/software platforms are primarily online tools/platforms and shared drives which facilitate various technical support including:

- Sharing of best practices/ standard procedures (discussed above).
- Real-time production control and monitoring.
- Planning/ forecasting the material and labor requirements.
- Survey the customer's demands/ requirements.

- Tracking and overall management of the project on real-time basis.
- Integration of costing software and accounting software (SAP).

b) Various tools like tech.net, prod.net, log.net, camline etc. are provided to the Appellant and some of the key tools in use by the Appellant are discussed below:-

Sl. No.	Tool Name	Tool/ platform description	Benefit to 'Continental India'
1	*Tech.Net*	It is a platform which provides access to latest technical information, standard practices, procedures, etc. Tech.Net members possess highest level of education (PHd) and provide support centrally to each location whenever a problem cannot be resolved locally.	Appellant uses *Tech.net* (manufacturing technology network) to gain access to the technical information, standard practices and documents, and applies/ implements the same for its manufacturing process, testing process, etc. As mentioned earlier, this information and support is a **catalyst for the Appellant's business**.
2	Collaborative robots ("Cobot")	Cobotis an advanced version of robots which focuses on safety and cost reduction. This is easy and simple to program as per the user requirement.	Cobothelps the Appellant in reducing dependency on man power, suppliers of raw material. This enhances overall performance with possible savings in terms of lead time and increase in efficiencies.
3	Camline	Camline is an internal customized software for monitoring and tracking of the line performance of the	Camline analyses performance of the machineries over a period and provides quality rates, performance rates. It also records the equipment

		machinery/ equipment in the plant during the process of manufacturing.	status and provides report of the unplanned errors occurred.
4	Space planning tool	LFPT tool is another tailor-made tool from Continental global for management of manufacturing floor space, logistics floor space etc.	This helps the Appellant in planning as well as optimum utilization of available resources.
5	Manufacturing execution systems ("MES")	MES is an auxiliary bundle of software that work hand-in-hand with Camline software/ platform and provides real time production monitoring.	MES is integrated with the SAP system in a way that MES provides automatic data to SAP. It counts automatically how many units were built, how many tests failed, how many units were shipped, what product routing (recipe) was used. These provide basic information for cost absorption calculation. It's a smart software that makes machines closer to Industry 4.0 smart equipment (industry standard).

Snapshots depicting the working of the tools and reports generated are produced before this Tribunal under cover of an application for additional evidence.

- **Assistance in sourcing:**

a) Continental global has a global strategic sourcing approach i.e. strategy for obtaining raw material/ resources across the world in a

standardized manner, which can achieve economic advantages in terms of obtaining significant discounts.

Continental global locates suppliers, seeks samples from them and tests their products. Upon satisfaction about the quality of the product, Continental global provides such information of suppliers located across the globe, to the group. It also negotiates for bulk discounts and set quality standards for the suppliers. This in turn helps the Appellant in procuring quality raw materials at best price without any efforts. Sample email communications demonstrating procurement of raw materials by Continental Global, instructions/solutions on raw material shortage and quality issues are produced before thisHon'ble Tribunal under cover of an application for additional evidence.

- **Provision of designs, procedures and layouts**

Every product that the Appellant manufactures is unique and complex. Continental global develops and shares its designs, layouts and drawings relating to products, manufacturing process, etc. with the Appellant. The requirement of the customers varies from country to country and therefore, Continental global provides customized versions of its designs, layouts and drawings to the Appellant which are best suited for the Indian market.

- **Training**

a) Continental global conducts online courses, training through video conferencing, live training workshops etc. to equip its people with updated technologies, products and solutions, and specifically focus on measures and guidelines for implementation of standards, new technology etc. These trainings are facilitated from the global

experts of the Continental group. This contributes to enhanced productivity.

- **Validation**

a) Continental global validates the complete product layout/ design as submitted to it by local teams for its feasibility and then provides a "go-ahead" to the local team for its implementation. This is prepared and submitted in the form of a project matrix.

b) Continental global, due to their expertise could uncover any issues at an initial stage itself. Therefore, the above process aids Continental India to prevent any issues, avoid duplication of efforts and ensures timely response to the issues beforehand.

- **Testing**

a) A crucial aspect of any manufacturing process is testing. The Appellant undertakes testing of the products/ components as per the guidance and set standards by Continental global. Continental global releases guides/ standard practices to be followed by the Appellant for testing purposes on continuous basis.

b) Where the existing testing procedures have not been helpful or the local team is unable to render the testing equipment/ software for testing purposes, the appellant requests the assistance of Continental global. A screenshot of the source code shared with the Appellant in one such instance is produced under cover of the application for additional evidence.

c) Sometimes, the technical support would be provided through emails. These are facilitated by the experts and generally entails steps and

action points for the Appellant. Sample email communications are also part of the application for additional evidence.

- **Problem resolution**

a) The Appellant seeks the help of Continental global to resolve issues in cases where the Appellant is unable to do so. Continental global provides the appellant with necessary technical support on call and through emails.

b) Continental global also voluntarily takes initiatives to mitigate the issues at every plant location across the world. If the issues are highly vulnerable and needs personal monitoring by the experts, the global team send experts to that particular location to address the specific and routine issues and bring down the occurrence of quality incidents.

- **Other assistance:**

a) Continental global enters into centralized agreements for procuring certain techniques, technical services. This helps the Appellant to improve the product quality. The aforesaid assistance received from Continental group helps in improving the technological performance of the Appellant's operations in terms of quality and cost and also helps in optimum utilization of resources in an efficient manner. It also creates synergy among the group entities including the Appellant and ensures access to latest technical information.

The assessee has filed an application for additional evidence to produce snapshots of various manuals, processes, standard documents and email communications demonstrating the rendering of services under each of the heads specified above. Based on the above, it was submitted that as the

present case satisfies the conditions of section 37 of the Act, the license fee paid should be allowed as revenue expenditure.

b. R&DCess:

118. The R&D Cess was paid by the assessee in the course of its business activities. This being an expense of revenue in nature, the same is claimed by the assessee u/s. 37 of the Act. The findings of the AO and assessee's submissions towards the same is tabulated below:-

Sl. No.	Learned AO's contention	Appellant's submission
1	No proper evidences furnished	The Appellant had submitted the following details to the learned AO: 1. Ledger extracts of R&D expense 2. Sample invoice copies raised on Appellant by group entities 3. Copy of agreements entered into with group entities 4. List of projects for which amount was charged specifically to projects 5. Sample copy of two patents which in the name of Continental, Germany The above substantiates rendition of service, the nature of expense incurred and the benefits obtained by the Appellant.
2	Reasons for classification of expense as R&D not provided	Appellant had submitted that R&D is only a nomenclature used by the Appellant in the financial statements and a major portion of the said expense is towards annual license fees paid by the Appellant to its group companies.
3	Expense is capital in nature since it provides enduring benefits	From the above factual and legal basis, the Appellant submits that the impugned expense is not a capital expenditure, as there is no enduring benefit derived by the Appellant. The same is related to the business of the Appellant.
4	No rationale for	The Appellant submits that merely because

	entering into agreement with its group entities since the Appellant was carrying on the business even prior to entering aforesaid agreements	an agreement is entered into, no businessman would change the business. It is for the purpose of the business that a businessman enters into an agreement. Appellant had taken a business decision to avail the services from group entities to facilitate and further its business objects. It is also submitted that having provided the factual and legal basis of the expense, the learned AO cannot question commercial expediency of a transaction. Further, entering into agreements for use of intellectual property of the group companies has benefited the Appellant.
5	Sundry creditors are increasing	This is a mere remark made by the learned AO without any basis/ conclusion towards the same. However, the Appellant submits that sundry creditors account is a running account and represents payables to third parties/ group entities for goods/ services availed from them.
6	Evidence for deducting the taxes at source not furnished	The Appellant submits that it has duly deducted tax at source under Section 195 of the Act, on the payments made/payable to the group companies.
7	No rationale for paying royalty since there are import of raw materials, consumables, and other supplies.	The import of raw material, consumable and other supplies from the group companies and payment of royalty are two distinct transactions, and the Appellant has substantiated the business rationale for the payment of royalty through evidences and submissions. Further, payment of royalty is towards use of technology of the Continental Group and technical information that helps facilitate the manufacturing activity of the Appellant.

119. Based on the above, the ld. AR submitted that the impugned expense is revenue in nature and the same is allowable under section 37 of the Act. Without prejudice to the above, it is submitted that for the

assessment years, i.e., 2009-10 and 2011-12, the similar issue has been remanded for fresh consideration by this Tribunal.

Claim of the Appellant under section 35(1)(iv) of the Act

120. Notwithstanding and without prejudice to the above, even if the said expenses incurred by the Appellant for its own business are held relating to R&D and that the expenses provide enduring benefit, the claim of deduction of the Appellant must be allowed under section 35(1)(iv) of the Act. It is further submitted that DSIR approval is neither required for claim of deduction under section 35(1)(iv) nor under section 37, as DSIR approval is mandated for weighted deduction under section 35(2AB).

Claim of the Appellant under section 32 of the Act

121. Notwithstanding and without prejudice to the above, even if the said expenses are held as capital in nature, the Appellant would be eligible to claim depreciation under section 32 of the Act at the rate of 25% on the amount capitalized as license fees, for income tax purposes.

122. In this regard, the ld. AR placed reliance on the decision of Hon'ble Supreme court in the case of *Honda Siel Cars India Ltd.[2019] 101 Taxmann 222 (SC)* wherein it was held that if royalty is treated as capital expenditure, needless to mention that the Appellant shall be entitled to depreciation thereon.

123. In view of the above, it was prayed that the claim of deduction for R&D expenses be allowed.

124. On the other hand, the ld. DR submitted that the DRP observed that similar objection raised by the assessee in assessment year 2011-2012, was decided by the DRP, as under:-

"we peruse the draft assessment order from which it is noticed by us that the A.O. in paragraph 10.3 has observed that the assessee has not produced necessary approval from the prescribed authority i.e. secretary , Department of Scientific and Industrial Research. It is also stated that no such approval have been produced nor any evidence has been produced in respect of nature of expenses. The A.O. also observed that the R&D activities carried out while result in enduring benefit to the assessee. It is also noticed by us from paragraph 10.2 of the draft assessment order that before the assessing officer, the evidences now has been produced before us have not been made available to arrive at a correct conclusion. It is also noticed by us that the similar issue was examined by the DRP in A.Y. 2009-10 and 2010-11. The observation of the DRP-1, Bengaluru for A.Y. 2010-11 as narrated in paragraph 4.3 of the order are reproduced below :-

> "Having heard the assessee and examination of the finding recorded by the Assessing Officer, we examined the records and submissions made by the assessee, the outcome of which is summarized below :-
>
> (i) In the profit and loss account, the amount has been debited under the head 'Research & Development' , there is nothing on record to suggest that before the Assessing Officer, the alleged license agreement between the assessee and Continental Automotive GMBH, Germany dated 01-01-2009 (hereafter referred as Agreement) was produced, which is further evident from the submission of the assessee reproduced by the Assessing Officer. The assessee is carrying out similar business prior to 01-01-2009, hence, we do not find any rationale for entering into agreement with the AE w.e.f. 01-01-2009.
>
> (ii) As per the Agreement, the amount claimed is Royalty and therefore, we do not find any rationale in debiting such amount in profit and loss account as R&D expenses.
>
> (iii) On perusal of the balance sheet, it is also noticed by us that the sundry creditor in respect of Continental Automotive GMBH, Germany is increasing on year to year basis.

(iv) On perusal of the audit report in Form 3CD, it is noticed by us that in respect of particulars of payment made to the specified persons u/s 40A(2)(b) of the Income tax Act, the amount of 10,88,25,803/- has been mentioned as payment for Research and Development/

(v) If we go by the Agreement, the amount is in the nature of Royalty paid to a non-resident hence, liable for deduction of tax at source u/s 195 of the Income tax Act. However, there is no evidence to support that the tax has been deducted at source on payment of such Royalty.

(vi) In the **TP** study, the above amounts has not been shown separately as payment of Royalty, similarly, in audit report in Form 3CEB also, the amount has not been shown as paid towards Royalty.

(vii) Except the copy of the agreement, the assessee failed to produce any evidence to support the technical knowhow provided by the AE, further, when the import of raw material, consumable and other supplies are from the AE, there is no rationale for making the payment of above Royalty on sales, In addition to the payment of capital expenditure on technical knowhow amounting to 45.41 crores to the AE during the year.

In view of the fact discussed as above, we are of the view that the above payment of Royalty is not a genuine expenditure which can be allowed u/s 37(1) or under any other provisions of the Income tax Act. Accordingly, the objection is not found acceptable.

The fact and circumstances are similar for the assessment year also. Further, it is a case where the similar disallowance is made from A.Y. 2009-10 and confirmed by DRPs, but the evidences in the form of so called agreement or any other evidence was never produced before the A.O., even though specifically asked for and therefore, we are not inclined to admit and examine such evidences produced before us at this stage, accordingly, the above objections are dismissed."

125. The ld. DR submitted that the factual aspect of the above claim remains the same with one more addition of fact that during the

assessment year, the assessee also failed to produce such evidences before the TPO during the TP proceedings and therefore the TPO considered the ALP of such transactions at 'nil'. In respect such payments to the extent of Rs.26,39,28,539, the findings recorded by the TPO and the Assessing Officer, both makes it clear that the expense of Rs.26,39,28,539 are not genuine and therefore not allowable under section 37(1) of the Act, question of allowing such claim under section 35(1) does not arise. At the same time, the DRP disagreed with the finding of the Assessing Officer that the said amount is a capital expenditure and hence was of the view that the question of allowing depreciation under section 32(1) does not arise. In respect of the balance amount of Rs.2,75,76,144 (29,15,04,683 - 226,39,28,539) also, the assessee failed to furnish evidences before the Assessing Officer to establish that the services are actually rendered and therefore such expenses cannot be allowed under section 37(1) of the Act.

126. However, as the amount of Rs.26,39,28,539 has been considered as part of the operating cost for computing the margin with respect to manufacturing segment and in the TP adjustment in that segment works out to more than the above expenses, the DRP was of the view that the TP adjustment includes the above amount and therefore the separate disallowance under section 37(1) amounts to disallowing the same amount twice. In such circumstances, the DRP observed that unless the adjustment made under section 92CA(3) of the Act, in respect of manufacturing segment, becomes less than Rs.26,39,28,539, it is not appropriate to make a separate disallowance under section 37(1) or under section 40(a)(i) of the Act, considering the fact that the above amount represents international transactions which was evaluated under CUP by the TPO and also under TNMM by aggregating the said transaction to the manufacturing segment. If at any subsequent stage, either the adjustment under TNMM is reduced to less than the above payments, then the disallowance under section

37(1) and alternatively under section 40(a)(i) has to be revived as the assessee failed to produce any evidence to establish that tax was deducted at source and paid within the time limit allowed under proviso applicable to sub-clause (i) of clause (a) of section 40 the Act for the assessment year. Accordingly, the DRP directed the Assessing Officer to reduce the proposed addition by Rs.26,39,28,539.

127. We have heard both the parties and perused the material on record. Similar issue came up for consideration before this Tribunal in assessee's own case for AY 2011-12 and the Tribunal vide order dated 12.4.2019 held as follows:-

> "7. Ground No.2 (a to h) - Annual Licence Fees / R & D Expenses 7.1 In the course of assessment proceedings, the AO noticed that the assessee had debited an amount of Rs.22,39,43,000/- towards R & D Expenses. The AO observed that the assessee had not furnished any evidence of the nature of expenses and therefore held them to be capital in nature and disallowed the assessee's claim. The AO also observed that approvals from prescribed authority were also not furnished. The DRP, while disposing off the assessee's objections, confirmed the action of the AO in disallowing the expense by stating that the evidences now produced before the DRP have not been made available to the AO to arrive at a correct conclusion. The DRP also noted that similar issue was examined by the DRP in Assessment Year 2009-10 and held that where similar disallowance was made for Assessment Year 2009-10 was upheld by the DRP. However, since the evidences were never produced before the AO, the DRP in this year i.e., Assessment Year 2011-12 declined admission of the evidence produced by the assessee and upheld the addition.
>
> 7.2.1 We have considered the rival contentions of both parties and perused and examined the material on record in respect of the issue of R & D IT(TP)A No. 457/Bang/2016 IT(TP)A No. 425/Bang/2016 expenses; which is for consideration before us. The assessee has debited these expenses in the Profit & Loss

Account under the head "R & D Expenses". However, in its objections before the DRP, the assessee claimed that these expenses are towards annual licence fee for the R & D work carried out by the group company, which was used by the assessee. This claim, though not put forth before the AO has been made before the DRP. The DRP, however, declined admission of this claim and also the details / documents filed in support thereof. In doing so, the DRP has relied upon the decision of the DRP for Assessment Year 2009-10.

7.2.2 We find that the Co-ordinate Bench of this Tribunal in its order in IT(TP)A No.165 and 254/Bang/2014 dated 28.09.2017 in the assessee's own case for Assessment Year 2009-10 had remanded this issue back to the file of the AO for fresh examination and adjudication. The grounds raised by the assessee in this regard before the Tribunal for Assessment Year 2009-10 at 8 to 8B at page 3 of the order of the Co-ordinate Bench are extracted hereunder:

> "8. Disallowance of Research and Development (R&D) Expenditure-- Rs. 33,897,837
>
> 8.A The learned AO erred in concluding approval under section 35(2AB) is mandatory for claiming expenses in the nature of annual license fee, testing charges and engineering services charges which have been merely grouped as R&D Expenditure. The learned AO ought to have appreciated that these expenditure are towards operating activities of the Appellant and do not provide any enduring benefits.
>
> 8.B Notwithstanding and without prejudice to the above, even if the said expenditure are held to give enduring benefit on the argument that the same pertain to research & development, the expenditure should be allowed as a deduction under section 35(1) of the Act."

7.2.3 The Co-ordinate Bench of the Tribunal in its order for Assessment Year 2009-10 (supra) disposed off this ground of appeal at paras 6 & 7 of the order; which is extracted hereunder:-

> "6. Regarding corporate tax issues raised by the assessee in its appeal as per ground nos. 8 and 9, it was submitted

by ld. AR of assessee that ground no. 9 is not pressed and accordingly ground no. 9 is rejected as not pressed. Regarding ground no. 8, it was submitted that the finding of DRP on this issue is in para no. 18 of DRP order wherein it is noted by DRP that the onus lies on the assessee to prove that the expenses was laid out exclusively for the business and that it wasn't in the nature of capital expenditure to claim it u/s.37(1) but in the present case, the assessee has not been able to substantiate its claim either way. It is also noted by DRP that before the AO, the assessee could not establish that the expenses was on Research & Development activities. He submitted that this matter may also be restored back to the file of AO for fresh decision and if that is done then the assessee will provide all the details required by the AO for this purpose. The ld. DR of revenue supported the orders of authorities below.

7. We have considered the rival submissions. Regarding ground no. 8 of assessee's appeal, we feel it proper that this issue should go back to the file of AO for fresh decision and hence, we restore this matter back to the file of AO for fresh decision with the direction that the assessee should provide complete details and evidence which may be required by the AO to examine and decide the claim of the assessee. The AO should provide reasonable opportunity of being heard to assessee. Ground no. 8 is allowed for statistical purposes."

7.2.4 In view of the above order of the Co-ordinate Bench of this Tribunal in the assessee's own case for Assessment year 2009-10 (supra), and considering that the claim of the assessee regarding the expenses being for annual licence fees has not been examined at all and that the details / evidences submitted by the assessee before the DRP has not been admitted for consideration, we deem it appropriate to follow the order of the Co-ordinate Bench of this Tribunal in the assessee's own case for Assessment Year 2009-10 (supra); admit the details filed by assessee before DRP and remand this issue back to the file of the AO with the same directions as contained in the Tribunal order for Assessment Year 2009-10 (supra). The assessee is directed to provide complete details and evidence of its claim which may be required by the AO to examine and decide the matter. Needless to add, the AO

shall provide adequate opportunity of being heard to the assessee and to duly consider the submissions, details and evidences put forth by the assessee before deciding the issue. Consequently, ground 2 (a to h) is treated as allowed for statistical purposes."

128. Being so, we remit this issue to the file of AO with similar directions as per the above order of the Tribunal in assessee's own case.

129. Thus, the claim of the assessee u/s. 35(1)(iv) and 32 of the Act have become infructuous in view of the main issue having remitted to the AO for fresh consideration.

130. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Pronounced in the open court on this 24th day of November, 2021.

Sd/-	Sd/-
(N V VASUDEVAN)	(CHANDRA POOJARI)
VICE PRESIDENT	ACCOUNTANT MEMBER

Bangalore,
Dated, the 24th November, 2021.

/*Desai S Murthy /*

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.