# IN THE INCOME TAX APPELLATE TRIBUNAL
# PUNE BENCH, 'C' PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.1766/PUN/2018
निर्धारण वर्ष / Assessment Year : 2014-15

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| Hyundai Construction Equipment India Private Limited,<br>Plot No.A/2, Chakan, MIDC,<br>Phase II, Khalumbre,<br>Chakan-Talegaon Road,<br>Chakan, Taluka Khed,<br>Pune 410 501<br>PAN : AABCH8756Q | Vs. | ACIT,<br>Circle-9,<br>Pune |
| Appellant | | Respondent |

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| Assessee by | Shri M.P. Lohia, Shri Rajendra Agiwal and Shri Heman Chandariya |
| Revenue by | Shri Rajiv Kumar |
| Date of hearing | 02-12-2021 |
| Date of pronouncement | 06-12-2021 |

## आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 11-09-2018 passed by the Assessing Officer (AO) u/s.143(3) r.w.s.144C(13) of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2014-15.

2. The first issue is in respect of transfer pricing adjustment of Rs.37,42,31,420/- pertaining to the Manufacturing segment. Another inter-connected ground is against treating subsidy received by the assessee as a revenue receipt.

3. Briefly stated, the facts of the case are that the assessee is a wholly owned subsidiary of Hyundai Korea and is mainly engaged in manufacturing and trading of excavators. It is also engaged in trading of spares. The assessee filed its return declaring total income of Rs. Nil. It reported certain international transactions in Form No. 3CEB, which were divided mainly into Manufacturing segment and Trading segment. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of international transactions. In the instant appeal, we are concerned only with the Manufacturing segment which comprises of Import of raw material amounting to Rs.256.29 crore; Sale of manufactured goods at Rs.69.95 crore; Payment of technical license fees/Royalty at Rs.5.81 crore; and Payment of one time technology transfer fees amounting to Rs.1.24 crore. The assessee computed its Profit Level Indicator (PLI) under the Transactional Net Marginal Method (TNMM) from this segment at 8.87% by treating, *inter alia*, the subsidy amounting to Rs.89,73,01,000/- as part of operating revenue, which was also

offered for taxation. The TPO opined that the subsidy was in the nature of extraordinary item of income which required exclusion from the operating revenue. By doing so, he computed assessee's PLI at (-) 4.01%. After making certain inclusions in and exclusions from the list of comparables drawn by the assessee, the TPO finally selected five companies as comparable with their mean adjusted PLI at 2.25%. Considering the same as benchmark, he recommended transfer pricing adjustment of Rs.39,43,92,035/-, which was notified in the draft order. The assessee contended before the Dispute Resolution Panel (DRP) that the subsidy received by it ought to have been considered as operating revenue. At the same time, it was also submitted that the subsidy should be considered as a capital receipt not liable to tax. The DRP rejected the assessee's contention on both the scores and treated the subsidy as a revenue receipt and also upheld its exclusion from the operating revenue for the purpose of the PLI determination. Certain directions were rendered in the context of comparables. While giving effect to such directions of the DRP, the AO, in the final assessment order, computed the amount of transfer pricing adjustment at Rs.37,42,31,420/-, against which the assessee has come up in appeal before the Tribunal.

4. We have heard the rival submissions and gone through the relevant material on record. The assessee received subsidy under Package Scheme of Incentives (PSI) given by the Government of Maharashtra amounting to Rs.89.73 crore, which was treated as an item of revenue receipt and at the same time, it was also included in the operating revenues for determining the ALP of the Manufacturing segment. In a note given to its balance sheet, the assessee mentioned as under:

> "The company has accounted for an industrial promotion subsidy of INR 89,73,01,000/- as income in its books of accounts. This subsidy is receivable from the Government of Maharashtra ('GoM') pursuant to the Memorandum of Understanding ('MoU') signed between the Company and GoM. As per the MoU, HCEIPL is entitled to receive an Industrial Promotion Subsidy in the form of VAT refund (which is equivalent to VAT paid by HCEIPL on its sales for the year (subject to the overall cap of the total eligible investment in HCEIPL), for a period of 8 years from the date of commencement of commercial operations, subject to certain annual compliances. *The said subsidy is in the nature of a capital grant receivable for the purpose of setting up the company in a backward area for the purpose of development of that area and employment generation.* In this regard reliance is placed on the following decisions :
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> -DCIT Vs. Reliance Industries Ltd. (2003) 88 ITD 273 (Mum) (SB)
> -Income Tax Officer Vs. The Thermodors Pvt. Ltd. (Unreported)
> -CIT Vs. P.J. Chemicals Ltd. (1994) 210 ITR 830 (SC)
> -CIT Vs. Elys Plastics Pvt. Ltd. (1991) 188 ITR 11 (Bom.)
> -CIT Vs. Tirumala Bricks and Tiles Factory (1996) 217 ITR 547 (AP)
> -CBDT Circular No.142 dated 1 August 1974
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> However, the Company for the purpose of its tax computation has offered the same to tax as a revenue receipt. *The Company reserves its right to claim the above amount as capital receipt*

> *and hence not subject to tax,* inter alia, in the event of any further clarifications from the CBDT, Supreme Court or any further judicial pronouncements in this regard."

5. We have verified the financial statements of the assessee from which it is apparent that the subsidy has been clubbed with other operating revenues included in the Statement of Profit and loss account. The resultant figure of loss has been taken as the opening point for the computation of total income, which means that the subsidy has been offered for taxation. The assessee also treated it as an item of operating revenue for the purposes of computing the PLI under the Manufacturing segment. Though the treatment of the subsidy as a revenue item was left intact by the AO, the TPO opined that the subsidy was an extraordinary item of income and hence liable to be excluded from the ambit of operating revenue. The contention of the assessee before the DRP that the subsidy should be considered as a capital receipt also came to be jettisoned which upheld its inclusion in the operating revenue. The net effect of these proceedings is that the subsidy received by the assessee amounting to Rs.89.73 crore has been taxed as a revenue receipt and has also been removed from the operating revenues in the computation of PLI from the Manufacturing segment.

6. The primary contention of the assessee is that the subsidy is in the nature of capital receipt and hence, should be excluded. We have gone through the nature of subsidy granted to the assessee by the Govt. of Maharashtra under Package Scheme of Incentives, 2007. A copy of the Scheme has been placed at page 753 of the paper book. The Preamble of the Scheme states that: "… The State has declared the new Industrial, Investment, Infrastructure Policy 2006 *to ensure sustained Industrial growth* through innovative initiatives for development of key potential sectors and further improving the conducive industrial climate in the State, for providing the global competitive edge to the State's industry. The policy envisages grant of fiscal incentives *to achieve higher and sustainable economic growth with emphasis on balanced Regional Development* and Employment generation through greater Private and Public Investment in industrial development." The Scheme talks of granting incentives subject to Eligibility Criteria in favour of the Eligible Units. The definition clause in the Scheme provides that "An Eligibility Certificate under the 2007 Scheme will be issued by the Implementing Agency after ascertaining that the eligible unit has complied with the provisions of the Scheme and has commenced its commercial production." Clause 5 of the Scheme states that *"New*

*projects, which are set up in these categories in different parts of the State, will be eligible for Industrial Promotion Subsidy*. The quantum of subsidy will be linked to the Fixed Capital Investment. Payment of IPS every year will be equal to 25% of any Relevant Taxes paid by the eligible unit to the State or to the any of its departments or agencies." Modalities for sanction and disbursement of IPS 2007 have been given by the Govt. of Maharashtra which state that the Industrial Promotion Subsidy in respect of Mega projects under PSI 2001 and 2007 means *an amount equal to the percentage of "Eligible Investments"* which has been agreed to as a part of the customised Package, or the amount of tax payable under Maharashtra VAT 2002 and CST Act 1956 by the eligible Mega Projects in respect of sale of finished products eligible for incentives before adjusting of set off or other credit available for such period as may be sanctioned by the State Government, less the amount of benefits by way of Electricity Duty exemption, exemption from payment of Stamp Duty, refund of royalty and any other benefits availed by the eligible Mega Projects under PSI 2001/2007, whichever is lower. A careful perusal of the PSI, 2007 emphatically manifests that the subsidy has been granted to encourage industrial growth in less developed areas of the State. The quantification of subsidy is linked

with the amount of investment made in setting up of the eligible units. However, the disbursal of the subsidy is in the form of refund of VAT and CST paid on sale of excavators. Taking assistance from the Note given in the Financial statements, the assessee claimed before the DRP that the subsidy was a capital receipt and hence not chargeable to tax. The DRP rejected the contention of the assessee on the ground that it was received after setting up of the unit and was in the form of refund of VAT and CST. In our considered opinion, the decisive factor for considering the nature of subsidy as a capital or revenue receipt is the '*purpose*' for which the subsidy has been granted and not the manner of its disbursal. The Hon'ble Supreme Court in *Sahney Steels and Press Works vs. CIT (1997) 228 ITR 253(SC)* has held in the facts of that case that the operational subsidy received after the commencement of business was a revenue receipt but simultaneously laid down the *ratio decidendi* of applying the 'purpose test' for ascertaining the true nature of subsidy. The *purpose test* has been reiterated by the Hon'ble Supreme Court in *CIT Vs. Ponni Sugars and Chemicals Ltd. (2008) 326 ITR 392 (SC)* by holding that the relevant consideration should be the purpose of subsidy and not its source or mode or payment. When we apply such a test on the facts and circumstances of the case, it demonstrably

emerges that the *purpose* of subsidy is industrial growth; it is linked with the setting up of industrial units; and the amount of subsidy is linked with the amount of investment made in the eligible unit. Simply because the subsidy has been disbursed in the form of refund of VAT and CST, it will not alter the *purpose* of granting the subsidy, which is nothing but establishment of new industrial units in less developed areas of the State. The authorities below have been swayed by the fact that the subsidy was granted post commencement and is in the nature of refund of VAT and CST and overlooked the *purpose* of its granting, which is nothing but momentum in industrial pace in less developed parts of the State. Testing the factual panorama on the touchstone of the *ratio* laid down by the Hon'ble Supreme Court in the above referred cases, we are of the considered opinion that the subsidy of Rs.89.73 crore is a capital receipt and not chargeable to tax.

7. At this stage, it is relevant to mention that we are concerned with the A.Y. 2014-15. The Finance Act, 2015 has inserted clause (xviii) to section 2(24) w.e.f. 01-04-2016 providing that the assistance in the form of subsidy or grant of cash incentives etc., other than the subsidy which has been taken into consideration in determining the actual cost of the asset in terms of Explanation 10 to

section 43(1), shall be considered as an item of income chargeable to tax. Since the amended provision of section 2(24)(xviii) is not applicable to the year under consideration, the sequitur is that the subsidy received by the assessee would not form part of its total income. We, therefore, overturn the impugned order and direct to treat the subsidy as an item of capital receipt not chargeable to tax.

8. In view of the fact that the subsidy of Rs.89.73 crore has been held to be a capital receipt, obviously, it cannot form part of operating revenue of the Manufacturing segment of the assessee company for the purpose of determining the ALP under the TNMM.

9. The ld. AR contended that in the hue of the amendment to section 2(24) of the Act, the assessee offered the subsidy as a revenue receipt chargeable to tax for the A.Y. 2016-17 and also claimed it as operating revenue for the purpose of the ALP determination, which issue is *sub judice* before the Tribunal. We desist from commenting on the treatment of subsidy as an item of operating revenue or otherwise because it is not required for the disposal of the present appeal, for which the subsidy has been held to be a non-operating revenue on the ground that it is a capital receipt and does not form part of the total income of the assessee.

10. To sum up, the subsidy of Rs.89.73 crore is capital receipt not chargeable to tax and at the same time it will not be included in the operating revenue for determining the ALP of the Manufacturing segment.

11. Another issue taken up by the assessee in the appeal is against not considering the impact of excess Custom Duty on imports while computing operating margin from the Manufacturing operations. At the outset, the ld. AR submitted that similar issue was raised in the assessee's appeal for the assessment year 2011-12 and the Tribunal has decided it against the assessee vide its order dated 04-06-2021. In view of the candid admission made by the ld. the learned AR, we hold that the profit margins of the comparables cannot be reduced by the difference in the *amount* of Custom Duty because there is no evidence of any difference in the Custom Duty *rates* paid by the assessee as well as the comparables. Respectfully following the precedent, we uphold the impugned order on this score. This ground fails.

12. The next ground is against the inclusion of Bharat Earth Movers Limited and JCB India Limited in the list of comparables. The TPO included Bharat Earth Movers Limited in the list of comparables despite the assessee's objections. The ld. AR submitted

that the comparable was there in the immediately preceding assessment year and the Tribunal has directed to exclude the same from the list of comparables. Relevant discussion has been made in para 7 of the Tribunal order. After considering the relevant material, the Tribunal has directed to exclude Bharat Earth Movers Limited. The ld. DR could not controvert the argument of the assessee. Respectfully following the precedent, we order to exclude this company from the list of comparables. This part of the ground is, therefore, allowed.

13. The next comparable assailed by the assessee is JCB India Limited, which was included by the TPO in the list of comparables. No relief was allowed by the DRP. The ld. AR fairly submitted that the inclusion of JCB India Limited in the list of comparables was challenged by the assessee for the immediately preceding assessment year as well but the Tribunal has upheld the decision of the authorities below in this regard. We have perused the order passed by the Tribunal on this issue for the immediately preceding assessment year. Relevant discussion has been made in para 8 of the order. After elaborate analysis of the factual and legal position, the Tribunal has finally held that JCB India Limited was rightly included in the list of comparables. Following the same view, we countenance

the inclusion of this company in the list of comparables. This part of the ground is, therefore, dismissed.

14. The last ground raised in this appeal is against the making of the transfer pricing adjustment on entity level as against the proportionate adjustment. Here again, the ld. AR submitted that similar issue was raised in the assessee's appeal for the immediately preceding assessment year and the Tribunal was pleased to direct the AO/TPO to restrict the transfer pricing adjustment to the extent of international transactions under the Manufacturing segment. The ld. DR also fairly admitted the position. Respectfully following the precedent, we direct the AO/TPO to restrict the transfer pricing adjustment to the extent of international transactions under the Manufacturing segment.

15. The other grounds are either consequential or premature.

16. In the result, the appeal is partly allowed.

Order pronounced in the Open Court on 06th December, 2021.

| Sd/- | Sd/- |
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| **(PARTHA SARATHI CHAUDHURY)** | **(R.S.SYAL)** |
| **JUDICIAL MEMBER** | **VICE PRESIDENT** |

पुणे Pune; दिनांक Dated : 06th December, 2021
सतीश

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:**

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The DRP-3, Mumbai-1/ DRP-3, Mumbai-2/ DRP-3, Mumbai-3/
3. The CIT(IT & TP), Pune
4. DR, ITAT, 'C' Bench, Pune
5. गार्ड फाईल / Guard file.

**आदेशानुसार**/ BY ORDER,

**// True Copy //**

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

| | | Date | |
|---|---|---|---|
| 1. | Draft dictated on | 02-12-2021 | Sr.PS |
| 2. | Draft placed before author | 06-12-2021 | Sr.PS |
| 3. | Draft proposed & placed before the second member | | JM |
| 4. | Draft discussed/approved by Second Member. | | JM |
| 5. | Approved Draft comes to the Sr.PS/PS | | Sr.PS |
| 6. | Kept for pronouncement on | | Sr.PS |
| 7. | Date of uploading order | | Sr.PS |
| 8. | File sent to the Bench Clerk | | Sr.PS |
| 9. | Date on which file goes to the Head Clerk | | |
| 10. | Date on which file goes to the A.R. | | |
| 11. | Date of dispatch of Order. | | |

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