

**IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER**

ITA No.129/Bang/2019
Assessment Year :2014-15

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

Assessee by	:	Shri. T. Suryanarayana, Senior Advocate
Revenue by	:	Shri. Mudavathu Harish Chandra Naik, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	21.03.2022
Date of Pronouncement	:	29.03.2022

ORDER

Per N. V. Vasudevan, Vice President :

This is an appeal by the assessee against the final Order of Assessment dated 30.11.2018, under section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (hereinafter called ‘the Act’), passed by ACIT, Circle – 3(1)(1), Bengaluru, in relation to Assessment Year 2014-15.

2. The assessee is a wholly owned subsidiary of Continental Automotive GmbH, Germany. The holding company is one of the world’s leading suppliers to the automotive industry specializing in tyres and break technology, vehicle dynamics control, as well as electronics and sensor systems. There are three segments where the assessee has transactions with it’s Associated Enterprises (AEs) viz., Manufacturing Segment, Trading Segment and Services Segment.

3. In the Manufacturing Segment, the assessee manufactures intermediate products that fall under the product classification automotive components/auto ancillary products like It operates in the following segments:

- Instrument clusters;
- Engine systems;
- Immobilisers and transponders
- Speed sensors,
- Airbag controllers
- Anti-lock braking systems(ABS)
- Fuel supply modules; and
- Temperature gauges, pressure gauges, etc.

4. In the manufacturing segment, the assessee is in charge of conceptualization and designs. It procures equipment for manufacture both fixed and capital equipments. It owns any intellectual Property rights (IPR) for the products developed by them. It receives technology and manufacturing know-how from its Associate Enterprise (AE) for its manufacturing process. It purchases raw materials and components from both third parties and AEs. The nature of raw materials purchased from the AEs and third parties are different. The raw materials procured from the AE are globally sourced by Continental group wherein prices are negotiated globally to get price advantage for bulk purchases. Manufacturing and assembly of products is undertaken by the assessee. The assessee receives guidance from its AEs on the quality control procedures to be followed. The assessee sells finished products to third parties as well as to its AE. Majority of the sales are to OEMs. Continental Group has a Global Key Key Accounts Management (KAM) structure through which it maintains customers relationship with OEMs having global presence which helps the assessee to establish customer relationship with the Indian entities of global OEMs. The assessee sells goods both to independent third parties as well

as to its AEs. For sales to third parties the price is driven by market conditions and for sales to AEs, it is based on agreed pricing policy.

5. In the trading segment the assessee imports finished goods from its AE for its trading/distribution activities. The assessee is responsible for undertaking all the logistic management activities including transportation from ports, custom formalities, ensuring proper warehousing of its finished goods etc. The assessee is responsible for sales and marketing and decides on the marketing strategy, sales and pricing, order processing and outbound logistics and distribution network.

6. Services segment: In the services segment, the Assessee renders application / specific services to its Associated Enterprises (“AEs”) with regard to development of software.

7. During the previous year relevant to the assessment year 2014-15, several international transactions took place between the Assessee and its AEs, including purchase of raw materials for the manufacturing segment, purchase and trading in finished goods of its AE, and the aforesaid provision of SWD services.

8. The Finance Act. 2001 had introduced a legislation with respect to transfer pricing by substituting the erstwhile section 92 of the Act with a new and separate code or sections, namely sections 92 to 92F, with effect from 1st April. 2002. i.e., the Assessment Year 2002- 2003. The salient features of the legislation with respect to transfer pricing, to the extent material for the purpose of deciding the question referred to the special bench, are as follows: -

- Section 92(l) of the Act provides that any income arising from an "international transaction" shall be computed having regard to the arm's length price. The Explanation to the said section provides that allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.
- The term "international transaction" has been defined in section 92B(1) of the Act to mean a transaction between two or more "associated enterprises" either or both of whom are non-residents in the nature of inter alia purchase, sale or lease of intangible property or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises.
- Section 92A of the Act defines the term "associated enterprise" in relation to another enterprise, in a manner where the enterprise directly or indirectly participates in the Management, control or capital of the other enterprise.
- The term "arm's length price" (ALP) has been defined in clause (ii) of section 92F of the Act, to mean a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. Section 92C(1) of the Act provides that the arm's length price in relation to an international.

By virtue of the provisions of section 92CA(1), the Assessing Officer, with the previous approval of the Pr Commissioner / Commissioner is empowered to refer to the Transfer Pricing Officer (TPO) the computation of the arm's length price of an international transaction or specified domestic transaction entered into by an assessee over whom the Assessing Officer exercises jurisdiction. The TPO, after due enquiry and opportunity of being heard, shall by order in writing determine the ALP in relation to the international transaction in accordance with provisions of section 92CA(3) and send a copy of his order to the Assessing Officer (AO) and to the assessee for finalization of assessment order. Section 92C(2) provides that the variation between the ALP and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the ALP.

The AO passes a draft order of assessment against which, the Assessee has a right to file objections before the Dispute Resolution Panel (DRP) u/s.144C of the Act. Under section 144C(5), the Dispute Resolution Panel (DRP) shall issue the directions, as it thinks fit, for the guidance of the AO to enable him to complete the assessment after considering report of TPO. The AO passes a final assessment order on the basis of directions of the DRP.

9. The legislative intent in introducing the new transfer pricing legislation, as available in the Memorandum explaining the provisions in the Finance Bill, 2001, which later on was enacted as the Finance Act, 2001, was as follows.

"The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. With a view to provide a statutory framework which can lead to computation or reasonable fair and equitable profits and tax in India, in the case of such multinational enterprises, new provisions are proposed to be introduced in the Income-tax Act, " ... " [248 ITR st 181].

10. In this appeal we are concerned with two of the International Transactions carried out by the assessee during the previous year, in respect of which additions were made to the total income on account of determination of ALP, which has been challenged by the assessee before the Tribunal, viz.,

- (i) Transfer pricing adjustment ("TP adjustment") of **Rs.117,35,51,190/-** made by the Transfer Pricing Officer ("TPO") in respect of the manufacturing segment of the Assessee pursuant to the DRP directions.
- (ii) TP adjustment of **Rs.25,95,18,911/-** made by the TPO in respect of the software development services ('SWD services' for short) rendered by the Assessee pursuant to the DRP directions.

11. In the course of assessment the Assessing Officer (“AO”) made a reference to the TPO for examination of the arm’s length price of the aforesaid transactions. On such reference, the TPO passed an order dated 30.10.2017 under Section 92CA of the Income-tax Act, 1961 (“the Act”) determining the TP adjustment with respect to manufacturing segment and SWD services segment totaling to Rs.155,70,82,500/-. Initially, a draft assessment order dated 08.12.2017 came to be passed by the AO in which, *inter alia*, the aforesaid TP adjustment was incorporated, apart from the additions made to the income of the assessee on account of disallowance of provision for warranties and annual license fees. Aggrieved, the assessee filed its objections before the DRP which, vide its directions dated 10.01.2018, rejected most of the assessee’s objections insofar as the TP adjustments made by the TPO were concerned. Pursuant to the directions of the DRP, the AO passed the final assessment order dated 30.11.2018 in which the TP adjustment was reworked to Rs. 143,30,70,101/-.

12. Apart from the Transfer Pricing additions, there are some issues that arise out of determination of total income viz., (i) Disallowance of provision for warranty to the extent of **Rs. 3,21,32,433/-**. (ii) Disallowance of annual license fees amounting to **Rs. 28,00,21,116/-**. And (iii) Non-set off of brought forward losses amounting to **Rs. 232,54,55,699/-** available to the assessee. As regards provision for warranty, the DRP directed allowance of the actual expenditure and as regards expenditure incurred towards annual license fees, the disallowance made by the AO in the draft assessment order was upheld.

13. Aggrieved by the final assessment order dated 30.11.2018, the assessee has filed the present appeal before the Tribunal. In this appeal, the following issues arise for consideration in this appeal:

- (i) Transfer pricing adjustment (“TP adjustment”) of **Rs.117,35,51,190/-** made by the Transfer Pricing Officer (“TPO”) in respect of the

manufacturing segment of the Assessee pursuant to the DRP directions.\

- (ii) TP adjustment of **Rs.25,95,18,911/-** made by the TPO in respect of the software development services ('SWD services' for short) rendered by the Assessee pursuant to the DRP directions.
- (iii) Disallowance of provision for warranty to the extent of **Rs. 3,21,32,433/-**.
- (iv) Disallowance of annual license fees amounting to **Rs. 28,00,21,116/-**.
- (v) Non-set off of brought forward losses amounting to **Rs. 232,54,55,699/-** available to the Assessee.

We shall take up for consideration, the issues as listed above for consideration in seriatim.

TRANSFER PRICING ADJUSTMENT IN THE MANUFACTURING SEGMENT:

14. As far as the issue of determination of ALP in the Manufacturing segment are concerned, the facts are that the Assessee filed a Transfer Pricing Study (TP Study) in terms of Sec.92D of the Act justifying the price it received from the AE. The Assessee chose Transactional Net Margin Method (TNMM) – as the Most Appropriate Method for comparing Assessee's profit margin with that of comparable companies. Under this method the comparison is made between the Assessee's the operating/ net margins with that of comparable companies to analyse if the related party transactions have been undertaken on an arm's length basis. Rule 10B(1)(e) of the Income Tax Rules, 1962 (Rules), explains transactional net margin method as a method by which,— (i) the **net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be**

employed by the enterprise or having regard to any other relevant base; (ii) the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base; Report this and (iii) **the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;** (iv) the net profit margin realized by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii); (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

15. In its TP Study, the Assessee in terms of Rule 10B(1)(e) (i) of the Rules, net profit realized by the Assessee was chosen with reference to cost i.e., Operating profit on Operating Cost was chosen as the profit level Indicator (PLI) for comparing Assessee's margin with the comparable companies. The TPO to whom a reference was made for determination of ALP in terms of Sec.92CA accepted the PLI chosen for the purpose of comparison. In terms of Rule 10B(1)(e) of the Rules, the Assessee in its TP Study adjusted the **net profit margin it earned to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market.** In this regard the Assessee reduced from its operating cost three items (i) a sum of Rs.60,80,69,000 towards difference in the capacity utilization by it vis-à-vis the comparable companies; (ii) a sum of Rs.14,85,40,000/- towards

customs duty adjustment and (iii) a sum of Rs. 23,43,61,607/- towards extraordinary expenses on account of Exchange fluctuation. Due to the above adjustment, the net profit margin as computed by the Assessee in its transfer pricing study and the net profit margin as computed by the TPO varied and consequently, the addition to the total income on account of determination of ALP stood enhanced. This is the major dispute between the Assessee and the Revenue as to how to compute the net profit margin. On making the above mentioned adjustments, the Assessee arrived at a margin of 2.38%. as against - 16.78% arrived at by the TPO. Besides the above, the Assessee also disputes, inclusion of certain companies as comparable with the Assessee by the TPO and exclusion of a company chosen by the Assessee as a comparable company in its TP study. Besides the above, the Assessee has also raised a contention that the provisions of Sec.92 of the Act have to be applied only to the proportionate value of international transaction i.e., transaction with the AE and transactions with non AEs should be not considered for the purpose of adjustment u/s.92 of the Act.

16. A comparison of the Assessee's TP study and the manner of determination of ALP by the TPO is given below:

1. Net mark-up on cost earned by the Assessee

As per the TP study:

Operating Income	Rs. 5,17,71,00,000/-
Operating Cost	Rs.5,05,41,30,000/-
Operating Profit (Op. Income – Op. Cost)	Rs. 12,29,70,000/-
Net mark-up (OP/OR)	2.38%

As reflected in the TP Order:

Operating Income	Rs. 5,17,71,00,000/-
Operating Cost	Rs.6,04,57,20,000/-
Operating loss (Op. Income – Op. Cost)	Rs.-86,86,20,000/-
Net mark-up (OP/OR)	-16.78%

2. Comparison of the TP studies done by the Assessee and TPO:

	Assessee	TPO
Methodology adopted	TNMM	TNMM
Profit Level Indicator (PLI)	OP/OR	OP/OR
Database used	PROWESS & CAPITALINE PLUS	PROWESS & Ace-TP
Comparables selected	6	11

3. Filters applied by Assessee in its TP study:

Step	Description
1.	Companies for which data available was for a period prior to 31.03.2012 – rejected
2.	Companies reporting net sales >Rs. 1 crore – selected
3.	Companies reporting average manufacturing income/average net sales>50% - selected
4.	Companies with related party transactions less than 10% of sales – selected
5.	Companies with positive net worth – selected
6.	Companies which were functionally comparable – selected

4. Comparables selected by Assessee and their arithmetic mean:

Sl. No.	Name of the company	Average OP/Sales(in %)
1.	Automotive Stamping Assembly Ltd	1.22
2.	Bharat Gears Ltd	4.78
3.	Hindustan Hardly Spicer Ltd	4.12
4.	JMT Auto Ltd	7.84
5.	Munjal Showa Ltd	5.25
6.	Wheels India Ltd	5.74
Arithmetical Mean		4.82

The TPO accepted 4 companies selected by the Assessee in its TP study viz., Automotive Stamping Assembly Ltd, Bharat Gears Ltd, JMT Auto Ltd and Wheels India Ltd.

5. Comparables selected by TPO and their arithmetic mean:

Sl. No.	Name of the Company	OP/Sales(in %)
1	Rajsriya Automotive Inds. Pvt Ltd	13.07
2	TVS Upasana Ltd	12.13
3	Aspee Springs Ltd	11.15
4	Supreme Treon Pvt Ltd	7.37
5	JMT Auto Ltd	6.46
6	Aditya Auto Products &Engg. (India) Pvt Ltd	5.48
7	Varroc Engineering Pvt Ltd	5.16
8	Leewon Precision Pvt Ltd	4.34
9	Borgwarner Morse TEC Murugappa Pvt Ltd	12.45
10	Maco Pvt Ltd	2.59

11	Vijayashree Autocom Ltd	2.20
AVERAGE MARK-UP		7.49

6. Computation of arm's length price by the TPO and the adjustment made:

A. Arm's Length Mean Mark-up	7.50%
A. Operating cost	Rs. 604,57,20,000
B. Operating Revenues	Rs.517,71,00,000
C. Arm's length Operating profit (7.50% of Rs.517.71 cr)	Rs. 38,82,82,500
D. Arm's length Cost (B-C)	Rs. 478,88,17,500
Shortfall being adjustment u/s. 92CA	Rs. 125,69,02,500

17. 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. It can be seen from the above that the TPO arrived at Rs.38,82,82,500 that the operating profit that the Assessee should have made by applying 7.5% on cost of Rs.517,71,00,000 and after reducing the same from the operating revenue arriving at cost of Rs.478,88,17,500. Since the Assessee's cost was Rs.604,57,20,000 incurred in the manufacturing segment and reduced the Arm's Length margin of 7.50% to arrive at the operating cost of Rs.478,88,17,500 that the Assessee ought to have incurred but since revenue that the Assessee's cost was Rs.604,57,20,000, the difference of Rs.125,69,02,500 (Rs.604,57,20,000 – Rs.478,88,17,500) was added as adjustment consequent to determination of ALP.

18. It is one of the contention of the Assessee before the TPO that the provisions of Sec.92 can be applied only to transactions with AE. In this regard

the Assessee pointed out that in the manufacturing segment, the Assessee is in charge of conceptualization and designs. It procures equipment for manufacture both fixed and capital equipments. It owns any intellectual Property rights (IPR) for the products developed by them. **It receives technology and manufacturing know-how from it's Associate Enterprise (AE) for its manufacturing process. It purchases raw materials and components from both third parties and AEs.** The nature of raw materials purchased from the AEs and third parties are different. The raw materials procured from the AE are globally sourced by Continental group wherein prices are negotiated globally to get price advantage for bulk purchases. Manufacturing and assembly of products is undertaken by the Assessee. **The Assessee receives guidance from its AEs on the quality control procedures to be followed. The Assessee sells finished products to third parties as well as to its AE. Majority of the sales are to OEMs. Continental Group has a Global Key Key Accounts Management (KAM) structure through which it maintains customers relationship with OEMs having global presence which helps the Assessee to establish customer relationship with the Indian entities of global OEMs.** The Assessee sells goods both to independent third parties as well as to its AEs. It can be seen from the aforesaid sentences in bold and underlined that the component of AE transaction in the Assessee in the manufacturing segment is only in respect of purchase of raw materials, getting technical know how for which the Assessee pays royalty, getting services specific and getting benefit of shared services and obtaining production support services. The ALP has to be determined only with reference to that proportion of the transaction in which the AE's are involved and the entire manufacturing segment cost base cannot be the subject matter of determination of ALP. The figures given by the Assessee in this regard were as follows:

18A. The percentage of international transactions to the total operating cost would be at 22.49%, as demonstrated below and therefore, the adjustment if any should be restricted to such percentage alone.

Particulars	As per TP order
Transfer pricing Adjustment	125,69,02,500 (which was reduced by Rs.27,63,35,693 being the payment of royalty by the Assessee to its AE to avoid double taxation) and the final figure of addition was Rs.8,05,66,807)
Total operating cost	6,04,57,20,000
Purchase of raw materials	76,47,58,690
Payment of technical know-how	14,89,99,314
Payment of royalty	27,63,35,693
Payment of services availed	17,07,549
Payment of shared services availed	13,40,30,481
Payment for production support services availed	3,37,97,500
Total value of international transactions in the manufacturing segment	1,35,96,29,227
Percentage of international transactions to total operating cost	22.49%
Revised transfer pricing adjustment restricted to percentage of international transactions	26,39,21,336
Relief from original adjustment	90,96,29,854

The above plea was not accepted by the TPO. No specific discussion is there on this issue in the order of the TPO.

18B. Aggrieved by the aforesaid determination of ALP by the TPO in the draft order of Assessment by the AO, the Assessee filed objections before the Dispute Resolution Panel (DRP) u/s.144C of the Act. The DRP issued directions, whereby it upheld the contentions of the TPO, subject to the following directions:

- (i) Company Hindustan Hardy Spicer Limited to be included in the list of comparable companies.
- (ii) The TPO to examine the claim of the Assessee that Supreme Treon Private Limited and Borg Warner Morse TEC Murugappa Pvt Ltd fail the RPT filter.
- (iii) Re-computation of margins for Vijayashree Automotive Ltd
- (iv) The rectification petition filed by the Assessee to be considered on merits.

19. The AO passed the impugned final assessment order in line with the directions of the DRP in which the TP adjustment was reworked to Rs. 117,35,51,190/- in accordance with the order dated 22.11.2018 passed by the TPO.

20. The grounds that were pressed for adjudication regarding determination of ALP in the Manufacturing segment, are as follows:

- (i) That the DRP erred in not granting an adjustment for underutilisation of capacity **(Ground No. 9)**.
- (ii) That the DRP erred in not granting adjustment towards custom duty expenses. **(Ground No. 10)**.
- (iii) That the DRP erred in not granting adjustment towards exchange fluctuations. **(Ground No. 11)**
- (iv) The DRP erred in not granting depreciation adjustment **(Ground No. 12)**
- (v) That the DRP erred in upholding the inclusion of Rajsriya Automotive Inds. Pvt Ltd., TVS Upasana Ltd., Aspee Springs Ltd., Supreme Treon Pvt Ltd., Leewon Precision Pvt Ltd., Borgwarner Morse TEC

Murugappa Pvt Ltd., and Maco Pvt Ltd. as comparable to the Assessee(**Ground No. 13**).

- (vi) That the DRP erred in not including Munjal Showa Ltd as a comparable to the Assessee. (**Ground No. 15**)
- (vii) That in any event, the DRP ought to have appreciated that adjustment if any, should be restricted to the proportionate value of the international transactions of the Assessee. (**Ground no. 16**)

21. As far as Ground No.9 raised by the Assessee is concerned, the same is in relation to the action of the revenue authorities in not allowing adjustment to the operating costs of the Assessee by reducing the cost on account of underutilization of capacity. It was 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 2013-14 to manufacture the products. The Assessee operated at 44.76% of its installed capacity whereas the comparable companies chosen by the Assessee operated at an average of 71.94%.It is evident from the capacity utilization of 44.76% 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.

22. The TPO did not grant an adjustment for capacity underutilisation on the ground 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. According to the AO in terms of Rule 10B(1)(e) clause (iii) the net profit margin arising in comparable uncontrolled transactions has only to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market and the Assessee's margin can never be adjusted. The TPO held that the data considered by the Assessee to compute the adjustment pertained only to 3 out of 7 companies and that the capacity utilisation for FY 2010 to 2014 alone were considered. 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. Normally, utilization of capacity is significantly different between the Assessee and comparable companies in the initial stage of operation. However, the Assessee is not in the initial stage of operation.

23. The DRP while upholding the order of the TPO relied on decision of ITAT Delhi in the case of Haworth India Pvt. Ltd ITA No.5341/Del/2010 ("Haworth India") and also on various other rulings to hold that the Assessee did not produce any evidence for assuming the capacity utilization of comparable companies and whatever data relied upon by the assessee for seeking the adjustment was either unreliable or incorrect.

24. Before the Tribunal, it was submitted by the learned counsel for the Assessee that 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 the rules 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 was 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, 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. Income-tax Officer* reported in [2017] 79 taxmann.com 303 (Mumbai - Trib.). This Hon'ble 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)

25. It was submitted that in the case of Haworth India, this Hon'ble 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, the Assessee 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.

26. The Assessee has also relied on the following judicial precedents in this regard:

- Global Vantage 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)*

27. Without prejudice to the above contentions on producing relevant data wherever practically possible by the Assessee, since the Respondent is of the opinion that the data provided by the Assessee is unreasonable and inaccurate, the Respondent can exercise his power under Section 133(6) 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 Hon'ble Tribunal in the case of IKA India Private Limited v. ACIT reported in [2019] 101 taxmann.com 276 (Bangalore).

28. 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 power to call for details from the comparable companies, such course may be adopted and the adjustment be granted.

29. The learned DR relied on the order of the DRP.

30. Both the parties agreed that identical issue was decided by this Tribunal in Assessee's own case for AY 2012-13 in IT (TP) A No.713/Bang/2017 and this Tribunal by its order dated 24.11.2021 remanded to issue to the TPO with the following observations:

"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 AOITPO 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."

31. Following the aforesaid order, we remand the issue to the TPO/AO for consideration afresh on the lines indicated in the decision of the Tribunal for AY 2012-13, after affording the Assessee opportunity of being heard.

32. As far as Grd.No.10 raised by the Assessee is concerned, the same is in relation to adjustment to the cost base of the Assessee on account of custom duty. 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 was 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 viz-a-viz 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 DRP upheld denial of such adjustment holding that price increase on account of imported raw material is also to correspondingly take place. It was submitted that the import of raw materials is not a commercial decision but on the other hand is necessitated for reasons beyond the Assessee's i.e., by lack of capacity to localize the procurement which the Assessee is still in the process of doing. Reliance was placed on the following decisions in support of the Assessee'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)

33. In this connection, the Assessee's import consumption vis-à-vis the imports of comparable companies selected by the learned TPO and the Assessee are as below for the FY 2013-14:

TPO's comparables	Import/Total purchases	Import/Sales
Rajsriya Automotive Inds. Pvt. Ltd.	0.06%	0.03%
TVS Upasana Ltd.	1.24%	0.48%
Aspee Springs Ltd.	4.46%	2.23%
Supreme Treon Pvt. Ltd	7.47%	3.84%
JMT Auto Ltd	6.21%	3.26%
Aditya Auto Products & Engg. (India) Pvt Ltd.	19.75%	10.25%
Varroc Engineering Pvt Ltd.	7.56%	4.80%
Leewon Precision Pvt. Ltd.	2.02%	1.05%
Borgwarner Morse TEC Murugappa Pvt. Ltd.	0%	0%
Maco Pvt. Ltd	64.88%	40.02%
Vijayshree Autocom Ltd.	0%	0%
Average Import Consumption	10.33%	6.00%

34. The learned DR while relying on the order of the DRP submitted that arithmetic mean of the margins of comparables under TNMM takes care of such differences and reiterated the stand of the TPO for refusing such adjustment.

35. Both the parties agreed that identical issue was decided by this Tribunal in Assessee's own case for AY 2012-13 in IT (TP) A No.713/Bang/2017 and this Tribunal by its order dated 24.11.2021 remanded to issue to the TPO with the following observations:

“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, Id. 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. Assn. CIT [20161 73 taxmanri.corn 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 SkodaAuto India p Ltd 122 TT.I 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. 17-25 additional argument was not available before 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 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 1013 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 direction."

36. Following the aforesaid order, we remand the issue to the TPO/AO for consideration afresh on the lines indicated in the decision of the Tribunal for AY 2012-13, after affording the Assessee opportunity of being heard.

37. The next grievance projected by the Assessee in Grd.No.11 is with regard to adjustment to operating cost on account of foreign exchange fluctuation. In this regard 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. Accordingly, it made an adjustment to its operating costs by reducing an amount of Rs. 23.44 crores therefrom. The TPO disallowed such

adjustment and the DRP upheld the same. The observations of the TPO/DRP and the Assessee's submission as regards the same was as under:

TPO/DRP observations	Assessee's submissions
➤ The Assessee has already included Foreign exchange gain/loss in its income statements and hence, it is not appropriate to adjust it for transfer pricing analysis. ➤ The Assessee imports components and raw materials in Euro, US dollars and JPY but sells them in Indian Rupees and does bear the risk of foreign exchange transaction. The Assessee's loss is mainly due to higher import cost of raw materials ➤ While the Assessee's submission talks about review and revision of rate contract with its unrelated customers, it does not talk about review/revision with AEs and the Assessee should have revised the same considering the foreign exchange market and depreciation of Indian rupee. ➤ Such adjustments are to be conducted not to the Assessee's profit but to comparable companies' profit. The Assessee failed to demonstrate that there exists such losses in the case of comparable companies selected by the Assessee.	➤ Forex 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). Hence 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 Assessee bears the forex risk and hence it has incurred high forex fluctuation loss which is embedded in the raw material import cost. The fact that forex risk is borne by the Assessee cannot be a valid reason for rejecting the adjustment claimed by it. ➤ As the Assessee bears the forex risk, any adverse fluctuation on foreign currency would be borne only by the Assessee. The AE has nothing to do whatsoever with this Indian leg of the transaction. Such fluctuation being due to external factors, there would be no reason for the AE to revise its rate contracts where components have been sold broadly at consistent prices (in some cases

	even at lower prices). It is to be noted that there has been an extraordinary and significant depreciation in INR over Yen/USD during the year when compared to the previous years. ➤ From a harmonious reading of the relevant provisions of Indian TP Regulations, 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 the relevant rules 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. 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 analyzed or examined. In certain cases there may arise some difficulty when the reliable data for particular cost or profit may not be available, therefore, a reasonable accurate adjustment in
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	the hands of the tested party may throw fruitful result. The Assessee's profitability is significantly impacted as a result of forex fluctuation where it had import content of around 73% unlike comparable companies with significantly lower portion of import of materials (4%). Hence such losses would not exist in the case of comparable companies.
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38. 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-à-vis INR for a 10 year period from FY 2008-09 to FY 2017-18 was as under.

Financial year	Euro to INR rate	% depreciation/ appreciation	Average depreciation/ appreciation
2008-09	65.45		2.03%
2009-10	67.37	2.94%	
2010-11	60.06	(10.85%)	
2011-12	66.29	10.37%	
2012-13	70.03	5.64%	
2013-14	80.66	15.18%	15.18%
2014-15	78.15	(3.11%)	(1.68%)
2015-16	71.78	(8.15%)	
2016-17	73.77	2.77%	

2017-18	75.08	1.77%	
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Financial year	USD to INR rate	% depreciation/ appreciation	Average depreciation/ appreciation
2008-09	46.48		4.11%
2009-10	47.67	2.57%	
2010-11	45.51	(4.54%)	
2011-12	47.86	5.16%	
2012-13	54.19	13.23%	
2013-14	60.33	11.34%	11.34%
2014-15	61.03	1.15%	1.75%
2015-16	65.36	7.10%	
2016-17	67.12	2.68%	
2017-18	64.48	(3.94%)	

39. It was submitted that during the FY 2013-14, 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.

40. The learned counsel for Assessee highlighted the following points that necessitate the adjustment to the Assessee's cost on account of foreign exchange fluctuations:

1. Higher Import Content of the Assessee vis-à-vis comparable companies:

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 learned TPO. It was 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 learned TPO and the Assessee are as below for the FY 2013-14:

TPO's comparables	Import/Total purchases	Import/Sales
Rajsriya Automotive Inds. Pvt. Ltd.	0.06%	0.03%
TVS Upasana Ltd.	1.24%	0.48%
Aspee Springs Ltd.	4.46%	2.23%
Supreme Treon Pvt. Ltd	7.47%	3.84%
JMT Auto Ltd	6.21%	3.26%
Aditya Auto Products & Engg. (India) Pvt Ltd.	19.75%	10.25%
Varroc Engineering Pvt Ltd.	7.56%	4.80%
Leewon Precision Pvt. Ltd.	2.02%	1.05%
Borgwarner Morse TEC Murugappa Pvt. Ltd.	0%	0%
Maco Pvt. Ltd	64.88%	40.02%
Vijayshree Autocom Ltd.	0%	0%
Average Import Consumption	10.33%	6.00%

Assessee's comparables	Import/Total purchases	Import/Sales
Automotive Stampings & Assemblies Limited	0.93%	0.73%
Bharat Gears Limited	0.85%	0.46%
Hindustan Hardy Spicer Limited	0.52%	0.29%
J M T Auto Limited	6.21%	3.26%
Munjal Showa Limited	8.03%	6.37%
Wheels India Limited	5.34%	4.15%
Average Import Consumption	3.65%	2.54%

41. It was pointed out that the TPO's and Assessee's comparable companies had an average import purchases to total purchases ratio of 10.33% and 3.65% respectively against the Assessee's ratio of 72.60%. As a result, the Assessee is more prone to the impact of foreign exchange fluctuation.

2. Pre-agreed contracts with customers prevents passing the additional costs as a result of forex impact

42. It was submitted that the Assessee enters into rate contracts with its customers and the same is fixed for a period of time. It is to be observed that INR vs various currency was depreciating in the relevant year. Subsequent to the commitment of sale price to the customers, there was significant negative movement of rupees to Euro, USD and other currencies as the rupee depreciated substantially. The Assessee could not negotiate for an increase in the selling price to customers, and thus it had to bear any increase in the cost of manufacture. The Assessee had to oblige with the terms of contract and supply the products at the committed rate for the entire year even though there was significant increase in the cost of the products by virtue of higher cost of the components being imported vis-à-vis comparable companies selected by the Assessee who had either no imports or less significant imports. Further, it is also to be noted that the Assessee may not be able to pass on the entire impact of

foreign exchange to customers as it operates in the competitive environment of the automobile industry. On an analysis carried out to determine the change in selling price per unit of the products to the customer across years, it was also observed that there was no significant increase in the selling price of the Assessee to its customers in majority of products. From the same it is evident that the Assessee is unable to negotiate for an increase in sale prices to account for the impact of forex fluctuations etc.

3. Impact of forex fluctuations on the Assessee

43. In this regard it was submitted that the imports are made in foreign currency by the Assessee. While accounting, the same is converted to INR based on the foreign exchange rates communicated by the Continental Group. It was submitted that there is no price increase by group affiliates/unrelated foreign suppliers in majority of the components supplied as compared to the previous year. To demonstrate the fact that the increase in material costs are as a result of depreciation in currency and not because of price increase, the Assessee applied the following methodology:

- Step 1: Identify the total component wise invoice value in foreign currency for the parts imported by the Assessee in FY 2013-14;
- Step 2: Determine the corresponding quantity against such invoices imported;
- Step 3: Determine the per unit price in foreign currency (Step 1 divided by Step 2);
- Step 4: Carry out the same methodology for FY 2012-13 (previous year) and determine the per unit price in foreign currency; and
- Step 5: Compare the price (for the same components imported) so arrived at the Step 3 vis-à-vis Step 4 and identify the change in such price.

44. The above exercise was carried out for FY 2013-14 and it was observed that majority of the components imported by the Assessee did not result in higher per unit price when compared with the previous year. In fact, in majority of cases, the per unit price has only declined/stayed constant. This demonstrates that the foreign exchange rate fluctuation is the lone factor that has significantly contributed towards higher import cost of the Assessee in turn affecting its profitability. Out of the total imports, INR 2,009.62 million pertained to import of components that were common for both FY 2013-14 and FY 2012-13. Out of the same it was observed that:

Particulars	Value (INR millions)	Percentage
Cases where purchase price has reduced/remained constant	1,688.74	84%
Cases where purchase price has increased	320.88	16%
Total	2,009.62	100%

45. It was submitted that from the above, it is evident that in 84% of the cases, the per unit prices of the common components have reduced/remained constant from the FY 2012-13 to FY 2013-14. Hence any increase in import costs could only be attributed to adverse forex fluctuation. The detailed workings are provided aspart of the additional evidence submitted before this Hon'ble Tribunal vide application of the Assessee dated 22.3.3019. The documents sought to be submitted in this regard are as follows:

1. Tabulation of appreciation/depreciation in exchange rate
2. Exchange rates prevailing as per Reserve Bank of India from the years 2008 to 2018
3. Comparison of Rates of import purchases for FY 2013-14 and FY 2012-13
4. Analysis of import prices across FY 2013-14 and FY 2012-13
5. Invoice listing for FY 2013-14

6. Invoice listing for FY 2012-13

7. Invoices submitted for FY2013-14 and FY2012-13

46. It was submitted that the Assessee bears the forex risk, any adverse fluctuation on foreign currency would be borne only by the Assessee. The AE has nothing to do whatsoever with the Indian leg of the transaction. Such fluctuation being due to external factors, there would be no reason for the AE to revise its rate contracts where components have been sold at consistent prices. Further the proportion of imports from AEs as against total imports is only approximately 24% and the majority of imports (76%) pertains to unrelated suppliers. It is evident from the above that the Assessee has incurred substantial cost due to fluctuation in foreign exchange rates and the Assessee has huge amount of imports when compared to the comparable companies. Therefore, the Assessee's claim for an adjustment of INR 23.44 crores on account of adverse fluctuation in foreign exchange during the year in order to arrive at the appropriate comparability ought to be allowed.

47. The learned counsel for Assessee placed reliance on the judgment of this Hon'ble Tribunal (Delhi Bench) in *Honda Trading Corpn. India Private Limited v. ACIT* reported in [2013] 33 taxmann.com 21 (Delhi - Trib.), *Gates Unitta India Company (P) Ltd* reported in [2017] 84 taxmann.com 69 (Chennai - Trib.), *Pangea3 & Legal Database Systems Pvt Ltd v. Income-tax Officer* reported in [2017] 79 taxmann.com 303 (Mumbai - Trib.) in support of its contentions.

48. The learned DR relied on the order of the DRP on this issue.

49. Both the parties agreed that identical issue was decided by this Tribunal in Assessee's own case for AY 2012-13 in IT (TP) A No.713/Bang/2017 and

this Tribunal by its order dated 24.11.2021 remanded to issue to the TPO with the following observations:

“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 Moronic India Automotive (P.) Ltd. (supra) in for assessment year 2009-10 vide order dated 17.08.2016 wherein held that:—

"g. We find force in the argument of the Id. 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. ALIT in ITA No.5297/De¹/2011 for the assessment year 2007-08 and DHL Express (India) Put. Ltd. v. ALIT 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."

50. Following the aforesaid order, we remand the issue to the TPO/AO for consideration afresh on the lines indicated in the decision of the Tribunal for AY 2012-13, after affording the Assessee opportunity of being heard.

51. As far as Grd.No.12 raised by the Assessee is concerned, the same is in relation to the plea of the Assessee for grant of depreciation adjustment in computing operating cost of the Assessee. In this regard it was submitted that the Assessee has invested huge capital in purchasing fixed assets which are an integral part of the manufacturing operations. The Assessee incurred high depreciation cost to sales of 11.55%. As it did not manufacture the products as estimated, the Assessee could not recover its fixed costs and incurred losses. The Assessee, without prejudice to the above arguments, has claimed adjustment to neutralize the difference between its depreciation cost and the significantly lower depreciation costs of the comparable companies. The DRP in its directions held that depreciation adjustment is related to the capacity adjustment and can be granted only in the initial years and that such high investments are observed not only for the Assessee but in the entire industry. It was further held that since the average of comparable margins are taken and a margin of 3% is also allowed, the same would take care of adjustments that cannot be carried out.

52. It was submitted that the DRP directed grant of depreciation adjustment vis-à-vis differences in depreciation cost in the Assessee's own case in AY 2012-13, consequent to which the transfer pricing adjustment in the manufacturing segment for the AY 12-13 was reduced by INR 24.23 crores. Since there has been no change in facts from AY 12-13, the Assessee prays that the same be granted in the AY 14-15 as well.

53. Without prejudice to the arguments below on the comparability of companies chosen by the TPO, if depreciation adjustment is granted, the arithmetic mean of the margin of comparable companies adopted by the learned TPO would be -0.14%. The learned counsel for Assessee relied on the following judicial precedents:

- CIT v. Petro Araldite Pvt. Ltd reported in *[2018] 93 taxmann.com 438 (Bombay)*
- SchefenackerMotherson Ltd vs. ITO reported in *[2009] 123 TTJ 509 (Delhi)*
- CIT vs. Rakhra Technologies Private Limited reported in *[2011] 15 taxmann.com 266 (Punjab & Haryana)*
- Amdocs Business Services (P.) Ltd. v. DCIT reported in *[2012] 26 taxmann.com 120 (Pune)*
- ACIT v. Fiat India (P.) Ltd. [IT Appeal No.1848 (Mum) of 2009, dated 30-04-2010]
- Brintons Carpets Asia (P) Ltd v. DCIT reported in *[2011] 12 taxmann.com 148 (Pune)*

54. We are of the view that the adjustment on account of underutilization of capacity will sufficiently take care of the depreciation adjustment and no separate adjustment is required to be granted on account of difference in quantum of depreciation vis-a-vis difference in capacity utilization and cost of fixed assets. We hold and direct accordingly. The decisions cited are all in the context of capacity utilization and cannot be extended to grant of depreciation adjustment.

55. Grounds No.13 and 15 raised by the Assessee are with regard to choice of comparable companies chosen by the TPO and confirmed by the DRP. In ground no. 13, the Assessee is seeking the exclusion of Rajsriya Automotive Industries. Pvt Ltd., TVS Upasana Ltd., Aspee Springs Ltd., Supreme Treon Pvt Ltd., Leewon Precision Pvt Ltd., Borgwarner Morse TEC Murugappa Pvt Ltd., and Maco Pvt Ltd. In ground no. 15, the Assessee is seeking inclusion of Munjal Showa Ltd. as a comparable. We shall deal with comparability of each of these companies.

a) Rajsriya Automotive Industries. Pvt Ltd: (“Rajsriya”)

56. It is the claim of the Assessee that this company is functionally dissimilar to the Assessee. It is the contention of the Assessee that though Rajsriya is primarily involved in the manufacture of part and accessories for two-wheelers, the components manufactured by Rajsriya can be categorised as mechanical in nature whereas the Assessee is engaged in the manufacture of electrical components like instruments clusters, engine systems, speed sensors, airbag controllers, anti-lock braking system etc. It was also the contention of the Assessee that this company possesses/owns intangibles and therefore cannot be compared with the Assessee who does not own such intangibles. It was contended that the DRP has erred in holding presence of intangibles is not a determinative factor in selecting comparables. It is submitted that the presence of intangibles evidences that Rajsriya preforms product design and development function which makes the company incomparable to that of the Assessee as in the Assessee’s case, the AE is responsible for the product design and development. The Assessee does not own any intangibles. Hence, the same company ought to be excluded from the final list of comparables. The learned DR relied on the order of the DRP which held that broad comparability as part of automotible components was good enough and the conclusion that presence of intangibles by itself is not sufficient to disregard comparability when otherwise there is functional similarity.

57. Rule 10B(2) of the Rules provides the criteria for considering an international transaction undertaken by an Assessee as comparable with an uncontrolled transaction and it lays down as follows:

“Rule 10B(2) For the purposes of sub-rule (1), the comparability of an international transaction [*or a specified domestic transaction*] with an uncontrolled transaction shall be judged with reference to the following, namely:—

- (a) the specific characteristics of the property transferred or services provided in either transaction;
 - (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
 - (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
 - (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.
- (3) An uncontrolled transaction shall be comparable to an international transaction [*or a specified domestic transaction*] if—
- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
 - (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.”

58. In terms of Rule 10B(2)(a) of the rules specific characteristics of property transferred or services provided in either transaction is a relevant criteria. It may be true that broadly the Assessee and the comparable Rajsriya can be said to be in automotive component manufacturing. However, the specific characteristics of the property manufactured by the Assessee is electrical/electronics parts whereas the comparable company Rajsriya is manufacture of automotive components. Therefore there is a difference in the specific characteristics of the property manufactured. So also in terms of Rule 10B(2)(b) of the Rules, presence of intangible as an Asset employed would be a relevant criteria to choose comparable. That being the case, we are of the view that if on a narrower search, if sufficient number of comparable companies are available in the automobile electrical/electronics component, then it would be

just and proper to disregard companies who manufacture automotive components. We hold and direct accordingly.

b) TVS Upasana Ltd: (“TVS”)

59. The plea of the Assessee for exclusion of TVS is almost identical to the plea for rejection of Rajsriya as a comparable. It is the plea of the Assessee that TVS is functionally not comparable to the Assessee as it is engaged in the business of manufacturing spokes and nipples for all the major OEM’s in India. These automotive components are less complex and are mechanical in nature as compared to the electric components manufactured by the Assessee. The Assessee is into the manufacture of electrical components like instrument clusters, engine systems, speed sensors, airbag controllers, anti-lock braking system etc for the automobile industry. It is the further plea of the Assessee that TVS is also engaged in manufacture of various products and operates in different segments. Moreover, raw material consumption ratio on sales of TVS and the Assessee are widely variant. The proportion of raw materials consumed by the Assessee (76%) exceeds 2 times that of TVS.

Particulars	TV Upasana Ltd Amt (in Rs)	Assessee Amt (in Rs)
Raw material cost	33,50,12,898	394,68,84,336
Sales	91,47,45,212	517,71,01,220
Raw material cost/Sales	37%	76%

It was also pleaded that TVS fails the RPT filter of 15% consistently applied by the Tribunal. Therefore, the said company cannot be considered as a comparable and ought to be excluded from the final list of comparables.

60. The learned DR relied on the order of the DRP and the submissions were identical to the choice of comparable Rajsriya.

61. After giving a careful consideration to the rival contentions, we find that the reason that the Assessee was in electrical/electronic components manufacture and TVS is in manufacture of automotive/mechanical components in the automobile industry is a difference in the characteristics of the property which is a relevant criteria for choosing comparable companies. On this aspect whatever conclusions we drawn in respect of the comparable Rajsriya would be equally applicable to this comparable company also. In respect of the Related Party Transaction (RPT), the range of related party transaction would vary between 15% and 25% depending on the availability of comparable companies. If more companies are available for comparability then the percentage of RPT can be restricted to 15% and in cases where such comparable companies are not available then the range can go upto 25% to rope in more comparable companies. The fact that raw material consumption is more in the case of the Assessee does not seem to fit into any of the criteria for deciding comparability in terms of Rule 10B(2) of the Rules.

c) Aspee Springs Ltd: (Aspee)

62. The plea of the Assessee for exclusion of this company is on the ground that this company is functionally dissimilar to the Assessee. Aspee is engaged in the business of manufacturing Washers, Circlips, Bushes, Retaining Rings, Clips and other similar automotive parts. These auto components are less complex and are mechanical in nature as compared to that of the Assessee which manufactures electrical components. Also, Aspee performs research and development activities and therefore, this company is not functionally comparable to the Assessee. It was submitted that the DRP has erred in holding

that R&D activities are not relevant in selection of comparables as the same will exist in many companies. The DRP has failed to consider that Aspee has spent an amount of Rs. 40,00,000 towards development of a product which will have a material impact on the financials of the company. Aspee can be characterized as a full-fledged manufacturer while the Assessee is only a licensed manufacturer assuming normal risks and not engaged in R&D activities. The company is also in possession of intangible assets generated during the course of its operations. The proportion of raw materials consumed by the Assessee (76%) exceeds 1.5 times that of the comparable company. The relevant details as extracted from the annual reports are provided below.

Particulars	Amt (Rs.)
Raw material cost	14,55,03,466
Sales	30,61,07,713
Raw material cost/Sales	48%

From the above, it is evident that Aspee operates on a different business model from that of the Assessee and hence is functionally non-comparable. Therefore, the said company ought to be excluded from the final list of comparables.

63. The learned DR relied on the order of the DRP.

64. In so far as the contention regarding the dissimilarity in the characteristics of the property and presence of R & D activities the conclusions while dealing with Rajsriya will apply to this company also. As far as the difference in own consumption of raw material and different business model, we are of the view that the conclusions while dealing with the comparable TVS will equally apply to this comparable also. We hold and direct accordingly.

d) Supreme Treon Pvt. Ltd. ('Supreme') (formerly Supreme– Treves Private Limited)

65. As far as the objection of the Assessee for exclusion of this company is concerned, it has been reiterated that Supreme is a supplier of Automotive Interior Trims and NVH components (door panels, acoustic and thermal floor insulation, carpets and textile floor coverings). Its product range includes:

- Interior components-trim and acoustics
- Exterior components-acoustic and thermal insulation

These auto components can be categorised as mechanical or acoustic in nature. The Assessee on the other hand is engaged in the manufacture of electrical components like instrument clusters, engine systems, speed sensors, airbag controllers, anti-lock braking system etc for the automobile industry. Hence the products of Supreme cannot be compared with that of the Assessee. Since the products manufactured by Supreme are completely different from that of the Assessee, the company is functionally non-comparable and ought to be rejected. It was further submitted that the company fails the RPT filter of 25% applied by the TPO. The RPT workings as extracted from the annual report are provided below:

Particulars	Amt (Rs.)
Related party transactions	119,35,66,404
Sales	424,62,83,702
RPT/Sales	28.11%

It was submitted that while the DRP directed the RPT filter to be reapplied by the TPO, the same was inappropriately applied by the latter and the company

was included in the final list of comparable companies. The learned DR relied on the order of the DRP.

66. In so far as the contention regarding the dissimilarity in the characteristics of the property is concerned, the conclusions while dealing with Rajsriya will apply to this company also. As far as the quantum of RPT is concerned, it would be appropriate to direct the TPO/AO to consider the plea of the Assessee that the RPT percentage is more than 25% for this comparable company.

e) Borgwarner Morse TEC Murugappa Pvt Ltd. ('Borgwarner')

67. As far as exclusion of this company is concerned, the submission of the Assessee was that Borgwarner is primarily engaged in the manufacture of bearings, gears etc. These auto components can be categorised as mechanical in nature. The Assessee on the other hand is engaged in the manufacture of more complex electrical components like instrument clusters, engine systems, speed sensors, airbag controllers, anti-lock braking system etc for the automobile industry. Hence the products of Borgwarner cannot be compared with that of the Assessee. It was also submitted that the company fails the RPT filter of 25% applied by the TPO. The RPT workings as extracted from the annual report are provided below:

Particulars	Amt (Rs.)
Related party transactions	33,14,12,001
Sales	129,10,14,168
RPT/Sales	25.67%

It was submitted that while the DRP directed the RPT filter to be reapplied by the TPO, the same was inappropriately applied by the latter and the company was included in the final list of comparable companies. The Assessee also submits that the raw material consumption ratio on sales of Borgwarner and the

Assessee are widely variant. The relevant details as extracted from the annual reports are provided below.

Particulars	Amt (Rs.)
Raw material cost	47,46,47,085
Sales	99,66,28,898
Raw material cost/Sales	48%

The proportion of raw materials consumed by the Assessee (76%) exceeds 1.5 times that of the comparable company. From the above, it is evident that Borgwarner operates on a different business model from that of the Assessee and hence is functionally non-comparable. The learned DR relied on the order of the DRP.

68. In so far as the contention regarding the dissimilarity in the characteristics of the property the conclusions while dealing with Rajsriya will apply to this company also. As far as the difference in own consumption of raw material and different business model, we are of the view that the conclusions while dealing with the comparable TVS will equally apply to this comparable also. We hold and direct accordingly. As far as the quantum of RPT is concerned, it would be appropriate to direct the TPO/AO to consider the plea of the Assessee that the RPT percentage is more than 25% for this comparable company. We hold direct accordingly.

f) Munjal Showa Ltd: (Munjal)

69. As far as comparability of this company is concerned, it was submitted that the said company is functionally similar to the Assessee and is engaged in the in the same industry and manufactures similar auto components as that of the Assessee. Therefore, the said company ought to be included in the final list of comparables. The learned DR relied on the order of the DRP.

70. After considering the rival submissions, we find that the DRP has not gone into the comparability of this company but has proceeded under the mistaken belief that this company was not part of the search matrix before the TPO. This was a comparable chosen by the Assessee and rejected by the TPO and it was the plea of the Assessee that this company is comparable functionally. We are therefore of the view that interest of justice would be met, if the TPO/AO is directed to consider comparability of this company afresh.

71. In ground No.16, the Assessee has contended that the adjustment, if any should be restricted to the proportionate value of the international transactions of the Assessee. In this regard it was pointed out by the Assessee that the adjustment (if any) should be restricted only to the international transaction of the Assessee 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 Hon'ble Tribunal in support of the Assessee. The Assessee submits 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 was placed on the following decisions in support of the above contention of the Assessee:

- 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.)

72. It was submitted that the percentage of international transactions to the total operating cost would be at 22.49%, as demonstrated below and therefore, the adjustment if any should be restricted to such percentage alone.

We have already given these figures in the earlier part of this order but for the sake of ready reference, we give below the details of percentage of international transaction in the manufacturing segment, which is as follows:

Particulars	As per TP order
Transfer pricing Adjustment	11,73,55,1190
Total operating cost	6,04,57,20,000
Purchase of raw materials	76,47,58,690
Payment of technical know-how	14,89,99,314
Payment of royalty	27,63,35,693
Payment of services availed	17,07,549
Payment of shared services availed	13,40,30,481
Payment for production support services availed	3,37,97,500
Total value of international transactions in the manufacturing segment	1,35,96,29,227
Percentage of international transactions to total operating cost	22.49%
Revised transfer pricing adjustment restricted to percentage of international transactions	26,39,21,336
Relief from original adjustment	90,96,29,854

It was submitted that the transfer pricing adjustment (if any) should be restricted to the international transaction of the Assessee. The learned DR relied on the order of the DRP.

73. In this regard, we find that identical issue has been decided by the Tribunal in the case of Ika India Pvt. Ltd., (surpa) and the Tribunal held as follows:

“44. Section 92(1) of the Act provides as under:-

"Any income arising from an international transaction shall be computed having regard to the arm's length price".

45. Section 92B defines the term "international transaction" to mean "a transaction between two or more associated enterprises".

46. A conjoint reading of section 92 with section 92B clearly brings out that computation of income at ALP is permissible only in respect of international transaction, which, in turn, means a transaction between two or more associated enterprises. Similar position has been reiterated in the machinery provision contained in section 92C dealing with the manner of computation of ALP. Sub-section (1) of section 92C stipulates that:-

"The arm's length price in relation to an international transaction shall be determined by any of the following methods.....".

47. It is the plea of the assessee that addition by way of transfer pricing adjustment is mandated only in respect of transactions between two or more AEs. The profit from comparable transactions of the assessee with non-AEs is one of the subtle and most reliable modes for determining ALP of the international transactions. The Act does not contemplate an addition by way of TP adjustment in respect of transaction with non-AEs.

48. The TPO determined addition to total income, consequent to determination of ALP only in relation to international transaction i.e., transactions with AE in the export of finished goods segment by considering the value of international transaction at Rs.3,31,50,982 which is the value of export of finished goods by the assessee to its AE and not on the total sales in the finished goods segment of Rs.39,19,74,355 (vide para 8.3 of the TPO's order).

49. The Hon'ble Bombay High Court in the case of Phoenix Mecano (India) Private Limited [ITA No. 1182 of 2014], had to deal with the following question of law suggested by the revenue:-

6.1 Whether on the facts and in the circumstances of the case, the Hon'ble Tribunal was correct in directing the AO to restrict the

determination of the ALP to transactions with the AE rather than on the entire turnover of the Company.

6.2 Whether on the facts and in the circumstances of the case and in law, the Hon'ble Tribunal was correct while issuing the above directions without appreciating the observations of the DRP that there was no segmental audit of the transactions of AE and non AE and therefore there was no method whereby the AO could come to a fair determination of ALP by only restricting to transactions with AE."

50. The Hon'ble Bombay High Court on the above questions of law held as follows:-

"5. With the assistance of the learned counsel for respective parties, we have considered the submissions and the judgment of the Tribunal. The Tribunal in para 7 of its order has observed as under:-

"7. We have heard both the parties and their contention have carefully been considered. So far it relates to grievance of the assessee that the TP adjustment can only be applied to international transactions of the assessee with the AE and it cannot be applied at entity level, the issue is found to be covered by the aforementioned decision of the Tribunal in the case of Thyssen Krupp Industries India Pvt. Ltd. (supra). Therefore, we hold that determination of arms length price should be restricted only to international transaction of the assessee with its AE. It was pointed out that the figures are available with the AO, details of which has also been filed before us at page 170 of the paperbook. Therefore, we direct the AO to take only the international transactions of the assessee with its AE for the purpose of determining arms length price. We direct accordingly."

*6. The Tribunal has held that the figures are available with the Assessing Officer, the details of which has also been filed with the Tribunal at page 170 of the paperbook. **It would be clear that the details of the international transaction are specifically made available and therefore the apprehension of the department as such is misplaced.***

.....

7. Considering the provisions of Section 92 of the Income Tax Act, so also the reasoning adopted by the Tribunal suggesting that separate figures of international transaction are available, so also

the order referred above. No substantial question of law arises for consideration. As such the appeal is dismissed with no costs."

(Emphasis supplied)

51. The Hon'ble Mumbai Tribunal in the case of Thyssen Krupp Industries India Pvt. Ltd. [ITA No. 7032/Mum/2011] held that the ALP can only be determined on the value of international transaction alone and not on the entire turnover of the assessee at entity level. This decision was further upheld by the Hon'ble Bombay High Court in the case of Thyssen Krupp Industries India Pvt. Ltd. [ITA No. 2201 of 2013], which held as below:-

"2.

(a) Whether on facts and the circumstances of the case and law, the Tribunal was justified in law in restricting the Transfer Pricing (TP) adjustment only to the transaction between the Associated Enterprises (AEs.)?

3.

(e) We find that ***in terms of Chapter X of the Act, redetermination of the consideration is to be done only with regard to income arising from International Transactions on determination of ALP. The adjustment which is mandated is only in respect of International Transaction and not transactions entered into by assessee with independent unrelated third parties.*** This is particularly so as there is no issue of avoidance of tax requiring adjustment in the valuation in respect of transactions entered into with independent third parties. The adjustment as proposed by the Revenue if allowed would result in increasing the profit in respect of transactions entered to with non-AE. This adjustment is beyond the scope and ambit of Chapter X of the Act.

5. In the above view, as the provisions of the Act in respect of transfer pricing are self evidence, Question No.(a) as proposed does not give rise to any substantial question of law. Thus not entertained."

52. The ITAT Bangalore in the case of Kirloskar Toyota Textile Machinery Pvt. Ltd. v. ACIT [IT(TP)A No.1401/Bang/2010 held as under:-

"Taking into consideration of these factors, we accept the first fold of submission made by the learned counsel for the assessee and direct the Assessing Officer to confine the adjustment, qua the

purchases made by the assessee from the AE. To be more specific, the adjustment is to be made only to the purchases made from the AE

(emphasis supplied)

53. The CIT(A) in exercise of his powers of enhancement of income took the view that the ALP has to be determined on the basis of the entire sales in the finished goods segment including transactions with Non-AE also. The reasoning adopted by the CIT(A) for doing so was as follows:-

“10.0 While examining the working of ALP in the case of appellant, it was observed that the TPO has reduced the adjustment proportionately by holding that only 8.46% of revenue of the appellant is from AE. She accordingly adopted 8.46% of the operating revenue and 8.46% of the Operating cost for purpose of the determination of ALP. However, this method is not the correct approach as the ALP determination should have been based on the entire operating revenue and entire operating cost. Since this change in method would have amounted to enhancement of the income of the appellant, so opportunity of being heard was given to the appellant vide order sheet entry dated 11.08.2017, as to why the proportionate reduction done by the TPO should not be disregarded. The appellant sought time to file written submissions and the same was allowed. The appellant filed written submissions vide letter dt 29.08.2017. The same have duly been considered and the issue is being decided as follows:

10.1 In the case under consideration, the appellant is selling its product to AE as well as to non AEs, for the manufacture of which, part purchases are from AEs and remaining from the non AEs. The TPO has considered OP/OR for purpose of computation of the ALP as the quantum of sales to AE are lesser than the purchase from AE and thus lesser controlled. When a product is sold, only overall profit margin is recorded without any data as to what would be the profit in relation to purchases from AE. So this cannot be presumed that the profit percentage earned in relation to costs related to AE transactions as well as non-AE transactions was same. Since costs are common to the products ultimately sold by the appellant, and the same includes AE transactions, so it is always possible that the margin of profit percentage vis-a-vis costs related to AE transaction is not the same as profit margin on costs related to non-AE transactions but ultimately overall certain profits are being shown. Further, the transactions with non-AEs can be presumed to be at

arm's length as there is no reason to earn lesser profit. But in case of transactions with AEs, there is always a likelihood of earning lesser profits as transactions are controlled and decisions are influenced by AE. Thus the overall profits on account of transactions with AE as well as non-AE gets suppressed.”

54. *We have heard the rival submissions. The ld. counsel for the assessee reiterated submissions made before the CIT(A) that transaction with non-AE cannot be subject matter of determination of ALP because section 92 clearly speaks of determination of ALP only in respect of transactions with AE. He also referred to certain decisions of the Tribunal for the proposition that section 92 of the Act is not applicable to non-AE transactions. These decisions have already been extracted in the earlier paragraphs. The ld. DR relied on the order of the CIT(Appeals).*

55. *We have considered the rival submissions. The reasoning of the CIT(A) for considering the entire sales in manufactured finished goods segment for determination of ALP is that certain components and raw materials used in manufacture of finished goods are also sourced from AE and there is a possibility of the cost of such component having been bargained at a price which is not at arm's length. This presumption of the CIT(Appeals) is without any basis. He has not demonstrated with actual figures as to how there would be impact on profit margin on sale of finished products to AE because of purchases of some components from AE. He has given examples which are imaginary figures. Apart from this, the TPO has accepted that purchase of raw material and components by the assessee from its AE is at arm's length. Therefore, the basis on which the CIT(A) proceeded to apply the ALP test for transactions with non-AE is neither correct on facts nor permissible in law. As rightly contended by the assessee, section 92 of the Act can be applied only in respect of international transactions i.e., transactions with AE.*

56. *In view of the above transfer pricing provisions and various judicial precedents, we hold that the transfer pricing adjustment should be restricted only to the AE related transactions of the assessee.”*

74. The facts and circumstances of the case in this appeal on this issue is identical to the case decided by the Tribunal in the case of IKA (supra). The reasoning of the CIT(A) in this case and the case of IKA (supra) are also identical. Therefore the decision rendered in the case of IKA (supra) squarely applies to the present case. Therefore, the adjustment on account of

determination of ALP has to be restricted only to that part of the transaction with AE and not the entire value of the manufacturing segment as was done by the revenue authorities.

75. As far as Grd.No.17 is concerned, the Assessee in this ground has challenged the order of the TPO whereby he treated the payment of Research and Development and licence fee (Royalty) to the AE as at nil. In this regard it was submitted that the TPO erred in making an adjustment treating the ALP as 'Nil' with respect to royalty fee payment on the ground that the Assessee had failed to prove that the services were actually rendered by the AE. It was submitted that though the DRP has upheld the order of the TPO, the DRP has held that as the adjustment in the manufacturing segment being made under TNMM incorporating the payment of license fee/royalty as a part of the operating cost, the adjustment comes to more than the amount of royalty and therefore, no separate adjustment is called for royalty. Further, the DRP held that in the event, the margin of the manufacturing segment is at arm's length or the adjustment under TNMM works out to be less than the payment for license fee/royalty, then the adjustment made towards royalty would be revived. It was submitted that as no adjustment with respect to royalty has been made in view of the adjustment in the manufacturing segment being more than the amount of royalty, the said ground may not be adjudicated at this stage. However, the Assessee reserves liberty to urge this ground at a later stage in the event the adjustment made towards royalty is revived.

76. We are of the view that the prayer so made is acceptable and the liberty prayed for is granted. We hold and direct accordingly.

77. The AO is directed to compute the ALP of the international transaction in the manufacturing segment as per the directions given in this order, after affording opportunity of being heard.

78. SWD SERVICES SEGMENT OF THE ASSESSE

It is not in dispute that the transaction of rendering of SWD services by the Assessee to it's AE is an international transaction.

ANALYSIS OF THE ASSESSEE'S TP STUDY AND THE TP ORDER

Net mark-up on cost earned by the Assessee (as reflected in the TP Order):

Operating Income	Rs. 1,38,06,40,000/-
Operating Cost	Rs.1,29,89,30,000/-
Operating Profit (Op. Income – Op. Cost)	Rs.8,17,10,000/-
Operating/Net mark-up (OP/OC)	6.29%

Comparison of the TP studies done by the Assessee and TPO:

	Assessee	TPO
Methodology adopted	TNMM	TNMM
Profit Level Indicator (PLI)	OP/TC	OP/OC
Database used	PROWESS & CAPITALINE PLUS	PROWESS & Ace-TP
Comparables selected	9	8

Filters applied by Assessee in its TP study:

Step	Description
1.	Companies reporting net sales >Rs. 1 crore – selected
2.	Companies with positive net worth - selected
3.	Companies reporting average manufacturing & trading income/average net sales>50% - selected
4.	Companies having related party transactions> 10% of operating revenue- rejected.
5.	Companies which were functionally comparable – selected

Comparables selected by Assessee and their arithmetic mean:

Sl. No.	Name of the company	Weighted Average margin (in %)
1.	Akshay Software Technologies Ltd.	4.39
2.	Cigniti Technologies Ltd	8.58

Sl. No.	Name of the company	Weighted Average margin (in %)
3.	KALS Information Systems Ltd	12
4.	R S software (India) Limited	16.48
5.	Sasken Communication Technologies Ltd	6.24
6.	Tata Elxsi Ltd	14.49
7.	Expert Global Solutions Pvt Ltd	13.36
8.	Hepatica Technologies Pvt Ltd	-1.43
9.	Hinode Technologies Pvt Ltd	-3.60
Arithmetical Mean		5.71%

The TPO selected 3 comparables from the TP study of the Assessee and rejected 6 comparables selected by the Assessee in its TP study.

Filters applied by the TPO:

Step	Description
1.	Companies whose data is not available for FY 2013-14- excluded.
2.	Companies which are functionally comparable - selected
3.	Companies having different financial year ending (i.e. not March 31, 2014) or data of the company does not fall within 12 month period i.e., 01-04-2013 to 31-03-2014- rejected.
4.	Companies whose service income <Rs. 1 Cr- excluded.
5.	Companies whose software development service income is less than 75% of the total operating revenues- excluded.
6.	Companies which have more than 25% related party transactions of the sales- excluded.
7.	Companies which have export service income less than 75% of the sales- excluded.
8.	Companies with employee cost less than 25% of turnover- excluded.

Comparables selected by TPO and their arithmetic mean:

Sl. No.	Name of the Company	OP/OC (in %)
1	Infosys Ltd.	36.13
2	Larsen & Toubro Infotech Ltd.	24.61
3	Mindtree Ltd.	20.43
4	Persistent Systems Ltd.	35.10
5	R S Software (India) Ltd.	24.25
6	Cigniti Technologies Ltd.	27.62
7	SQS India Ltd.	22.37

8	Thirdware Solution Ltd.	44.68
AVERAGE MARK-UP		29.40%

Computation of arm's length price by the TPO and the adjustment made:

Arm's Length Mean Mark-up	29.40%
Operating Cost	Rs.129,89,30,000/-
Arm's Length Price @129.40% of cost	Rs.168,08,20,000/-
Price Received	Rs.1,38,06,40,000/-
Shortfall being adjustment u/s. 92CA	Rs.30,01,80,000/-

79. Aggrieved by the aforesaid determination of ALP by the TPO in the draft order of Assessment by the AO, the Assessee filed objections before the Dispute Resolution Panel (DRP) u/s.144C of the Act. The DRP issued directions, whereby it upheld the contentions of the TPO, subject to the following directions:

Selection of comparable companies:

- The following companies were directed by the DRP to be excluded from the list of comparables by accepting the contentions of the Assessee:
 - (i) Cigniti Technologies Ltd.; and
 - (ii) SQS India Ltd.
- The DRP also directed the inclusion of CG-Vak Software and Exports Ltd.
- The TPO was directed to examine the RPT of Expert Global Solutions Pvt. Ltd. and include the same if it satisfied the RPT filter, which the TPO accepted and included in the OGE.
- However the other contentions of the Assessee seeking the exclusion of incomparable companies and inclusion of comparable companies came to be rejected.

Working capital adjustment:

The DRP upheld the action of the TPO in not granting any adjustment towards the differences in working capital (“WC Adjustment”) of the Assessee and the comparable companies.

80. List of Comparables post the DRP’s Directions:

On giving effect to the above directions issued by the DRP, the final list of comparables is as follows:

Sl. No.	Name of the Company
1.	Infosys Ltd.
2.	Larsen & Toubro Infotech Ltd.
3.	Mindtree Ltd.
4.	Persistent Systems Ltd.
5.	R S Software (India) Ltd.
6.	Thirdware Solutions Ltd.
7.	CG-Vak Software and Exports Ltd.
8.	Expert Global Solutions Pvt. Ltd.

81. The Respondent passed the impugned final assessment order in line with the directions of the DRP in which the TP adjustment was reworked. Briefly, the grounds in the appeal which are being pressed are as follows:

(i) That the DRP erred in upholding the inclusion of Infosys Ltd., Persistent Systems Ltd., Mindtree Ltd, Larsen and Toubro Infotech Ltd. and Thirdware Solutions Ltd. (**Ground No. 23**).

(ii) That the DRP erred in not directing inclusion of Akshay Software Technologies Ltd., KALS Information Systems Ltd, Sasken Communication

Technologies Ltd., Hepatica Technologies Pvt Ltd., Maveric Systems Ltd., Daffodil Software Ltd., and I2T2 India Ltd. **(Ground No. 24).**

(iii) That the DRP erred in not granting WC Adjustment **(Ground No. 25).**

82. As far as Ground No.23 raised by the Assessee is concerned, in this ground, the Assessee is seeking the exclusion of **Infosys Ltd., Persistent Systems Ltd., Larsen and Toubro Infotech Ltd. and Thirdware Solutions Ltd and Mindtree Ltd.** from the list of comparables.

83. As far as the challenge by the assessee on exclusion of aforesaid 5 companies in ground No.23, the ld. counsel for the assessee has brought to our notice a decision of Bangalore Bench of ITAT for the very same Assessment Year 2014-15 in the case of *LG Soft India Pvt. Ltd. in IT(TP)A No.3122/Bang/2018 for AY 2014-15, order dated 28.5.2019.* In this order rendered in a case of assessee rendering SWD services such as the assessee, the Tribunal excluded 3 out of 5 companies referred to in the earlier paragraph were directed to be excluded with the following observations:-

“5. The Ld A.R submitted that **M/s Infosys Ltd, M/s Persistent Systems Ltd and M/s Thirdware Solutions Ltd** have been excluded by the co-ordinate bench in the assessee’s own case in AY 2008-09 in IT(TP)A No.1673/Bang/2012.

6. We notice that the co-ordinate bench has excluded M/s Infosys Ltd in AY 2008-09 by following the decision rendered by another co-ordinate bench in the case of 3DPLM Software Solutions Ltd (IT(TP)A No.1303/Bang/2012 dated 28.11.2013, wherein the decision rendered in the case of Triology E Business Software India P Ltd (ITA No.1054/Bang/2011) was followed and it was held that M/s Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It was further observed that the break-up of revenue from software services and software product is not available.

6.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in AY 2008-09, we direct exclusion of M/s Infosys Ltd.

7. In AY 2008-09, the co-ordinate bench has excluded M/s Persistent Systems Ltd also by following the decision rendered in the case of 3DPLM Software Solutions Ltd (*supra*), where in it was held that M/s Persistent Systems Ltd is engaged in product development and product design services while the assessee is a software development service provider. Further, the segmental details were not available.

7.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in AY 2008-09, we direct exclusion of M/s Persistent Systems Ltd.

8. We also notice that in AY 2008-09, the co-ordinate bench has excluded M/s Thirdware Solutions Ltd also by following the decision rendered in the case of 3DPLM Software Solutions Ltd (*supra*), where in it was held that M/s Thirdware solutions Ltd is engaged in product development and earns revenue from sale of licenses and subscription. Further, the segmental details were not available.

8.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in AY 2008-09, we direct exclusion of M/s Thirdware Solutions Ltd.

84. As far as exclusion of Larsen & Toubro Infotech Ltd., is concerned, the Tribunal in the very same case of *M/s. LG Soft Pvt. Ltd. (supra)* in another order dated 27.9.2019 in MP No.95/Bang/2019 held that exclusion of Larsen & Toubro Infotech Ltd., was omitted to be adjudicated in the original order dated 28.5.2019 passed by the Tribunal referred in the earlier paragraph and held that Larsen & Toubro Infotech Ltd., is also not a comparable company because there were extraordinary events that occurred in the relevant previous year and that it possessed brand and intangibles and there was no segmental information of sub-contracting expenses.

85. Respectfully following the aforesaid decision, we direct exclusion of (1) Infosys Ltd. (2) Larsen & Toubro Infotech Ltd. (3) Persistent Systems Ltd. & (4) Thirdware Solutions Ltd. from the list of comparable companies.

86. As far as exclusion of Mindtree Ltd., is concerned, it was submitted that Mindtree ought to be excluded from the final list of comparables *inter alia* for the reasons that it is not functionally comparable to the Assessee. Mindtree is engaged in the business of Manufacturing, Banking, Financial Services and Insurance, Hitech, Travel & Transportation and Others. It undertakes application development and maintenance, data analytics, digital services, Engineering R&D, Infrastructure management, IT strategy and consulting, integrated services, salesforce, SAP services, test engineering services. Despite rendering diverse services, there are no segmental details in respect of the services rendered. Mindtree has also invested significantly in Intellectual Property whereas the Assessee does not own any IP. It was further submitted that the DRP has failed to consider that Mindtree has a high turnover which makes it incomparable with the Assessee. Also, Mindtree is widely engaged in research and development activities. During the FY 2013-14, Mindtree has incurred sub-contracting expenses of Rs. 1406 million. Also, the Assessee submits that the growth of Mindtree has been driven by the onsite revenue. The onsite revenue had an extraordinary growth of 27.4% compared to a growth of 7.2% in offshore services during the year. It has incurred foreign branch expenditure of Rs. 1120.3 Cr. Against the total expenditure of Rs. 1177.0 Cr. during the year. Hence, the business model of Mindtree is different from that of the Assessee. The significant presence of intangibles worth Rs. 3,26,60,000/-, makes it incomparable to the Assessee. Therefore, it was submitted that Mindtree is incomparable to the Assessee and ought to be excluded from the list of comparables for the above reasons. The learned DR relied on the order of the DRP.

87. Having considered the rival submissions, we find that this company was sought to be excluded from the list of comparable companies before the DRP on the ground of functionally dissimilar- diversified operations, revenue from Subcontracting charges, Onsite revenue, Segmental data unavailable, presence of R&D activity, Presence of intangibles, existence of IP led solutions and large Scale operations. This plea was refused by the DRP on the following findings viz., that this company was not engaged in product sales as contended. In note 2.8.1 of the financial statement shows revenue is derived primarily from software services and there is no reference to revenue from product sales. Asset schedule refers to IPR value of Rs. 67 million, which is meager. No specific debit towards R&D in the P/L account. Assessee failed to establish material effect on margin on account of intangibles/patents. Assessee failed to justify the significant expenditure in foreign currency affects comparability and in any event Assessee cannot be aggrieved by a company which undertakes onsite development activity in which the profit earned is low.

88. We are of the view that if the onsite revenue of the comparable is more than 25% of its total revenue, then the company cannot be regarded as comparable. In this regard, we find that this tribunal has been taking a consistent stand by following the decision in the case of Triology E-Business Software ITA No.1054/Bang/11 order dated 23.11.2012 wherein it was held that companies who generate more than 75% of the export revenues from onsite operations outside India are effectively companies working outside India having their own geographical markets, cost of labour etc., and also return commensurate with the economic conditions in those countries. Thus assets and risk profile, pricing as well as prevailing market conditions are different in predominantly onsite companies from predominantly offshore companies like the taxpayer. Since, the entire operations of the tax payer are taking place offshore i.e. in India; it is but natural that it should be compared with companies

with major operations offshore, due to the reason that the economics and profitability of onsite operations are different from that of offshore business model. As already stated the Assessee has limited its analysis only to functions but not to the assets, risks as well as prevailing market conditions in which both the buyer and seller of services located. Hence, the companies in which more than 75% of their export revenues come from onsite operations are to be excluded from the comparability study as they are not functioning in similar economic circumstances to that of the tax payer. Hence, it is held that this filter is appropriately applied by the TPO. We are of the view that it would be just and appropriate to remand the issue of comparability of Mindtree Ltd., to the TPO/AO afresh in the light of the principles set out above and apply the onsite revenue filter. We hold and direct accordingly.

89. As far as Grd.No.24 is concerned, Vide this ground, the Assessee is seeking inclusion of Akshay Software Technologies Ltd., Sasken Communication Technologies Ltd., Maveric Systems Ltd., I2T2 India Ltd., KALS information Systems Ltd. and Daffodil Software Ltd., and Hepatica Technologies Pvt Ltd.

90. As far as inclusion of Akshay Software Technologies Ltd. is concerned, it was selected by the assessee as a comparable company in its TP study, but was rejected by the TPO for the reason that this company was engaged in providing professional services, procurement, installation, implementation, support & maintenance of ERP products and services and incurring significant foreign branch expenses indicating a different operating model from that of assessee. It is the plea of assessee that assessee's function is comparable with this company and that the TPO had chosen companies with significant foreign branch expenses as comparable companies. The ld. counsel for the assessee brought to our notice a decision of ITAT Bangalore in the case of *EMC Software & Services India P. Ltd. v. JCIT in IT(TP)A No.3375/Bang/2018, order dated*

18.12.2019 for AY 2014-15, wherein in the comparability of this company was remanded to the TPO for consideration afresh. The ld. DR relied on the order of the DRP.

91. After considering the rival submissions, we find that comparability of this company was remanded to the TPO for consideration afresh in the case cited by the ld. counsel for the assessee. Following were the relevant observations of the Tribunal:-

“(i) Akshay Software Ltd. which has a margin of 8.13%. The income from commission on sale of software license constitute meager 0.5% of total revenue and TPO has not applied transfer development filter. The said company was rejected by the TPO for the reason that the company is engaged in providing provisional services, procurement installation, employment support of ERP products. The DRP has rejected the comparable without applying the filter and there is no difference in the business model adopted by the company and the assessee. We on perusal of the Annual Report at Page 1373 of Paper Book, found that major revenues are from operations as per Note 19 being income from software services and commission received on sale of software licenses. The earnings as per Note 28 as per the financial statements, the company has earning from export of software and in the F.Y. 2013-14 which constitute more than 95% of income. Therefore we found these facts are not considered by the TPO or DRP and accordingly we restore this issue to the file of TPO for examination and verification.”

92. We are of the view that the issue of comparability of Akshay Software Ltd. should be examined afresh by the TPO as per the directions of the Tribunal in the order referred to above. We hold and direct accordingly.

93. As far as inclusion of Maveric Systems Ltd. are concerned, we find that inclusion of Maveric Systems Ltd. was remanded by the Tribunal to the TPO for consideration afresh in the case of *EMC Software & Services India P. Ltd.* (*supra*) with the following observations:-

“(iii) Maveric Systems Limited : This comparable was rejected by the TPO and it was sought for inclusion by the assessee and whereas

TPO has rejected without any basis and was excluded on the ground that the company was engaged in R & D activity and expenditure is 6% of total turnover. Similarly, the DRP has upheld the exclusion of the company. The learned Authorised Representative submitted that company's functional profile is comparable and applied the TPO filters. Whereas the DRP has observed that the company has incurred substantial expenses to the tune of 6% of turnover towards R & D and the tolerable limit is 3%. We found the observations of the DRP are without any basis. Accordingly we restore this issue to the file of TPO to give a logical conclusion and findings."

94. Following the aforesaid decision, we remand the issue of inclusion of this company i.e., Maveric Systems Ltd. to the TPO for fresh consideration on the lines directed in the order of the Tribunal referred to above.

95. As far as inclusion of I2T2 India Ltd. is concerned, we find that in the case of *LG Soft India Pvt. Ltd. (supra)* this company was directed to be included. The Tribunal in para 11 of its order held that the TPO excluded this company for the reason that the Related Party Transaction (RPT) had not been disclosed in the annual report. The Tribunal held that if there is no disclosure of RPT in the annual report, it has to be concluded that there was no RPT and therefore this company should be included as a comparable company. Following the aforesaid decision, we direct inclusion of I2T2 India Ltd. as comparable company.

96. Regarding inclusion of Kals Information Systems Ltd., (KALS), we find that this company was selected by the Assessee and came to be rejected by the TPO for the reason that the company is functionally not comparable to the Assessee as the company is involved in the business of both software products and software services. It was submitted that KALS was engaged only in software development services during the FY 2013-14. KALS has not earned any revenue from software product during the current financial year and does not have any inventory of software products. KALS was engaged both in provision of software product and services till the year ending March 2012.

Thereafter, the company has been only engaged in provision of the software development activities and had not owned any software products during the year ended March 2014. Therefore, it was submitted that the company ought to be included in the final list of comparables. We are of the view that this aspect was not examined either by the TPO or DRP and therefore deem it fit and appropriate to remit the issue and direct the TPO/AO to consider the claim in this regard.

97. As far as exclusion of Sasken **Communication Technologies Ltd. (“Sasken”)** We find that this company was selected by the Assessee and came to be rejected by the TPO for the reason that the company is functionally not comparable to the Assessee. The exclusion of the company came to be upheld by the DRP on the grounds that (i) the company fails export turnover filter; (ii) the company earns revenue from licensing, SWD and royalty; and (iii) the company offers R&D consultancy, wireless and software products. In this regard, it was submitted that the company is functionally similar to the Assessee as the services rendered by the company predominantly are in the nature of SWD services. The services rendered by the company predominantly fall within the ambit of SWD services as per the Safe Harbour rules prescribed by the CBDT and therefore the company is comparable to the Assessee. The income from software products constitutes a meagre 4.2% of total revenue, which would not have any impact on the profitability of the company’s SWD services segment. It was contended that the DRP erred in upholding the exclusion of the company on altogether different grounds than what was held by the TPO, without first putting the Assessee on notice of the same. Without prejudice, it is submitted that the DRP erred in taking into account only the revenues earned from services rendered to customers in North America, Europe and Asia Pacific region while determining whether the company passes the export revenue filter applied by the TPO. It was submitted that if the entire foreign exchange earned by the company during the year is taken into consideration, it would pass the

export revenue filter applied by the TPO. It was submitted that Sasken has incurred research and development expenditure only to the tune of 0.50 percent of the software services revenue amounting to INR 35,083.49 lakhs. Therefore, it was submitted that the company ought to be included in the final list of comparables. We have considered the submissions and are of the view that it would be appropriate to remit the issue and direct the TPO/AO to consider the claim in this regard afresh as the DRP has drawn conclusions, without opportunity to the Assessee.

98. As far as exclusion of **Hepatica Technologies Pvt Ltd** is concerned, we find that this company was selected by the Assessee and came to be rejected by the TPO for the reason that the company fails the employee cost filter. The DRP held that there is no sufficient information in this regard. In this regard it was submitted that this Company is functionally comparable to the Assessee and passes the employee cost filter. We have considered the submission and are of the view that it would be fit and appropriate to remit the issue and direct the TPO/AO to consider the claim in this regard.

99. As far as exclusion of **Daffodil Software Limited** is concerned, we find that this company proposed by the Assessee during the course of TP proceedings came to be rejected by the TPO for the reason that the company has earned revenue from sale of software services as well as from products and segment data for the same in unavailable. It was contended that the DRP has erred in rejecting the company on the ground that the company employs intangible assets developed by itself amounting to INR 2,80,59,023/-. It is submitted that the said amount of is intangible under development, i.e. work-in-progress which the company has not yet employed in its operations. Therefore, this company ought to be included in the final list of comparables. We have considered the submission and are of the view that once the company is found

to be a product company also and no segmental details are available and if that finding is not in challenge, then that ground would be sufficient to disregard this company as a comparable company and therefore the presence of intangibles would not make any difference. Hence, the plea of the Assessee for inclusion of this company as a comparable company is rejected.

100. The next issue that requires adjudication is ground No.25 with regard to **Non grant of Working Capital adjustment**. In this regard it was submitted that Rule 10B(3) of the Income-tax Rules, 1962 (“the Rules”), itself categorically provides that an adjustment ought to be provided for any differences in the economic factors between the tested party and the comparables. A working capital adjustment is one such adjustment which is to be applied in order to adjust for the differences between the working capital positions of the tested party and of the comparable. Reliance is placed by the Assessee on the decision of this Hon’ble Tribunal in the cases of Bearing Point Business Consulting (P.) Ltd. vs. DCIT [(2013) 33 taxmann.com 92]. Therefore, it is submitted that since it is now a settled proposition of law that necessary adjustments are to be made to the margins of comparables to give effect to the differences in the working capital positions of the tested party and of the comparables, the TPO ought to have given the Assessee the benefit of the same. We are of the view prayer in this regard deserve to be accepted. This tribunal has been consistently taking a view that working capital adjustment has to be allowed. Hence, we direct the TPO/AO to allow working capital adjustment, in accordance with law.

101. The other grounds raised in its appeal in relation to its international transaction of provision of SWD services are not pressed at this stage. However, the Assessee seeks liberty to urge the said grounds in any future proceeding, appellate or otherwise, and in these proceedings at a future point in time. The liberty prayed for is allowed. The TPO/AO is directed to compute the ALP in

the SWD services segment, after due opportunity of being heard to the Assessee afforded.

CORPORATE TAX GROUNDS

102. Ground Nos. 27 to 35 in the appeal project the grievance of the Assessee with regard to Disallowance of provision for warranty of Rs. 3,21,32,433/-. The facts in this regard are that during the year, the Assessee had created a provision for warranty amounting to Rs. 3,21,32,433/- which was claimed as deduction. According to the Assessee, the provision for warranty has been created by the Assessee on scientific basis based on past experience. The AO disallowed the provision for warranty contending the same to be contingent liability/ created on estimate basis. The DRP upheld the disallowance proposed by the learned AO and rejected the Assessee's objections in this regard. The AO passed the final order disallowing the aforesaid expense pursuant to DRP directions.

103. It was submitted by the learned counsel for the Assessee that it supplies dashboard sensors and other allied auto components to various automotive manufactures like TVS, Hyundai, Tata, etc. The Assessee provides warranty of 12 months on its products to the customers. The Assessee 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 Assessee 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, there was no additional provision for warranty created.

The movement in provision for warranty as accounted for by the Assessee for the year under consideration is as under:

Amount in INR

Particulars	General Warranty	Specific Warranty	Total
Opening balance	2,60,13,380	2,81,32,797	5,41,46,177
Add: Provision created during the year (debited to P & L A/c)	3,21,32,433	0	3,21,32,433
Less : Actual warranty claims	(2,60,13,380)	(2,27,52,798)	(4,87,66,178)
Closing balance	3,21,32,433	53,79,999	3,75,12,432
Amount directly debited to profit and loss account	2,61,30,796	0	2,61,30,796

It was pointed out that it can be seen from the movement of provision for warranty tabulated above, the actual utilization (Rs. 4,87,66,178) during the year under consideration is more than the provision created (Rs. 3,21,32,433). As such the net impact that has been considered in the profit and loss results in negative amount (Rs. -1,66,33,745). To this amount, certain warranty expense which is not in the nature of provision and directly incurred by the Assessee (Rs. 2,61,30,796) has been added. Therefore, the net warranty expense of Rs. 94,97,051 is reflected in the profit and loss account. Accordingly, the learned counsel for Assessee submitted that the utilization of the expense is

on the higher side compared to the provision created, which itself indicates that the methodology followed by the Assessee is scientific. It was pointed out that in the draft assessment order, the AO had made several observations which the Assessee had clarified before the DRP as under:

Sl. No.	Learned AO's contention	Assessee's submission	Reference
1	There is a huge difference between provision amount and utilization	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. 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. Further, utilization amount represents expense incurred on actual claims received by the Assessee.	
2	Provision is made on estimate basis/ adhoc basis	The Assessee had submitted following details to the AO: - Ledger extract for actual warranty expenses incurred by the Assessee along with the supporting documents on sample basis - Summary of provision created for warranty	<i>Please refer paper book - Volume-3 filed on 11 March 2019</i> <i>Page No.1385 to 1509</i> <i>Page No.1511</i>

		The above evidences the methodology of creating such provision and substantiates that the warranty policy adopted by the Assessee is on scientific basis and not adhoc basis.	
3	Actual warranty claims debited to profit and loss account/ No separate ledger	The AO failed to appreciate that the Assessee adjusts actual warranty claims against provision in the provision account, a separate ledger is maintained for the said purpose. Further, certain direct actual warranty expense not in the nature of provision was directly debited to profit and loss account.	

It was reiterated that 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 was submitted that the Assessee creates provision for warranty on a scientific basis.

104. Reliance was placed on the following decisions in support of the contentions of the Assessee:

- 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).

Further, 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.

105. Notwithstanding and without prejudice to the above, the learned AO has erred in disallowing an amount of Rs. 3,21,32,433 without appreciating that "net" warranty expense debited to the profit and loss account amounts to Rs. 94,97,051 only. Based on the above discussion, the Assessee submits that the expenses incurred by it towards warranty expense are allowable under section 37 of the Act. Notwithstanding and without prejudice to the above, the learned AO ought to have allowed the utilization of actual warranty claims amounting to Rs. 4,87,66,178 against the provision created during the year amounting to Rs. 3,21,32,433. It was pointed out that in this regard, the DRP in Assessee's own case for AY 2012-13, had directed the AO to allow the actual expenses on warranty incurred during the said year. Without prejudice to the above, it is submitted that for the assessment year, i.e., 2008-09 and 2010-11 the similar issue has been remanded for fresh consideration by this Hon'ble Tribunal.

106. The learned DR relied on the order of the DRP.

107. We have carefully considered the submissions and are of the view that provision for warranty created is based on past experience and historical trend of each product and at a percentage. The claim made by the Assessee that the method followed for creating provision for anticipated liability on account of

warranty stands vindicated by the fact that the actual liability on account of warranty expenses is always on the higher side. The reasons given by the DRP for not accepting the claim of the Assessee is that the provision is created as a percentage of sale, ignoring the fact that past experience is also the basis for creation of provision for warranty. We are therefore of the view that the provision for warranty has to be allowed as a deduction, as the provision created satisfies the requirements for claiming provision as a liability, as laid down in the judicial precedents referred to above. We hold and order accordingly and allow the relevant ground of appeal of the Assessee.

108. Ground Nos. 36 to 46 are in respect of Disallowance of annual licence fee of Rs. 28,00,21,116/-. The facts with reference to these grounds are that during the year under consideration the Assessee debited expenses amounting to Rs. 28,00,21,116 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	21,36,97,972
2	Project Research and Development expenses	6,59,74,419
3	Third party and others	3,48,724
Total		28,00,21,116

The Assessee submitted that it had entered into two license agreements with Continental Automotive GmbH, Germany and Continental Teves AG & Co., Germany dated 1.1.2009 and 11.3.2019 respectively, whereby it was given non-exclusive, non-transferable licence to use intellectual property for manufacturing and sale of automotive products; and payment of compensation as an annual royalty on net sales for use of intellectual property. The Assessee claimed the above expense as one incurred for the purpose of business and revenue in nature and therefore claimed as deduction by the Assessee under section 37 of the Act.

109. The AO disallowed the above for the reason that the reasons for mention “licence fee” as R & D expenses were not submitted and except the Agreement, no supporting documents were furnished with regard to technical know-how provided by the group companies. He also held that the expenditure would give an enduring benefit and would therefore be a capital expenditure. The AO also held that there was no rationale for payment of licence fees when there was import of raw material, consumables and other supplies from the AEs.

110. The DRP upheld the disallowance proposed by the AO and rejected the Assessee’s objections in this regard and also rejected the alternative claim of the Assessee for allowing depreciation on the expenses in question treating them as intangible asset. Pursuant to above, the learned AO has passed the final order disallowing the aforesaid expense.

SUBMISSIONS ON LICENSE FEES PAID TO GROUP COMPANIES OF Rs.21,36,97,972:

111. The learned counsel for the Assessee submitted that the expenditure in question of Rs. 21,36,97,972 was incurred 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 refer page no. 1527 to page no. 1539 of the paper book – volume 3 filed on 11 March 2019): The Assessee has entered into a License Agreement dated 1 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 Assessee for development, manufacturing and sale of automotive products.

- Compensation for the aforementioned license has been agreed to be paid by the Assessee 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 refer page no. 1541 to page no. 1551 of the paper book – volume 3 filed on 11 March 2019): The Assessee has entered into a License and Technical Assistance Agreement dated 1 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 and supply information relating to commercial manufacture, sale and distribution. Compensation for the aforementioned license has been agreed to be paid by the Assessee as an annual royalty fees of 6% of net sales of sensoric products per year.

112. It was submitted that the usage of the term "R&D" was just a nomenclature used by the Assessee for the purpose of accounting such expenditure and the nature of expense as clearly laid out in the aforesaid agreements was royalty. It was submitted that the annual license fee incurred by 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 submission:

- 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 Assessee for increasing profitability relating to products manufactured by the Assessee 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 Assessee.
- 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 Assessee 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.

113. In this regard, reliance was 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***

114. Based on above judicial decisions, the factors to be considered and conditions to be satisfied were summarized as 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 further rights/ assignment	The licensee has restricted rights to create further rights/ assign the license in favor of third parties
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. It was submitted that 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

Factors under consideration	Whether the conditions are satisfied?	Clause reference in the Agreements A and B
Restriction on creation of further rights/ assignment	Yes. The Assessee can sub-license only on receipt of prior written approval from the Licensor.	• Agreement A - 2.2 • Agreement B - 3.1
Confidentiality	Yes. The Assessee 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 was 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 Assessee on a year on year basis. The broad key areas of support/ assistance/ service provided by Continental global to Assessee 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 Continentalgroup 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 Assessee 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 Assessee 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 – CPMs and CPMS provided by Continental global aid in project management. Further, the Assessee 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 Assessee 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 Hon'ble Tribunal under cover of an application for additional evidence. The additional evidence sought to be filed by the Assessee are the following.

Sl. No.	Particulars	Page Nos.
1	<i>Annexure 1</i> - License agreement	521-534
2	<i>Annexure 2</i> - License and technical assistant agreement	535-546
3	<i>Annexure 3</i> - Sample invoice copies	547-560
4	<i>Annexure 4</i> - Ledger abstract of Research and Development expenses	561-562
5	<i>Annexure 5</i> - Project management process	563-574
6	<i>Annexure 6</i> - Future technologies	575-576
7	<i>Annexure 7</i> — Technology roadmap	577-588
8	<i>Annexure 8</i> — Key manufacturing technologies	589-590
9	<i>Annexure 9</i> - Strategic areas for the business development	591-592
10	<i>Annexure 10</i> — Tech.net	593-606
11	<i>Annexure 11</i> - Tech.net snapshot	607-608
12	<i>Annexure 12</i> — Cabot concept	609-616
13	<i>Annexure 13</i> - Camline report	617-620
14	<i>Annexure 14</i> - Equipment status Report	621-624
15	<i>Annexure 15</i> - Camline planning tools	625-626
16	<i>Annexure 16</i> - Manufacturing execution systems ("MES")	627-628
17	<i>Annexure 17</i> - Compliance information communication	629-630
18	<i>Annexure 18</i> - Global material shortage communication	631-632
19	<i>Annexure 19</i> - Risk mitigation measures communication	633-636
20	<i>Annexure 20</i> - Design for Six Sigma for development of new	637-648
21	<i>Annexure 21</i> — Planning a factory sequence of phases	649-670
22	<i>Annexure 22</i> - Team structure of CEP manufacturing	671-672

23	<i>Annexure 23 - Training on application of new methodology</i>	673-674
24	<i>Annexure 24 - Library sharing</i>	675-676
25	<i>Annexure 25 — Screenshot of a project</i>	677-678
26	<i>Annexure 26 - Verification procedures</i>	679-690
27	<i>Annexure 27 - Webinars for testing</i>	691-692
28	<i>Annexure 28 - Software source code</i>	693-694
29	<i>Annexure 29 - Technical support email communication</i>	695-696
30	<i>Annexure 30 - Manufacturing technology support from experts</i>	697-700
31	<i>Annexure 31 - Faulty part detection communication</i>	701-704
32	<i>Annexure 32 - Support from Germany</i>	705-706
33	<i>Annexure 33 - Quality ranking</i>	707-708
34	<i>Annexure 34 - Taskforce</i>	709-712
35	<i>Annexure 35 - Robots service agreements</i>	713-714
36	<i>Annexure 36 — Key milestones</i>	715-716
37	<i>Annexure 37 - Intellectual property of Continental global</i>	717-744

The additional evidence is necessary for proper adjudication of the dispute viz., to understand the nature of expenditure in question.

118. It was 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 Assessee 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, camlineetc are provided to the Assessee and some of the key tools in use by the Assessee are discussed below:

Sl. No.	Tool Name	Tool/ platform description	Benefit to 'Continental India'
1	<i>Tech.Net</i>	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	Assessee uses <i>Tech.net</i> (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 Assessee's business.

		problem cannot be resolved locally.	
2	Collaborative robots (“Cobot”)	Cobot is an advanced version of robots which focuses on safety and cost reduction. This is easy and simple to program as per the user requirement.	Cobot helps the Assessee 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 machinery/ equipment in the plant during the process of manufacturing.	Camline analyses performance of the machineries over a period and provides quality rates, performance rates. It also records the equipment 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 Assessee 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).
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119. Snapshots depicting the working of the tools and reports generated are produced before this Hon'ble 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 sets quality standards for the suppliers. This in turn helps the Assessee 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 this Hon'ble Tribunal under cover of an application for additional evidence.

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

Every product that the Assessee manufactures is unique and complex. Continental global develops and shares its designs, layouts and drawings relating to products, manufacturing process, etc. with the Assessee. 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 Assessee 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 Assessee 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 Assessee 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 Assessee requests the assistance of Continental global. A screenshot of the source code shared with the Assessee 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 Assessee. Sample email communications are also part of the application for additional evidence.

- **Problem resolution**

- a) The Assessee seeks the help of Continental global to resolve issues in cases where the Assessee is unable to do so. Continental global provides the Assessee 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 Assessee to improve the product quality. The aforesaid assistance received from Continental group helps in improving the technological performance of the Assessee'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 Assessee and ensures access to latest technical information.

120. Based on the above, it was submitted as the present case satisfies the conditions of section 37 of the Act, the license fee paid should be allowed as revenue expenditure.

SUBMISSIONS WITH REGARD TO PROJECT RESEARCH AND DEVELOPMENT EXPENSES OF RS.6,59,74,419:

121. The Assessee has entered into an Agreement for application research and development services according to which the Assessee is eligible to avail technical knowhow from its group companies. The research and development work is performed by the group companies to support the other group companies in their manufacturing and sales business. The technical knowhow payment is towards the product application works and development projects ("Application projects") based on specific requirement of the Assessee as per its customer orders. As mentioned above, the development activities for such projects may be performed by several R&D centers of the Continental Group worldwide based on the availability of suitable skilled resources for the project. All the costs associated with such projects are charged to the benefiting manufacturing companies. Continental Automotive GmbH acts as a central administrator for this intercompany service. For all Application projects to be

performed for any manufacturing company, Continental Automotive GmbH will either use its own facilities, or use its group affiliates to perform the developmental work. All technical knowhow costs are charged as far as feasible, project by project to the companies which plan to manufacture the project-relevant product for the outside customer. All Application Projects actually running, are permanently listed in the SAP sub-system "Global PS" or similar tools. These lists contain the actual technical knowhow costs per project, and an indication in which manufacturing site the relevant product is planned to be produced. The manufacturing company to which the relevant plan belongs to, will be charged with the technical knowhow fee of the specific project. Therefore, the major individually chargeable projects are directly charged to the relevant manufacturing company. The relevant projects wherein the manufacturing of products are undertaken by the Assessee, are charged to the Assessee and the same are either:

- capitalised and amortised over the useful life of such Project if the Assessee has actually commercialized the same; or
- charged off to the profit and loss account if the same could not be commercialized or recovered from the customers.

122. It was submitted that in line with the above, during the captioned AY, the Assessee has availed technical knowhow from group companies amounting to Rs. 14,89,99,314/- and a summary of the same is as under:

Particulars	Amount in Rs.
Expense capitalized since the same was commercialized	4,10,56,133
Expense charged to the customers in the subsequent year (recorded as unbilled revenue in the captioned AY)	4,07,27,558

Expense charged off in the profit and loss account as it could neither be commercialized nor chargeable to the customers	6,59,74,419
Total	14,89,99,314

It was pointed out that party-wise Invoice details of technical knowhow availed from group companies amounting to Rs. 14,89,99,314 and sample invoice copies thereof were submitted before the Hon'ble DRP.

123. It was submitted that as can be seen from the above, an amount of Rs. 6,59,74,419 has been charged to profit and loss account related to specific projects. This expense relates to the technical knowhow availed from the group companies which was utilized by the Assessee towards the manufacturing and sales activities which is in the ordinary course of its business. However, since the same did not lead to any fructuous result (as it could neither be commercialized nor chargeable to the customers), it was charged off to the profit and loss account. In this regard, list of projects for which amount was charged off during the year was provided before the AO during the course of assessment proceedings. It was submitted that the project R&D expenses mentioned above are actual R&D expense incurred by the Assessee. The aforesaid R&D was undertaken by the Assessee in the course of its business activities which did not lead to any fructuous result. As this involved an outflow of resources i.e., amount has been spent by the Assessee in carrying out the aforesaid activity, the same should be allowed as revenue expense. This being an expense of revenue in nature, the same is claimed by the Assessee under section 37 of the Act.

124. The learned counsel for the Assessee has also filed the following chart to show how the conclusions drawn by the AO on disallowance of expenses on licensee fee and Project R & D were incorrect.

Sl. No.	Learned AO's contention	Assessee's submission	Reference
1	No proper evidences furnished	The Assessee had submitted the following details to the learned AO: 1. Ledger extracts of R&D expense 2. Sample invoices copies raised on Assessee 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 Assessee.	<i>Please refer below page(s) in the paper book - Volume-3:</i> <i>Page No. 1512</i> <i>Page No. 1513 to 1526</i> <i>Page No. 1527 to 1551</i> <i>Page No. 1553 to 1554</i> <i>Page No. 1555 to 1595</i>
2	Reasons for classification of expense as R&D not provided	Assessee had submitted that R&D is only a nomenclature used by the Assessee in the financial statements and a major portion of the said expense is towards annual license fees paid by the Assessee to its group companies.	<i>Please refer page no. 1375 of the paper book - Volume-3 filed on 11 March 2019</i>
3	Expense is capital in nature since it provides enduring benefits	From the above factual and legal basis, the Assessee submits that the impugned expense is not	The judicial precedents discussed above supports the case

		a capital expenditure, as there is no enduring benefit derived by the Assessee. The same is related to the business of the Assessee.	of the Assessee that expense is not capital in nature.
4	No rationale for entering into agreement with its group entities since the Assessee was carrying on the business even prior to entering aforesaid agreements	The Assessee submits that merely because 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. Assessee 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 Assessee.	Reliance in this regard is placed on below judicial decisions, where it has been observed that “AO cannot take managerial decision and conclude what expense needs to be incurred by the business and what not”. • DCIT vs. International Institute of Planning & Management (P.) Ltd. [2015] 41 ITR(T) 733 (Delhi - Trib.) • CIT vs. Dalmia Cement (P.) Ltd. [2002] 254 ITR 377 (Delhi) – this was affirmed by the Hon’ble Supreme Court [2007] 288 ITR 1 (SC)
5	Sundry creditors are increasing	This is a mere remark made by the learned AO	-

		without any basis/ conclusion towards the same. However, the Assessee 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 Assessee had submitted details of tax deducted at source before the learned AO pursuant on directions issued by the Hon'ble DRP.	<i>Please refer page no. 1303 to page no. 1313 of the paper book - Volume-3 filed on 11 March 2019</i>
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 Assessee 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 Assessee.	<i>Please refer point no. 4 above</i>

125. In view of the above submissions, the learned counsel for the Assessee prayed that the impugned expense is revenue in nature and the same is allowable under section 37 of the Act.

126. It was submitted that for the assessment year, i.e., 2009-10 the similar issue has been remanded for fresh consideration by this Hon'ble Tribunal. Notwithstanding and without prejudice to the above, even if the said expenses incurred by the Assessee for its own business are held relating to R&D and that the expenses provide enduring benefit, the claim of deduction of the Assessee must be allowed under section 35(1)(iv) of the Act. Notwithstanding and without prejudice to the above, even if the said expenses are held as capital in nature, the Assessee 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. In this regard, the Assessee places reliance on the decision of Hon'ble Supreme court in the case of ***Honda Siel Cars India Ltd.***[2019] 101 ***Taxmann*** 222 (***Supreme Court***) wherein it was held that if royalty is treated as capital expenditure, needless to mention that the Assessee shall be entitled to depreciation thereon. It was also submitted that the DRP has erred in holding that the annual license expense does not fall under the definition of intangible assets under section 32 of the Act, without appreciating that the same falls under the limb of aforesaid definition, namely, "any other business or commercial rights of similar nature". Notwithstanding and without prejudice to the above, even if the said expenses are to be disallowed, the AO failed to appreciate that out of the total amount of Rs. 28,00,21,116, an amount of Rs. 27,63,35,693 has already been included in the adjustment made under section 92CA of the Act thereby leading to double disallowance of the same amount. In this regard, reliance is placed on the decision of ***DCIT v. Honda SIEL Power Products Ltd.*** (*supra*) wherein the Delhi Bench of Hon'ble Tribunal accepted the contention of the assessee in the said case that royalty has been already considered while

arriving at the TP adjustment and hence, disallowance under section 37 of the Act has led to double disallowance. Further, the DRP in Assessee's own case for AY 2012-13, had directed the AO to remove the disallowance of R&D expense made under section 37 of the Income-tax Act, 1961. In view of the above, the learned counsel for the Assessee prayed that the claim of deduction for R&D expenses be allowed.

127. The learned DR relied on the order of the DRP. We have carefully considered the rival submissions. The discussion in the order of the DRP on this issue is at paragraph 2.47.2 to 2.47.9. The DRP in upholding the order of the AO has followed a decision of Hon'ble Kerala High Court in the case of MIL Controls Ltd., Vs. CIT. Perusal of the same reveals that 50% of the expenditure claimed by the Assessee was disallowed owing to non furnishing of specific details about the services rendered. The Hon'ble Court observed that merely because payments were made and the same is bonafide cannot be the basis to allow the claim of the Assessee, especially when the payment is to a related party. The ratio laid down therein is based on facts of that case. In this case however we find a plethora of evidence and substantiation of the expenses were given by the Assessee. The DRP disregarded the same by merely observing that submission of license agreements, raising of invoices, payments by cheques will not help the cause of the Assessee. Each and every one of the allegations of the AO has been countered by the Assessee and these have been given in the chart in the earlier paragraphs. As rightly submitted by the Assessee, the nomenclature of R & D should not be the basis to conclude that the expenditure is capital expenditure in nature. We also find that similar disallowance in the earlier AYs has been set aside by the Tribunal to the AO for consideration afresh. We are therefore of the view that the issue needs to be examined afresh in the light of the evidence filed before the Tribunal and the submissions made by Assessee as above. The AO will examine the issue afresh in the light of the

observations made above and in the light of the evidence and additional evidence and submissions made as above, after affording the Assessee opportunity of being heard.

128. In ground No.49, the Assessee has raised issue with regard to **Non-set off of brought forward losses amounting to Rs. 232,54,55,699/- available to the Assessee.**The learned counsel for the Assessee submitted that as per its return of income, an amount of Rs. 232,54,55,699/- was brought forward under the head 'profits and gains from business or profession', which ought to be available for set off in terms of Section 72 of the Act. It was prayed that the same be allowed to be set off against income under the head 'profits and gains from business or profession'. We are of the view that a direction to the AO to consider the claim of the Assessee after affording opportunity of being heard and after due verification, would be sufficient to dispose this ground of appeal. We hold and direct accordingly.

129. The ground with regard to levy of interest u/s.234B is purely consequential and the AO is directed to give consequential relief.

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

Pronounced in the open court on the date mentioned on the caption page.

Sd/-

(B. R. BASKARAN)
Accountant Member

Sd/-

(N. V. VASUDEVAN)
Vice President

Bangalore.
Dated: 29.03.2022.
/NS/*

Copy to:

- | | |
|-------------|---------------|
| 1. Assessee | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.