

IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER

ITA No.1947/PUN/2018

निर्धारण वर्ष / Assessment Year : 2014-15

Rieter India Private Limited, Gat No.768/2, Shindewadi-Bhor Road, Village Wing, Taluka Khandala, District Satara – 412 801 PAN : AAACR3556P	Vs.	ACIT, Circle-5, Pune
Appellant		Respondent

Assessee by Shri M.P. Lohia
Revenue by Shri Anurag Shivastava

Date of hearing 26-04-2022
Date of pronouncement 28-04-2022

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 25-10-2018 passed by the Assessing Officer (AO) u/s 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') in relation to the assessment year 2014-15.

2. Tersely stated, the facts of the case are that the assessee, an Indian company, is a part of Rieter group of companies having

origin in Switzerland. The assessee is engaged in the manufacture of textile machineries, related parts and components. It also carries out installation and commissioning of the machines/equipments sold by the Rieter group companies from outside India and also provides warranty and post warranty support services. The assessee also trades in spare parts required by Indian customers for machines sold by Rieter group companies in India. A return of income was filed declaring loss of Rs.62.53 crore and odd which was later on revised with the same figure of loss. Certain international transactions were reported by the assessee in Form No.3CEB including `Purchase of raw materials/components/parts` at Rs.400.12 crore and `Sale of goods` at Rs.312.12 crore. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of the international transaction. The TPO noted that the assessee processed the above two transactions under the Transactional Net Margin Method (TNMM). Initially, internal TNMM was applied as the most appropriate method, which, later on during the course of proceedings before the TPO, was switched over by the assessee to

external TNMM. The assessee had computed its PLI of Operating profit (OP)/Operating Revenue (OR) at (-) 4.48%. The TPO carried out some alterations in the Profit level indicator (PLI) of the assessee after adopting the external TNMM as the most appropriate method and recalculated the assessee's PLI at (-) 5.13%. He also made some changes in the list of comparables. On the above basis, the TPO proposed transfer pricing adjustment of Rs.59,87,15,956/-. The assessee approached the Dispute Resolution Panel (DRP) but without success. This is how, the AO made transfer pricing addition of Rs. 59.87 crore in the impugned order, against which the assessee has approached the Tribunal.

3. We have heard the rival submissions in the hue of the relevant material on record. At the outset, it is pertinent to mention that albeit the TPO carried out several changes to the Transfer pricing analysis done by the assessee, but the assessee in the extant appeal is disputing only three broader aspects, viz., some issues concerning the PLI computation of the assessee; selection/rejection of some comparables; and proportionate adjustment.

4. Though the assessee raised four additional grounds, but the ld. AR pressed only the issue of Subvention receipt out of them, which is brought out through the following grounds:

1. Considering subvention receipt as operating in nature while computing the net operating profit margins of the Appellant.
2. Without prejudice to above ground, in case transfer pricing adjustment of INR 59,87,15,956 in relation to the international transactions pertaining to manufacturing operations is sustained, subvention receipt should be set off against transfer pricing adjustment and the transfer pricing adjustment should be restricted only to the extent it is excess of subvention receipt.

5. The Hon'ble Supreme Court in *National Thermal Power Company Ltd. Vs. CIT (1998) 229 ITR 383 (SC)* has observed that “the purpose of the assessment proceedings before the taxing authorities is to assess correctly the tax liability of an assessee in accordance with law. If, for example, as a result of a judicial decision given while the appeal is pending before the Tribunal, it is found that a non-taxable item is taxed or a permissible deduction is denied, we do not see any reason why the assessee should be prevented from raising that question before the tribunal for the first time, so long as the relevant facts are on record in respect of that item”. Answering the question posed before it in affirmative, their

Lordships held that on the facts found by the authorities below a question of law arises (though not raised before the authorities) which bears on the tax liability of the assessee and the Tribunal has jurisdiction to examine the same. We are, therefore, admitting the above additional grounds to be espoused for disposal on merits.

I. P.L.I. COMPUTATION OF ASSESSEE

6.1. The first issue raised is against the computation of the assessee's PLI of OP/OR. The first item which the assessee is pressing is the treatment of 'Provision written back' amounting to Rs.85.46 lakh and 'Balances written off' amounting to Rs.134.88 lakh as non-operating. While determining the ALP, the assessee treated the above two items as Operating revenue, which the TPO did not agree with. A copy of the assessee's Profit and loss account has been placed at page 8 of the paper book, which gives detail of the amount of 'Other income' at Rs.22.14 crore. Break-up of such an amount is given in Note No.21, which includes Miscellaneous income of Rs.5.74 crore. The further break-up of this amount has been given at page 657 of the paper book which, *inter alia*, contains the above two items of Provision written back

and Balance written off. The TPO has discussed this aspect at page 15 of his order and gave the reasons for treating them as non-operating as the provisions are non-operating and no details were submitted to prove that the balances written off pertained to current year. The DRP countenanced this view.

6.2. The Id. AR contended that these two items totaling Rs.220.34 lakh represent the reversals made by the assessee during this year and credited to the Profit and loss account for which the corresponding expenses/provisions were taken as operating expenses in same or earlier years. A detail of such items has been furnished at page 1180 of the paper book which contains 19 items. On a specific query, the Id. AR could not demonstrate item-wise correlation between the showing of these expenses/provisions as operating expenses in the current/preceding year and their reversal in the current year. It goes without saying that if a particular expenditure or provision has been allowed as deduction and taken as part of operating cost in preceding/current year and later on during the subsequent/current year it is realized that the provision earlier made was excessive or there was some adjustment in the

actual expenditure leading to lowering of its incidence, then its reversal to that extent constitutes operating revenue. If, on the other hand, it is not proved that a particular amount reversed in the year under consideration and taken to the credit side of the Profit and loss account was treated as part of operating costs in the ALP determination of a preceding year, then obviously, such reversal would not qualify as an item of operating revenue. In view of the fact that the item-wise link between the 19 items reflected on page 1180 of the paper book with the corresponding expenditure/provision taken as a part of the operating costs in this/earlier year has not been ingrained, we consider it expedient to set-aside the impugned order and remit the matter to the file of AO/TPO for undertaking this exercise in order to determine whether the amounts of reversal and credit to the Profit and loss account of 'Provision written back' amounting to Rs.85.46 lakh and 'Balances written off' amounting to Rs.134.88 lakh were earlier included in the operating costs base for the ALP determination of the year of their debit to the Profit and loss

account. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in this regard.

7.1. The next item under challenge is 'Miscellaneous income' of Rs.15.87 lakh which was taken by the assessee as Operating revenue. The TPO held it non-operating. Detail of such amount has been placed at Page No. 815 of the paper book. The first amount is 'Recovery of Telephone deposit' amounting to Rs.8,702.

A deposit, when made, goes to the balance sheet under the head Current assets, loans and advances. Subsequently, when the deposit is received back, the asset earlier created is squared up. Recovery of a deposit, in our considered opinion, cannot be considered as a part of operating revenue. Though a feeble attempt was made by the Id. AR to claim that the payment of Telephone deposit was initially considered as part of Operating costs, but no evidence was placed on record in this regard. Going by the nature of the item, being, Recovery of deposit, we hold that the authorities below rightly took it as a part of non-operating revenue.

7.2. The other item is 'Recovery of contribution to Provident Fund on behalf of employees' amounting to Rs.15,79,187/-. On

being called upon to explain the nature of this item, the ld. AR submitted that the assessee paid the employees' share of Provident Fund and later on recovered it from them. However, no detail of such payments or document showing them as a part of operating costs in the year of the payment, was brought on record. Such payment, when made on behalf of employees, is ordinarily shown as Advance recoverable from employees, which again goes to the balance sheet. Recovery of such an amount cannot be construed as a revenue receipt. As the assessee could not produce necessary details showing that the amount was taken as a part of the operating costs at the time of its payment, we hold that its recovery cannot be treated as a part of operating revenue. This contention also fails.

8.1. Now we turn to items of expenses which the assessee wants to be taken as non-operating as against operating taken by the TPO. The first item is 'Extraordinary one-time cost due to change in assumption for actuarial valuation' quantified by the assessee at Rs.1.37 crore. The assessee claimed deduction for Employee benefit costs of Rs.70.48 crore with its break-up given under Note

No.24 to its Annual accounts. However, while computing the ALP, the assessee claimed that a sum of Rs.1,37,72,122/- should be treated as non-operating cost because there was a change in the actuarial assumption related to salary growth rate from 5% in A.Y. 2013-14 to 8% in A.Y. 2014-15.

8.2. We are disinclined to accept the contention raised on behalf of the assessee because the object behind actuarial valuation is to calculate the present value of the payments to employees which would be required to be made in future. Actuarial valuation is done at the end of an accounting year showing the charge to be made to the Profit and loss account for that year. This exercise is done on year-to-year basis. Actuarial valuation indicates the liability of the assessee that it will incur for that year. The amount quantified by actuary is nothing but the obligation of the company on this account for the year. It is impermissible to bifurcate such liability into two parts viz., the part relating to year under consideration and another artificial part showing the effect of the provision made in earlier years, which also does not get reflected even in the actuarial report. Since the actuary determined the

amount of the provision to be created at the end of the year, the same became an operating cost without any need for reduction. We, therefore, do not find any force in the submission of the ld. AR that a part of the provision for approved gratuity etc. should be treated as non-operating when the full amount of such provision has been claimed as deduction for the year only. This contention is, therefore, repelled.

9. The next item in dispute is excess payment of non-deductible import duty. The ld. AR fairly admitted that the Tribunal has decided similar issue against the assessee in *Hyundai Construction Equipment India Private Ltd. vs. ACIT* vide order dated 29.6.2021 (ITA No. 2453/Pn/2017). This case was argued by the ld. AR, whose copy has also been placed on record. He, however, urged to keep the issue alive for consideration by the Hon'ble High Court. We, therefore, approve the view of the authorities below on treating excess payment of non-deductible import duty as part of operating cost base.

10. The next point raised by the assessee is to treat additional effect of foreign exchange fluctuation as non-operating. Here

again, the ld. AR fairly submitted that the Tribunal in *Hyundai Construction Equipment India Private Ltd. (supra)* has decided this issue against the assessee by holding foreign exchange fluctuation as part of operating cost. This issue was also intended to be kept alive to be taken up before the Hon'ble High Court. Following the view taken in *Hyundai (supra)*, we approve the view point of the authorities. This contention of the assessee is, therefore, rejected.

11.1. The last point *qua* the PLI, raised by the assessee through additional ground, is against the exclusion of Subvention receipt from operating revenue base. The TPO, while determining the ALP, excluded the amount of Subvention receipt of Rs.5.01 crore, which was shown by the assessee as 'Exceptional item' below the line after determining the Profit/(Loss) in its Profit and loss account, and the same was not included in the total income. The DRP did not allow any relief on this score.

11.2. We have heard both the sides and gone through the relevant material on record. The assessee received Rs.5.01 crore as Subvention amount, which has been explained in Note No.42 to

the accounts as the amount received from holding company on account of difficult business environment and harsh market conditions, especially, the impact on cost of production due to foreign exchange fluctuations on account of imports from overseas group entities. Admittedly, this amount of Rs.5.01 crore was not included in the total income for the purposes of taxation. However, while determining the ALP, the assessee included this amount in the operating revenue base. We are not satisfied with the vacillating stand of the assessee. If the contention of the assessee is accepted that the Subvention receipt was to compensate the assessee towards cost of production due to foreign exchange fluctuation on account of imports from overseas group entities, then such amount should have reduced the cost of imports. Admittedly, the assessee did not reduce the cost of production with this amount. Once the assessee takes a stand that the subvention receipt is not a part of the total income because of its no link with the value of imports for use in production, then, ostensibly, the sum loses the character of operating revenue as well in the

determination of ALP. One cannot blow hot and cold in same breath.

11.3. The situation can be compared with certain operating costs not incurred by an assessee but similar costs incurred by comparables. In that case, notional expenditure cannot be added to the operating cost base of the assessee in its ALP determination. The same analogy applies, if an expenditure is incurred but *suo motu* disallowed by the assessee in the computation of total income. This also has the same effect of reducing the operating cost base accordingly by considering as if such expenditure was not at all incurred. The Pune Bench of the Tribunal in *Bilcare Limited Vs. ACIT (2021) 211 TTJ 0429 (Pune)* considered a situation in which the assessee in the revised return made a *suo motu* disallowance of depreciation. The revised return was accepted by the AO. However, at the time of computation of ALP, the TPO considered them as operating costs. The Pune Bench held that when the AO accepted the revised return by taking the resultant income/loss for the purposes of computation of total income, there was no rationale in going backwards and adopt the

figure of depreciation as per the original return for the ALP determination, which had ceased to exist after the filing of the revised return. The Tribunal observed that there was no qualitative difference between one situation in which expenditure is not incurred and not claimed as deduction and the second in which the expenditure is incurred but *suo motu* disallowed by the assessee in the computation of total income. In both the situations, such expenditure actually unincurred or incurred cannot form part of the operating cost base in the ALP determination. Similar is the position prevailing in the instant case though *qua* the item of income as against the item of cost in the case of *Bilcare (supra)*. Though there was Subvention receipt of Rs.5.01 crore but the assessee did not include it in the total income. Once the amount of Rs.5.01 crore is considered as not received for the purposes of taxation, it cannot crop up as a revenue receipt while determining the ALP. A claim dead for computation of total income cannot become alive for the ALP determination. If we accept the contention of the assessee, the situation will be akin to considering Subvention amount as having been received only for the purposes

of ALP determination and not for taxation, which, by no logic, can be a correct proposition. As the assessee admittedly did not include Rs.5.01 crore in the total income, the *sequitur* is that such an amount cannot be included in the operating revenue base for the ALP determination. Though the ld. AR initially relied on a Pune Tribunal decision in *Nalco Water India Ltd. vs. ACIT* (ITA No. 742/Pn/2017) to buttress his contention, but, later on during the course of hearing, did not press reliance on that case. We, therefore, approve the stand of the AO on this count.

II. INCLUSION OR EXCLUSION OF COMPARABLES

12. Before adverting to consider the inclusion or exclusion of certain comparables assailed in this appeal, it would be apt to take note that the assessee is engaged in manufacturing of textile machines and is also providing installation and commissioning of machines sold by Rieter group in India in addition to trading in spare parts. In the ALP determination, the assessee selected three comparables. The TPO introduced two more comparables. During the course of proceedings before the TPO, the assessee requested for inclusion of two more companies. In the final analysis, the

TPO determined the ALP by considering three comparables originally considered by the assessee plus two comparables chosen by him. The assessee is aggrieved by certain inclusions/exclusions.

Elgi Electric Industries Ltd.

13.1. The assessee is aggrieved by the inclusion of this company by the TPO in the list of comparables. It was contended before the TPO that the company was functionally different and was not engaged in manufacturing textile machines. The TPO rejected the assessee's version, which came to be affirmed by the DRP.

13.2. We have gone through the Annual report of this company, whose copy has been provided at page 287 of the paper book. There is no precise reference to the nature of work done by this company in the entire Annual report. The assessee, with reference to the Annual report of this company for the succeeding year, submitted before the TPO that it was manufacturing a) Bobbin Transport System; b) Yarn Conditioning System; and c) Overhead Travelling Cleaner, which indicated the nature of its business as that of textile and not of manufacturing textile machines. We have gone through the segmental information of this company for the

year under consideration, given at page 321 of the paper book, which divulges that it has two divisions, namely, 'Motor Division' and 'Textile Division'. The details from the next year's Annual report show that this company was not in the textile machine manufacturing but in the textile business. Even if it is considered as not decisive for the current year, still, this company in the instant year has two divisions, namely, Textile and Motor, which make it distinguishable from the assessee, which admittedly is not in any Motor business. Primary onus to prove the comparability of a company is on the party who includes it in the list of comparables. If the assessee adopts a particular company as comparable, he will have to prove the comparability. On the other hand, if the TPO includes a company, it will be upon him to prove the comparability. There cannot be a case where the TPO introduces a company without ingraining the comparability. We are confronted with a situation in which the TPO included this company in the list of comparables without showing even the primary condition of functional similarity, much less the other filters. Nature of work done by this company is borne out nowhere

from its Annual report. The Id. DR also could not help in pointing out that this company is in the manufacture of textile machines as is the assessee. Whatever little could be gathered from the Annual report of the succeeding year is that this company was engaged in textile business and not textile machines manufacturing. As such, this company is held to be functionally dissimilar and goes out of the list of comparables.

Luwa India

14.1. This company was offered by the assessee as comparable during the course of transfer pricing proceedings. The TPO rejected the assessee's contention of the similarity of business and ordered to exclude it from the list of comparables, which got echoed by the DRP.

14.2. Having heard the rival submissions and perused the relevant material on record, we find from the Annual report of this company, copy placed at page 199 of the paper book, that this company is engaged in: 'Manufacturing, assembling, installing ... renovating, hiring out or letting out on hire industrial air engineering machinery for textiles...and filtration plants for

controlling humidity and air pollution, industrial process and comfort air treatment systems'. On going through the description of the products manufactured, it can be clearly seen that in addition to manufacturing textile machines it is also manufacturing and selling air pollution and air treatment systems. As the assessee is engaged exclusively in the manufacturing of textile machinery, this company loses its comparability. The position is similar to Elgi Electric Industries Ltd., discussed above, whose incomparability has been accepted because of that company also having dissimilar Motor division in addition to the *ex facie* similar Textile division. We, therefore, hold that this company has been rightly expelled from the list of comparables.

Yamuna Machine Works Ltd.

15.1. The assessee offered this company for inclusion in the list of comparables during the course of proceedings before the TPO. He rejected its inclusion on the ground that the Annual report did not properly divulge the related party transactions. This view was countenanced by the DRP.

15.2. Having heard the rival submissions and gone through the relevant material on record, it is seen from the Annual report of this company, copy placed at page 154 onwards of the paper book, that its revenue from operations is to the tune of Rs.75,78,37,518/-. Detail of such revenue is given in Note No.10 as 'Textile processing machines'. There is no other product manufactured by this company. The TPO rejected this company only on the ground that it had not filled up the details of the Related party transactions properly, as such information was given at Nil, whereas the company has actually paid Directors' remuneration at Rs.28.68 lakh. We do not find any force in the view point of the TPO on this score. In Form No. 23ACA, copy at page 148 onwards of the paper book, this company has reported a figure of Rs.28.68 lakh under Point 8 with the remarks 'Gross value of the transaction with the related parties as per AS-18'. This is the amount of Directors' remuneration. Since other Related party transactions were declared by this company at Nil, this shows that it did not have any such transactions. Once the functional similarity of the company is established with the assessee and further, there are no Related party

transactions, the very foundation of exclusion ceases to exist. We, therefore, order to include this company in the list of comparables.

16.1. Ground No.10 is against not making transfer pricing adjustment on proportionate basis by restricting it only to the international transactions. The assessee requested the TPO that the transfer pricing adjustment, if any, should be worked out only on the value of international transactions. The TPO rejected such contention at the last page of his order and worked out the amount of transfer pricing adjustment by adopting entity level approach. No relief was given by the DRP.

16.2. Having heard both the sides and gone through the relevant material on record, we find that this issue came up for consideration before the Tribunal in the assessee's own case for the immediately preceding assessment year 2013-14. Vide order dated 04-03-2021 in ITA No.2371/PUN/2017, the Tribunal accepted the assessee's contention and directed the AO/TPO to restrict the transfer pricing adjustment only to the value of international transactions rather than entity level transactions. Relevant discussion has been made at para 5 of the order. Respectfully

following the precedent, we direct the AO/TPO to restrict the transfer pricing adjustment only to the value of international transactions.

17. To sum up, we set-aside the impugned order on the question of transfer pricing adjustment and remit the matter to the file of the AO/TPO for a fresh determination of the ALP in accordance with our above directions. Needless to say, the assessee will be allowed reasonable opportunity of hearing.

18.1. The only other ground which survives in this appeal is against the treatment of subsidy received by the assessee under Package Scheme of Incentives, 2007 introduced by the Government of Maharashtra.

18.2. The assessee received a sum of Rs.2,60,05,628/- as subsidy from Maharashtra Government in the form of Electricity Duty exemption, Stamp duty exemption and Exemption of VAT and CST, which was claimed as a capital receipt. The AO observed that the assessee was granted subsidy under the Package Scheme of Incentives, 2007 by the Government of Maharashtra vide Eligibility Certificate of 2013 for its manufacturing unit. He

opined that the amount in question was chargeable to tax being of revenue nature. The DRP accorded its imprimatur.

18.3. Having heard the rival submissions and gone through the relevant material on record, we find that the assessee received subsidy under Package Scheme of Incentives, 2007 from the Maharashtra Government. Preamble of the Scheme states that: 'State has declared the new Industrial, Investment, Infrastructure Policy 2006 to ensure sustained Industrial growth through innovative initiatives for development of key potential sectors and further improving the conducive industrial climate in the State'. It further provides that "new projects, which are set up in these categories in different parts of the State, will be eligible for Industrial Promotion Subsidy". The quantum of subsidy has been linked to the Fixed Capital Investment and the payment of incentive equal to 25% of the relevant taxes paid by the eligible unit to the State. On going through the Scheme, it becomes evident that the purpose and object of this Scheme is to incentivize industrialists to set up new industries in the backward areas. It is only the manner of disbursement of the subsidy which is linked

with the payment of taxes. What is essential for ascertaining the taxability or otherwise of subsidy is to see the purpose for which it was granted. In that view of the matter, the amount in question cannot be treated as a revenue receipt.

18.4. At this stage, it is vital to mention that we are concerned with the A.Y. 2014-15 and the Finance Act, 2015 has inserted clause (xviii) to section 2(24) w.e.f. 01-04-2016 providing that assistance in the form of subsidy or grant of cash incentives etc., other than the subsidy which has been taken into consideration in determining the actual cost of the asset in terms of Explanation 10 to section 43(1), shall be considered as an item of income chargeable to tax. Since the amended provision of section 2(24)(xviii) is not applicable to the year under consideration, the fortiori is that the subsidy received by the assessee cannot be included in its total income. We, therefore, overturn the impugned order and direct to treat the subsidy as an item of capital receipt not chargeable to tax. Similar issue has been considered by the Pune Bench of the Tribunal in *Hyundai Construction Equipment India Private Limited Vs. ACIT* (ITA No. 1766 /PUN / 2018). Vide order

dt. 06-12-2021 for the A.Y. 2014-15, the Tribunal has held such subsidy as not chargeable to tax. This ground is, therefore, allowed.

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

Order pronounced in the Open Court on 28th April, 2022.

Sd/-
(S.S.VISWANETHRA RAVI)
JUDICIAL MEMBER

Sd/-
(R.S.SYAL)
VICE PRESIDENT

पुणे Pune; दिनांक Dated : 28th April, 2022
Satish

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

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(DRP-3), Mumbai-1, CIT(DRP-3), Mumbai-2, CIT(DRP-3), Mumbai-3,
4. The concerned CIT, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे “C” / DR ‘C’, ITAT, Pune
6. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

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

		Date	
1.	Draft dictated on	26-04-2022	Sr.PS
2.	Draft placed before author	27-04-2022	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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