IN THE INCOME TAX APPELLATE TRIBUNAL,
DELHI BENCH: 'I' NEW DELHI

BEFORE SHRI G.S. PANNU, HON'BLE PRESIDENT
AND
SHRI SAKTIJIT DEY, JUDICIAL MEMBER

ITA No.1109/Del/2017
Assessment Year: 2010-11

DE Diamond Electric India Pvt. Ltd., Plot No. 38, Sector-5, HSIIDC Growth Centre, Phase-II, Bawal, Rewari, Haryana	**Vs.**	DCIT, Circle-10(1), New Delhi
PAN :AACCD6342B		
(Appellant)		**(Respondent)**

Appellant by	Sh. Ashutosh M. Rastogi, Advocate Sh. Garvit Sosain, Advocate
Respondent by	Sh. Mrinal Kumar Das, Sr. DR

Date of hearing	21.10.2022
Date of pronouncement	19.01.2023

ORDER

PER SAKTIJIT DEY, JM:

The present appeal by the assessee arises of order dated 21.09.2016 of learned Commissioner of Income Tax (Appeals)-44, New Delhi, pertaining to assessment year 2010-11.

2. Though, the assessee has raised multiple grounds, however, at the time of hearing, learned counsel for the assessee restricted his arguments to limited issues relating to transfer pricing

adjustment made to the Arm's Length Price (ALP) of the trading and manufacturing segments.

3. Before we proceed to deal with the specific issues raised by the assessee, it is necessary to observe, ground nos. 1 to 3 are general grounds, hence, do not require specific adjudication. Further, learned counsel for the assessee, on instructions, did not press ground no. 5. Accordingly, ground no. 5 is dismissed as not pressed.

4. Ground no. 6 being premature, at this stage, is dismissed.

5. As regards the substantive issue relating to Transfer Pricing (TP) adjustments, briefly the facts are, the assessee is a resident corporate entity and a wholly owned subsidiary of Diamond Electric Mfg. Co. Ltd., a Japanese company engaged in the business of manufacturing and sale of automobile and electric equipments. The assessee carries out its operations in India initially trading in automotive ignition coils. Subsequently, the assessee set up a factory unit in Haryana and started manufacturing and sale of ignition coils. In the year under consideration, the assessee had carried out activities, both in trading as well as manufacturing segments. Insofar as trading segment is concerned, the assessee imports ignition coils from its

parent company in Japan and sells it primarily to Maruti Suzuki India Ltd. (MSIL). As far as the international transaction relating to purchase of traded goods, the assessee benchmarked it for transfer pricing analysis applying Cost Plus Method (CPM) by treating the overseas Associated Enterprise (AE) as the tested party and the price paid to the AE was claimed to be at arm's length. However, after verifying the TP study report of the assessee, the Transfer Pricing Officer (TPO) was not convinced. Therefore, he insisted upon the assessee to carry out a fresh benchmarking by considering itself as the tested party and applying Transactional Net Margin Method (TNMM). In compliance to the direction of TPO, the assessee carried out a fresh benchmark under TNMM showing operating margin of 8.94% as against the average margin of comparables worked out at 9.71%. Thus, the transaction was claimed to be at arm's length. While examining the benchmarking of the assessee, the TPO disallowed certain adjustments made by the assessee while computing the margin, such as, foreign exchange fluctuation adjustment and depreciation adjustment. As a result, the operating margin of the assessee was worked out at (-)12.76%. Due to substantial difference between the margin of the assessee

and that of the comparables, the TPO proposed a downward adjustment to the purchase price paid to the AE.

6. Insofar as manufacturing segment is concerned, the TPO rejected the benchmarking done by the assessee under CPM, in so far, purchase of raw material from AE is concerned. Further, he also rejected assessee's claim of cash profit margin as Profit Level Indicator (PLI) and adjustment on account of difference in depreciation rates and capacity under utilization. As a result, assessee's margin in manufacturing segment was determined at (-)37.18% and adjustment was suggested to price paid to the AE towards purchase of raw materials. Though, the assessee challenged the adjustment made in appeal preferred before learned Commissioner (Appeals), however, it was unsuccessful.

7. Before us, learned counsel appearing for the assessee, more or less, reiterated the stand taken before the departmental authorities. He submitted, the assessee secured its contract with MSIL in January, 2008. He submitted, the assessee imported ignition coils from its AE at a fixed price of 590 Yen as per the purchase order/price list agreed with the AE. He submitted, at the time of placing the purchase order and fixing the price vis-à-vis the contract with MSIL, a gross profit margin of 19.43% was

ensured, keeping in view the prevailing exchange rate of 1 Yen = Re.0.35. However, subsequently, there was substantial appreciation in value of Yen vis-à-vis Rupee, thereby, increasing the import cost. It was submitted, the forex rate increased from Re. 0.35 in financial year 2008-09 when the agreement with MSIL was entered to approximately Re.0.54 during October, 2009. Thus, he submitted, the foreign exchange fluctuation was to the extent of 54.29%, which had an adverse impact on the profitability of the assessee. He submitted, though, negotiation was taken up with MSIL to commensurate increased purchase price for ignition coil to absorb the increased cost on account of foreign exchange fluctuation, however, MSIL did not revise the purchase price for ignition coils substantially. Therefore, the assessee had to bear the adverse impact on its resale operation due to the foreign currency appreciation. He submitted, since, the comparable companies did not face any foreign exchange fluctuation risk, whereas, 90% of assessee's transactions are in foreign currency, the assessee sought adjustment on account of foreign exchange fluctuation. He submitted, in assessee's own case in assessment year 2009-10, the DRP has allowed adjustment on account of foreign exchange fluctuation to ensure

parity between comparables and the assessee. In this context, he also referred to Rule 10B(iv) and paragraph 2.97 of OECD Transfer Pricing Guidelines. Further, he submitted, the source of foreign exchange gain/loss lies in the fluctuation of exchange rate between two countries, hence, not a related party transaction. In support of his contention, learned counsel relied upon the following decisions:

i. Honda Trading Corp. India Pvt. Ltd. Vs. ACIT (ITA No.5297/Del/2011) (Tribunal Delhi)
ii. Motonic India Automotive (P.) Ltd. Vs. ACIT [2016] 73 taxmann.com 235 (Chennai-Trib.)
iii. Komatsu India (P.) Ltd. Vs. DCIT [2017] 78 taxmann.com 60 (Chennai – Trib.)

8. Without prejudice, he submitted, while the assessee has charged higher rate of depreciation under the Income Tax Act, the comparables have charged depreciation under the Companies Act. He submitted, higher rate of depreciation charged by the assessee has affected the profit margin compared to the comparables. Thus, he submitted, to ensure parity between the assessee and the comparables, necessary adjustment on account of depreciation has to be allowed. He submitted, in assessee's own

case, learned DRP has allowed depreciation adjustment in assessment year 2013-14, whereas, the Tribunal has allowed such adjustment in assessment year 2012-13.

9. Insofar as, adjustment made in manufacturing segment, learned counsel submitted, this is the first year of operation of the assessee in manufacturing segment. He submitted, for this reason capacity under utilization adjustment is necessary for various fixed costs, such as, depreciation and fixed personal cost. He submitted, in absence of sufficient details on capacity utilization cash profit is a reliable mode of adjustment for capacity utilization. He submitted, adjustment is also required for differential depreciation policy between assessee and comparables as the assessee follows depreciation rates under the Income Tax Act, whereas, comparables follow the rates under the Companies Act. He submitted, cash profit ratio is a permitted PLI under Indian Transfer Pricing Regulation and is commonly employed to account for differences in depreciation policies and to adjust for capacity utilization. Drawing our attention to working of margin computed by using cash profit as PLI under TNMM, learned counsel submitted, the margin of the assessee works out to 15.80% as against the average margin of comparables worked out

at 13.89%. In support of such contention, learned counsel relied upon the following decisions:

i. Schefenacker Motherson Ltd. Vs. ITO [2009] 123 TTJ 509 (Delhi)

ii. DCIT Vs. Reuters India (P.) Ltd. [2013] 33 taxmann.com 481 (Mumbai – Trib.)

iii. CIT Vs. Reuters India (P.) Ltd. [2016] 69 taxmann.com 187 (Bombay)

iv. Qual Core Logic Ltd. Vs. DCIT [2012] 22 taxmann.com 4 (Hyd.)

v. Amdocs Business Services (P.) Ltd. Vs. DCIT [2012] 26 taxmann.com 120 (Pune)

vi. DCIT Vs. Epcos Ferrites Ltd. [2019] 102 taxmann.com 422 (Kolkata –Trib.)

vii. DCIT Vs. AT & S India (P.) Ltd., IT Appeals No.1262 & 2071 (Kol.) of 2010, 186 (Kol.) of 2011 and 779 (Kol.) of 2012

10. Learned Departmental Representative strongly relied upon the observations of the Assessing Officer and learned Commissioner (Appeals).

11. We have considered rival submissions and perused the materials on record. As regards, the transfer pricing adjustment

made to trading segment, on perusal of facts and materials on record, we find that the assessee imports ignition coil from its AE in Japan and sales it to MSIL. It is further observed that the price fixed for purchase and sale of ignition coils were fixed in terms with agreements between the assessee and its AE on one hand and the assessee and MSIL on the other. Facts on record further reveal that between January, 2008, wherein, the assessee entered into an agreement with MSIL for sale of ignition coils and the financial year relevant to assessment year under dispute, there has been substantial appreciation in the price of Yen. Thus, the assessee was put to foreign exchange fluctuation risk as the value of Rupee depreciated compared to Yen. Therefore, the assessee had to pay more to the AE due to variation in foreign exchange rate. Whereas, it was unable to fully recover the increased amount paid form MSIL. Therefore, the assessee had to absorb loss on account of foreign exchange fluctuation. In its benchmarking under TNMM the assessee has claimed adjustment towards foreign exchange fluctuation. However, both the TPO and learned Commissioner (Appeals) have disallowed such adjustment. It is observed, while considering identical nature of dispute in assessee's own case in assessment years 2009-10,

learned DRP has directed the TPO to determine ALP after considering the margin computed by the assessee after making foreign exchange fluctuation adjustment. The decisions cited before us by learned counsel also express similar view.

12. In view of the aforesaid, we direct the Assessing Officer to allow adjustment for foreign exchange fluctuation rate while computing margin of the assessee and the comparables.

13. Insofar as adjustment on account of difference in rates of depreciation as per Income-tax Act followed by the assessee and Companies Act in case of comparables, we find that while deciding identical issue in assessee's case in assessment year 2012-13, the Tribunal vide order dated 10.02.2022 in ITA No.600/Del/2017 has held as under:

> *"7. We have heard the rival submissions perused the orders of the authorities below and the decisions relied upon. From the record placed before us, we observe that the claim for depreciation adjustment was allowed to the assessee by the DRP for the A Y 2013-14 in its directions dated 22.09.2017. However, it is the finding of the DRP for the assessment year under consideration in its directions dated 18.11.2016 is that in the preceding previous year relevant to A Y 2011-12 the claim of the assessee for depreciation adjustment was denied by the Ld. TPO and this was upheld by the DRP. We have also gone through the judgments relied upon by the Ld. Counsel on this issue.*
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> *8. In the case of the Honda Motor Cycle and Scooter India Pvt. Ltd. vs. ACIT 56 taxmann.com 237 it was held that where there was difference in rates of depreciation charged by comparables viz-a-viz assessee suitable adjustment was to be made to profits of comparables. While holding so the Tribunal observed as under:*

"In. other words, the amount of depreciation of the comparable companies on their assets shall be recomputed under straight line method alone as per the rates at which the assessee has provided depreciation. To clarify, if the comparables have charged depreciation at a higher rate in comparison with the assessee on some of its assets, then suitable reduction should be made in the amount of their depreciation"

"9. Similarly in the case of DCIT vs. Sumi Motherson Innovative Engineering Ltd. 2014 (30) ITR (Trib) 367(Delhi) the Tribunal observed as under:

"The crux of the matter is that a higher amount of a particular expenditure per se can be no reason to claim adjustment in profit ratio. That is the reason for which the legislature has provided for comparing composite figure of operating profit which envelopes the overall effect of all the items of operating expenses and revenues. We are not laying down the proposition that once the operating profit is available, then no adjustment is possible. Sub-clause (iii) to rule 10B(1)(e) clearly provides that the normal gross profit mark-up of comparables is adjusted to take into account the functional and other differences, if any, between the is international transaction and the comparable uncontrolled transactions etc. To ask for adjustment, it is sine qua non that there should be some independent and substantial reason for claiming adjustment in profit rate of comparables. The singular effect of higher quantum of an item of expenditure de hors the other relevant factors, is not permissible. In the context of depreciation, one can rightly appreciate the need to make adjustment, if rate of depreciation charged by the assessee vis-a-vis its comparables is different."

10. In the case of Excel Service the Tribunal held as under: -

"5.10 The primary question which falls for our consideration is whether any adjustment to the operating profits can be made on account of the difference in the rates of depreciation on various assets ....

5.11 …When we read sub-clauses (ii) & (iii) of Rule 10B(l)(e) in juxtaposition to sub-rules (2.) & (3) of rule 10B, the position which emerges is that the net operating profit margin of the comparable companies is required to be adjusted in such a manner so as to bring both the international transaction and comparable cases at the same pedestal .....

.....

5.14 However, the position may be a little different when there is a difference in the rates of depreciation charged by two companies -on similar' category of assets. One company may adopt the policy of charging depreciation on its assets in conformity with the rates prescribed in Schedule XlV of the Companies Act and other company may adopt a policy of charging depreciation at the higher rates or lower than those prescribed under Schedule XIV. This can be demonstrated with the help of an example. Other things being equal, if the operating profit of company A, claiming depreciation of Rs, 10 on the value of asset worth Rs.50 with rate of depreciation 20%, is Rs: 100, the operating profit of company B with everything same including the value of asset at Rs, 50, but with rate of depreciation 30% will be Rs95. It shows that the comparability is jeopardised due to higher rate of depreciation charged by company B at 30% in comparison with lower rate of depreciation claimed by company A at 20%. In such a situation, although both the companies use similar type of assets and everything else is also equal, but their respective operating profit percentages undergo change due to higher or lower rate of depreciation, thereby distorting their comparability. It is this difference in the amounts of depreciation due to different rates of depreciation and not due to different quantums of depreciation simplicitor, which calls for bringing both the companies at par.

.....

5.23 ...The assessee is seeking adjustment only due to higher rates of depreciation charged by it under SLM with the lower rates of depreciation charged by four comparable companies, other than Mapro Industries Ltd. and Karvy Consultants Ltd. In view of above discussion, we hold that the operating profit margin of these four comparable companies, should be recomputed by the TPO/AO in line with the rates of depreciation charged by the assessee under SLM....."

11. The ratio of the above decisions clearly applies to the facts of the assessee's case. Following the said decisions, we hold that the Ld. TPO has rightly allowed the adjustment for depreciation on assets. Thus, we reverse the findings of the DRP on this issue and direct the TPOIAO to restore the depreciation adjustments on assets which was earlier allowed while passing the order u/s 92CA dated 29.01.2016. Ground nos. 4.6, 4.7 and 5 are allowed."

14. Respectfully following the decision of the Coordinate Bench, as aforesaid, we direct the Assessing Officer to allow depreciation adjustment while determining the ALP.

15. Insofar as adjustment relating to manufacturing segment, we find, the assessee has claimed certain adjustments for computing the profit margin qua the comparables and also applying the cash profit to sales as PLI. The aforesaid adjustments have been claimed by the assessee to set off the impact of capacity under utilization and difference in depreciation rates provided in the Income Tax Act followed by the assessee and Indian Companies Act followed by the comparables. On careful perusal of the orders of the Transfer Pricing Officer (TPO) and learned Commissioner (Appeals), we find, though, detailed submissions were made by the assessee in support of its claim, however, they have not at all been considered on merits and have been rejected on flimsy grounds. Even, the ratio laid down in various judicial precedents have not been taken note of. Considering that this is the first year of commencement of manufacturing activity in case of assessee, the submissions made by assessee require deeper examination.

16. In view of the aforesaid, we are inclined to restore this issue to the Assessing Officer for fresh adjudication after considering the submissions of the assessee on merits through a well reasoned and speaking order. Further, the Assessing Officer is directed to examine the decisions relied upon by the assessee and must consider applicability of the ratio laid down in the decisions to assessee's case. Needless to mention, the assessee must be provided reasonable opportunity of being heard before deciding the issue.

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

Order pronounced in the open court on 19th January, 2023

Sd/-	***Sd/-***
(G.S. PANNU)	**(SAKTIJIT DEY)**
PRESIDENT	**JUDICIAL MEMBER**

Dated: 19th January, 2023.
RK/-
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi