IN THE INCOME TAX APPELLATE TRIBUNAL "J" BENCH, MUMBAI

BEFORE SHRI PRASHANT MAHARISHI, AM
AND
SHRI SANDEEP SINGH KARHAIL, JM

ITA No. 7470/Mum/2011

(Assessment Year 2004-05)

ITA No. 7469/Mum/2011

(Assessment Year 2005-06)

Schindler India Pvt. Ltd. 401B, Delphi, Hiranandani Business Park, Powai, Mumbai-400 076	Vs.	The ACIT Circle 8(3) Mumbai
(Appellant)		**(Respondent)**

PAN No. AAECS1548J

ITA No. 7330/Mum/2011

(Assessment Year 2005-06)

The ACIT Circle 8(3) Mumbai	Vs.	Schindler India Pvt. Ltd. 401B, Delphi, Hiranandani Business Park, Powai, Mumbai-400 076
(Appellant)		**(Respondent)**

Assessee by	:	Shri Dhanesh Bafna, Ms. Chandni Shah, Ms. Riddhi Maru, ARs
Revenue by	:	Shri Samuel Pitta, DR

Date of hearing: 06-01-2023
Date of pronouncement : 03.04.2023

O R D E R

PER PRASHANT MAHARISHI, AM:

01. ITA number 7476/M/2011 is filed by the assessee for assessment year 2004 – 05 against appellate order passed by The Commissioner Of Income Tax

(Appeals) – 15, Mumbai [the Ld CIT (A)] dated 23/8/2011 wherein appeal filed by the assessee against the assessment order passed under section 143 (3) of The Income Tax Act 1961 [the Act] dated 29/12/2006 was dismissed.

02. Assessee is aggrieved with that and has preferred this appeal raising following grounds of appeal: –

Ground in ITA No.7470/Mum/2011 for A.Y. 2004-05:-

"Ground No 1: Transfer Pricing adjustment of Rs. 2,30,24,555/-

1) On the facts and circumstances of the case, the learned Commissioner of Income-tax (Appeals) (CIT(A)) erred in upholding the action of the Assessing Officer (AO)/ Transfer Pricing Officer (TPO) of ascertaining the arm's length price of the international transactions at Rs. 5.13,30,548/- instead of Rs. 7,43,55,103/- as determined by the Appellant.

2) The learned CIT(A) further erred in:

a. not accepting / appreciating the fact that the Appellant's loss was on account of its business strategy and not on account of its international transactions with the Associated Enterprises;

b. not accepting / appreciating the economic adjustments carried out by the Appellant on account of annual maintenance contract income for future

years, cost savings on differential duties & incidental expenses, extra-ordinary replacement costs and indigenization of components.

c. not granting the (+/-) 5% range benefit available under proviso to Section 92C(2) of the Income Tax Act, 1961.

3) The Appellant prays that it be held that the international transactions are at arm's length and accordingly the adjustment of Rs. 2,30,24,555/- be deleted.

Ground No 2: Short TDS credit of Rs. 14,16,080/-

1) The learned CIT(A) erred in not directing the AO to grant a TDS credit of Rs. 14,16,080/- (i.e. Rs.42,24,974/- as claimed by the Appellant in his return of income less Rs. 28,08,894/- granted by AO)

2) The Appellant prays that the AO be directed to grant credit for balance TDS of Rs. 14,16,080/-

The Appellant craves leave to add to, alter, amend or withdraw all or any of the Grounds of Appeal."

03. Brief facts of the case shows that assessee is a private limited company established in India and started its operation in 1999. The assessee offers customers the latest models of lifts, technologically advanced to those currently available in Indian market at affordable prices. It provides installation, modernization and maintenance services for the

products sold by it. The assessee filed its return of income for assessment year 2004 – 05 on 31/10/2004 at loss of Rs. 192,200,620/–.

04. The assessee has entered into following international transactions: –.

Serial number	Particulars of transaction	Amount of international transaction	Method adopted by the assessee	benchmarking
1	Purchase of stores and spares	4,01,03,050	Transactional net margin method	Assessee selected 5 comparable companies whose Oprah rating profit margin was 4.21% assessee has incurred losses at the gross profit level of gross loss of 4.46%. Assessee adjusted the profit level indicator and after that computed adjusted operating margin ratio of 1.03%. Thus stated in transfer pricing study report that international transaction is at arm's-length.
2	Purchase of lifts and escalators	2,32,86,474		
3	Professional fees	40,96,285		
4	Reimbursement of expenses	68,69,294		

05. For the purpose of computation of adjusted operating margin ratio, assessee adjusted its gross loss as under:-

Serial number	particular	amount	amount
1	Gross margin of the assessee		-2,44,33,998
2	Add discounted value of gross margin of annual maintenance contract	1,704,98,667	
3	Cost savings on differential duties	3,51,05,394	
4	Extraordinary replacement cost	2,01,13,028	
	total		2257,17,089
5	less Annual maintenance contract margin for the year		93,04,221
6	And foreign exchange in miscellaneous income		1,91,06,047
7	Less operating costs such as salaries, other operating expenditure, depreciation and bank charges		19,04,43,866
8	Add cost of indigenization		21,98,011
9	Adjusted operating margin		56,49,062
10	sales		54,75,62,904
11	Adjusted operating margin		1.03%

06. Assessee has made following for adjustments to its margins.

i. The first adjustment made it to margins of the assessee is increase of the gross margin by a discounted value of gross margin of annual maintenance contracts amounting to Rs. 1,704,98,667/- . The annual maintenance contract income of the assessee for March 2004 is Rs. 93 lakhs. The contention of the assessee is that its annual maintenance contract income is less

than that of the comparable companies. Going forward, some years down the line, the annual maintenance contract income of the assessee may become comparable to the comparables. Currently, the income of comparables may be higher due to the higher composition of annual maintenance contract income in their income profile. Hence, to make the margins of the comparable, the assessee has made an adjustment because of future annual maintenance contract income. For this purpose, the assessee presumes that the useful life of elevator is 20 years and therefore the assessee has presumed the amount of income that would arise from the elevators each year over the period of 20 years on account of AMC Income. The net earnings have been discounted by the assessee by using the government of India Treasury rates. After discounting, assessee arrived at the present value of the earnings from the lifts for each year over the 20-year period. The sums of the present value of these earnings have been added to the gross profit of the assessee. Therefore, the assessee has increased the margin by Rs. 17,04,98,667 and reduced it by the margin for the current year of Rs. 93,04,221.

ii. The assessee has calculated the differential because of customs duties such as excise duty

and other expenses incurred in course of import of goods. The assessee's contention is that its import percentage is 28% compared to 12% for the comparables. The rate of customs duty is 57.8% representing custom duty, freight, insurance, clearing charges et cetera which assessee incurs. If it had locally purchased the product then the excise duty payable would be 16%. Therefore, the assessee made an adjustment of Rs. 3,51,05,394 by increasing its margin for the year.

iii. The assessee has also made an adjustment of extraordinary replacement cost of Rs. 2,01,13,028. According to the assessee, it imports products from its associated enterprises located in the European countries. The products are more suitable for the European climate condition and are not good for Indian climatic condition. Hence, these costs are considered as extraordinary by the assessee.

iv. The assessee has also made an adjustment of indigenization of cost. Assessee states that its business model is to import the product from the associated enterprises, assemble it in India and sell them. Since these products are expensive and unsuitable to Indian climatic condition, the assessee is shifting to Indian

initiation. Assessee has incurred certain cost on account of this in form of technical personnel visits, designs received et cetera. These costs are considered an adjustment by the assessee.

07. On examination of the above data, the learned transfer-pricing officer, on reference by the learned AO, examined the arm's-length price of the international transaction. He accepted all comparable companies selected by the assessee and that profit level indicator of comparables at 4.21%. However he did not allow various adjustment proposed by the assessee to the margins of assessee itself.

08. The learned transfer pricing officer held as under:-

i. On annual maintenance contract income adjustment made by the assessee, the learned transfer-pricing officer was of the view that the assessment is for the period ended 31st of March 2004 and therefore the profitability of the assessee for that year only would be under consideration. Income of each year is separate and taxed separately. Therefore he did not agree with an economic adjustment to increase the income of 20 years and adjust it to the gross profits of the current year as it would unnecessarily inflate the profits of the current year as these profits would accrue to the assessee over 20 years.. He further noted that assessee is making this adjustment only for the

comparability purposes and this adjustment is not made by them in the accounting or tax records. For tax purposes, the income would be accrued in the respective years and tax would accordingly be calculated and paid for each year. Therefore, it does not justify the credit for annual maintenance earnings of 20 years and adjust it in the current year. He further held that this is a single sided adjustment made by the assessee and no adjustment is proposed to the comparables. From the annual report of the comparable is it is not possible to work out the proportion of the annual maintenance income in the total income or the life of the equipment sold by them. Accordingly, he rejected the above adjustment.

ii. With respect to the adjustment on account of cost saving on account of differential duties and incidental expenses such as custom duty, the learned TPO held that custom duty etc are the expenses incurred in the course of the business. Every importer who is engaged in the import of products would be required to pay these charges. These charges would be recovered by them from their ultimate customer. Accordingly, the sale price of the assessee to that extent would be higher to recover these costs. He further held that if these costs were excluded then even the

corresponding sale price would be required to be adjusted. Therefore, he rejected this adjustment.

iii. With respect to the extraordinary replacement cost, the learned TPO held that these costs are incurred in the course of the business and are intrinsic to the products imported by the assessee. Hence, they should not be considered as an adjustment as the assessee does not consider them extraordinary in its return of income and does not pay tax on it. He rejected this adjustment also.

iv. With respect to indigenization cost, the learned transfer-pricing officer held that the business model of the assessee is to import the products from the associated enterprises, assemble it in India, and sell them. These costs are normal cost incurred in the course of the business as these cost would benefit the assessee in the form of better profits due to reduced imports in the period under consideration.

09. Accordingly, he computed the operating profit of the assessee at a loss of Rs. 212,961,817/–. He computed the profit margin of the assessee taking the margins of the comparable at 4.21% at Rs. 23,133,064/– and accordingly proposed an adjustment of Rs. 236,094,881/–. After that he is of the view that the total adjustment of Rs. 23.60

crores are more than the value of the international transaction of Rs. 7.43 crores which is unjustified and therefore, after reworking of the expenses and the margin he made an adjustment of Rs. 2,30,24,555 to the arm's-length price of the international transaction. Accordingly the order under section 92CA (3) of the act was passed on 22/12/2006 and adjustment of Rs. 23,024,555/- was made to the arm's-length price of the transaction.

010. Based on the above adjustment an Assessment order under section 143 (3) of the act was passed on 29/12/2006 determining the total loss of the assessee of Rs. 169,176,070 against the returned loss of Rs. 192,200,620.

011. The assessee aggrieved with the above order preferred an appeal before the learned CIT – A who passed the appellate order on 23/8/2011. Assessee argued that the profit level indicator i.e. margin of the assessee is correctly computed which is not appreciated by the learned transfer pricing officer. The learned CIT – A referred to the provisions of rule 10 B (1) (e) with respect to the transactional net margin method and rejected the adjustment made by the assessee to margins of the assessee itself. Accordingly, appeal of the assessee was dismissed.

012. Aggrieved, assessee is in appeal before us. The learned authorized representative submitted that

i. Economic adjustment made to the operating margin of the appellant is permissible under rule 10 B (1) (e) of the act. He submitted that rule requires that the net profit margin of the tested party should be compared with the net profit margin arising out of the comparable uncontrolled transaction and both must be compared using the same profit level indicator. He further referred to sub clause (iii) which according to him allows adjustment to be made to the net profit margin arising out of the comparable uncontrolled transactions for differences, which can materially affect emergence in the open market. The calculation of net profit margin of the tested party is now well defined under the rule and further there is no provision under the rule, which bars the appellant being a tested party to make adjustment for difference to its operating margin. He referred to the decision of the coordinate bench in case of 147 ITD 388 Aristone Thermo India private limited versus DCIT. He further submitted several other judicial precedents wherein various coordinate benches have allowed an adjustment to be made to the operating margin of the tested party for comparability purposes. It was further his submission that rule 10 B (2) and (3) of the rules specifically provides that while conducting

the comparability analysis, conditions prevailing in the market such as level of competition etc. should be in taken into consideration.

ii. He submitted that assessee has considered its relative position in the market being a new entrant in an established industry and facing tough competition from rivals and other economic conditions to compute the various economic adjustments calibrated. He submitted that the learned CIT appeal in his order has wrongly rejected the adjustment made by the assessee holding that these are the factors not affecting the net profit margin in the open market. He submitted that the assessee has claimed an adjustment for factors such as business strategies, market penetration schemes, competition in the market, difference in import content, replacement cost etc. Which materially affect the price, cost of profit of the transaction. Therefore, according to him the economic adjustment claimed by it is justified because it raises the material difference arising between the assessee and the comparable is due to its initial year of operation, marketing penetration scheme adopted and competition in the market. He further referred to the note submitted by him on assessee is India business strategy.

iii. Coming to the economic adjustment with respect to the higher import duty contained in differential duties, he submitted that assessee offers customers latest renowned models of elevators which are technologically advanced and therefore it imports from its associated enterprises and third parties that matches its quality standards which cannot be procured locally approximately 28% of the component and knockdown kits purchased were imported from its associated enterprises. He submitted that comparable company is only import 11.83% of the total material purchased and source the balance material locally. Therefore, the assessee pays heavy custom duty on such import the rate of 57.8% against a relatively lower excise duty of 16% paid by the comparable companies. Therefore, assessee has considered this differential expenditure for the purpose of making an adjustment was operating margin. For this proposition assessee relied on the decision of Skoda auto India private limited versus ACIT 122 TTJ 699 wherein an adjustment to the operating margin of the assessee was allowed in case of fire contention of important row material vis a vis lower in comparable companies.. Accordingly, he submitted that an adjustment in the operating margin is imperative the business

models of the tested party and the comparable companies are fundamentally different. According to him high variation of import content of tested party and comparable company shows that the business models are different and thus calling for an adjustment for the same. He further stated that it is not necessary that the assessee company shall always pass on the higher import duty paid by to its customers. According to him, the onus is not on the assessee to get all the details of the comparable companies to enable adjustment for different business models, which are not in public domain. Therefore, he submitted that while computing an adjustment for differences it is inevitable to resort to some export proxy and reasonable assumptions when sufficient information is not available in public domain.

iv. With respect to the adjustment for market penetration strategy in the form of annual maintenance income for future years submitted that the elevator industry is highly competitive and price sensitive. While determining the sale price of a left, a company would definitely take into account the expected realization from annual maintenance contract in future years and accordingly arrive at the selling price. The annual maintenance cost revenue is measure business driver in the elevator industry and the

company would sell/install at substantially discounted price with the objective of securing future annual maintenance contract income. Therefore, the income earned by the companies from annual maintenance contracts play a significant role in deciding whether or not to a specified contract should be executed. According to him, the average life of the left is usually around 20 years and therefore the annual maintenance contract. Is also available where the retention ratio with respect to the maintenance of elevator is hundred percent. Therefore, income earned from annual maintenance contract forms a substantial portion of the elevator companies' revenue, which cannot be ignored for computing the operating margin of the appellant. He submitted that during the financial year 2003 – 04 assessee is in its fifth year of operation. AMC income for this area is only Rs. 2.07 crores on revenue from completed contract of installation of lift are only Rs. 52.75 crores. The special portion of the appellant revenue is from sale of lifts, which has been transacted at reducing price due to the expected annual maintenance contract income in future and cutthroat competition in the market. Therefore, the operating margins of the assessee for the current year are not comparable with that of

the comparable companies, which have been established themselves many years ago. Therefore the appellant and the comparable companies must be on a level playing field therefore the operating margin of the appellant is required and adjustment in this regard. He further stated that annual maintenance contract income is closely linked to the sale price of the lift. Hence, it was considered appropriate to aggregate the sale price of lift with the sum representing the discounted value of annual maintenance contract income expected to be received from the customers during the useful life of lifts, which is typically around 20 years. Therefore, assessee has adjustment made in the current year's gross profit. The adjustment has been worked out using the discounted cash flow method for arriving at the present value of future cash flow. It was also shown to us that in the current year that is assessment year 2004 – 05 the annual maintenance contract income are just 3.79% of the total income of the assessee whereas in assessment year 2012 – 13 it is 12.59% of the total income. In nutshell it is the contention that when the percentage of annual maintenance contract income increases the profitability improves. Thus, the annual maintenance contract income has a direct

bearing on the profitability of the company in the elevator industry hence assessee is justified in making economic adjustment in relation to the AMC income.

v. Alternatively assessee also contended that the economic adjustment for the market penetration strategy can also be computed by adjusting operating margin by substituting the lower average sale price per unit by the rate equivalent to the sale price in the post-market penetration stage or by substituting the meager annual maintenance contract income by income at the rate equivalent to the AMC rate in the post-market penetration stage. Thus it was submitted that operating margin of the appellant as adjusted would be 9.07% which is much higher than the arm's-length price at 4.21% of the comparable companies. He further relied on the decision of the coordinate bench in case of Syngenta India Ltd versus additional CIT wherein it has been held that the market penetration schemes, business strategies, increase in market share et cetera relevant factors affecting prices and profits of a transaction and thus reasonable adjustment should be allowed.

vi. The adjustment for extraordinary replacement cost was also justified by the assessee stating

that that mostly the equipments of the assessee are condition for European climates and were not conducive to the Indian environment because of heat, dust and humidity and therefore assessee has granted a warranty for free replacement/repair/customer for a period of 18 months assessee is offering free maintenance. Of 1.5 years to 3 years in order to attract rental however due to the unexpected failure rate of components turned out to be 71 units within the warranty period and other 40 units beyond warranty period. It was further shown that the documentary evidences to show that replacement cost for extraordinary in nature are demonstrated in the form of showing constant failure and replacement of repair required. Therefore and adjustment made to the operating margin of the appellant on account of high replacement cost is justified.

vii. With respect to adjustment of indigenization of cost, it was submitted that during the year under consideration the appellant is following a model wearing imports specific components from abroad in order to match Schindler brand quality standards. It is appreciated that indigenization cost will give used benefit to the assessee. The assessee obtained technical information and assistance from its associated

enterprise with respect to the products and also advise for vendor development for maximizing indigenization to meet the safety to really let out specification for Indian elevators the cost incurred in this regard essentially includes cost of designs and plans and expenses incurred on expatriates personnel as well as material used in testing and other incidental costs. The same has been debited to the profit and loss account of the appellant, which requires to be adjusted in the operating margin.

013. Accordingly, he submitted that the economic adjustment made in the operating margin of the appellant should be allowed to the assessee for comparability purposes in transfer pricing analysis.

014. The learned departmental representative vehemently supported the order of the lower authorities. He extensively relied on the order of the learned CIT – A and submitted that in the transaction net margin method above adjustment is not permitted. He further referred to the decision of the coordinate bench in case of ITA number 1727/M/2015 for assessment year 2010 – 11 in case of Alstom India Ltd wherein identical adjustment was denied by the coordinate bench holding that the expenses incurred by the assessee are normal expenditure incurred during the course of the business. With respect to the income accounted for by the assessee for

computing the gross margin of the assessee submitted that it is a noble methodology applied by the learned authorized representative, which is not permitted. He submitted that how the income of the respective subsequent years could be considered for increasing the margin of the assessee for the current year. He submitted that the adjustments proposed by the assessee are not supported by the transfer pricing provisions.

015. We have carefully considered the rival contention and perused the orders of the lower authorities. The learned CIT – A has dealt with this issue as under :-

""a) From the plain reading of the aforesaid rule, it is crystal clear that profit level indicator (PLI) prescribed under TNMM is the net operating margins computed in relation to the prescribed base as mentioned in sub-section (i) above. The choice with the tax payer is regarding selection of base i.e. cost incurred or sale effected or assets employed or any other relevant base, but not in the selection of margins.

b) Net profit margins have not been defined in the I.T. Act or rules made therein. When the statues have not provided the definition of a term used in it then general meaning of the term has to be taken into consideration. It has been held by the Kerala High Court in the case reported in 190 TTR 32(Ker)" While interpreting the meaning of a word, the court in the absence of the statutory definition will have to

consider its meaning in the manner in which it is understood generally by those who deal with the subject in question.

Thus, the net profit normally means profit before tax, computed in accordance with the accounting principles. However, any item of income or expenditure which has no bearing on the amount of the transactions under examination have to be excluded or included as the case may be. Some of these items may be as dividend income and interest income, which are not directly related to the transactions.

c) Thus, under TNMM in the first step, net operating margin from international transaction is computed in relation to the appropriate base. In the second step, net operating margin of the uncontrolled transactions are identified. In the third step the net operating margin of uncontrolled transaction are adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entered into such transactions which could materially affect the amount of net profit margin computed in step 3 above is then taken to be net operating margin and the Arms Length Price of the transactions computed by that operating margin.

Appellant in its analysis has made an attempt to make adjustments to account for annual maintenance

contract income, to account for indigenization of components, adjustment towards expected cost savings on differential duties and incidental expenses and also in respect of extra-ordinary replacement costs. This adjustment has been made in the case of the appellant itself. As per the plain reading of the rule reproduced above it is clear that for the adjustment to be made, first it is essential to arrive at the difference between the international transaction and the comparable uncontrolled transaction and in respect of such difference, if any, the adjustment has to be made to the net profit margin arising in comparable uncontrolled transaction. It is clear from the Rule 10 (1) (e) (iii) of the I.T. Rules, 1962 and that the adjustment could be made if the 'difference' existed in respect of the details of the comparables vis-à-vis the assessee company and then too the adjustment would have been required to be made in respect of the margins arising in respect of the comparables and not in respect of the net margins of the assessee company. Under any circumstances, the unilateral adjustment to the net margin arising in respect of the international transaction, in complete disregard and without verifying whether such adjustment, in the first place are required vis-a-vis the comparables adopted, is not permissible under the Rule 10B(1)(c)(ii) of the I. T. Rules, 1962.

The nature of the 'difference' which may warrant any adjustment should be such "which could materially affect the amount of net profit margin in the open market"". The appellant has made adjustment to

account for annual maintenance contract income, to account for indigenization of components, towards expected cost savings on differential duties and incidental expenses and also in respect of extra-ordinary replacement costs. These are not factors affecting the net profit margin in the open market. Further the factors affecting the profit margins in the open market would probably be as under:

i) Factor of demand and supply

ii) Existence of marketable intangibilities i.e. brand name, etc.

iii) Geographical location, and the like

For the purposes of the comparability analysis and benchmarking following TNMM, the comparables have been searched which are functionally similar. Further the search of comparables has also been done having regard to assets and risks of the appellant and the comparables. Thus the companies being comparable and fulfilling comparability criteria would have faced similar conditions in respect of demand and supply. The higher profitability in respect of the comparables is for the reason of either existence of marketing intangibles or geographical location is also not what is coming out of the facts of the case or the analysis carried out by the appellant. Thus even on this count the adjustment made by the appellant to its PLI is not acceptable.

In view of the facts of the case and discussion as above the contention of the appellant in respect of

adjustment to account for annual maintenance contract income, expected cost savings on differential duties and incidental expenses, in respect of extra-ordinary replacement costs and to account for indigenization of components to its PLI is not found to be as per law and is accordingly rejected. On without prejudice to the aforesaid conclusion that the adjustments carried out by the appellant are not consistent with the rule 108 (1) (6) (ii) of the I. T. Rules, 1962; even if such adjustments are considered then too as per the submission of the appellant and as per the facts of the case the adjusted PLI of the appellant comes to 1.03% as against the arithmetic mean of the PLIS of the set of comparables at 4.21%. The consequent contention of the appellant that such adjusted margin of the appellant fall within the range of +/- 5% is a wrong statement. As the +/-5% range is to be computed with respect to the ALP of the international transactions and not in absolute term the entity level margin is leveraged by this margin of 5%. Even after considering the adjusted margin of the appellant, the adjustment required to arrive at the ALP of the international transactions would be Rs. 1,74,73,430/-. (Computed on the basis of difference in the adjusted PLI of the appellant and arithmetic mean of PLIs of the set of comparables and considering sales turnover of the appellant.) It only goes to prove that the appellant having done the analysis and benchmarking of its international transactions, has instead of making an adjustment to the value of its international transactions to arrive at

the ALP, has wrongly claimed its international transactions to be at arm's length.

Appellant has further submitted in respect of genuineness of losses incurred and has mentioned that its losses are to the tune of Rs. 19,22,00,620/- whereas its international transactions is only Rs. 7,43,55,103/-. In this regard it is mentioned here that as per the transfer pricing study conducted by the appellant, which has been accepted by the TPO except acceptance of the so called economic adjustments carried out by the appellant, the adjustment required to arrive at the margins of the set of comparables (following TNMM) has been determined by the TPO at Rs. 23.80 crores. However subsequently considering the portion of the international transactions of the appellant, only proportionate adjustment has been considered and worked out at Rs. 2,30,24,555/-. Obviously this portion of adjustment is relatable to only the international transaction of the appellant. Accordingly the differential amount to the tune of Rs. 20 crores, which has been not considered by the TPO/AO towards the adjustment could only be considered towards the business losses of the appellant on account of the various non transfer pricing factors which have been mentioned by the appellant and have been discussed here in above.

The appellant has also contended to consider the set of comparable which it gave during the course of the proceedings before the TPO. It may be mentioned

here that such set of comparables were given by the appellant on being specifically asked by the TPO and of the companies which were in the business of elevator manufacturing. In this regard it is stated that it is not the contention of the appellant the said set, forms set of comparables for the appellant's international transactions. Further it is mentioned here that the Transfer Pricing Regulations of India do not state to adopt the competitors in the business to benchmark the international transaction. The comparability has to be vis-à-vis the comparables and not competitors. Accordingly such set cannot be taken for the purposes of comparability and benchmarking. It may be further mentioned that the TPC in the benchmarking analysis has followed the same set of comparables which has been taken by the appellant in its T.P. study report and further it is not a submission of the appellant that such set of comparable is no more valid for one reason or the other or the new set given by it is of the set of comparables. Accordingly this contention of the appellant is not found to acceptable...

In view of the facts and discussion hereinabove, the contention raised by the appellant in respect of Ground no. 2 is not found to be acceptable and accordingly the ground so raised is dismissed."

016. Now we look at The Income tax Rules 1963 whether in TNMM application such an adjustments are permitted or not.

017. Provision of Rule 10 B (1) (e) is as under :-

(*e*) transactional net margin method, by which,—

(*i*) the net profit margin realized by the enterprise from an international transaction [94][or a specified domestic 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;

(*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 [94][or the specified domestic 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 realised 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 [94][or the specified domestic transaction];

018. On Plain reading of the Rule, what is to be compared is profit Realized by the Enterprises with profit Realized by unrelated enterprises. Therefore, without looking in to further merit of claim of assessee, that discounted cash flow earnings of probable annual maintenance contract income to be generated for 20 years is to be included in to the margins of the assessee, we find that such income is not at all realized, therefore, such an economic adjustment, if at all permitted, cannot be carried out in application of TNMM method. Hence, we are not inclined to consider the claim of the assessee that a

sum of Rs. 1704,98,667/- be included in the margin of the assessee , hence we reject it. We concur with the views of ld TPO and ld CIT (A) on this issue. Ld TPO is directed to include only Rs 93,04,221/- in the computation of Margin of the Assessee.

019. There is an another aspect to this claim, Assessee has computed what it would earn in a period 20 years subsequent to this year on account of annual maintenance contract income . We find that such a working is based on many assumptions that cannot be verified or tested in this year. Further, to the future income there is no functions performed by the assessee during the year, no risks assumed and no assets employed for earning in future of such an annual maintenance income of the assessee.

020. None of the decisions cited before us deal with an issue of inclusion of future income to compute margin of current year.

021. On the issue of higher custom duty component, it was submitted that assessee has 28 % of import content compared to 11 % in case of comparable. The Import duty as sated is 57 % where as the excise duty is only 16 % therefore, assessee should get an adjustment in margin of the Assessee.

022. It is to be noted that the claim of assessee for exclusion of differential Customs duty is based on the premise that it made more imports with the

resultant increased cost of import because of higher incidence of Customs duty as against the comparables paying less amount of local duties. In our considered opinion, this argument is devoid of merits. It is not a case of payment of Customs duty by the assessee at a higher rate *vis-a-vis* comparables. It is just fundamental that if a person uses better quality raw materials, obviously, the corresponding sale price also has definitely premium price and vice-versa. Given the fact that the assessee imported more lifts from its AE, it is a natural corollary that corresponding sale price would also have been on higher side, thereby nullifying the effect of higher payment of Customs duty, forming a part of the Operating cost base on the overall basis. It is not the case of the assessee that it is paying higher customs duty then others, which would have necessitated for adjustment to have a level playing. Therefore on this count we concur with the views of lower authorities that no such adjustment can be granted to assessee to increase its margin.

023. With respect to extraordinary replacement cost, we find that product failure and customization are the normal business expenditure in case of machinery manufacturers and traders. The product failure is part of warranty cost and provisioning which is a normal provisioning and expenditure in such business, therefore we do not find any fault with the Action of LD TPO in not granting adjustment of

extraordinary replacement cost and cost of indigenization. Therefore, we concur with the views of the lower authorities. Accordingly, we dismiss ground no 1 of the appeal.

024. Ground no 2 is with respect to short tax credit, we direct the ld AO to grant tax credit of TDS to the assessee after verification. Ground no 2 is allowed.

025. Accordingly, appeal of assessee for AY 2004-05 is partly allowed.

026. Now we come to the appeal for assessment year 2005 – 06 where both the parties is challenged the order of the learned CIT – A dated 18/8/2011.

027. The brief facts shows that assessee filed its return of income on 31 October 2005 declaring a total loss of ₹ 137,071,800/–. As assessee has entered into international transaction identical to assessment year 2004 – 05, the learned transfer pricing officer by passing an order under section 92CA (three) has determine the arm's-length price of such transaction proposing and adjustment of Rs. 1,81,09,090/–. Subsequently that the total income of the assessee was computed at rupees loss of 11,89,62,705 by passing an assessment order under section 143 (3) of the act on 10/12/2008. The assessee preferred appeal before the learned CIT – A challenging the transfer pricing adjustment. The learned CIT – A disposed of the appeal of the assessee by passing an

appellate order on 18/8/2011 granting the assessee relief of ₹ 3,866,040 on account of benefit of plus or -5% but rejecting the adjustment to the margins of the assessee on account of future annual maintenance contract income as well as indigenization cost. Therefore, both the parties aggrieved with the same are in appeal before us. The learned AO is aggrieved by granting the relief of ₹ 3,866,040/– and assessee is aggrieved by the adjustment not granted by the learned CIT – A with respect to the annual maintenance contract income to be received by the assessee in future and not granting the deduction from the margin of the assessee with respect to the indigenization of the cost.

028. With respect to the appeal of the assessee, identical issue is decided by us also in appeal of assessee for assessment year 2004 – 05, for the similar reasons we dismiss the appeal of the assessee.

029. With respect to the appeal of the learned AO we find that the learned CIT – A has granted the benefit of proviso to section 90 2C (2) of the act following the decisions of the coordinate benches holding that proviso to section 92C (two) has been amended subsequently and as per circular of the civility number 5/2010 dated 3/6/2010 amended provision is applicable with effect from 1/4/2009 i.e. for assessment year 2009 – 10 and subsequent

assessment years, the benefit of plus or -5% as short by the appellant was found to be acceptable. We do not find any infirmity in the order of the learned CIT – A. In the result, the appeal of the AO is dismissed.

030. In the Result, appeal of the assessee for assessment year 2004 – 05 and 2005 – 06 are dismissed and appeal of the learned assessing officer for assessment year 2005 – 06 is also dismissed.

Order pronounced in the open court on 03/04/2023

Sd/-	Sd/-
(SANDEEP SINGH KARHAIL)	(PRASHANT MAHARISHI)
(JUDICIAL MEMBER)	(ACCOUNTANT MEMBER)

Mumbai, Dated:
Sudip Sarkar, Sr.PS
Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

BY ORDER,

True Copy//

Sr. Private Secretary/ Asst. Registrar
Income Tax Appellate Tribunal, Mumbai