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

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

ITA No. 7255/MUM/2018
(Assessment Year 2014-15)

Rosoboronservice (India) Limited R-700, TTC Industrial Estate, P.O. Ghansoli, MIDC Rabale, Navi Mumbai- 400701	Vs.	Deputy Commissioner of Income Tax-15(3)(1) Room No. 473, Aayakar Bhawan, New Marine Lines, Mumbai-400020
(Appellant)		**(Respondent)**

PAN No. AADCR0040B

Assessee by	:	Mr. Gaurav Jain, Advocate
Revenue by	:	Mr. Manoj Kumar, CIT DR

Date of hearing: 26.07.2023
Date of pronouncement : 12.10.2023

O R D E R

PER PRASHANT MAHARISHI, AM:

01. This appeal is filed by the assessee i.e. Rosoboronservice (India) Ltd [Appellant] against the assessment order dated 24.10.2018 passed by the Deputy Commissioner of Income Tax 15(3)(1), Mumbai [The AO] u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (The Act) pursuant to direction dated 24.09.2018 issued by The Dispute Resolution Panel, Mumbai (Ld. DRP) dated 24.09.2018 wherein the transfer pricing adjustment proposed by the Ld. TPO u/s 92CA(3) of the Act is incorporated.

02. The assessee has raised the following grounds of appeal as under:-

1. "That on the facts and circumstances of the case, the final assessment order dated 24 October 2018 (and received by the Appellant on 29 October 2018 passed by the Deputy Commissioner of Income-tax, 15(3)(1), Mumbai u/s 143(3) read with section 144C(13) of the Income-tax Act, 1961 Act"), pursuant to the directions dated 24 September 2018 by Dispute Resolution Panel. Mumbai ("DRP") u/s 144C(5) of the Act and read with order dated 27 October 2017 issued by Transfer Pricing Officer ("TPO") u/s 92CA(3) of the Act, is bad in law and void ab-initio

2. General Ground

2.1. That on the facts and circumstances of the case and in law, the learned AO/ DRP/ TPO have erred in making an upward adjustment of Rs. 11,29,97,681/- to the total income of the Appellant by holding that transactions of purchase of trading equipments etc. and payment for services by the Appellant to its Associated Enterprise ("AE") is not at arm's length.

2.2. The learned AO/DRP/TPO failed to appreciate that the MoD, is the Government of India with stringent controls over its procurements coupled with a rigorous system of purchasing, thus enjoys superior commercial leverage against its vendors such as the Appellant precluding any possibility of excessive profits. On the other hand the Russian Federation, being related party supplier also decides its selling price under strict Russian government regulations. Between the two, the Appellant cannot hope to have any unreasonable profits. This arrangement has a substantial bearing to the low profits of the Appellant.

2.3. The learned AO/DRP/TPO also failed to appreciate that by asking the Appellant Company to make profits at the arm's length margin determined by TPO, is in fact, violation of provisions of section 92(3) of the Income-tax Act, 1961, since MoD is the end client for the Appellant Company. That the profits of an enterprise are determined by commercial realities, and not by any benchmarking

formula independent of such realities, needs to be considered.

2.4. The learned AO/DRP/TPO erred in not acknowledging the fact that the Appellant Company is dealing with Government Agencies viz Defense Ministries on both sides of the transactions. That the very nature of these organizations makes it impossible to have anything but the arm's length price in contracts with them.

3. Erroneous consideration of facts by splitting Appellant's business into trading and service segment and erroneous computation of margins by the learned AO/DRP/TPO

3.1. The learned AO/ DRP/ TPO erred in considering/splitting the Appellant's business activity into two segments for benchmarking the international transaction of import of equipments from AE and availing allied services from AE in connection to said imports supplied to Ministry of Defense ("MOD").

3.2. The learned AO/ DRP/ TPO erred in accepting comparables which fails various filters to be scrutinized before the same can be considered as a comparable.

3.3. The learned AO/ DRP/ TPO erred in adopting different methodology to compute margins of the Appellant and that of the comparables which has led to incorrect margin computations.

3.4. The learned AO/ DRP/ TPO erred in calculating the margin of the Appellant in case of service segment."

4. Violation of Natural Justice: The learned AO/ DRP/ TPO erred in not providing complete information/benchmarking analysis

4.1. The learned AO/ DRP/ TPO has erred in violating the principle of natural justice by not providing any information/ details of the filters applied while arriving at his set of comparable companies.

5. Inappropriate approach adopted by the learned AO/ DRP/TPO for benchmarking

5.1. The learned AO/ DRP/ TPO has erred in cherry picking the comparable companies for benchmarking the international transaction of the Appellant.

5.2. The learned AO/ DRP/ TPO erred in selecting comparable companies which are functionally different from the functional profile of the Appellant. Further, that the companies chosen by the learned AO/ DRP/ TPO for benchmarking differ significantly from the Appellant in terms of nature of business, scale, composition, nature of clientele and peculiar nature of the contracts rendering those companies inappropriate for benchmarking with the Appellant.

5.3. The learned AO/ DRP/ TPO also erred in selecting companies which are having incomparably high turnover, related party transactions and different financial year ending etc. during the year under consideration.

5.4. The learned AO/ DRP/ TPO erred in rejecting the Transfer Pricing Documentation without stating reason as required under Section 93(C)(3), merely on premise that financials of AE were not provided.

5.5. The learned AO DRP/ TPO erred in not considering detailed rebuttals filed against the comparable companies selected by the learned AO/ TPO.

6. Principle of Res-judicata

6.1. The learned AO/DRP/TPO failed to appreciate that the modus operandi of the Appellant has not undergone any changes over the years, and its position was accepted during the previous transfer pricing assessments.

6.2. The learned AO/DRP/TPO erred in not appreciating the fact that it is well settled position in law, in absence of any material differences in the functions, assets or risks, the position once accepted in prior years, ought to have been followed.

7. Erroneous initiation of penalty proceedings under section 271(1)(c) of the Act

7.1. The learned AO erred in initiating penalty proceedings u/s. 271(1)(c) of the Act for furnishing inaccurate particulars of income thereby concealing income.

8. Addition on account of AIR Mismatch

8.1 The learned AO erred in making addition of Rs. 7,51,252/- on account of AIR Mismatch.

03. Brief facts of the case shows that assessee company is engaged in the business of execution of composite project of trading in defense equipments, servicing and repairing thereof. In fact it is acting as an interface for supplying of Russian origin military products between the Russian Federation and Ministry of Defence government of India. The associated enterprise of the assessee is established in accordance with the decree of President of Russia Federation. The AE had contract with Indian defense Ministry for supply of defense equipments, spares of such equipments and related services. In order to ensure delivery and reduction in response time for products and payments towards supply of spares, assessee was established as an Indian entity.

04. Assessee filed its return of income on 28.11.2014 at loss of Rs. 5,81,64,543/-. Return of income was picked up for scrutiny. As assessee has entered into international transactions of import of defense equipments of Rs. 93,76,92,845/- and also paid technical Services fee of Rs. 87,63,241/-. Both the transactions, taken together were benchmarked adopting the Resale Price Method [RPM] as the Most Appropriate Method. For testing the margins, assessee took itself as Tested party, gross profit was

considered as profit level indicator. Gross profit of the assessee was determined at 7.84%. Assessee was also stated to be performing limited functions and limited risk assumed as it is merely acting as a facilitator/distributor of goods of spare parts between associated enterprises and Ministry of defense India. As as per TPSR, all comparables were rejected, the transaction was stated between tow government entities where prices are negotiated between them, it states that International Transaction of Purchases of equipments spares and service fees is at Arm's Length.

05. The Ld. Transfer Pricing Officer held that the assessee is mere distributor of product, he adopted the transactions net margin method [TNMM] as the most appropriate method and determined the arm's length price of import of stores considering the gross profit as the PLI. The PLI was determined after considering liquidated damages expenses and forex loss as operating expenses at -4.06%. As assessee has disclosed the grass margin of 7.60%, the learned TPO substantially computed it at a lower figure for the reason that foreign currency fluctuation loss of ₹ 11.84 crore suffered by the assessee during the year was considered to be an operating item. The assessee considered it to be non-operating expenditure. The TPO selected 26 comparables whose PLI was 21.12% and assessee was asked to show cause why the adjustments should not be proposed. The assessee submitted that

a. As the rate of supply of equipment is decided by The Ministry of Defense and therefore it does not have any control whether the assessee makes a profit or not.

b. Assessee's transaction of import and technical services cannot be segregated and should be benchmarked together.

c. Comparables were also challenged stating that the none of the comparable are supplier to the defense ministry.

d. Computation of the margin was also challenged stating that the foreign exchange fluctuation loss is to be considered as non-operating expenditure.

06. The Ld. TPO rejected the contention stating that

a. the ministry of defense has neither decided the price of the equipment or price of the services, the ministry of defense has decided the price of import of equipment from the associated enterprises and hence this argument of the assessee is not found favour. The learned TPO further held that though assessee is dealing in defense equipments but in fact those are also the machineries and therefore there is no difference as defense equipments also falls into the broad category of machinery. He further stated that distribution of spares and the services should not be aggregated, as both are different

transactions. Accordingly, the Ld. TPO found that the import of material of Rs. 93.77 Cr as ALP of Rs. 80.05 Cr and accordingly an adjustment of Rs. 13.71 Cr was made on trading segment.

b. With respect to the service segment it was found that the revenue is Rs. 87,63,241/- having the cost of Rs. 80,49,345/- and profit is Rs. 7,13,896/- which is barely 8.14%. The Ld. TPO selected ten (10) comparable companies who margin was 24.85% and issued a show cause notice for the adjustment. The assessee objected on separate benchmarking as well as comparability analyses. The Ld. TPO rejected the contention of the assessee and made an adjustment of Rs. 10,30,329/- as per order u/s 92CA(3) of the Act dated 27.10.2017 the total transfer pricing adjustment of Rs. 13,81,82,259/-.

07. Accordingly daft assessment order was passed on 20.12.2017 wherein above of adjustment was made. There was also addition on account ARI mismatch of Rs. 72,56,192/-. Total income was assessed at Rs. 8,72,73,911/-.

08. The assessee objected before the Ld. Dispute resolution panel. The direction was passed on 24.09.2018. The learned dispute resolution panel held that

a. resale price method is the most appropriate method instead of transactional net margin method adopted by the TPO.

b. However, comparable selected by the learned transfer pricing officer were considered, TPO was directed to exclude 11 comparable companies which were found to be engaged in service segment, but accepted the filters adopted by the TPO.

c. The learned DRP deleted the adjustment proposed by the TPO on account of international transaction towards import of service.

09. on the basis of directions, the ALP adjustment of Rs. 13,81,82,259/- was scaled down to Rs. 11,29,97,681/-. With respect to the disallowance of ARI mismatch was confirmed to Rs. 7,51,252/-.

010. Accordingly, final assessment order was passed on 20.12.2017 determining income at Rs. 5,55,84,393/- .Assessee aggrieved with the same is an appeal before us.

011. Ground no. 1 general and nature and ground no. 7 initiating penalty proceedings is premature. Therefore, those are dismissed. Ground no. 4 challenging the violation of the principle of natural justice was not pressed, hence, dismissed.

012. Adverting to ground number [2] to [6] except [4] on transfer pricing adjustment, The Ld. Authorized Representative has referred to the paper book containing 282 pages and further written note containing 24 pages. The Ld. Authorized Representative submitted that

a. for assessment year 2013-14 co-ordinate bench has passed an order in assessee's own case in ITA No. 7418/MUM/2017 dated 01.08.2018 wherein as per paragraph 9 it set aside the issue to the file of the AO/TPO. In that appeal, it was stated that the assessee has provided only support services, which involves supply of part and providing services. Both the activities are composite services and therefore interlinked. Accordingly, the product segment should be combined, it directed TPO to examine this aspect.

b. It was further held that liquidate damages paid by the assessee cannot be considered to be part of cost incurred and therefore should not enter into computation of the profit level indicator.

c. The Ld. AR on the most appropriate method stated that assessee is not making any value addition to be products which our procured from Russian Government and supplied to ministry of defense, India and therefore assessee has selected resale price method as the most appropriate method for the benchmarking these transactions. It was stated that in earlier years the TPO accepted the resale price method as the most appropriate method even for assessment year 2013-14 the DRP has also held the resale price method as the most appropriate method.

d. The Ld. TPO has adopted the transactions net margin method as the most appropriate method incorrectly.

e. It was further stated that the comparable selected by the TPO are not at all functionally comparable because none of them is in the business of trading of defense equipments, even otherwise none of the comparables are dealing in spare parts. All the comparable are dealing with difference set of machineries.

f. It was further submitted that though the learned dispute resolution panel has accepted that resale price method was the most appropriate method to benchmark the prices charged by the appellant however the learned dispute resolution panel also did not exclude forex fluctuation losses which cannot enter into the gross profit working of the assessee as well as the comparables. He therefore submitted that when resale price method is accepted as the most appropriate method, only gross profit requires to be computed and compared. He therefore submitted that foreign exchange fluctuation loss as well as liquidated damages are required to be excluded from PLI.

g. Even otherwise he submitted that comparable taken by the learned TPO are dealing in different set of machineries and none of them is engaged in trading of defense equipments. Further assessee is only dealing in spare parts and not even the machineries, even if, the defense equipments are also considered to be the broader part of machinery segment. He

referred to the OECD guideline at paragraph number 2.29 and 2.34 for principles of identification of comparables.

h. He further submitted that the learned transfer-pricing officer himself has considered some of the companies to be incompatible with the appellant while completing assessment of immediately preceding year. He made a reference to page number 125 of the paper book where different set of companies were selected which if those are selected for the current year results into the average margin of 2.04% which was less than the gross margin earned by the appellant.

i. He further stated that the foreign currency fluctuation loss of ₹ 11.84 crores suffered by the assessee is on account of abnormal fluctuations/depreciation in the value of Indian currency which resulted in loss on account of outstanding payables in foreign currency to associated enterprises. He referred to the audited accounts of the assessee to show that assessee is constantly asking for reimbursement of the exchange loss to the extent it is related to delayed/overdue realization of the sales proceed. He further stated that the accounting note clearly shows that assessee has recognized income of ₹ 7.90 crores on account of pending recovery. He further submitted that in the earlier years foreign exchange gain was not

considered as operating income and therefore on the principle of consistency also the forex loss should be excluded.

j. He further submitted that in immediately preceding year the learned DRP has directed to exclude the forex loss while computing the profit level indicator. To substantiate his argument he referred to the DRP directions for assessment year 2013 – 14. He also referred to several judicial precedents wherein forex loss was not considered as part of operating expenditure. He also pressed into service the principle of consistency. Accordingly he submitted that resale price method should be accepted as the most appropriate method and the gross margin of 7.60% shown by the assessee should be compared for determination of transfer pricing adjustment.

k. He even otherwise stated that revenue as well as the assessee both admits that there are no comparable is available to benchmark gross margin on by the appellant even if resale price method is adopted. Therefore in the circumstances the most appropriate method for benchmarking these international transactions, 'other method' can also be considered. He submitted that assessee can resile from most appropriate method adopted in the transfer pricing study report. He specifically referred to the guidance note issued by the Institute of chartered accountants of India on transfer pricing which provides guidance

on situation when other methods could be applied. He further stated that there are instances where comparable transactions are not available, then the method adopted for pricing transaction between a could be justified by adopting other method.

l. To justify the other method, he submitted that that prices are negotiated by the Ministry of Defense and associated enterprises. Last traded price is the fair market price mutually agreed between two independent parties, therefore such last traded price of similar items can be considered as comparable price. He therefore submitted that for benchmarking the international transaction of the assessee, the 'other method' should be adopted as the most appropriate method.

m. He referred to 15 comparables selected by the learned TPO and submitted a chart stating that all these 15 comparables cannot be used for comparability of this international transaction as none of the company is engaged in the business of supply of equipments to the Ministry of Defence and also spare parts and services. He submitted that as assessee is supplying the goods to the Ministry of Defence the cost structure, the functions, the risk are different than all these 15 entities.

n. In the result is submitted that the transfer pricing adjustment measures to be deleted.

013. The learned CIT DR vehemently supported the order of the learned AO and transfer pricing officer and direction of the learned dispute resolution panel. He submitted that admittedly the learned dispute resolution panel has upheld the most appropriate method as the resale price method. However with respect to the computation of the margin of the assessee, though the issue is covered in favour of the assessee however the revenue had the time to file the appeal before the honourable High Court and therefore that decision could not have been followed. He accepted that the coordinate bench in its order dated 1/8/2018 in case of the assessee has decided this issue in favour of the assessee. With respect to the most appropriate method he submitted that it is for the assessee to substantiate with the functions, assets and risk of the assessee to demonstrate that what is the most appropriate method. He submitted that constantly resale price method has been accepted as the most appropriate method in case of the assessee. Now the assessee has raised new plea of adopting 'other method' as the most appropriate method. The relevant details substantiate the arm's-length price of the international transaction by adopting that method has not been placed on record. Therefore the order of the learned transfer-pricing officer/assessing officer after the direction of the learned dispute resolution panel deserves to be upheld.

014. In rejoinder the learned authorized representative reiterated the submission already made.

015. We have carefully considered the rival contention and perused the orders of the learned lower authorities. The facts clearly shows that assessee is an Indian entity of its foreign associated enterprises which has been awarded the contract for supply of defence equipments, and it servicing and repairs. The assessee imports spares for defence equipment from its associated enterprises and also performs the services of repairs and maintenance. It is further held by the learned dispute resolution panel and also the claim of the assessee that resale price method is the most appropriate method and the service availed by the assessee for technical services in connection with import and service of the equipments cannot be separately benchmarked. As per rule 10 B (1) (b) prescribes the steps to determine the arm's-length price of an international transaction by adopting resale price method. From the sale price, as reduced by the amount of normal gross profit margin accruing to the enterprises and further reduced by the expenses of purchases. The functional differences are also required to be adjusted which could have materially affected the amount of gross profit margin. As per transfer pricing study report the transaction of the import shows that pursuant to the agreement entered into by the associated enterprises and assessee, equipments are supplied with a predetermined condition that the end-user for all those equipment shall always be Ministry of defence. Each independent transaction entered into between assessee and the associated enterprise is governed by supplement contracts

which are concluded on the basis of the contract/purchase order with the Ministry of defence signed after due negotiation based on the last purchase price or the estimated price on record is with the Ministry of Defence. The assessee imports spares for military equipments from assessee only if the same is ordered by the Indian Navy as per the approval from the Ministry of Defence Enterprises approved by the Ministry of defence which forms the basis of the pricing. In this circumstances the functions of the assessee are very limited except to the extent of training and personnel management where it trains its employees and may also send them to a joint location along with the specialist of associated enterprise for joint training if necessary. Assessee also does not undertake any research and development activities and does not own any intangible assets. It does not have any market risk also. The foreign exchange risk lies on the assessee with respect to the payment to the associated enterprises. Thus the assessee is a limited risk distributor. Based on this FAR, assessee in its transfer pricing study report placed at page number 35 of the report stated that out of the 52,215 companies [capitaline] the only company which could be considered a similar to the assessee was Brahmos aerospace private limited which was also rejected for nonavailability of the latest available data in public domain. One more reason was given that company owned significant intangible and technology of developing missiles. It was also stated to be a full-fledged manufacturer. In the end it was stated that the gross

profit margin of the assessee at 7.84% is stated to be at arm's-length for the reason that the contract is in essence between two governments therefore it was held to be reasonable to conclude that the international transactions entered into by the associated enterprise with its associated enterprise is at arm's-length. In the circumstances, we find that even if the resale price method is adopted, in absence of comparable, the comparability analysis fails. Thus there is no use of adoption of most appropriate method as resale price method. Assessee has also stated that in such cases the 'other method' is the most suitable method for benchmarking the international transaction by considering the last purchase price of the similar items which are negotiated between the two governments.

016. Considering the facts and circumstances of the case, we set-aside the whole issue back to the file of the learned TPO/assessing officer to benchmark above international transaction by adopting either resale price method , if adequate comparability data is available, or 'other method' as the most appropriate method. However it would be the duty of the assessee to substantiate before the AO/TPO to show that the international transaction entered into with its associated enterprise are at arm's-length based on certain credible information. In the result, ground number 2 – 6 [except 4, of the appeal are restored to the file of the learned AO/TPO to benchmark the international transaction afresh by selecting first the

most appropriate method and thereafter benchmark the international transaction. Thus, these grounds of appeal are allowed with above directions.

017. In the result, appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 12.10.2023.

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

Mumbai, Dated:12.10.2023
Dragon
Copy of the Order forwarded to:

BY ORDER,

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

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