IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I : NEW DELHI

BEFORE SHRI ANUBHAV SHARMA, JUDICIAL MEMBER
AND
SHRI BRAJESH KUMAR SINGH, ACCOUNTANT MEMBER

ITA No.705/DEL/2022
Assessment Year: 2017-18

Anand NVH Products P. Ltd., F-3/5, Vasant Vihar, New Delhi – 110 057.	Vs	DCIT, Circle-1(1), New Delhi.

PAN: AAECA0297J

(Appellant) (Respondent)

Assessee by	:	Shri Mukesh Bhutani, Shri Saurabh Nandy & Ms Drishti Goel, Advocates
Revenue by	:	Shri Dharamvir Singh, CIT-DR
Date of Hearing	:	17.10.2024
Date of Pronouncement	:	02.12.2024

ORDER

PER ANUBHAV SHARMA, JM:

This appeal is preferred by the Assessee against the final assessment order dated 21.02.2022 of the National Faceless Assessment Centre, Delhi (hereinafter referred to as the Ld. AO) passed u/s 143(3) r.w.s. 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') for assessment year 2017-18.

2. Heard and perused the records. At the time of hearing the Ld. Counsel for the assessee has mentioned of the fact that on instructions of assessee the grounds no. 2 to 4 are not pressed and at the same time we find that ground no. 1 is general in nature.

3. The assessee company is engaged in the business of manufacturing of Rubber Metal Automobile parts. The return of assessee was selected for scrutiny assessment and TPO observed, that during the year under consideration the assessee has not charged any Interest on Corporate guarantee given to its AE amounting to USD 5 Million. The TPO considered interest rate of 4.01% for an arm's length level of interest that charged for the deemed Corporate guarantee advanced by the assessee to its AE and accordingly adjustment has been made.

3.1 The grounds argued being ground no. 5 to 7 are with regard to the issue if the TPO/DRP erred in considering bank guarantee rates as suitable comparable under CUP method for determination of ALP of the international transaction i.e. Stand-by Letter of Credit (SBLC) issued to foreign AE.

4. In regard to this issue the relevant facts are that during the year under consideration, the Appellant had issued a Standby Letter of Credit (hereinafter referred as 'SBLC') of USD 5 million to its foreign Associate Enterprise (hereinafter referred as 'AE'), which has been disclosed as an international transaction by the Appellant in its Transfer Pricing Study Report (hereinafter

referred as 'TP Report') as made available at Pg. 326 of PB and disclosed in Form 3CEB, copy of which is made available at Pg. 60 of PB.

4.1 The TPO noted that Appellant had charged no commission from its AE for the issuance of SBLC and, therefore, benchmarked the transaction using Comparable Uncontrolled Price (hereinafter referred as 'CUP') method. The TPO determined the commission fee to be charged at 4.01% by taking the average bank guarantee rates of various banks and adding 200 base points to it on account of the various alleged risks undertaken by the Appellant. The DRP upheld the TPO's order and dismissed the objection of the Appellant. Accordingly the Appellant is now in appeal before this Tribunal.

4.2. Ld. Counsel of the assessee has submitted that the TPO has erred in treating the SBLC akin to a bank guarantee. It was submitted that the SBLC was issued to the foreign AE to enable it to further expand the Appellant's business in the United States of America, such that the foreign AE may avail of a loan to acquire a manufacturing unit. Had the SBLC not been issued, the Appellant would have had to do a cash infusion of USD 12 million, into the funds of AE.

5. Thus, what we find is that appellant does not dispute that issuance of SBLC is an international transaction. The limited issue before us, as argued, is determination of the arm's length price of the SBLC.

5.1 The Ld. Counsel of appellant submits that the adjustment proposed by the TPO should be capped at 0.5% per annum of the value of the SBLC in light of following judicial precedents cited before us;

Everest Kanto Cylinder Ltd. v. DCIT – [2013] 34 taxmann.com 19 (Mumbai - Trib.); Micromax Informatics Ltd. v. DCIT – [2015] 56 taxmann.com 203 (Delhi - Trib.); Havells India Ltd. v. ACIT – [2022] 140 taxmann.com 576 (Delhi - Trib.)

5.2 It was further submitted that in any case the Appellant paid 0.5% commission fee per annum to HDFC Bank for the issuance of SBLC which is an internal CUP. During the final hearing on 17.10.2024 ld. Counsel of assessee had submitted before the Bench a copy of letter certified by HDFC Bank admitting that the HDFC Bank charged a commission of 0.5% per annum as fee from 17.06.2016 to 17.06.2018 (1% cumulatively for FY 2016-17 & 2017-18) and 0.5% per annum for subsequent years. Hence, 0.5 % paid to the bank should be considered as the arm's length rate of commission.

5.3 It is also submitted by the Ld. Counsel that the TPO used an incorrect foreign exchange conversion rate to convert USD to INR for the purposes of calculating the amount of transfer pricing adjustment, as per the provisions of Rule 115 of the Income-tax Rules, 1962. The TPO incorrectly applied the conversion rate of INR 72.9 instead of the conversion rate of INR 64.8 (SBI TT buying rate),which was the rate on the last day of the relevant previous year, i.e., as of 31.03.2017.

6. Ld. DR has defended the impugned order on this aspect and has submitted that there is no difference between the SBLC and a bank guarantee and his contention was that ultimately it is the AE which is beneficiary at the cost of the assessee. He placed heavy reliance on the judgement of the coordinate Bench of the Delhi Tribunal in the case of ***Havells India Ltd. vs. ACIT (LTU) (2022) 140 taxmann.com 576 (Delhi-Trib.)***.

7. The next issue covered in Grounds Nos. 9 to 12 is if the Ld. AO/DRP while making disallowance u/s 35(2AB) of the Act, with respect to the revenue expenditure claimed by the Appellant, which was in excess of the amount quantified by the DSIR, erred in further disallowing the same also u/s 37(1) of the Act.

8. In this context the relevant facts are that the appellant incurred revenue expenditure towards scientific research of INR 2,88,44,229 and capital expenditure of INR 2,02,60,996. These expenses were claimed as weighted deduction @ 200% under S.35(2AB) of the Act. The DSIR, while approving the expenditure under Form 3CL, quantified and approved capital and revenue expenditure to be allowed u/s 35(2AB) of the Act. Subsequently, the AO/DRP disallowed the revenue expenditure of INR 41,64,390 claimed by the Appellant u/s 35(2AB), which was in excess of the amount quantified by the DSIR. The AO, in its draft order identified that only a portion of revenue expenditure was

being disallowed. Further, the AO/DRP rejected the Appellant's contention of allowing the excess revenue expenditure u/s 37(1) of the Act.

9. The case of assessee before us is that the AO ought to have allowed the excess revenue expenditure of the differential amount Rs. 20,82,229(2,88,44,229 – 2,67,62,000) under S.37(1) of the Act as the same has been incurred exclusively for the purpose of business undertaken by the Appellant. It was submitted that this is undisputed fact that this expenditure was incurred wholly for business purposes and is revenue in nature. The AO/DRP has not challenged the revenue nature of the expenditure. Ld. Counsel has relied decision in Auto Ignition Ltd. v. ACIT– ITA No. 3248/Del/2017 and M/s. BEML Limited v. DCIT – ITA No. 222/Bang/2023 (Bangalore Tribunal).

10. Ld. DR has submitted that AO did not have opportunity to examine the fact of expenses being for the purposes of business.

11. We have given thoughtful consideration to the matter on record. Taking ground Nos.5 to 7, we are of the view that in common parlance, there is no difference between a Bank Guarantee and an SBLC in regards to their intended purpose however they may be governed by different rules and local laws with regard to their enforceability. However, for the purpose of issue before us, if the provision of benefit of any guarantee to AE has a bearing on the profits, income, losses or assets of the company and the overall risk exposure of the

assessee company becomes higher by virtue of the amount of guarantee and the assessee company becomes more leveraged including by virtue of its debt equity ratio which would ultimately affect the cost of borrowings, then providing SBLC or corporate guarantee becomes an international transaction.

12. We are also of the considered view that for determination of ALP of the this sort of international transaction there is no justification and commercial prudence to compare the bank guarantees with corporate guarantees or SBLC as guarantors accepting the liability to compensate in respect of principal borrower have different commercial and business reasons, to enter into these transactions. While granting bank guarantees is one of the main functions of the commercial banks and the corporate guarantee or SBLC given to an AE is more or less an attempt to ensure freeing up working capital of AE and potentially securing better contract terms for the AE.

13. Therefore, the commission charged by a commercial bank under bank guarantee cannot be a benchmarking parameter and a suitable comparable for determination of arm's length price of the alleged international transaction, if some other internal comparable is available where assessed has paid commission or other charges for securing a guarantee for itself.

14. Further, we find that in **M/s Technocraft Industries (I) Ltd. v. DCIT, ITA No. 6686/Mum/2014** the Mumbai Tribunal has held that as the said

Appellant had issued an SBLC to its AE and had been charged a rate of 0.9% by an Indian bank for such SBLC which can be considered as an internal CUP. Hence, 0.9% paid to the bank should be considered as the arm's length rate of commission. Then in **M/s GMR Infrastructure Ltd. v. DCIT– ITA No. 1705/Bang/2017** the Bangalore Tribunal has held that the considerations involved in a corporate guarantee are distinct from that of a bank guarantee and hence, the adjustment proposed by the TPO based on commercial bank rates cannot be upheld. The Tribunal while upholding the same relied on the Delhi High Court ruling of **CIT v. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523 (Delhi)**.

15. In the case of **CIT vs. Everest Kento Cylinders Ltd. [2015] 58 taxmann.com 254 (Bombay),** the Hon'ble High Court has dealt with this issue with the following relevant observations in para 10 of the order:-

> *"10. ……. Furthermore, having considered the fact that a sum of Rs.4,47,649/- was not conceded in the return but was adhoc acceptance during the course of assessment, the assessee could not be bound by it. The Tribunal as the second fact finding authority had gone into factual aspects in great detail and therefore having interpreted the law as it stood on the relevant date the order passed cannot be faulted. In the matter of guarantee commission, the adjustment made by the TPO were based on instances restricted to the commercial banks providing guarantees and did not contemplate the issue of a Corporate Guarantee. No doubt these are contracts of guarantee, however, when they are Commercial banks that issue bank guarantees which are treated as the blood of commerce being easily encashable in the event of default, and if the bank guarantee had to be obtained from Commercial Banks, the higher commission could have been justified. In the present case, it is assessee company that is issuing Corporate Guarantee to the effect that if the subsidiary AE does not repay loan availed of it from ICICI, then in such event, the assessee would make good the amount and repay the loan. The considerations which applied for*

issuance of a Corporate guarantee are distinct and separate from that of bank guarantee and accordingly we are of the view that commission charged cannot be called in question, in the manner TPO has done. In our view the comparison is not as ita1165.13 between like transactions but the comparisons are between guarantees issued by the commercial banks as against a Corporate Guarantee issued by holding company for the benefit of its AE, a subsidiary company. In view of the above discussion we are of the view that the appeal does not raise any substantial question of law and it is dismissed. There will be no order as to costs."

15.1 In the said case, the assessee had charged guarantee commission @ 0.5% from the AE. However, the TPO, taking into consideration the fact that banks and companies are charging at least 3% for providing guarantee at benchmarked arm's length price for the guarantee given by the assessee for the benefit of AE at 3% of the amount of guarantee and this was sustained by the CIT(A), but, was deleted by the Tribunal. In that case, the assessee had not benchmarked the guarantee commission. Accordingly, the assessee had taken the ALP of the said transaction at 'nil' as it had contended that no cost was incurred in providing bank guarantee for its AE and the Tribunal had not agreed to the contention of the assessee that there could not be any cost or charge of the guarantee if by providing corporate guarantee to a subsidiary because there is by way of element of benefit or cost while providing such kind of guarantee to AE. Therefore, the fact that the assessee in that case had itself charged 0.5% guarantee commission from its AE the same was considered at arm's length.

15.2 Even in the case relied by ld. DR, ultimately the assessee was given benefit of decision in Everest Kento Cylinders's case (supra) in para 8 as follows:-

> *"8. Rebutting the argument of the ld. DR, the ld. AR alternatively argued that determination of the corporate guarantee at 1.3% is on a higher side and relied on the judgment of Hob'ble High Court of Bombay in the case of CIT Vs. Everest Kento Cylinders Ltd . 58 Taxmann 254 and also on the judgment of Hon'ble High Court of Bombay in the case of CIT Vs Thomas Cook (India) Ltd. in ITA No. 712 of 2017 order dated 26.08.2019. Keeping in view, the judgments of the Hon'ble Bombay High Court and in the absence of any other judgment contrarily brought to our notice, we hereby direct that the adjustment in respect of corporate guarantee provided to AEs be determined at date of 0.5% instead of 1.3% determined by the revenue."*

16. Here in case before us, we find that the assessee's bank has charged 0.50% per annum for the period after 17.06.2018 till 17.06.2022 and before that assessee was charged @ 1% for the period 17.06.2016 to 17.06.2018. Thus, in the financial year 2016-17 assessee had paid 1% as the cost of extending the SBLC to AE, for which assessed should have been compensated by the AE. Therefore, we are inclined hold that Ld. AO/TPO shall consider rate of 1%, to be ALP for this international transaction and accordingly we allow the grounds No.5-7. Further as per the provisions of Rule 115 of the Income-tax Rules, 1962, the TPO will apply the correct conversion rate for which assessee may also be given opportunity of hearing.

17. In regard to grounds No.9-12, the only contention of the ld. DR is that the AO has not examined the aspect of differential amount being for the purpose of

business only. We are of the considered view that section 37 of the Act is the primary basis for consideration of an expense debited in the books before being considered for a disallowance u/s 35(2AB) of the Act and the fact that a part of the expenditure stands allowed on the basis of Form 3CL as capital expenditure. The remaining should be allowed as revenue expenditure and both the tax authorities have fallen in error in not considering the same. Accordingly, these grounds are also allowed.

18. As a consequence of the above, the appeal of the assessee is allowed with consequences to follow as per determination of the grounds as above.

Order pronounced in the open court on 02.12.2024.

Sd/-	Sd/-
(BRAJESH KUMAR SINGH) ACCOUNTANT MEMBER	(ANUBHAV SHARMA) JUDICIAL MEMBER

Dated:02nd December, 2024.

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Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asstt. Registrar, ITAT, New Delhi