**IN THE INCOME TAX APPELLATE TRIBUNAL**
**DELHI BENCH 'H': NEW DELHI**

**BEFORE SHRI VIKAS AWASTHY, JUDICIAL MEMBER**
**AND**
**SHRI AVDHESH KUMAR MISHRA, ACCOUNTANT MEMBER**

**ITA No.3292 & 3293/Del/2018, A.Y. 2009-10 & 2010-11**

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| **Rajasthan Prime Steel Processing Center Pvt. Ltd., SPL-1(A), Tapukara, Industrial Area, Kushkhera, Alwar** | Vs. | **DCIT Circle-15 (1) New Delhi** |
| **(Appellant)** | | **(Respondent)** |

**ITA No.3537 & 3538/Del/2018, A.Y. 2009-10 & 2010-11**

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| **JCIT(OSD) Circle- 21(1) New Delhi** | Vs. | **Rajasthan Prime Steel Processing Center Pvt. Ltd., SPL-1(A), Tapukara, Industrial Area, Kushkhera, Alwar** |
| **(Appellant)** | | **(Respondent)** |

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| **Assessee by** | **Sh. Nageshwawr Rao, Advocate**<br>**Sh. Parth, Advocate** |
| **Revenue by** | **Sh. S. K. Jhadav, CIT DR** |

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| **Date of Hearing** | **30/12/2024** |
| **Date of Pronouncement** | **27/03/2025** |

**ORDER**

**PER AVDHESH KUMAR MISHRA, AM**

All the above-captioned contra-appeals of the assessee and Revenue of Assessment Years (hereinafter, the 'AY') 2009-10 and 2010-

11 are against orders dated 18.12.2017 of the Commissioner of Income Tax (Appeals)-38, New Delhi [hereinafter, the 'CIT(A)'].

2. These appeals contain common grounds and facts; therefore, these were heard together and are being disposed off by this common order.

3. Vide various grounds, issues raised in these appeals are summed up as under:

**Assessee's appeals (ITA No.3292 & 3293/Del/2018):**

i. Addition on account of ALP adjustment [All grounds except the last one]

ii. Initiation of penalty under section 271(1)(c) of the Act [Last ground]

**Revenue's appeals (ITA No.3537 & 3538/Del/2018):**

i. Exclusion of preoperative and or non-recurring expenses; such as custom duty from operating margin (Ground No.1 of both years).

ii. To treat foreign exchange gain/loss as operating profit/loss (Ground No.2 of both years)

iii. Allowance of working capital adjustment (Ground No.3 of ITA No. 3538)

4. The brief facts giving rise to these appeals are that the assessee is the group company of Honda Trading Corporation, Japan, who is engaged in the business of manufacturing and distribution of automobile, Motor Cycle etc. The assessee, engaged in the business of manufacturing of auto parts and trading of steel coils & sheets, dies, auto components & equipment, auxiliary services, etc., filed its Income Tax Return (hereinafter, the 'ITR') declaring losses of (-) Rs.24,55,827/- and (-) Rs.5,00,77,416/- for AYs 2009-10 and 2010-11 respectively. These cases were picked up for scrutiny. Keeping in view the quantum of international transactions; the AO referred the matter of these years to the Transfer Pricing Officer (hereinafter, the 'TPO') for determining Arm's Length Price of international transactions. The assessee commenced its business in AY 2009-10 and had worked for 5 months in this year. It imports steel coils, processes the same as per specification for sale to Honda Automobile in India. The appellant assessee is not required to pay Central Excise on processing of steel coils. For transfer pricing/benchmarking purposes, the assessee and TPO has divided the assessee's activities into two segments; namely, Manufacturing and Trading. The TPO has benchmarked Trading and Processing operation segments separately.

4.1 As per the assessee, it procures steel coils for supplying without any value addition to its customers including its Associated Enterprises (hereinafter, the 'AE') across the globe; India and abroad. Thus, in Trading segment, it acts as a pure distributor of steel coils exclusively sourced from its overseas AEs. Under the Processing segment, the assessee procures coils from its AEs and after performing slitting, blanking and welding, it resells the processed tailor-made goods to its AE; Honda Automobiles and others. In the processing, there is no substantial value addition as it is not a full-fledged manufacturing activities.

4.2 There are three types of international transactions as under:

i. Purchase of raw material, stores, spares, and consumables,

ii. Payment of royalty for technical support services and

iv. Purchase of capital goods.

4.3 In AY 2009-10, the assessee has utilized only 75% of its capacity. The assessee has considered its AEs; namely, Honda Japan and Honda Trading Company as the tested parties and has used foreign comparables in AY 2009-10. Whereas in the subsequent year; i.e. AY 2010-11, the assessee itself is the tested company. The assessee has not owned any intangible. It has taken technical guidance & support

from its foreign AE and paid fee for that. The functional analysis of the assessee' business shows that it has performed simpler functions. During the relevant years, its trading functions were more than 50%. In AY 2009-10, the TPO has issued show-cause notice to the assessee that why not the assessee should be taken as tested party instead of its foreign AEs and then separate comparability analysis of two segments; Manufacturing and Trading. In response to the Show-cause notice, the assessee raised following contentions before the AO:

i. Its foreign AEs perform simpler functions and thus, require least adjustments with foreign comparables,

ii. The comparables picked up by the AO are not appropriate,

iii. Adjustment of underutilization of capacity,

iv. Adjustments cannot be more than the margin retained by its supplier AE and

v. Adjustment has to be restricted to the value of international transactions.

4.4 Following objections to the proposed show-cause notice for adjustment were raised in AY 2020-11:

i. Application of Cost-Plus Method in Manufacturing segment,

ii. Application of RPM in Trading segment,

iii. Incorrect calculation of profit margin and

iv. Adjustment has to be restricted to the value of international transactions.

4.5 In AY 2009-10, the TPO, placing emphasis on the OECD guidelines, has held that least complex entity that offers higher degree of comparability with uncontrolled companies should be selected as the tested party. The assessee is not carrying any R & D risk. It does not own any intangible property and unique asset. In simpler words, the assessee has mainly acted as a distributor with major revenue (more than 50%) from trading. The purchases and sales are mainly from/to AEs. The assessee draws technical guidance & support from its AEs having global operations and pays technical fee for that. The AO has noted that the assessee has taken comparables from different geographic locations with different functionality than that of the tested party (Idex, USA, deals in motors & compressors, etc. Bosch, Germany, deals in home appliances). Further, the AO also rejected Cost Plus Method for benchmarking on the reasoning that the AEs, Honda Japan & Steel Centre Company and Honda Trading are performing far more complex functions and have assumed all risks.

4.6 The TPO considered assessee as the tested party and applied TNMM for bench marking both segments separately. Consequential

adjustments of INR 149,172,965/- and INR 149,597,790/- were made in AYs 2009-10 and 2010-11 respectively.

4.7 Aggrieved, the assessee filed appeals and succeeded partially in both years. It got relief on two issues (i) Exclusion of custom duty from operating margin and (ii) Inclusion of foreign exchange gain/loss as operating profit/loss in both years. Further, the Ld. CIT(A) allowed working capital adjustment in the AY 2009-10. The Revenue Challenged these issues before us. The assessee challenged the creation of two segments for benchmarking, comparables taken by the TPO for both segments and applicability of TNMM in the relevant years.

5. At the outset, the ld. Counsel argued that the TPO had erred in making the adjustments even without rejecting the FAR and TP Study of the assessee and thus, the entire adjustments were uncalled for. Further, he argued that the Ld. TPO/CIT(A) had erred in segregating the business into two segments; Manufacturing and Trading for bench marking purposes particularly when the assessee was not indulged in manufacturing activities and had not paid any excise duty as it had not made any heavy value addition in the processing work. Even the Central Excise did not consider its processing as manufacturing for the excise purposes. The Ld. Counsel further submitted that the TPO had

not brought facts in the TPO's order mandating applicability of section 92C(3) of the Act. The Ld. Counsel contended that the comparables had to be judged as per the Rule 10B(2) of the Income Tax Rules. It was also submitted that comparables taken by the TPO were not picked up properly and objectively. In support of his contentions, the Ld. Counsel placed reliance on the decisions of the Hon'ble Delhi High Court in the case of Li and Fung India Pvt. Ltd. in ITA No. 306 of 2012 (date of order 16.12.2013) and Coim India Pvt. Ltd. ITA No. 269/2019 and 429/2022 (date of order 19.02.2024).

6. On the other hand, the Ld. CIT(DR) placing reliance on the TPO's orders, argued that the said adjustments were justified. He argued vehemently and defended the TPO orders. Further, he requested that the Ld. CIT(A) has erred in giving relief to the assessee by directing the TPO to exclude the custom duty from operating margin and to include foreign exchange gain/loss for determining the operating profit/loss in both years. Further, the Ld. CIT(A) has also erred in allowing working capital adjustment in the AY 2009-10. He further contended that the decision of the Hon'ble Delhi High Court in the case Coim India (supra) was distinguishable on factual matrix because in the present cases, the TPO had identified distortions in the TP study reports, inappropriate comparables and pointed out shortcomings

therein entailing rejection of assessee's TP study whereas it was no so in the case of Coim India.

7. We have heard both parties at length and have perused the material available on the record. We are of the considered view that the assessee is indulged in two types of business activities. Firstly, the pure trading and secondly Trading after processing the goods as per specification/tailor-made. We are not going into technicalities of the term 'manufacturing' from the excise point of view vis-à-vis trading. Definitely, the tailor-made goods are different than the raw material because the said raw material passes through some processing activities; such as slitting, blanking & welding for tailor-made products. Hence, we are not going into technicalities of manufacturing vis-à-vis processing. The coordinate bench in the assessee's own case in the ITA No.488/Del/2021 (order dated 11.11.2021) has upheld the segmental analysis in principle. Respectfully following the reasoning in the order of the coordinate bench in the assessee's own case in the ITA No.488/Del/2021, we do not find any infirmity into the segmentation; Manufacturing and Trading done by the TPO for benchmarking purposes.

8. We have taken note of the fact that the assessee itself has applied TNMM in AYs 2012-13, 2013-14 and 2014-15 in its 3CEB Forms (TPO's orders are placed on the record by the Ld. Counsel) and Revenue has accepted the same. In view of the above facts, we do not find any infirmity in impugned orders upholding TNMM in these years. Hence the applicability of TNMM instead of Cost-Plus Method is upheld in both years. Further, in view of the TPO's orders of AYs 2012-13, 2013-14 and 2014-15, we upheld the finding of lower authorities in treating assessee as a tested party in both years.

9. Now the next issue is with respect to comparables. The dispute is over the inclusion and exclusion of some comparables. We, without going into the merit and demerit of comparables, direct the TPO to take comparables from the baskets of comparables of these years for benchmarking purposes only. The undisputed comparables of these years; AYs 2012-13, 2013-14 and 2014-15, which have been finally selected for benchmarking purposes in the TP study of the assessee or by the TPO have to be taken as comparables for the present cases; AY 2009-10 and 2010-11. However, financial data of these comparables of AY 2009-10 and 2010-11 available in public domain have to be taken for respective years separately. The comparables have to be taken and done for two segments; Manufacturing and Trading, separately. We are

restoring this limited issue to the TPO for working of quantum of adjustments to be made in view of the above. Broad principles accepted by the TPO in AYs 2012-13, 2013-14 and 2014-15 have to be taken for the cases in hand; AY 2009-10 and 2010-11. Ordered accordingly.

10. Further, we find merit in the arguments of Ld. Counsel that the assessee deserves consequential relief on the score of capacity utilization in AY 2009-10. In principle, the TPO has also agreed to the same. But he has not allowed the same on the reasoning that the assessee has failed to provide requisite data. The AO is directed to allow the consequential relief on this score (capacity utilization) after proper verification. For this purpose, this matter of AY 2009-10 is restored back to the TPO. Needless to say that the assessee should cooperate and make available all details required by the TPO. Ordered accordingly.

11. In view of the above, all grounds relating to the transfer pricing issue of both years stand disposed of accordingly. The issue of initiation of penalty under the Act, being premature, stands dismissed.

12. The assessee's appeals of both years thus get disposed of as above.

**Revenue appeals:**

13. The first issue is in respect of exclusion of custom duty from operating margin. The Ld. Counsel submitted that the assessee had incurred significant customs duty charges which were proportionately greater than that of the comparable companies leading to a lower profitability for the assessee. To meet the quality standards and to overcome technological challenges, the assessee imports raw materials from its AEs. It was further submitted that this was not the case for the comparables, thus, putting the assessee in a comparative disadvantage viz-a-viz the comparables. The TPO rejected the adjustment sought. However, the Ld. CIT(A) allowed it. The Ld. Counsel, placing reliance on the various decisions of the tribunal and Hon'ble High Courts, submitted that this issue was covered in the assessee's favour. On the other hand, the Ld. CIT(DR) submitted that the effect of custom duty had not been properly examined by the Ld. CIT(A) before allowing relief on this score. Further, the Ld. CIT(DR) submitted that the decisions relied upon by the Ld. Counsel were distinguishable on the facts and therefore, this issue at most could be restored back to the TPO for verification.

14. We have heard both parties and have perused the materials on records. Before us, the Ld. Counsel submitted that the raw materials of

the assessee had been imported as such customs duty adjustments to be made. In principle, we are of the considered opinion that the custom duty adjustments have to be done if it affects adversely the operating margin of the assessee than those of comparables. We have analysed the relevant provisions of Income Tax rules vis-à-vis the scope of the adjustments on this score. The Authoritied below have not work out the difference between the Arms-Length Margin before and after the said adjustments on account of 'import cost'. In these factual circumstances and in the light of the scope of adjustments. No doubt, a higher import content of raw material by itself does not warrant an adjustment in operating margins, as was held in the Sony India Pvt. Ltd. case, but what is to be really seen is whether this high import content was necessitated by the extraordinary circumstances beyond assessee's control. In case the differences which are likely to materially affect the price, cost charged or paid in, or the profit in the open market are to be taken into consideration with the idea to make reasonable and accurate adjustment to eliminate the differences having material effect. In case the import is part of the business model, then the higher import duty is considered to be passed on to the customers or it must be adjusted for in negotiating the purchasing price. The adjustments then are required to be made for functionally differences.

15. The other way of looking at the present situation is to accept that business model of the assessee company and the comparable companies are the same and it is on account of initial stages of business that the unusually high costs are incurred. The adjustments are thus required either way. It is, therefore, permissible in principle to make adjustments in the costs and profits in fit cases. We also do not agree with the authorities below that the onus is on the assessee to get all such details of the comparable concerns so as to make this comparison possible. The assessee cannot be expected to get the details and particulars which are not in public domain. In such a situation, i.e. when information available in public domain is not sufficient to make these comparisons possible, it is inevitable that some approximations are to be made and reasonable assumptions are to be made. None of these arguments were before any of the authorities below. What was argued before the TPO was mere fact of higher costs on account of higher import duty. We, therefore, deem it fit and proper to remit this matter to the file of the TPO for fresh adjudication in the light of our above observations with direction to examine the claim of the assessee relating to the import cost factor and eliminate the difference if any. However, the TPO see to it that the difference in question is 'likely to materially affect' the price/profit in the open

market as envisaged in sub rule (3) of Rule 10B of the Income Tax Rules, 1962. Accordingly, we direct the TPO to give suitable adjustment against the custom duty component while determining the ALP. Hence, to bring uniformity, the customs duty was to be eliminated from the comparable price also to arrive at correct PLI. Accordingly, we remit the issue raised in both years to the file of TPO for fresh consideration.

16. The next issue is whether foreign exchange gain/loss arising from international transactions was to be considered as an item of operating revenue profit/loss. Ther Ld. CIT-DR submitted that there were divergent views of Hon'ble tribunal in earning foreign exchange as operating or non-operating items. The foreign exchange fluctuation as operating and non-operating items has not been defined in the TP provisions. The Ld. CIT-DR further contended that the present cases are not covered by the Safe Harbour Rule, it would be better to take the report as definition for operating revenue or non-operating revenue from the Safe Harbour Rules interpretation. As per the definition in Safe Harbour Rules, foreign exchange fluctuation as non-operating items. None of the Judicial pronouncement relied by the Ld. Counsel has considered definition of safe Harbour Rules where foreign exchange fluctuation has been considered as non-operating. On the other hand, the Ld. Counsel submitted that the foreign exchange fluctuation is

directly related to business/revenue transactions; therefore, it was an operative item and in turn operating revenue.

17. We have heard the parties and have perused the material on records. It is the case of the taxpayer that Safe Harbour Rules are not in case of the taxpayer qua AYs 2009-10 and 2010-11 and it is required to be treated as operating while computing the operating margins of the taxpayer as well as comparable companies and relied upon the decision rendered by Hon'ble Delhi High Court in Cash Edge India Pvt. Ltd. (ITA 279/2016 order dated 04.05.2016) and Fiserv India Pvt. Ltd. (ITA 17/2016 order dated 06.01.2016). The Hon'ble Delhi High Court in case cited as Cash Edge India Pvt. Ltd. (supra) decided the identical issue qua AY 2010-11 in favour of the assessee as under: -

> *"7. As far as the question, i.e., foreign exchange fluctuation element is concerned, the records clearly reveal that the Safe Harbour Rules came into force later whereas the facts of this case pertain to the assessment year 2010-11 (Financial year 2009-10). As a consequence, the impugned order cannot be interfered with. No question of law thus arises. The appeal is consequently dismissed."*

18. Similarly, the Hon'ble Delhi High Court in case cited as Fiserv India Pvt. Ltd. (supra) also decided the identical issue pertaining to AY 2009-10 in favour of the assessee as under: -

> *"10. As regards question (ii) it is pointed out by learned counsel for the Assessee that the Safe Harbour Notification dated 18th*

*September 2013 relied upon by the Revenue is prospective and did not apply to the AY in question. Even otherwise the Court finds that the decisions relied upon by the ITAT in the impugned order covers this issue in favour of the Assessee as Yutaka Autoparts India Vs. ITO far as the AY in question is concerned. Consequently, the Court declines to frame any question on the issue."*

19. In view of the above, we are of the considered opinion that in order to compute the operating margin of the taxpayer, foreign exchange gain is to be considered as part of operating income for computing the operating margin of taxpayer as well as comparables. Thus, we do not find any infirmity in the order of the Ld. CIT(A) on this issue; foreign exchange gain/loss arising from international as operating revenue profit or loss. Accordingly, the grounds relevant to this issue raised by the Revenue stand dismissed in both years.

20. The last issue is in respect of Working Capital Adjustment. This issue has been decided in favour of the assessee in its own case in the ITA No.488/Del/2021 (order dated 11.11.2021). Respectfully, following the said decision of the coordinate bench in the ITA No.488/Del/2021, we decide this issue against the Revenue as we do not find any infirmity in the order of the Ld. CIT(A) on this issue. Accordingly, the Revenue's ground in this regard in AY 2009-10 stands dismissed.

21. To sum up, the assessee's appeals; ITA No.3292 & 3293/Del/2018 and the Revenue's appeals; ITA No.3537 & 3538/Del/2018 are partly allowed as above for statistical purposes.

Order pronounced in open Court on 27th March, 2025

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| **Sd/-** | **Sd/-** |
| **(VIKAS AWASTHY)** | **(AVDHESH KUMAR MISHRA)** |
| **JUDICIAL MEMBER** | **ACCOUNTANT MEMBER** |

Dated: 27/03/2025
*Binita, Sr. PS*
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. CIT(DR)

ASSISTANT REGISTRAR
ITAT, NEW DELHI