

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I': NEW DELHI
BEFORE SHRI SATBEER SINGH GODARA, JUDICIAL MEMBER
AND
SHRI AVDHESH KUMAR MISHRA, ACCOUNTANT MEMBER
ITA No.3821/Del/2017, A.Y. 2006-07**

Lummus Technology Heat Transfer BV 2 nd Floor, Infinity Tower-B, DLF Cyber City, Phase-II, Sector 25A, Gurgaon PAN: AABCA9045K	Vs.	Deputy Commissioner of Income Tax, Circle-Gurgaon, International Taxation, Gurgaon
(Appellant)		(Respondent)

Appellant by	Shri Vishal Kalra, Ms. Reema Malik & Ms. Snigdha Gautam, Advocat, Ms. Reema Grewal, CA
Respondent by	Sh. Sandeep Kr. Mishra, & Ms. Ambika Aggarwal, Sr. DR

Date of Hearing	07/02/2024
Date of Pronouncement	07/05/2025

ORDER

PER AVDHESH KUMAR MISHRA, AM

This appeal of the assessee for the Assessment Year (hereinafter, the 'AY') 2006-07 is directed against the order dated 16th December, 2016 of the Commissioner of Income Tax (Appeals)-44, New Delhi [hereinafter, the 'CIT(A)'].

2. Following grounds have been raised in this appeal:

- "1. That on the facts and circumstances of the case and in law, the Assessing Officer ("AO") erred in completing the assessment of the Appellant at an income of INR 1,25,69,902 (loss of INR 17,97,924 after setting off brought forward losses of INR 1,43,67,826) as against

returned loss of INR 1,80,21,014. Further, the CIT(A) has erred in confirming the adjustments made in the assessment order/transfer pricing order by the AO.

- 2. That on the facts and circumstances of the case and in law, the order passed by the CIT(A) is erroneous in law as the same is non-speaking and arbitrarily upholds the adjustments made by the AO/Transfer Pricing Officer ("TPO").*
- 3. That on the facts and circumstances of the case and in law, the CIT(A) has erred in making factually incorrect / arbitrary averments while rejecting the grounds of appeal raised by the Appellant.*
- 4. That on facts and circumstances of the case and in law, the AO/TPO erred in not complying with the directions and observations given by the Hon'ble Income Tax Appellate Tribunal ("ITAT") vide order dated October 31, 2013, thus, the orders passed by the lower authorities are bad in law. The CIT(A) further erred in upholding such arbitrary orders passed by the AO/ TPO.*
- 5. That on the facts and circumstances of the case and in law, the CIT(A) has erred in upholding the transfer pricing adjustment amounting to INR 3,02,64,835 in relation to provision of engineering and design services, made by the AO/TPO to the transfer price of the international transaction of the Appellant alleging the same to be not at arm's length in terms of Chapter-X of the Act.*
- 6. That on facts and circumstances of the case and in law, the AO/TPO erred in not appreciating the economic analysis undertaken by the Appellant in accordance with provisions of the Act for determination of arm's length price and simultaneously proposing modifications to the analysis in a subjective and arbitrary manner. The CIT(A), further erred in upholding the action of the AO/TPO.*
- 7. That on the facts and circumstances of the case and in law, the CIT(A) erred in upholding the action of the AO/TPO in not accepting the economic adjustment on account of idle capacity claimed by the Appellant for computing the net profit margins.*
- 8. That on the facts and circumstances of the case and in law, the CIT(A) erred in upholding the action of the AO/TPO in arbitrarily rejecting the internal Transactional Net Margin Method ("TNMM) adopted to benchmark the international transaction pertaining to rendition of engineering and design services to the associated enterprises (AEs) without further considering the observations and directions given by the Hon'ble ITAT.*

- 8.1 *That on the facts and circumstances of the case and in law, the CIT(A)/AO/TPO erred in disregarding the submissions and documentary evidence furnished by the Appellant in respect of basis and bifurcation of costs into AE and non-AE segments.*
9. *That on the facts and circumstances of the case and in law, the CIT(A) erred in arbitrarily upholding the action of the AO/TPO to reject the segmental profit and loss maintained by the Appellant on the ground that the same was unaudited and arbitrarily created to allocate costs and thereby reduce losses.*
10. *That on the facts and circumstances of the case and in law, the AO/TPO erred in not considering the claim of excluding extra-ordinary one-time expenses incurred by the Appellant for setting up a new office/business division, while computing the profitability of the Appellant. The CIT(A) erred in not adjudicating upon the issue.*
11. *Without prejudice to the above grounds, that on the facts and circumstances of the case and in law, the CIT(A) erred in upholding the action of the AO/TPO to benchmark the international transaction of the Appellant with its AEs at entity level by using external TNMM and the comparable companies, without providing a cogent reason for rejection of internal TNMM adopted by the Appellant.*
- 11.1 *That on the facts and circumstances of the case and in law, the CIT(A) erred in arbitrarily upholding the action of the AO/TPO in arbitrarily selecting comparable companies which are not functionally comparable to the Appellant.*
- 11.2 *That on the facts and circumstances of the case and in law, the CIT(A) erred in disregarding the Appellant's submission regarding computation of margins and functional comparability of certain comparable companies vis-à-vis the Appellant.*
12. *That on the facts and circumstances of the case and in law, the AO/TPO erred in applying the provisions of section 92 of the Act in respect of Appellant's transactions with the head office, without appreciating that as per the India-Netherlands Double Taxation Avoidance Agreement ("DTAA"), branch office is not covered under Article 9 and thus, the DTAA would override provision of the Act. The CIT(A), further erred in not adjudicating the grounds raised in this regard.*
13. *That on the facts and circumstances of the case and in law the CIT(A) erred in not directing the AO/TPO to allow the benefit of (+/-) 5 percent range as provided by the proviso to section 92C (2) of the Act.*

Each of the above grounds is independent and without prejudice to the other grounds of appeal preferred by the Appellant.

The Appellant prays for leave to add, alter, vary, omit, substitute or amend the above grounds of appeal at any time before, or at the time of hearing of the appeal.”

3. The relevant facts giving rise to this appeal are that ABB Lummus Heat Transfer BV (now known as Lummus Technology Heat Transfer B.V.) (assessee), incorporated in the Netherlands and had a branch Office in India, engaged in the business of designing, engineering and construction projects in the power, oil and gas, fertilizer and petrochemical sectors, filed its Income Tax Return (hereinafter, the 'ITR') on 30th November 2006 declaring loss of INR (-) 18,021,014/-. The case was scrutinized and the original assessment was completed making adjustment on account of ALP of international transactions of INR 30,264,835/-. The issue of adjustment on account of ALP came up to the Tribunal, who vide order dated 31st October 2013 remitted this matter to the Assessing Officer/Transfer Pricing Officer (hereinafter, the 'AO') as under:

“Adverting to the facts of the instant case, it is seen that the assessee gave certain non-exhaustive details to the TPO to justify its ALP. The TPO rejected the same simply only the ground that the assessee allocated around 50% of the total costs to each segment, whereas the revenue from non-AE segment was only 5%. The assessee has filed paper book No. 2 with pages 172 to 391 before us with a view to demonstrate that the allocation of expenses between the two segments was justified. This paper book was also submitted before the DRP, which did not consider it appropriate to comment upon the correctness or otherwise of the documents contained therein, which the assessee

claims to a well-defined segregation of expenses into AE and non AE segments. Admittedly, this paper book was not filed before the TPO. Since the TPO did not have any occasion to go through the papers contained in this paper book and the DRP remained silent. We are of the considered opinion that the ends of justice would meet adequately if the impugned order in this issue is set aside and the matter is restored to the file of AO/TPO. We order accordingly and direct the TPO to examine these documents or any other material which he considers necessary to verify the segregation of expense between A.E. and non-AE segments and thereafter determine the ALP as per law after allowing a reasonable opportunity of being heard to the assessee. We want to make it dear that the matter is at large before the TPO and no part of this order should be considered as our observations on the merit of the case. We further want to elucidate that if the TPO comes to a positive and well-founded conclusion, after full verification of necessary records/documents, that there is no authenticity of such segregation of expenses done by the assessee and as such, the determination of ALP is not possible, he will be free to adopt any other suitable base or some other appropriate method for this purpose. This direction has been made to ensure that the power of the TPO to determine the ALP should not get eclipsed if the compartmentalization of the data done by the assessee is either not capable of acceptance or not open to verification. Needless, to say, the assessee will be allowed a reasonable opportunity of hearing by the TPO. With these observations, we set aside the impugned order on this issue and remit the matter to the AO/TPO for fresh decision as per our directions.

[Emphasis is supplied by us.]

3.1 In pursuance of the above referred Tribunal order, the TPO showed caused the assessee to justify its claim/segregation of expenses between AE and Non-AE segments. In response, the assessee filed submission justifying his stand by stating that the idle capacity utilization had been taken into account for apportionment of expenses between AE and Non-AE segments. However, the TPO, holding that the assessee had not provided any working of idle capacity; hence, the adjustment on this score, in view

of the decision of the Tribunal in the case of Will Processing Services Pvt. Ltd. [2013] 30 Taxmann.com 350 (Mum), was not allowable. Since the assessee had filed submission before the TPO that the segregation of expenses between AE and Non-AE segments was not feasible as the assessee had not maintained separate segmental accounts; therefore, the TPO inferred that the claimed capacity utilization was not backed by the accounts. The TPO, in view of the above and highlighting the Auditor's comment in 3CEB audit report, rejected the internal TNMM and applied external TNMM and made the adjustment of INR 30,264,835/-. Aggrieved, the assessee filed appeal before the CIT(A), who dismissed the appeal holding as under:

“4.3 I have considered the original orders, direction of Hon'ble ITAT, Order of the TP subsequent to such direction, written submissions and oral arguments of the Ld. AR carefully. Hon'ble ITAT vide its order dated Oct/31/2013 has set aside the order of the TPO with direction to examine the reliability of the segmental data for AE and Non-AE. In the Second round TPO has considered the data provided after issuing show cause and has held that segmental data is not reliable. The TPO has relied on the Form No. 3CEB where it has been preferred TNMM as the most appropriate method with unrelated party. Further, the Ld. TPO has not agreed for idle capacity adjustments which has led the determination of profit. margin of AE and Non-AE segment.

Ld. AR has argued that Hon'ble ITAT has not questioned idle capacity. It has only directed TPO to examine the working of profit between AE and Non-AE segment for the purpose of internal TNMM. Ld. AR explained that cost allocation to its 3 segment AE, non-AE and idle capacity segment is based on man hours' time basis which is not been questioned by the TPO.

I have considered the facts of the case. During the appellate proceedings, Ld. AR has explained the appellant is maintaining 3 segment i.e. AE, Non-AE and idle capacity. Vide order dated

16/12/2016, Ld. AR Shri Vishal Kalra explained that bifurcation of the cost for AE and Non-AE partly direct cost as sum of the employees are directly attached to those segments. Rest of the manpower is common for all 3 segments. Idle capacity computation of man hours basically constitutes of leave, leave travel and general time when the employees are idle and for training. He further, explained that training is not through external source. Those resources are trained through existing manpower who are deployed for AE and non-AE segments through different platforms but not on site. However, vide order dated 27/12/2010 he clarified that there is no specific manpower is assigned to AE and non-AE manpower. Manpower is common for AE and non-AE segments.

From above facts, it is clear that there is no separate manpower for AE, Non-AE and idle capacity segments. Even as per the claim, appellant/Ld. AR segment has been prepared on the man hours basis. Idle capacity segment has been computed on the basis of resources going for leave or leave travel or sitting idle for work or training. Even training is not through the external agencies but on the existing projects for AE and Non-AE only. In my view under these circumstances idle capacity segment is created for same manpower who is not at work for some time either due to leave or leave travel or shortage of work can not constitute a separate segment.

Even for training there is no separate mechanism through outside agency. It has been explained that it is internal training on existing projects. In view of the above facts, I am not satisfied with the existence of idle capacity segment. Ld. AR has argued that Hon'ble Tribunal has not questioned the existence of idle capacity segment. I do not agree with these arguments of the Ld. AR that. As idle capacity segment is intrinsically connected to AE and non-AE segment as the cost allocated to idle capacity segment has to be excluded from total cost base which is bifurcated to AE and non-AE segment. Further, acceptance of Ld. AR vide order sheet dated 27/12/2016 that there is no separate manpower for any segment prove the need of justification of idle capacity segment. AE and non-AE segments are homogenous and type of jobs undertaken in AE and non-AE is similar. In case of homogenous functions for AE and non-AE and having same manpower, it would not be proper to accept AE and non-AE segment only on the basis of hourly basis as claimed to have been maintained by the appellant. There is no concrete basis for creation of idle capacity segment under these circumstances it is difficult to accept through existing data existence of internal TNMM for AE and non-AE segment. Therefore, I do not approve application of internal TNMM in appellant's own case.

Ld. AR's arguments that for AY 2008-09 internal TNMM has been accepted by Hon'ble Tribunal does not affect for the decision as the data for Assessment. Year 2008-09 may be different. Data and facts for AY 2008-09 may be different.

Ld. AR has argued that adjustment of cost of new office was not allowed in external TNMM. This issue was not raised before Hon'ble ITAT. Therefore, in my view such claim cannot be examined at this stage.

Accordingly, I confirm the action of the use of external TNMM for comparability purposes.

External TNMM

In original TP proceedings. the TPO has rejected certain external comparables namely BLK life style, Geologging Industries Limited and Pronzone Enterprises Ltd. These comparables were excluded on account of related party transactions. Similarly, in comparable M/s Sikka N Sikka Engineers was excluded on account of super normal profit.

In respect of objections raised on additional comparables TPO has commented that small different in functionality is permitted under TNMM analysis and the TPO has come up with the final set of comparables consisting of 5 companies as under: -

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During the appellate proceedings Ld. AR has filed written submission that comparables namely IBI Chematur (Engg. & Consultancy) Ltd., MJB India Gas Turbine Services Ltd. and Oil Field Instrumentation India Ltd. are functionally different. Ld. AR has argued that even 2 comparables namely Mahindra Consulting and NTPC Electric Supply, functions are completely dissimilar. Therefore, he argued that international transactions cannot be benchmarked by applying external TNMM.

I have perused the TP order. These comparables has been chosen by using the search with key word Business Services, Technical Constancy & engineering service. Ld. AR has given the business profile of his comparable namely as under: -

.....

I have perused the above business profile of these 3 companies~ Functionality these company will come under overall engineering services and Technical Services which is the function of the appellant and the small variation in functionality is permitted in TNMM analysis. Accordingly, I confirm the external TNMM analysis as done by the TPO. As a result, all the Grounds of Appeals are dismissed.”

4. At the outset, the Ld. Counsel submitted that Ground Nos. 1, 2 and 3, being general in nature did not require specific adjudication. Further, he submitted that the Ground No. 12 and should be dismissed being not pressed and consequential. In view of these submissions, Ground Nos. 1, 2, 3, 12 and 13 stand dismissed.

4.1 The Ld. Counsel further submitted that in case the Ground No. 11, 11.1 and 11.2 would be decided in favour of the appellant, then Ground Nos. 5 to 10 would become academic in nature.

4.2 Further, the Ld. Counsel submitted that the issue of external TNMM resulting adjustment on account of ALP of international transactions of INR 30,264,835/- in the appeal had been decided in favour of the assessee by the coordinate bench of the Tribunal in the assessee's own case in the ITA No.: 6227/Del/2012 for the AY 2008-09 and duly upheld by the Hon'ble Delhi High Court. The relevant part of the Tribunal order in the ITA No.: 6227/Del/2012 reads as under: -

3. The assessee before us, Lummus Technology Heat Transfer BV, is a Dutch company (L-GE, in short) specializing in heat treatment equipment, and it has a permanent establishment, by way of a branch, in India (L-PE, in short). L-PE is engaged in providing certain engineering services to L- GE and another associated enterprise by the name of ABB Lummus Global Inc. USA (L-US, in short). These engineering services are for projects, undertaken by the associated enterprises, in oil and gas, fertilizers and petrochemical industries. The assessee has also rendered these services to the independent enterprises, i.e. non-AEs, as well. In the relevant previous year, the assessee's turnover with the AEs was Rs 1,424.93 lakhs, whereas its turnover with the non-AEs was Rs 13.52 lakhs. The assessee had used Transactional Net Margin Method (TNMM) for determining the

arm's length price of its transactions with the AEs, and had benchmarked their profitability on the basis of profitability of its transactions with non-AEs, i.e. independent enterprises. The assessee had produced segmental accounts separately reflecting three segments, i.e. (a) Business with AEs; (b) Business with Non-AEs; and (c) Idle capacity. The assessee's claim was that since its margin on the business with AEs was better than margin on non-AEs, the transactions with the AEs are to be accepted as on arm's length price under the TNMM. While assessee's operating profit over operating revenue was 40.68%, so far as business with AEs was concerned, the assessee's net operating profit over operating revenue was 29.02% for non-AE business. This approach for determination of ALP, however, did not satisfy the Transfer Pricing Officer. The TPO was of the view that the segmental accounts of the assessee were not subjected to the tax audit, as evident from the fact that the segmental accounts were not referred to in the tax audit report. The TPO noted that, "it is evident from segmental information, as disclosed in the transfer pricing report, that the segmental information has been created to arbitrarily allocate the costs with design to show higher profitability in AE transactions" and that the tax auditor has not been able to "ascertain the propriety" of such segmental accounts. The TPO further opined that since these segmental accounts have not been subjected to tax audit, the allocation of expenditure cannot be relied upon to determine segmental results. On this basis, the TPO formed the opinion that the segmental results prepared by the assessee cannot be relied upon to benchmark international transaction, and observed that "the pertinent need of the assessee to draw segmental accounts for the sole purpose of transfer pricing when there was already a set of audited accounts has a stark reasoning that, by drawing manipulated segmental accounts, the assessee has camouflaged the actual profitability". He further added that "these (segments) are homogenous segments and cannot be differentiated on any analysis". The Transfer Pricing Officer also rejected the comparability of AE transactions with non AE transactions on the ground that the size of non AE business was very small and yet costs were equally divided, as evident from the observation that, "it is seen that the quantum on non AE (i.e. independent third party transaction) is only about 0.94% of the total revenue" and that, it defies "logic to comprehend that the assessee has, with uncared impunity allocated the designated operating costs almost equally in both these segments, though the revenue in non- AE segment is meagre Rs 13,52,440". It was in this backdrop that the internal TNMM given by the assessee was rejected by the TPO. The TPO the proceeded to take up external comparables, but, for the reasons we will set out in a short while, it is not necessary to deal with that aspect of the matter. Suffice to say that objecting to

the stand of the Transfer Pricing Officer, assessee raised objections, to the draft assessment order, before the Dispute Resolution Panel, but without any success. In its brief operative portion of the order, the DRP held that, "In our view, the accounts of the assessee were bifurcated for TP purposes only and the audited accounts do not show different segments. Hence, DRP concurs with the TPO's action in not giving credence to this segmentation". Accordingly, in the final assessment order passed by the Assessing Officer, an addition of Rs 2,72,42,901 was made as an ALP adjustment of invoice value of services rendered by the assessee to its AEs, namely L-GE and L-US. The assessee is aggrieved and is in appeal before us. 4. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case in the light of the applicable legal position.

5. Rule 10B(1)(e) of the Income Tax Rules, which deals with the Transactional Net Margin Method, provides requires that "the net profit margin realised by the enterprise (i.e. the assessee) from an international 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" is compared with "the net profit margin realised by the enterprise (i.e. the assessee) or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base" – of course, subject to comparability adjustments which could affect the amount of net profit margin in uncontrolled conditions. It is not at all necessary, as the authorities below seem to suggest, that such net profit computations, in the case of internal comparables (i.e. assessee's transactions with independent enterprise), are based on the audited books of accounts or the books of accounts regularly maintained by the assessee.

In our considered view, all that is necessary for the purpose of computing arm's length price, under TNMM on the basis of internal comparables, is computation of net profit margin, subject to comparability adjustments affecting net profit margin of uncontrolled transactions, on the same parameters for the transactions with AEs as well as Non AEs, i.e. independent enterprises, and as long as the net profits earned from the controlled transactions are the same or higher than the net profits earned on uncontrolled transactions, no ALP adjustments are warranted. It is not at all necessary that such a computation should be based on segmental accounts in the books of accounts regularly maintained by the assessee and subjected to audit. We are, therefore, of the view that the authorities below were in

error in rejecting the segmental results on the ground that the segmental accounts were not audited and that these segmental accounts were not maintained in the normal course of business. As regards vague generalizations by the TPO to the effect that these accounts are manipulated, that allocation basis of expenses is unfair and that these accounts conceal true profitability, we find that these observations are too sweeping and generalized the observations to have any merits. In any event, learned counsel for the assessee has painstakingly taken us through the segmental accounts, pointed out the basis of allocation of the expenses. We have noted that the allocation of expense is on the man hour basis, which is quite fair and reasonable, and that every person has to punch in hours on a specific project. We have also noted that all these details and expense allocation basis were also before the TPO and even then, no specific defects were pointed out by the TPO. Taking into account all these factors, as also entirety of the case, we are of the considered view that the TPO indeed erred in rejecting the segmental accounts and thus declining to accept the internal comparable. We are also of the view that the size of the uncontrolled transaction or transactions being smaller, by itself, does not make these transactions incomparable with the transactions in controlled conditions. Size of the comparable does matter in entity level comparison because scale of operations substantially vary and so does the underlying profitability factor, but in a transaction level comparison within the same entity, mere difference in size of the uncontrolled transactions does not render the transaction incomparable. If the size of uncontrolled transaction is too big, it may call for an adjustment for volume business. If the size of the uncontrolled transaction is too small, it may provoke an inquiry by the TPO to ensure that it is not a contrived transaction outside the normal course of business or with regard to other significant factors surrounding smallness of such transaction. However, in our considered view, in none of these cases, a comparable can be rejected on the basis of its size per se. In this view of the matter, the authorities below were clearly in error in rejecting the internal comparable, i.e. profitability of assessee's transactions with non-AEs, on the ground that the volume of business with non-AEs was too small vis-à-vis business with AEs. In view of these discussions, as also bearing in mind entirety of the case, the assessee was quite justified in adopting internal TNMM and comparing the profit earned on its transactions with AEs with profit earned with non-AEs. Accordingly, the ALP adjustment of Rs 2,72,42,940 deserves to be deleted. We order so. The assessee gets the relief accordingly.

4.3 The Ld. Counsel drew our attention to the decision of the Hon'ble Delhi High Court in case of the assessee in ITA No. 997/2018, 482/2023 and 484/2023 (order dated 17 May 2024), wherein the Revenue appeal raising the similar issue of adjustment on account of ALP of international transactions was rejected. It was specifically submitted that there was factual similarity in the present case of the assessee with those decided by the Hon'ble High Court.

5. The Ld. Sr. DR supported the orders of lower authorities and prayed for dismissal of the appeal of the assessee.

6. We have heard both parties and have perused the material available on the record. We find merit in the argument of the Ld. Counsel that no adjustment on account of ALP of international transactions of INR 30,264,835/- is called for. We have given a thoughtful consideration to the entire facts of the case and submissions/contentions/arguments of both parties and are of the considered view that this issue is squarely covered by the decision of the Hon'ble Delhi High Court in case of the assessee in ITA No. 997/2018, 482/2023 and 484/2023. We therefore, following the reasoning given by the Honorable Delhi High Court in case of the assessee in ITA No. 997/2018, 482/2023 and 484/2023, set aside the order of the Ld. CIT(A) and delete the adjustment on account of ALP of international transactions of INR 30,264,835/-. The assessee gets the relief INR 30,264,835/- accordingly.

7. Other grounds, in view of the above finding, become academic in nature. Therefore, the same are not being adjudicated here.

8. In the result, the appeal of the assessee is allowed as above.

Order pronounced in open Court on 07 May, 2025

Sd/-

Sd/-

(SATBEER SINGH GODARA)
JUDICIAL MEMBER

(AVDHESH KUMAR MISHRA)
ACCOUNTANT MEMBER

Dated: 07/05/2025

Binita, Sr. PS

Copy forwarded to:

1. Appellant
2. Respondent
3. PCIT/CIT
4. CIT(A)
5. Sr. DR-ITAT

ASSISTANT REGISTRAR
ITAT, NEW DELHI