

**IN THE INCOME TAX APPELLATE TRIBUNAL  
'C'BENCH: BANGALORE**

**BEFORE SHRI PRASHANT MAHARISHI, VICE – PRESIDENT  
AND  
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER**

<b>ITA No.:2381/Bang/2024</b>
<b>Assessment Year:2010-2011</b>

Deputy Commissioner of Income Tax, Circle-2(1)(1), Bengaluru, Karnataka	<b>Vs.</b>	Brady Company India Private Limited, No.26 SY.No.41. Konappana Agrahara Village, Begur Hobli, Electronic City PhaseII, Bengaluru 560100  <b>PAN: AACCB8163A</b>
<b>APPELLANT</b>		<b>RESPONDENT</b>

Assessee by	:	Shri Suryanarayana Advocate & Ms Mansa Ananthan Advocate
Revenue by	:	Sri. N. Balusamy - JCIT

Date of Hearing	:	03-02-2026
Date of Pronouncement	:	15-04-2026

**ORDER**

**PER PRASHANT MAHARISHI, VICE – PRESIDENT**

1. ITA No. 2381/Bang/2024 for assessment year 2010-11 is filed by the Deputy Commissioner of Income Tax Circle 2(1)(1) Bangalore (the learned AO) in case of Brady Company India Private Limited (assessee) against the appellate order passed by the Commissioner of Income Tax Appeals Bangalore 12 (the learned CIT-A) on 10<sup>th</sup> October

2024 wherein the appeal filed by the assessee against the assessment order passed under Section 143(3) read with Section 144C of the Income Tax Act, 1961 (the Act) dated 22<sup>nd</sup> April 2014 passed by the Deputy Commissioner of Income Tax Circle 11(2) Bangalore (the AO) was allowed for statistical purposes.

2. Based on the order of the learned CIT-A the appeal effect order was passed by the learned Assessing Officer wherein the transfer pricing adjustment of Rs. 2,95,99,030 made by the learned Assessing Officer based on the order of the Transfer Pricing Officer with respect to the manufacturing segment was deleted.
3. The Assessing Officer is aggrieved and has raised **ten grounds of appeal as under:**
  - i. *Whether the CIT(A) was right in directing to confine the TP adjustment to the value of International Transactions in manufacturing segment of the assessee?*
  - ii. *Whether the CIT(A) erred in not considering the fact that whatever is the reduction in the margin of the assessee viz a viz comparables is on account of purchase from AE at a higher price and the same gets considered when ALP is calculated by applying TNMM?*
  - iii. *Whether the CIT(A) is right in restricting the adjustment to international transaction when it brings the margin of the tested party at 1.43% which is lower than the ALP of 6.40%, when the ALP margin is confirmed?*
  - iv. *Whether the CIT(A) erred in ignoring the interdependence between AE and non-AE transactions and the impact of controlled*

- transactions driving down the margin in manufacturing segment?*
- v. *Whether the CIT(A) is right in granting capacity utilization adjustment, without verifying the claim of capacity utilization of comparables when the same is not available in public domain?*
  - vi. *Whether CIT(A) is right in granting capacity utilization adjustment when there is absence of reliable data and methodology to determine the same?*
  - vii. *Whether CIT(A) is right in granting capacity utilization adjustment when the same introduces inaccuracies in benchmarking due to assumptions about fixed cost allocations.*
  - viii. *Whether the CIT(A) is right in granting Working Capital Adjustment to the assessee without establishing as to how working capital has affected the profitability margins?*
  - ix. *Whether the CIT(A) is right in granting Working Capital Adjustment to the assessee without taking cognizance of ITAT order in the case of Mobis India ITA No 2112/Mds/2011(AY: 2007-08) [2013] 38 taxmann.com and ITAT order in the case of SAME Deutz-Fahr India Pvt. Ltd. ITA No.2666/Mds/2016 in which working capital was not granted owing to absence of requisite details pertaining to working capital?*
  - x. *Whether the CIT(A) was right in directing TPO to treat both provisions of bad debts and provisions written back as operating on the grounds of consistency without considering the fact that the nature of both the transactions being non-operating?*

*xi. The Appellant craves to add, alter, delete, modify or withdraw any of the above grounds of appeal.*

4. Briefly stated the facts of the case show that assessee was incorporated as a private limited company on 7 March 2006 and it is three distinct operations namely manufacturing, shared services, including services. Assessee carries on the business of manufacturing identification solutions including high-performance electronic tracker's and die cut. The manufacturing unit is an export-oriented unit. In shared services segment it has a unit established in the software technology Park of India commenced its operation in October 2006. The unit is engaged in the provision of business process outsourcing services and information technology enabled services. These are rendered in the net domain of accounting, information technology, procurement and related services. The unit acts as a centralised location providing accounting services to various group companies across the globe. In the trading segment it imports finished goods from associated enterprises and sales it in the domestic market.
5. The assessee company filed its return of income on 15<sup>th</sup> October 2010 of Rs. NIL after claiming deduction under Section 10A of Rs. 2,18,44,872. The return was picked up for scrutiny.
6. During the year the assessee has entered international transactions and therefore these international transactions were referred to by the learned Transfer Pricing Officer for determination of arm's length price. The consequent order under Section 92 CA of the Act was passed on 30<sup>th</sup> January 2014 wherein the adjustment of Rs. 2,95,99,030 was made to the total international transaction of the assessee.
7. The assessee has returned eight distinct types of international transactions. The financial statement on the segment-wise

basis shows that in manufacturing segment the assessee has earned negative margin of 2.27%, profit of 16.98% in trading segment and 21.48% in shared services segment. The assessee for all these three segments has selected three sets of comparables using multiple year data. The learned Transfer Pricing Officer also verified the filters adopted by the assessee and found this inappropriate. It was also noticed that the comparable selected by the assessee also did not pass the FAR test. Accordingly, he rejected the transfer pricing study report of the assessee. The learned Assessing Officer issued a show cause notice; the learned Transfer Pricing Officer selected ten comparables including the taxpayer's own comparables computing the margins of the comparables at 7.32% on OP/OC and 6.40% on OP/Sales based on this on operating revenue of Rs. 33,92,74,880 determined the arm's length price of the cost incurred at Rs. 31,75,01,288 whereas the actual cost incurred by the assessee was at Rs. 34,71,60,318 and made an adjustment of Rs. 2,95,99,030.

8. Based on this the assessment order was passed. Certain other disallowances in the normal computation of total income were also made by the AO and final assessment order was passed on 22<sup>nd</sup> April 2014 at total income of Rs. NIL.
9. The assessee challenged the same before the learned CIT-A who passed an appellate order on 10.10.2014. The learned CIT Appeal directed the learned Assessing Officer to restrict the transfer pricing adjustment only to the extent of international transaction i.e. only transaction with the AE. He further directed the AO to verify the difference in capacity utilization of tested party and the comparables and thereafter, if found proper, to grant the capacity utilization adjustment. He also directed the learned TPO AO to provide working capital adjustment in manufacturing segment and further directed the

AO to treat Forex Gain on uniform basis as operating income. He further directed that the AO when treated the provision as expenses but did not treat the provisions written back as income is not correct and uniform view is required to be taken.

10. Based on the above directions of the learned CIT Appeal the Transfer Pricing Officer conducted a hearing where the assessee submit the details as per letter dated 18<sup>th</sup> November 2024 and based on this the learned TPO was satisfied about granting of capacity adjustment, working capital adjustment treating the Forex Gain as operating income and also provision returned back as operating income. He further restricted the addition only to AE related transactions. Accordingly, the margins of the comparable was re-computed at 3.64% which resulted in deletion of the arm's length price adjustment of Rs. 2,95,99,030.
11. Thus, AO is aggrieved with the appellate order and is in appeal before us.
12. The learned Departmental Representative made a detailed submission stating that adjustment cannot be restricted to the international transaction but is required to be made on total transaction. He stated following **reasons for not accepting the above view:**

*i. **Interdependency of AE and Non-AE Transactions:***

*Even if the primary transactions occur between the appellant and non-AEs, the cost structures for goods and services derived from AES (such as rate materials or components) may significantly impact the final pricing. Transfer pricing principles aim to ensure that profits from such interdependent transactions reflect an arm's length standard, which includes indirect effects on non-AE transactions.*

- ii. **Need for Comprehensive Analysis of ALP:** Section 92 intends to capture the entirety of influence from AE transactions, which may not be fully isolated to international transactions alone. The IKA India Pot Ltd. decision presumes that such separation is feasible, yet in practice, cost structures may not be easily divided without distorting true profit allocations. A holistic approach that considers overall transactions, rather than artificially isolating AE-specific transactions, might provide a truer reflection of economic reality and profit attribution.

At this juncture it is important to analyse the Transfer pricing procedure and the relevant methodology for adopting the arm's length price. In the case of the assessee TNMM method is used for adjustment in manufacturing segment. Object of applying the TNMM at the manufacturing segment level, by considering the comparables engaged in the manufacturing functions, is to find out the negative influence on the assessee company due to the international transactions related to cost and revenue by comparing the margin of the segment with the mean margin of the independent comparables. Therefore, it is not appropriate to restrict the adjustment to the AE cost or revenue. In the case of the assessee, the ALP margin (OP/OR being the PLI) has been worked out by the TPO at 6.40% for the Operating Revenue of Rs. 33,92,74,880/- and by applying that margin, the TPO arrived at the conclusion that the operating cost should have been at Rs. 31,75,61,288/- as against the incurred operating cost of Rs. 34,71,60,318/- which includes a controlled transaction of Rs. 3,53,48,429/- driving the OP/OR of the tested party to -2.32% as against the ALP of 6.40%. It is this controlled transaction of Rs. 3,53,48,429/-

*which has driven the margin of the segment down and accordingly, the adjustment is to be made to the extent of international transaction and not making proportionate adjustment. Hence, restricting the adjustment to the AE's cost/sales amounts to holding that non-AE cost has also impacted the profit margin of the manufacturing segment will defeat the very purpose of Transfer Pricing Analysis. Further, if the ALP adjustment is restricted proportionately to international transaction, then the adjusted margin of the manufacturing segment will still be -1.43% as against the ALP margin of 6.40%*

*The argument of the assessee could have some strength if the data in relation to profits earned by assessee in relation to costs related to international transactions were available. However, this is not so. The assessee is selling a product, for the manufacture of which, part purchases are from AEs and remaining from the non-AEs. When the product is sold, only overall profit margin is recorded without any data as to what would be the profit in relation to purchases from AE. So, this cannot be presumed that the profit percentage earned in relation to costs related to international transactions as well as non international transactions was same. Since costs are common to the products ultimately sold by the assessee, and the same includes international transactions, so it is always possible that the margin of profit percentage vis a vis costs related to international transaction is not the same as profit margin on costs related to non-international transactions, but ultimately overall certain profits are being shown. In fact, the profit margin of the assessee in relation to imports should be higher than the profit margins on costs related to domestic*

sector as the imported items would be scarce while domestic items would be abundantly available in local markets.

The following paragraphs provide a detailed explanation of the transfer pricing analysis and adjustments made:

*Analysis of the Taxpayer's Financials*

<b>Particulars</b>	<b>Amount</b>	<b>Remarks</b>
Operating Revenue (OR)	33,92,74,880	
Operating Cost (OC)	34,71,60,318	Includes controlled transaction of Rs. 3,53,48,429
AE's Operating Cost	3,53,48,429	Controlled Purchase
Non-AE's Operating Cost	31,18,11,889	<i>Uncontrolled Purchase</i>
Operating Profit (OP)	-78,85,438	
OP/OR	-2.32%	

The TPO has determined the ALP margin (OP/OR) as 6.40% for the taxpayer. Whereas in the case of the taxpayer the OP/OR is -2.32%. Accordingly, the operating cost of the taxpayer is revised as below:

	<b>Particulars</b>	<b>Amo</b>	<b>Remarks</b>
1.	ALP OP/OR	6.40%	
2.	Operating Revenue (OR)	33,92,74,880	
3.	ALP OP	2,17,13,	(6.40% * OR)
4.	ALP OC	31,75,61	OR - ALP OP
5.	Non-AE's Operating Cost	31,18,11	Uncontrolled Purchase
6.	ALP AE's Operating Cost	57,49,39	ALP OC - Non-AI's
7.	AE's Operating Cost	3,53,48,	Controlled Purchase
8.	Adjustment to be made	2,95,	AE's OC - ALP AE's

*The objective of transfer pricing adjustments is to prevent profit shifting through controlled transactions. The above calculations indicate that after making the necessary adjustment, the taxpayer achieves an ALP margin of 6.40%. The reduction of the profit margin to -2.32% was due to excessive controlled transactions amounting to Rs. 3,53,48,429, whereas it should have been only Rs. 57,49,399. The adjustment corrects this discrepancy.*

**Impact of CIT(A)'s Ruling and Proportionate Adjustment**

*If the ruling of the CIT(A) is considered and proportionate adjustment is made, the PLI (OP/OR) of the taxpayer will be as below:*

<b>Particulars</b>	<b>Amount (Rs.)</b>	<b>Remarks</b>
ALP OP/OR	6.40%	
Operating Revenue (OR)	33,92,74,880	
Operating Cost (OC)	34,71,60,318	
ALP OP	2,17,13,592	6.40%*OR
ALP OC	31,75,61,288	OR-ALP OP
AE's Operating cost	3,53,48,429	Controlled Purchase (10.18% of total cost)
Non-AE's Operating Cost	31,18,11,889	Uncontrolled Purchase (89.82% of total cost)
Total Adjustment	2,95,99,030	OC – ALP OC
Proportionate Adjustment	30,13,821	Total Adjustment*10.18%
Revised OC	34,41,46,497	OC – Proportionate Adjustment
Revised OP	-48,71,617	OR – Revised OC
Revised OP/OR	-1.43%	Revised OP/OR

*Following CIT(A)'s proportionate adjustment ruling, the revised PLI (OP/OR) remains at 1.43%. This contradicts the purpose of transfer pricing adjustments, which aim to prevent base erosion and profit shifting.*

*CIT(A) has overlooked that the negative PLI of -2.32% is solely due to the controlled transaction of Rs.*

3,53,48,429. Therefore, the adjustment should be limited to the extent of the AE's transaction, rather than applying on a proportionate basis.

**Demonstrating the Issue with Proportionate Adjustment**

Consider a hypothetical scenario where Company X incurs an operating cost of Rs. 60 from non-AEs and generates an operating revenue of Rs. 100 from non-AEs. The PLI (OP/OR) in this scenario is 40% (100-60/100). The financials of Company X are:

Particulars	Amount	Remarks
Operating Revenue (OR)	100	
Operating Cost (OC)	60	
Operating Profit (OP)	40	OP = OR - OC
OP/OR	40%	40% is also the ALP Margin for

Now, assume the group instructs Company X to procure Rs. 50 from non-AEs and the remaining Rs. 10(ALP price) from AEs at an inflated cost of Rs. 40. The revised financials are:

	Particulars	Amount	Remarks
(1)	Operating Revenue (OR)	100	
(2)	Operating Cost (OC)	90	50+40
(3)	AE'S OC	40	
(4)	Non-AE's OC	50	
(5)	Operating Profit (OP)	10	OR - OC
(6)	OP/OR	10%	
(7)	ALP OP/OR	40%	As per assumption
(8)	ALP OP	40	OR*ALP OP/OR
(9)	ALP OC	60	OR - ALP OP
(10)	Total Adjustment	30	OC - ALP OC

(11)	Proportionate Adjustment	13.33	Total Adjustment * (AE's OC/OC)
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*If proportionate adjustment is applied, despite the controlled transaction being inflated to Rs. 40 from an ALP of Rs. 10, the adjustment is limited to Rs. 13.33 instead of Rs. 30. This flaw in proportionate adjustment fails to address the core issue of excessive controlled transactions and weakens the intent of transfer pricing regulations.*

*Therefore, adjustments should be strictly confined to controlled transactions to prevent profit shifting and ensure compliance with transfer pricing laws.*

**International precedent pertaining to similar transactions.**

*This scenario is elaborated in detail by U.S. Section 482 of the Internal Revenue Code (IRC). Relevant portions of the example mentioning the same is reproduced below:*

**Example 2. (i)** *S, a U.S. corporation, is the exclusive distributor for FP, its foreign parent. There are no changes in the beginning and ending inventory for the year under review. S's total reported cost of goods sold is \$800, consisting of \$600 for property purchased from FP and \$200 of other costs of goods sold incurred to unrelated parties. S's applicable resale price and reported gross profit are as follows:*

*Applicable resale price \$ 1000*

*Cost of goods sold:*

*Cost of purchases from FP 600*

*Costs incurred to unrelated parties 200*

*Reported gross profit 200*

**(ii)** *The district director determines that the appropriate gross profit margin is 25%. Therefore, S's*

*appropriate gross profit is \$250 (i.e., 25% of the applicable resale price of \$1000). Because S is incurring costs of sales to unrelated parties, an arm's length price for property purchased from FP must be determined under a two-step process. First, the appropriate gross profit (\$250) is subtracted from the applicable resale price (\$1000). The resulting amount (\$750) is then reduced by the costs of sales incurred to unrelated parties (\$200). Therefore, an arm's length price for S's cost of sales of FP's product in this case equals \$550 (i.e., \$750 minus \$200).*

*It is clear from the above example that the adjustment is restricted to the controlled transaction and not on proportionate basis.*

13. Accordingly, the Assessing Officer expressed significant concern regarding Ground No. 1 of the appeal. As the ground No. 5-7 for capacity utilization and ground No. 8-9 with respect to working capital adjustment same was granted by the learned Assessing Officer/TPO after verification, nothing much was submitted. With respect to ground No. 10, also because of the uniformity provision written back, it is to be treated as operating income no further arguments are advanced.
14. The learned Authorized Representative vehemently submitted that it is now beyond doubt and judicially settled that adjustment to the arm's length price is required to be restricted only to the extent of international transaction. He referred to plethora of judicial precedent and stated that there is no infirmity in the order of the learned CIT Appeal. With respect to capacity utilization, he also submitted that it is after the verification granted by the learned TPO. Similarly on working capital adjustment he also referred to paragraph No. 5.6.2 of the order of learned CIT Appeal.
15. We have carefully considered the rival contention and perused the orders of the learned lower authorities.

16. Ground no 1 to 4 are against the direction of the Id. CIT (A) in directing Id. TPO to compute ALP adjustment only on the transactions with AE. We appreciate the logic and reasoning given by the Id. CIT DR. However, We find that the learned CIT Appeal directed the Assessing Officer to restrict the adjustment only on international transaction and not on the whole of the transaction of the assessee is already judicially decided. by several High Courts *CIT v. Goldstar Jewellery Design (P.) Ltd.* [2016] 67 taxmann.com 86/238 Taxman 5/388 ITR 510 (Bombay) and *CIT v. Alstom Projects India Ltd.* [2017] 88 taxmann.com 465/394 ITR 141 (Bombay) . Issues is pending before Honourable supreme court as SLP is granted against High Court's ruling that ALP can only be considered on transactions with AEs and not on entire turnover of assessee in *Commissioner of Income-tax, Mumbai vs. Firestone International (P.) Ltd.* [2016] 73 taxmann.com 39 (SC)/[2016] 242 Taxman 7 (SC)[16-08-2016]. Therefore, we do not find any infirmity in the order of the learned CIT-A in directing the adjustment restricting to the extent of international transaction only. Accordingly, we do not find any merit in ground No. 1-4 of the appeal of the AO. Hence dismissed.
17. Ground no 5 to 7 are against the direction of the Id. CIT (A) to verify the capacity adjustment claim of the assessee. We find that the Id. TPO has after verification granted the same. There is no reservation expressed by the Id. TPO. Further the Id. CIT A has merely restored the issue to Id. TPO who has granted it now. So, we do not find how the Id. AO is aggrieved now. We dismiss ground no 5 to 7 of the appeal.
18. Ground no 8 is against the working capital adjustments allowed by the Id. CIT (A) and to be verified by the Id. TPO. We find that it is not the case of Id. TPO that working capital adjustment is not part of the process of determining ALP of the

International transaction. Further, if the assessee is eligible then only it was to be granted, the Id. TPO after verification allowed it. So, there is no grievance to the Id. AO on this count. Hence this ground is dismissed.

19. Ground no 9 is with respect to direction by Id. CIT A to be consistent in considering forex gain and losses and provisions vis a vis it wrote back We find no infirmity in the same. Hence Ground no 9 is dismissed.
20. In the result appeal filed by the learned Assessing Officer is dismissed.

Order pronounced in the open court on 15<sup>th</sup> April 2026.

Sd/-  
(SOUNDARARAJAN K.)  
JUDICIAL MEMBER

Sd/-  
(PRASHANT MAHARISHI)  
VICE-PRESIDENT

Bangalore,  
Dated, the 15<sup>th</sup> April 2026.

\*VM\*

Copy to:

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

By order

Assistant Registrar,  
ITAT, Bangalore