

आयकर अपीलीय अधिकरण, मुंबई "के" खंडपीठ
Income-tax Appellate Tribunal -"K"Bench Mumbai
सर्वश्री राजेन्द्र,लेखा सदस्य एवं सी. एन. प्रसाद,न्यायिक सदस्य

Before S/Sh.Rajendra,Accountant Member and C.N. Prasad,Judicial Member
आयकर अपील सं./I.T.A./2601/Mum/2015,निर्धारण वर्ष /Assessment Year: 2009-10

Mahindra Automobiles Distributor Private Limited C/o. Automotive Sector, Mahindra Towers, First Floor, Akurli Road, Kandivali, Mumbai-400 101. PAN: AAECM 2999 P	Vs.	DCIT, Circle-2(2) Aayakar Bhavan, Churchgate, Mumbai.
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आयकर अपील सं./I.T.A./2618/Mum/2015,निर्धारण वर्ष /Assessment Year: 2009-10

Addl. CIT, Range-2(2) Aayakar Bhavan, M.K. Road, Mumbai-20	vs.	Mahindra Automobiles Distributor Private Limited,Mumbai-400 101.
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(अपीलार्थी /Appellant)

(प्रत्यर्थी / Respondent)

Revenue by: Shri N.K.Chand-CIT

Assessee by: Bhavin Shah

सुनवाई की तारीख / **Date of Hearing: 20.04.2016**

घोषणा की तारीख / **Date of Pronouncement: 18.05.2016**

आयकर अधिनियम,1961 की धारा 254(1)के अन्तर्गत आदेश

Order u/s.254(1)of the Income-tax Act,1961(Act)

लेखा सदस्य राजेन्द्र के अनुसार PER RAJENDRA, AM-

Challenging the order, dated 6.2.2015, of CIT(A)-57,Mumbai, the assessee and the Assessing Officer(AO)have filed cross appeals for the above mentioned AY.Assessee-company,engaged in the business of designing, manufacturing and marketing of motor vehicles, filed its return of income on 29.09.2009, declaring total income at Rs.16.21 crores. On 30.3.2011,it filed a revised return, declaring loss of Rs.179.58 crores.Before us,the Authorised Representative (AR)of the assessee stated that assessee was not interested in pursuing Ground No.6.Hence, same stands dismissed.

ITA/2601/Mum/2015 Assessee's Appeal :

2.First effective ground of appeal(GOA 1-5)is about Transfer Pricing(TP) adjustment of Rs.35.15crores.During the assessment proceedings,the Assessing Officer(AO)found that assessee had entered into International Transactions (IT.s)with its Associated Enterprise(AE).He made a reference to the Transfer Pricing Officer(TPO)for determination of arm's-length-price(ALP)of the transa

-ctions reported in Form-3CEB.

During the Transfer Pricing(TP) proceedings,the TPO found that the assessee was a Joint Venture(JV) between Mahindra & Mahindra Ltd.(M&M)and Renault s.a.s.,France,(RF),that it was formed to design and build a vehicle manufacturing and assembly plant/facility at Nasik with an installed capacity of 50,000cars per year,that it was incorporated on 2.6.2005, that it was a 51:49 partnership between M&M and RF,that commercial sale of vehicle started from April 2007,the JV was set up for manufacturing and marketing 'Logan', a low cost family Sedan, that the assessee had net sales of Rs.591.1 crores,that transaction worth Rs.221 crores were entered into with the AEs,that the purchase from the AE were of Rs.154.96 crores out of the total purchase of Rs. 499 crores,that the operating margin was arrived at(-)21.46%(after deducting the operating income of Rs.606 crores from operating expenditure of Rs.736.1 crores),that the assessee had imported some components/supplies from the AE for carrying out the manufacturing process,that it had entered into CKD parts and components supply agreement with the AE on 28.09.2005 to purchase knocked-down parts components and accessories, that the purchase agreement was decided in the JV agreement. It was claimed before the TPO that at the time of agreement both the partners were independent parties and the terms and conditions of the agreement had not changed.However, the TPO rejected the claim made by the assessee.

3.The TPO found that,during the year under consideration,the AE had procured 1611 Logan vehicles from the assessee,that the price of those vehicles was finalised after rounds of negotiation between the assessee and RF.He observed that the assessee had entered into technical assistance,engineering and training service agreement with RF vide agreement dt.28.07.2005, that RF had deputed its service engineer for Nasik plant,that the assessee had charged overheads plus a mark-up of 5% on direct costs.He further found that the assessee had sold

'L90' spare parts in India that were sourced from RF, that the assessee had received commission on sale of those parts from the AE, that the commission was received at a percentage on FOB cost of the spare parts, that the percentage of commission agreed between the parties was 5%. It was also found that the assessee had entered into a Technology and Licence agreement with RF, that as per the said agreement it was required to pay a royalty of 2% on the aggregate quarterly sale of spare parts at ex-factory supplier price before the excise duty of the spare parts manufactured and sold in India by the assessee. The TPO noted that the assessee had aggregated all the above transactions (except purchase of raw material and salary of expats) and had bench-marked on a whole entity applying TNMM as the Most Appropriate Method (MAM) for bench-marking the IT.s, that it had taken six comparable and on the basis of multiple year data, that the mean margin of six companies was arrived at 3.66%, that data for the AY.2009-10 was not available in respect of the comparables. The assessee submitted updated margin of 17 companies which were taken as comparables with RPT Filter at 10%. He directed the assessee to update the margin and resubmit the list of companies after taking RPT filter of 25%. The same was submitted vide letter dt.8.1.2013 and it read as under :

SN	Comparables	Net Sales	Total cost	O/P	OP/Total Sale (%)
1	Ashok Leyland Ltd.	598,107	568,640	29,467	4.93
2.	Asia Motor Works Ltd.	5,574	5,227	346	6.22
3.	Eicher Motors Ltd.	3,774	3,482	292	7.73
4.	Force Motors Ltd.	7,730,553,617	8,900,680,759	1,170,127,142	-15.14
5.	Hindustan Motors Ltd.	59,118	67,599	8,481	-14.35
6.	Honda Siel Cars India Ltd.	34,982,902	37,466,506	(2,483,604)	-7.10
7.	Maruti Suzuki India Ltd.	207,756	195,303	12,453	5.99
8.	Sona Koyo Steering systems Ltd.	69,590	70,551	(961)	-1.38
9.	Swaraj mazda Ltd.	54,505	52,387	2,118	3.89
10	Tata Motors Ltd.	25,079	24,834	245	0.98
11.	Atul Auto Ltd.	1,168,820,573	1,179,062,746	(10,242,173)	-0.88
12.	TVS Motor Company Ltd.	3,671	3,653	18	0.50
				Mean	-0.72

3.1.After considering the chart,the TPO observed that the margin of the comparables worked out by the assessee was(-)0.72%,that Sona Koyo Steering Systems Ltd.(Sl.No.8)was not an automobile company and was dealing only in certain parts of automobiles, that it was not a correct comparable,that the margin of balance 11 companies,finally selected by the assessee, came to (-) 0.66%. The assessee was asked that since the its margin was (-)21.46% and the margin of comparables was (-)0.66%why adjustment should as per the provisions of section 92 of Act not be made.The assessee filed an elaborate explanation in that regard and stated that after making adjustment the margin of the assessee was better than the comparables.The assessee made submission for giving following adjustments :

Particulars			
PBIT (Before Adjustment)		(130.1)	-21.47%
Total Capacity Utilisation	29.1	(101.0)	-16.66%
Homologation Expenses	1.8		
Advertisement and Brand promotion Expenses	41.66		
	43.5	(57.5)	-9.49%
Compensation for shortfall in manufacturing	22.3		
Abnormal expenditure on account of Exchange fluctuations	40.3		
	62.6	5.1	0.85%
Exceptional warranty expenses	6.7		
Change in excise duty	6.5		
	13.2	18.3	3.02%

It was submitted by the assessee that if the adjustments were taken into consideration,the revised operating margin of the assessee would be 3.02%, that the operating margin of the comparables was (-)0.66%, that the IT.s were at arm's length .

Regarding the adjustment on capacity utilisation the assessee submitted that the manufacturing activity was highly capital intensive and required high degree of capacity utilisation to achieve a high degree of profitability,that in the case under consideration capacity utilisation was required to be made,that it started

its commercial production in the AY 2008-09 only, that the year under appeal was second year of sale, that the installed capacity for assembly plant was 50000 units per annum, that it was able to produce 14404 units (28.81%) against 50000 units, that there was sharp decline in production. The TPO noted the capacity utilisation and asked the assessee to find out utilisation of comparables which were found to be at 46.07%. The assessee worked out under utilisation to the tune of 29.3% in following manner:

Particulars	Amount in Crores
Fixed costs (A)	75.10
Capacity utilisation of the appellant (B)	28.81%
Industry Utilisation rate (C)	47%
Cost attributable to utilisation (D) assessee $(A) * (B) / (C)$	45.98
Adjustment for Under utilized capacity (E) assessee $(A) - (D)$	29.13

The TPO was of the opinion that there were certain cost items which were in the nature of fixed costs, that same amounted to 50 crores. He reworked the capacity utilisation on the basis of fixed cost of Rs.50 crores and made certain adjustments. He allowed adjustment of Rs.19.36 crores while working out operating profits. The working of TPO read as under :

Particulars	Amount
Fixed cost (A)	50.00
Capacity utilisation of the appellant (B)	28.81%
Industry Utilisation rate (C)	47%
Cost attributable to utilisation (D) assessee $\{(A) * (B)\} / (C)$	30.64
Adjustment for underutilized capacity (E) assessee $(A) - (D)$	19.36

The assessee sought two adjustments on start up cost namely homologation expenses and sales and marketing expenses. The TPO held that the homologation expenses were extraordinary expenses which were not there in the case of comparables, that it had included sale and distribution cost, advertisement, sales promotion etc. in the marketing costs, that in the other comparables only advertisement and sales promotion cost was considered, that other companies had not included distribution cost, that the claim of the assessee about incurring extra

ordinary expenses in the bad year of the automobile industry was factually incorrect. Finally, he held that adjustment claimed by assessee on account of higher advertisement and marketing cost was not allowable. He allowed some other adjustment and re-worked the operating margin. He finally held that operating income of the assessee was Rs.605.9 crores, that after making the adjustments, the operating margin of the assessee was (-) 6.46%, that the comparable companies' margin was (-) 0.66%. He proposed an adjustment of Rs.35.15 crores.

4. Aggrieved by the order of the TPO/AO, the assessee preferred an appeal before the First Appellate Authority (FAA). Before him it was argued that it had claimed economic adjustment in respect of various items of expenditure, that the TPO had rejected the claim for adjustment of Under Capacity Utilisation (UCU) abnormal sales and marketing and change in excise duty, that the cost pertaining to UCU included depreciation, personnel cost, other operating expenses, warehouse charges, travelling expenses, insurance, that the cost of resources maintained its existence, that the other operating expenses and personnel expenses were fixed in nature, that such expenses were considered as extra ordinary expenses, that average advertisement and selling expenses as a percentage of net sale of the comparable companies was 3.75%, that the advertisement and selling expenses of the assessee as a percentage of net sale for same period was 7%, that UCU on account of fixed expenditure was on production side, that the selling and marketing expenditure were on the sale side, that there was no nexus between allowance of UCU and disallowance of abnormal sales and marketing expenses, that the TPO had not allowed UCU on expenditure other than depreciation, that there was no double adjustment, that in the relevant FY there was reduction in excise duty, that it had to compensate the dealer for such reduction, that if the relief was granted on abnormal selling and marketing expenses it would fall under proviso to 92C (2) i.e. within 5% \pm of tolerance

limit.

4.1.After considering the submission of the assessee and order of the TPO/AO, the FAA held that the TPO had allowed adjustment of Rs.29.36 crores for CUC after comparing the same with the comparable companies,that the personnel cost and variable cost were not treated as fixed cost, that the assessee would always decrease/increase such cost depending upon the market position, that operating expenses like traveling expenses,legal-professional charges were not fixed cost,that the TPO had rightly disallowed such expenses with regard to adjustment on account of abnormal selling and marketing expenses the FAA held that the assessee had not rebutted the observations of the TPO .Finally, he upheld the order of the TPO /AO.

5.During the course of hearing before us,the AR stated that no TP adjustment could be made where there was a JV arrangement,that TP adjustment should be restricted only to related party transactions,that both the contentions were not adjudicated upon by the FAA.The assessee filed a fresh working wherein it claimed that if the transfer pricing adjustments were restricted to only transaction with related party it would result in restricting the adjustments to Rs.231.53 Crores.He further submitted that the TPO had allowed economic adjustment on account of UCU on fixed cost-depreciation on tangible and intangible assets,that the TPO had not allowed UCU on personal cost and other operating expenses,that the assessee had made a clear submission before the TPO as to how the said expenditure were fixed in nature and therefore,qualify for UCU,that the TPO as well as the FAA without any discussion rejected the submission made by the assessee,that issue was not decided on merits.With regard to the economic adjustment on account of abnormal sales and marketing the assessee submitted that sales and marketing expenditure incurred by the assessee were abnormal in nature,that same should be allowed.Finally,the AR

argued that once the assessee was granted economic adjustment on account of abnormal sales and marketing expenses, the price charged by it would be at arms' length, that even where the assessee was granted relief of Rs.2.53 crores (Rs.235.28 crores - Rs. 221.66 crores), price charge by it would fall within Proviso to section 92C (2) i.e. within 5% +/- tolerance limit. He relied upon the order of J.M.Financial Institutional Securities Ltd.(ITA/ 7455/M/2011).He also relied upon cases of Thyssenkrupp Industries India Pvt. Ltd.(ITA 2201 of 2013, dt.2.12.2015),Ratilal Becharlal & Sons(237taxmann 71).With regard to UCU it was stated that operating expenses as well as personal expenses were generally fixed in nature,that they would not change as per the sales volume,that such expenses were considered in the nature of extra ordinary expenses.He relied upon the case of M/s.Fiat India Pvt.Ltd.(2010-TII-30-ITAT-MUM-TP)and stated that the Tribunal had allowed an economic adjustment for high salary cost,that salary level would remain more or less consistent irrespective of level of production, in case of UCU,that adjustment on account of other fixed over - heads such as expenses,travelling /conveyance were to be allowed, that same were necessary to offset the excess cost incurred by the assessee.The DR argued that the TPO had already allowed the allowable economic adjustments while passing the order,that salary and wages were rightly excluded by the TPO for making adjustments,that UCU factor was considered by the FAA also,that adjustments could be made even in the case of a JV.He relied upon the cases of Metro Tunnelling Group(154 ITD 774).The DR during the course of hearing brought in the concept of AMP expenses, where the Indian company incurs abnormal advertisement, marketing and promotion(AMP) expenditure which results into brand building for the AE.He argued that the assessee should recovered the such excess AMP from the AE at a mark-up.

6.We have heard the rival submissions and perused the material before us.First of all we would like to consider the cases relied upon by the both sides. In the

matter of J.M.Financial Institutional Securities Ltd.(supra)the Tribunal had restored back the issue to the file of the AO for deciding the issue as to whether in case of a JV can TP adjustments be made. In the case of Metro Tunnelling Group(supra), the Tribunal had held that in Transfer pricing study,transaction of reimbursement of head office overheads by the assessee-JV to foreign JV members would be benchmarked within external comparable,that the auditor certificate spelling out head office overheads as a percentage of revenue would not satisfy test of TP study.The Tribunal had restored back the matter to the file of the TPO.In the case of Fiat India Private Ltd.(supra) the Tribunal has dealt with the issue of salary cost,other fixed overheads,higher incidence of change in excise duty rates etc.,while deciding the appeal.All these cases are relevant to decide the various issues raised by the assessee.

6.1.We find that the FAA had not adjudicated two grounds raised by the assessee and had not dealt with the arguments taken by the assessee with regard to economic adjustments.A reasoned order was not passed by the TPO or the FAA.In these circumstances,we are of the opinion that the matter needs further verification.Therefore,in the interest of justice we restore back the issue of TP adjustments to the file of the FAA for fresh adjudication.He would decide the issue after affording a reasonable opportunity of hearing to the assessee.

6.2.Before departing,we would like to mention that in our humble opinion,the TPO was not justified in making adjustment to the entire segment of manufacturing activity and not restricting the same to the ITs.We find that in the cases of Tara Jewels Exports Pvt. Ltd.(ITA No. 1814 of 2013) and Thyssen Krupp Industries India Pvt.Ltd.(supra),the Hon'ble Bombay High Court has held that for making adjustment as per the provisions of chapter X of the Act transaction with AEs of an assessee had to be considered. We would like to reproduce the relevant portion of the judgment of Thyssen Krupp Industries India Pvt. Ltd. (supra)and same reads as under:

“We find that in terms of chapter X of the Act, the determination of the consideration is to be done only with regard to income arising from international transactions on determination of ALP. The adjustment which is mandated is only in respect of international transaction and not transactions entered into by assessee with independent unrelated third parties. This is particularly so as there is no issue of avoidance of tax requiring adjustment in the valuation in respect of transactions entered into with independent third parties. The adjustment as proposed by the revenue if allowed would result in increasing the profit in respect of transactions entered into with non-AE. The adjustment is beyond the scope and ambit of chapter X of the Act.

Respectfully, following the above judgments, we hold that while invoking the provisions of chapter X of the Act, the TPO should have restricted adjustments to the IT.s. only.

7. Ground No.7 is about provisions of product warranty of Rs.13.92 crores. The AR stated that identical issue was sent back to the file of the AO by the Tribunal in assessee's own case, while deciding the appeal for AY.2008-09. DR left the issue to the discretion of the Bench. We find that while deciding the appeal for the earlier AY., the Tribunal had sent back the matter to the file of the AO following the judgment of Rotork Controls India Pvt.Ltd.(314 ITR 62) of the Hon'ble Apex Court.

Respectfully following the above, the issue is restored back to the file of AO for fresh adjudication. Gr.No.7 is partly allowed.

8. Next ground deals with deduction for provision for warranty made in earlier year and not reversed in the year under consideration.

During the course of hearing before us, the AR stated that the AO should be directed to allow the deduction of actual expenditure incurred. The DR did not object to the said proposal. We direct the AO to make verification and allow the claim. Ground no.8 is decided in favour of the assessee, in part.

9. Last Ground deals with Service Coupon Commission of Rs.2.27 crores. The

AO had invoked the provisions of section 40(a)(ia) r.w.s.194H/194C of the Act. The AR stated that the Tribunal had restored back the identical issue to the file of AO,while deciding appeal for the earlier AY.DR left the issue to the discretion of the Bench.We find that while deciding the appeal for the earlier AY.,the Tribunal has dealt the issue as under :-

“5.Once of the assessee relates to disallowance of expenditure by way of payment to dealers against service coupons by invoking provisions of section 40 (a) (ia) of the Act,rejecting the contention of the assessee that there was no obligation to deduct tax at source.The AO disallowed the amount by observing that same is in the nature of payment to contractor for work assigned by the assessee company to the dealer and therefore, the same is covered under section 40(a)(ia).The CIT (A) confirmed the action of the AO by following the decision for the assessment year 2007-08.

6. We found that tribunal in assessee’s own case for the assessment year 2007-08, wide order dated 86 2012, in ITA number 7999/NUM/2011 has decided the issue, wherein the tribunal had held as under:

XXXXXXXXXXXXXX

The facts and circumstances during the year under consideration are same. Respectfully following the order of the Tribunal in assessee’s own case, we restore the matter back to the file of the AO for deciding a fresh in terms of direction given by the Tribunal in its order dated 8-6-2012.”

Respectfully,following the above,matter is restored back to file of AO.Ground No.9,raised by the assessee is allowed,in part.

ITA No.2618/Mum/2015: (Revenue’s appeal)(09-10):

Solitary ground of appeal,raised by the AO,is about dealer’s incentives. Representatives of both the sides agreed that the identical issues was sent back to the file of the AO by the Tribunal while adjudicating the earlier year’s appeal.Following the same,we restore back the matter to the file of the AO for fresh adjudication. Ground raised by the AO is partly allowed.

As a result,Appeal filed by the assessee and the AO stand partly allowed.

फलतः निर्धारिती एवं निर्धारिती अधिकारी द्वारा दाखिल की गई अपील अंशतःमंजूर की जाती है।

Order pronounced in the open court on 18th May, 2016.

आदेश की घोषणा खुले न्यायालय में दिनांक 18th मई, 2016 को की गई।

Sd/-

(सी. एन. प्रसाद / C.N. Prasad)

न्यायिक सदस्य / JUDICIAL MEMBER

Sd/-

(राजेन्द्र / Rajendra)

लेखा सदस्य / ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांकDated : 18.05.2016.

Jv.Sr.PS.

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

- 1.Appellant /अपीलार्थी
2. Respondent /प्रत्यर्थी
- 3.The concerned CIT(A)/संबद्ध अपीलीय आयकर आयुक्त, 4.The concerned CIT /संबद्ध आयकर आयुक्त
- 5.DR "K " Bench, ITAT, Mumbai /विभागीय प्रतिनिधि, खंडपीठ,आ.अधि.मुंबई
- 6.Guard File/गार्ड फाईल

सत्यापित प्रति //True Copy//

आदेशानुसार/ **BY ORDER,**
उप/सहायक पंजीकार **Dy./Asst. Registrar**
आयकर अपीलीय अधिकरण, मुंबई /**ITAT, Mumbai.**