

IN THE INCOME TAX APPELLATE TRIBUNAL
BENGALURU BENCH 'A', BENGALURUBEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER
AND

SHRI. S. JAYARAMAN, ACCOUNTANT MEMBER

I.T(TP).A No.1472/Bang/2010
(Assessment Year : 2006-07)M/s. Sealed Air (India) P. Ltd,
No.245, 8th Main, 3rd Phase,
Peenya Industrial Area, Peenya,
Bengaluru 560 058
PAN : AABCC1597Q

.. Appellant

v.

Asst. Commissioner of Income-tax,
Circle -12(3), Bengaluru

.. Respondent

Assessee by : Shri. Chytanya K.K., Advocate
Revenue by : Smt. Priscilla Singit, CIT, DR - IHeard on : 25.07.2016
Pronounced on : 21.10.2016**ORDER****PER S. JAYARAMAN, ACCOUNTANT MEMBER :**

This is an appeal filed by the assessee against the order of the ACIT , Circle 12(3) , Bengaluru , dt.22.09.2010 for the assessment year 2006-07 subsequent to the DRP direction .

02. The assessee company is a dealer in packaging materials, bags, films, trays, containers, cartons, cans, systems and equipment of all kinds for packing of foodstuff, pharmaceutical, cosmetics, electronic

and other items. During the previous year 2005-06 relevant to the assessment year 2006-07, it had international transactions with associated enterprises to carry out business like I. T. Enables services. The Transfer Pricing Authority i.e., the Dy. Director of Income Tax (Transfer Pricing) –V, Bengaluru, suggested in his order dt.30.10.2009, a difference in arms length price at Rs.1,48,77,053/- u/s.92CA. Thereafter, the A O passed a draft assessment order dt 14.12.2009 making the arms length price adjustment of Rs.1,48,77,053/- and ,inter alia, made the following corporate tax disallowances :

(i) Disallowance of Rs. 16,61,150/-, being amount payable under cost sharing agreement

(ii) Disallowance of amortised compensation cost at Rs.6,86,025/-.

Aggrieved against that draft order, the assessee filed an appeal before the DRP on 20.01.2010 challenging elaborately on the additions proposed under Transfer pricing adjustments alone. The DRP issued its directions dt 22.09.2010 wherein it upheld the adjustments proposed by the AO , in part, at Rs.1,19,60,773/- as against Rs.1,48,77,053/-. Consequently, the AO passed the final order dt. 18.10.2010. Aggrieved, the assessee filed this appeal. The effective grounds of the appeal are extracted as under :

Corporate Tax Matters

4. The learned AO erred in making an addition of Rs. 16,61,150 to the returned income of the Appellant on account of non deduction of tax on expenses debited to the profit and loss account as per the "information service cost allocation agreement", without appreciating that no tax could have been deducted as the necessary regulatory approvals for making the payment were not received and the said expense was reversed in the subsequent year.
5. The learned AO erred in making an addition of Rs. 686,025 to the returned income of the Appellant by not considering deferred compensation amortization expenses as business expenditure.

Transfer Pricing Matters

6. The learned AO/TPO erred in disregarding the direction issued by the Hon'ble DRP and making an addition of Rs. 1,48,77,053 to the total income of the Appellant on account of adjustment to the arm's length price of the international transactions, as against Rs. 11,960,773 determined by the Hon'ble DRP.
8. The learned AO/TPO erred in concluding that the trading and manufacturing segments of the Appellant are distinct, without appreciating that both the segments are interlinked and interrelated warranting the adoption of the "combined transaction approach".
9. The learned AO/TPO erred in rejecting the segmental information submitted by the Appellant in response to the show-cause notice, re-computing the segmental margins in an arbitrary manner, and using the re-computed segmental margins for determining the arm's length price of the impugned international transactions without giving an opportunity to the Appellant to examine/ comment on the methodology adopted.
10. The learned AO/TPO erred in rejecting certain comparables identified by the Appellant, using unreasonable comparability criteria.
14. The AO/TPO erred in not appreciating that the transfer pricing adjustment, if any, should be restricted to the international transactions only and not to the total segmental purchases/ costs, including the purchases from independent third parties.
15. The learned AO/TPO erred in not making appropriate adjustments for enterprise and transactional level differences between the Appellant and the comparable companies.
16. The learned AO/TPO erred in not making appropriate adjustments for qualitative and quantitative differences between the Appellant and those of the comparable companies.
17. The learned AO/TPO erred in computing the arm's length price without giving benefit of +/- 5 percent under the proviso to section 92C of the Act.

03. The additional grounds of appeal filed by the assessee are extracted as under :

“(19) The learned Assessing Officer erred in law and on facts in making reference to TPO even though the value of international transactions is less than Rs. 15 crore:

(20). The learned Assessing Officer erred in law and on facts in making reference to the TPO for computation of ALP in relation to

international transactions in a mechanical manner without showing as to why it is necessary and expedient to do so.

(21) The learned Commissioner erred in law and on facts in granting mechanical approval for reference to the TPO.

(22) The learned lower authorities are not justified in failing to determine the operating cost in a proper manner.

2. The aforesaid Grounds No. (19) to (22) were inadvertently missed out in the original appeal memorandum. It is submitted that the above grounds being legal in nature can be disposed off based on facts on record. Thus the omission to take the above grounds is not malafide and willful.

3. Therefore, it is sincerely prayed before your Honourable Members that the leave to take up the aforesaid grounds may kindly be granted for the AY 2006-2007.

04. The AR took us to the operative portion of the DRP order which is extracted as under :

“ We have considered the submissions made by the assessee. Since the main grievance of the assessee was that it had not been provided with proper opportunity of being heard by the TPO, the matter was referred to the TPO for his comments. The TPO has examined the submissions made by the assessee and submitted his comments vide letter no. TP-3751TPV/10-11 dt. 13-09-2010. The relevant portion from the report of the TPO is being reproduced below.

2. Pursuant to your directions, the taxpayer has filed a copy of its submission dated 20-01-2010 and a letter dated 06-09-2010. In the letter dated 06-09-2010, the taxpayer has furnished a list of those comparables of the TPO which it has found functionally comparable to its own functions.

3. The important points relating to the case are as under:

(i) The taxpayer is a manufacturer of plastic packaging goods and trader of packaging goods and machinery. Thus, it had two business segments of manufacturing and Trading.

(ii) During the year, the taxpayer had transactions relating to both the segments :

| | |
|--|-------------------|
| 1. Purchase of trading goods | Rs. 8,56,86,731/- |
| 2. Purchase of raw material | Rs. 2,11,92,197/- |
| 3. Payment of inspection service and technical fee | Rs. 82,32,995/- |
| 4. Commission received from Sealed Air, Hongkong. | Rs. 26,19,896/- |

The details of the financial results for year 2005-06, as per profit loss & account are as follows:

| Description | Amount (Rs.) |
|---|----------------|
| Operating revenue-manufacturing & Trading | 28,87,17,446/- |
| Operating Expenditure * | 27,54,50,607/- |
| Profit for the year | 1,32,66,839/- |
| PBIT/Cost | 4.81% |
| PBIT/Sales | 4.60% |

(*Excluding forex Loss, Interest and amortization expenses of Rs. 6302665/-, Rs. 1855371/- and Rs. 686025/- respectively.)(Total exclusion:Rs.88,44,061/-)

(iii) In its TP study, the taxpayer did not consider the two segments separately for TP analysis.

The taxpayer combined the two segments for TP analysis saying that the transactions of these two segments were closely linked . However, the TPO was of the view that manufacturing trading are different activities and considering their different FAR analysis, they should be analysed separately. For manufacturing the taxpayer uses Plant & machinery which is not used for trading activity Thus, the assets used are different for manufacturing activity Risks are also different. If a defective piece of item manufactured by the taxpayer is brought back by the customer, the taxpayer itself is responsible for replacing it. Further considering the risk angle, in case of return of any defective item sold out of sock of traded goods, the taxpayer may get a replacement from the AE from whom the purchases of such

goods are made by the taxpayer. Thus, there is greater risk of quality in respect of manufacturing activity . Thus, the FAR analysis of the two activities of trading and manufacturing are quite different. It may also be pointed out that even where two transactions are closely linked there is no bar on analyzing them separately In fact, the real aim behind the taxpayer's argument for clubbing the two segments is to cover up the loss in the manufacturing segment with the help of higher profit margin of the trading segment The taxpayer did not maintain separate accounts for these two different business activities intentionally and then says that segmental details are not available

The taxpayer has contended in the submission before your good self that the technical assistance fee and receipts of commission have been clubbed by the TPO for analysis as the same are closely related transactions. It may be pointed out that tech fee paid is an expenditure debitabte to the P&L account but it has been considered separately also as is evident from the notice issued by the TPO which stands reproduced in the order. Commission has not been analysed separately as the amount is less than one crore and the TPO has used filter of excluding companies having turnover < one crore, it was not possible to find comparables Companies having turnover < one crore are not considered because either these are start-up companies or they are very small companies whose financials are very

volatile. Mostly in such companies, the promoters of the company happen to be employees and RPTs are very high Even minor changes in financials result into significant changes in profit margin. Hence, data of such companies if available in public domain, are not very reliable

(iv) The taxpayer clubbed the two segments and then picked up common comparables for analysis . The comparables searched by the taxpayer were, therefore, not accepted as the search itself was *ab initio* based on clubbing of two different business activities. In fact, the taxpayer considered the same comparables as it had considered for the immediately preceding year (AY 05-06) .Thus, it did not make any new search and there was no fresh TP study for this year . The taxpayer did not furnish the computations of PLIs and the search process (Accept/Reject matrix etc.) for this year as pointed out in the notice, Thus, the taxpayer did not discharge its onus fully. Under the backdrop of these facts, the taxpayer was required to furnish the segmental details. The taxpayer furnished these details as under:

Sealed Air (India) Private Limited
Annexure B: Statement depicting the segmental revenues and costs

| | 2010-11 | 2009-10 | 2008-09 |
|---|--------------------|-------------------|------------------|
| Net Sales | 87,053,081 | 199,044,469 | 286,097,550 |
| Commission Income | 797,176 | 1,822,720 | 2,619,896 |
| Cost of Goods Sold | 73,233,548 | 147,712,816 | 220,946,364 |
| Sales % | 30% | 70% | 100% |
| Admn. & Selling Exp. | 17,520,411 | 40,059,937 | 57,580,348 |
| Depredation | 942,897 | 2,155,909 | 3,098,806 |
| Operating Income | (3,846,600) | 10,938,528 | 7,091,928 |
| Margin on revenue | -4.38% | 5.45% | 2.46% |
| Net Profit before tax as per Financials | | | 4,422,777.60 |
| Difference being finance charges | | | 2,669,150.80 |

Thus, the taxpayer showed loss in the manufacturing segment. In these segmental details, allocation of costs, other than the costs of materials, was not based on the 'actual' but in proportion to the turnover. Further, the TPO found that even the allocation on the basis of turnover was not correct as the depreciation of Plant & machinery had also been allocated on this basis though the depreciation on Plant & machinery should have been allocated entirely to the manufacturing segment. Hence, the TPO reallocated the costs as shown in the order.

| Description | Manufacturing | Trading | Total (Rs.) |
|---------------------|--------------------|--------------------|--------------------|
| Operating revenue | Rs. 8,70,53,081/- | Rs. 20,16,64,365/- | Rs. 28,87,17,446/- |
| Operating cost | Rs. 9,60,80,166/- | Rs. 17,93,70,441/- | Rs. 27,54,50,607/- |
| Profit for the year | (-)Rs. 90,27,085/- | Rs. 2,22,93,924/- | Rs. 1,32,66,839/- |
| PBIT/Cost | (-)9.39% | 12.42% | 4.81% |
| PBIT/Sales | (-)10.36% | 11.05% | 4.60% |

Transactions of the Trading segment were held to be at arm's length while an adjustment was made in respect of transactions pertaining to Mfg. Segment, that is, the transactions of purchase of material for manufacturing and payment of technical fee.

4. Now before the Hon'ble DRP, the taxpayer has filed some material objecting to the comparables of the TPO. The same has been examined as directed. Taxpayer's objections regarding computations of PLIs of the comparables have also been examined in the light of extracts of ARs and databases filed by it. The taxpayer has laid special emphasis on the aspect of the functionality of the TPOs comparables. It may be submitted that the TPO had adopted a broad search criterion of functionality by considering all those companies as comparable which were into manufacturing of plastic packaging material . Only those companies which were predominantly into manufacturing of these materials (manufacturing turnover>75%) were considered. The taxpayer has picked up only those companies out of TPO's comparable companies as comparable which are nearest to its activity in terms of manufactured items

These companies are as under as per taxpayers submission dated 06-09-2010 filed before the TPO:

| Name of the company considered comparable | Margin on sales as computed by the taxpayer |
|---|---|
| Abdos Polymers Ltd. | 1.38% |
| Agreni Polymers Ltd. | 1.38% |
| Orient Press Ltd. | 2.11% |
| Paper Products Ltd. | 6.38% |
| Raj Packaging Industries | 5.11% |
| Uma Polymers Ltd. | 4.76% |
| Average | 3.52% |

The taxpayer's PLIs of comparables as computed by it have also been examined afresh on the basis of information available in public domain and that filed by the taxpayer. As a result, the company named Orient Press Ltd. cannot be accepted as a comparable as it is a sick company and its business conditions set it apart from a normally functioning company . In para 6.10.6 of its submission before the Hon'ble DRP, the taxpayer has also pleaded for application of a turnover filter which it did not apply to its own comparables in the study filed for this year. It is seen that if a filter of $\pm 100\%$ of the taxpayers turnover is applied , that is, only the companies having turnover between the double the turnover of the taxpayer and Rs. One crore are selected, only three companies remain as comparable The taxpayer's turnover of Rs, 8.78 crores and so the companies having turnovers between one crore and 18 crores come under the

turnover range. The PLIs of these companies are as under as per the databases available

| | | | | |
|----------------------|----------------|----------------|---------------|-------|
| Agreni polymers Ltd. | Rs. 16.12crore | Rs.15.73 crore | Rs.0.39 crore | 2.41% |
| | | | Average | 3.37% |

Considering this PLI the computation of the adjustment in respect of manufacturing segment is as under:

| | |
|--|--------------------------|
| Operating Revenues | Rs. 8,70,53,081/- |
| The Arithmetical Mean Margin of the comparables | 3.37% on Sales |
| Arm's length cost (96.63% of operating revenues) -- (a) | Rs. 8,41,19,392/- |
| The cost of the taxpayer as computed in the order | Rs. 9,60,80,166/- |
| Cost with related parties (Purchases of Rs. 21192198/- + Technical Fee of Rs. 82,32,995/-) --- (b) | Rs. 2,94,25,193/- |
| Cost with unrelated parties – (c) | Rs. 6,66,54,973/- |
| Arm's length cost of international transactions – d = (a – c) | Rs. 1,74,64,419/- |
| The ALP difference (b-d) | Rs. 1,19,60,773/- |

After going through the reports submitted by the TPO it is clear that all the issues raised by the assessee have been considered in this report. The TPO has given reasons for considering the manufacturing segment and the trading segment separately. He has analysed the difference in FAR for these two segments and concluded that the FAR analysis of the two activities of trading and manufacturing were quite different. The TPO also pointed out that even where two

transactions were closely linked, there was no bar on analyzing them separately. We find ourselves in agreement with the conclusion of the TPO. The TPO has pointed out that the real aim in clubbing the two segments was to cover up the loss in the manufacturing segment with the help of higher profit margin of the trading segment. The TPO has also given reasons as to why the technical assistance fee and receipts of commission had been clubbed by the TPO for analysis. The TPO observed that the comparables searched by the tax payer could not be accepted as the search itself was ab initio based on clubbing of two different business activities, The TPO for the reasons given in his report had allocated the costs between the manufacturing segment and the trading segment for determining the correct PU. The TRO has dealt with the objections raised regarding the comparables. The TPO has recalculated the ALP on the basis of three comparables. These comparables are out of the six comparables chosen by the assessee itself. The remaining three companies have been rejected on account of certain filters applied. We find that the filters applied by the TPO are proper and have been correctly applied under the facts and circumstances of the case. One of the company has been rejected being a sick company. After going through the discussion made in the report of the TPO we find that all the issues raised by the assessee in its grounds of objection have been dealt with by the TPO in its report in a proper and satisfactory manner. We find ourselves in agreement with *the*

computation made by the TPO in this report.”

05. The AR pleaded that the assessee is not a full fledged manufacturer, as against the value of material consumption at Rs.7,24,27,173/- its entire labour charges were just at Rs.5,90,767/- only, the book value of its plant and machineries are just at Rs.1.35 crores and hence it is essentially a trader. The TPO applied ALP on entire turnover without restricting to the so called manufacturing segment and he artificially splitted the transactions etc. He sought our attention to its letter dt 19.6.2009 filed before the TPO during the remand proceedings wherein, inter alia, it requested as under :

“ In case your good self proposes to determine the arm’s length price for the international transactions of the Company which is different from the price determined by the Company as the arm’s length price , we request your good self to provide as with an opportunity to make further submissions in support of the arm’s length price adopted by the Company”.

06. The AR further submitted that the TPO rejected the ALP determined by it under TNMM at enterprise level and determined separate ALP under TNMM in respect of manufacturing segment and trading segment . When the TPO rejected its ALP , he ought to have given an opportunity of being personally heard to the appellant

despite the assessee having specifically sought in the above letter. Further, it was submitted that the assessee made specific objections on following aspects:

(i) The technical fee paid is reimbursement of salary cost

(ii) The TPO committed error while computing the ALP

(iii) The TPO failed to make economic adjustments to improve degree of comparability ie the TPO erred in not making adjustments for the differences in functions performed, risks assumed and assets employed by the comparables as compared to the appellant

(iv) The TPO has not disclosed the search process carried out to identify comparable etc and the DRP merely relied on the remand report given by the TPO without disposing off the objections raised by the assessee and hence pleaded that the additions may be quashed. On the other hand, the DR supported the orders of the TPO and the DRP.

07. We have considered the rival submissions, gone through relevant materials and orders. It is clear from the TPO's order u/s 92CA that the ACIT, C-12(3) , Bengaluru , after obtaining due approval from the CIT-1, Bengaluru has referred this case to the TPO. Hence, the assessee's additional grounds of appeal are untenable. From the passage extracted from the DRP order, supra, and from the

above submissions, we are of the considered opinion that the TP issues are required to be examined by the TPO afresh and accordingly we remit the TP issues to him. The TPO shall adjudicate the matter after affording due opportunity to the assessee.

08. In respect of the corporate tax disallowance issues viz.,

(i) Disallowance of Rs. 16,61,150/-, being amount payable under cost sharing agreement and

(ii) Disallowance of amortised compensation cost at Rs.6,86,025/-, it is seen that the AO passed the draft assessment order on 14.12.2009 . The assessee filed its objections before the DRP in Form No 35A on 20.01.2009. From the ground of objections before the DRP, it is seen that the assessee has not raised any objection on these issues and hence they were not dealt by the DRP . Thus, these issues attained finality at that stage itself. In view of such facts, they are not dealt by us.

09. In the result, the assessee's appeal is treated as allowed for statistical purposes.

10. Order pronounced in the open court on 21st day of October, 2016.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

(S. JAYARAMAN)
ACCOUNTANT MEMBER

MCN*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income Tax
4. The Commissioner of Income Tax (A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar