IN THE INCOME TAX APPELLATE TRIBUNAL
Pune Bench 'A' Pune

Before Shri G.S. Pannu, Accountant Member and
Shri R.S. Padvekar, Judicial Member

ITA No. 1683/PN/2011: A.Y. 2007-08

Demag Cranes & Components (India) Pvt. Ltd.
Gat No. 330, 332, 333, 334
Nanekarwadi, Chakan, Tk. Khed, Pune
PAN AABCM 9351 Q Appellant

Vs.

Dy. CIT Cir. 1(2) Pune Respondent

Appellant by: S/Shri M.P. Lohia, Rajendra Agiwal and Amit Jain
Respondent by : Shri Mukesh Verma, CIT

ORDER

PER G.S. PANNU, AM

This appeal by the assessee is directed against the order of the Dy. CIT Cir. 1(2) Pune passed u/s 143(3) r.w.s. 144C(B) of the Income-tax Act, 1961 (in short "the Act") dated 25-10-2011 pertaining to the assessment year 2007-08, which is in conformity with the directions given by the Dispute Resolution Panel, Pune (in short 'the DRP) in order dated 20-5-2011.

2. In brief, background is that the appellant is a company incorporated under the provisions of Indian Companies Act, 1956 and is, inter alia, engaged in the business of providing state of art material handling solutions to Indian customers. The appellant is a wholly owned subsidiary of Demag Cranes & Components, GmbH, Germany. The assessee filed a return of income for the assessment year 2007-08 declaring a total income of Rs. 8,81,20,598/- which was subject to a scrutiny assessment. The Assessing Officer noticed that during the year under consideration, assessee had entered into 'international transactions' pertaining to

provision of material handling solutions with its Associated Enterprises (in short 'AE's) within the meaning of section 92B(1) of the Act. Section 92(1) of the Act requires that any income arising from an international transaction shall be computed having regard to the Arm's Length Price (in short 'ALP'). The computation of ALP u/s 92C of the Act in relation to the international transactions carried out by the assessee was referred by the Assessing Officer to Transfer Pricing Officer (in short TPO) in terms of section 92CA(1) of the Act. The TPO vide his order passed u/s 92CA(3) of the Act, after allowing an opportunity to the assessee of being heard, determined the ALP in relation to the international transaction by enhancing the same by Rs. 6,36,05,887/-. The aforesaid adjustment to the international transactions determined by the TPO has since been considered by the Assessing Officer while computing the total income of the assessee. The Assessing Officer has computed the total income of the assessee as per section 92C(4) of the Act having regard to the ALP of the international transactions so determined by the TPO and accordingly an addition of Rs. 6,36,05,887/- has been made to the total income The subject matter of dispute before us revolves around the transfer pricing adjustment of Rs. 6,36,05,887/- made to the international transactions undertaken by the assessee with its AEs. Notably, the Assessing Officer passed the impugned order u/s 143(3) read with section 144C(13) of the Act in pursuance to the directions issued by the Disputes Resolution Panel (in short DRP) vide its order dated 20-5-2011, whereby the determination of ALP by the TPO was affirmed. Against such framing of assessment by the Assessing Officer, the assessee is in appeal before us raising the following Grounds of Appeal.

> *"On the facts and in the circumstances of the case and in law, the learned AO based on directions of Hon'ble DRP has:*

General ground challenging the transfer pricing adjustment

1. erred in making transfer pricing adjustment of Rs. 6,36,05,887/- to the international transactions of provision of material handling solutions;

Non-consideration of comparability analysis as documented in the transfer pricing study report

2. erred in not considering/accepting the comparability analysis documented in the Transfer Pricing Study report for bench marking the international transactions pertaining to provision of material handling solutions;

Rejecting the aggregation of international transactions entered into by the Appellant pertaining to manufacturing activity.

3. erred in not agreeing with the Transfer pricing study conducted by the Appellant for benchmarking the international transactions pertaining to provision of material handling solutions.

Incorrect determination of margin of manufacturing activity

4. erred in determining the margin of the manufacturing activities by excluding the transaction of sale of component and spares to third parties and high sea sales and service income;

Non-grant of adjustment

5. erred in not providing working capital adjustment to the unadjusted margins of the comparable companies for financial year 2006-07;

6. erred in not providing adjustment on account of expenses for import of raw materials, components and spares;

Incorrect computation of transfer pricing adjustment to the manufacturing activity.

7. erred in computing the transfer pricing adjustment on the entire manufacturing segment sales instead of computing the transfer pricing adjustment on manufacturing segment sales pertaining to import of components and spares from Associated Enterprises only.

Applicability of +/-5% range.

8. erred in computing the arm's length price of the international transactions pertaining to manufacturing activity and export of components and spares without taking into account the +-5% variation from the mean, which is permitted and which has also been opted for by the appellant under the provisions of sec. 92C(3) of the Act.

Use of multiple year data

9. erred in considering the operating margins earned by comparable companies based on the financial data pertaining to the year ended 31st March 2007 only by rejecting the financial data of comparables for F.Y. 2004-05 and FY 2005-06 considered by the appellant.

Use of contemporaneous data

10. erred in computing the arm's length price using the financial information of the comparable companies available at the time of assessment, although such information was not available at the time when the appellant complied with these regulations;

Erroneous levy of interest under section 234B of the Act.

11. erred in levying interest u/s 234B of the Act to the extent of addition to income on account of transfer pricing adjustment based on the updated financial data for the comparable companies;

Initiation of penalty proceedings u/s 271(1)(c) of the Act.

12. erred in initiating levy proceedings u/s 271(1)(c) of the Act.

The appellant craves 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, so as to enable the learned AO to decide this appeal according to law.

3. At the time of hearing, the learned representative for the assessee submitted that in so far as Ground nos. 1 and 2 are concerned, the same are, general in nature and do not require any specific adjudication and accordingly the same are dismissed as such.

4. In so far as Ground no. 9 relating to use of financial data of Comparable Companies for the year ending 31-3-2007 only by the TPO as against the assessee's plea for use of data for multiple financial years 2004-05 and 2005-06 is concerned, the same has not been pressed at the time of hearing and accordingly, Ground no. 9 is dismissed for non-prosecution.

5. Further, Ground no. 10 regarding computation of ALP by the TPO using financial information of the Comparable Companies available at the time of assessment as against assessee's plea that only the financial information available at the time of carrying out of the transfer pricing study by the assessee be considered, has also not been pressed at the time of hearing and accordingly Ground no. 10 is also dismissed as not pressed.

6. Ground no. 12 challenging initiation of penalty proceedings u/s 271(1)(c) of the Act has also not been pressed being premature and is accordingly dismissed.

7. We may now proceed to adjudicate the substantive disputes raised by the assessee in the remaining Grounds of Appeal. In order to appreciate the contours of the controversy between the assessee and the Revenue in this case, the following discussion is relevant. As noted earlier, the appellant is a company engaged in providing material handling solutions to Indian customers and is wholly owned subsidiary of Demag Cranes and Components, GmbH, Germany, who is a market leader in the field of cranes and hoists. The assessee is engaged in manufacturing of material handling equipment., viz. industrial cranes like standard cranes, process cranes, jib cranes and KBK cranes. The assessee is not only engaged in the activity of manufacture of such equipments, but also installation and servicing thereof. The assessee assembles/manufactures material handling equipments in India and provides entire range of products and support for Demag material handling equipments. Assessee company also undertakes sales/distribution of imported material handling equipments viz. cranes/hoists, their components and spare parts and renders technical and after sales service to the Indian customers. For the previous year ending on 31-3-2007 corresponding to assessment year

under consideration, appellant was found to have entered into the following international transactions within the meaning of section 92B of the Act with its AEs:-

Sr.No.	Detail of transactions	Amount (Rs)
1.	Import of raw materials, components and spares	10,68,36,349/-
2.	Import of trading goods	15,66,43,926/-
3.	Export of components and spares	1,01,50,152/-
4.	Receipt of Technical service - Rs. 11,89,194/- Professional service – Rs. 86,62,357/-	
5.	Rendering provision of marketing service	30,34,352/-
6.	Provision of Engineering/Supervisory services	39,82,635/-
7.	Development cost and/or remuneration for technical consultancy and know how	62,29,938/-
8.	Guarantee and issuing render fee	11,80,360/-
9.	Reimbursement of expenses	35,28,521/-
	TOTAL	30,14,37,784/-

8. The assessee aggregated the transactions itemized at 1 to 7 in the above table and benchmarked the same on the basis of Transactional Net Margin Method (in short 'TNM method') prescribed in sec. 92C(1) of the Act considering the same to be the most appropriate method. In the transfer pricing study conducted to benchmark such transactions, assessee enumerated a set of seven external comparable companies, which has been noted by the TPO in para 6 of his order. While ascertaining the average operating margin ratio of such comparable companies, the assessee used the financial data of two financial years, i.e. 2004-05 and 2005-06, and accordingly, the grand average of operating margin ratio of the Comparable Companies came to 7.64%. On being compared with the operating margin ratio of the assessee-company, computed at 9.81%, assessee asserted that its aforesaid international transactions were at an arm's length price (ALP) from the Indian Transfer Pricing regulations perspective.

9. The TPO has accepted the application of TNM method adopted by the assessee as the most appropriate method for the purposes of determining arm's length price u/s 92C of the Act. The TPO has also found it appropriate to accept the seven Comparable Companies selected by the assessee in its transfer pricing study. However, the TPO differed with the assessee for computing the grand average of operating margin ratio of such seven Comparable Companies, inasmuch as, as per the TPO the operating margin ratio of the Comparables Companies has to be seen on the basis of financial data of such companies for the period ending 31-3-2007 alone, which corresponds to the financial year in which the impugned transactions have been undertaken by the assessee. On the basis of such an approach the average operating margin ratio of such seven Comparable Companies was computed at 10.64%, as is enumerated in para 6 of the order of the TPO. Pertinently, on the aforesaid approach of Revenue, there is no dispute by the assessee inasmuch as the grievance on this issue manifested by way of Ground of Appeal No. 9 has not been pressed at the time of hearing as noted earlier.

10. The second and more potent difference between the approach of the assessee and the TPO is as follows. In its transfer pricing study, assessee aggregated the transactions itemized at 1 to 7 in Tabulation appearing in para 7 of this order, for the purposes of benchmarking the same while determining the ALP using TNM method. In other words, the international transactions in connection with (i) import of raw materials, components and spares for assembly/manufacture of material handling products; (ii) import of equipment components and spares; (iii) export of components and spares; (iv) receipt of professional/consultancy services; (v) provision of marketing services; (vi) provision of Engineering / Supervisory services; and, (vii) development cost and/or remuneration for technical consultancy/know-how were aggregated and considered as a

composite transaction for the purpose of benchmarking it with the Comparable uncontrolled transactions. The TPO noticed that the aggregated transactions included transactions relating to (i) import of trading goods which was basically an activity in the distribution of material handling products manufactured by the AEs; (ii) providing of marketing, installation and commissioning services and as per the TPO, these activities could not be considered to be closely interlinked with the manufacturing activity undertaken by the assessee company. As per the TPO, the aforesaid transactions are distinguishable in nature and scope and cannot be considered to be closely interlinked with the manufacturing activity carried out by the assessee. Thus in this manner, TPO observed that the assessee was engaged in three distinct segments of businesses, viz. manufacturing of handling equipments i.e. manufacturing activity; trading activity; and, rendering of services for which it received service income. The TPO excluded the latter activities and did not consider it as a part of manufacturing activity undertaken by the assessee for the purposes of benchmarking the international transactions of the assessee. The TPO observed the comparable companies selected by the assessee in its transfer pricing study were to be compared only with regard to their manufacturing segment alone, and therefore, he required the assessee to furnish necessary financial information to compute the operating margin ratio of the assessee's manufacturing segment in terms of which the operating margin ratio of the assessee was computed at (-)7.05%.

11. Another area of difference was with regard to assessee's plea to the TPO for adjustment on account of additional charges/cost incurred towards import of components undertaken by the assessee-company. The aforesaid plea of the assessee has not been accepted by the TPO, which according to him, was impermissible in terms of Rule 10B(1)(e)(i) of the

Income-tax Rules 1962 (in short 'the Rules'). In final analysis, the TPO proceeded to benchmark assessee's international transactions falling under the manufacturing segment as per the TNM method and taking the comparables selected by the assessee in its transfer pricing study but after considering the financial data of the comparable companies for the financial year 2006-07 alone. In this manner, TPO noticed that the arithmetic mean of the operating margin ratio of seven comparable companies was 10.64% and that of the assessee's manufacturing segment was (-)7.05%. As a result, the international transactions of the assessee relating to manufacturing activity were not found to be stated at arm's length price and therefore, an adjustment was worked out. The difference in the arithmetic mean of operating margin of comparable companies and that of the assessee for its manufacturing activity was worked out at 17.69% (i.e. 10.64% minus (-)7.05%). Accordingly, the adjustment required to the assessee's international transactions falling under the manufacturing segment was computed by applying 17.69% on the net sales of manufacturing segment adopted at Rs. 35,95,58,438/- which came to Rs.6,36,05,887/-. In this background, now we may consider the objections raised by the assessee and the rival stand of the Revenue thereof.

12. Before us, the learned counsel for the assessee, at the outset, pointed out that the income-tax authorities have erred in not accepting the plea of the assessee that the transfer pricing adjustment on manufacturing activity has to be restricted to the sales pertaining to import of components and spares from AEs only and not on the entire sales of manufacturing segment. It has been pointed out that the TPO has benchmarked the manufacturing activity using TNM method and determined the transfer pricing adjustment @ 17.69% which was applied on the total sales of manufacturing segment at Rs. 35,96,58,438/-

whereas the quantum of import of components and spares from AE in respect of manufacturing segment is only Rs. 10,93,36,384/- as compared to the cost of material forming part of manufacturing segment of Rs. 29,05,89,906/-. Without prejudice to the assessee's plea of challenging the entire adjustment by way of Ground No. 7, an alternative plea has been raised to the effect that the adjustment if any, to the manufacturing segment, be restricted to the sales relatable to import of components and spares from AEs only instead of entire manufacturing segment sales. In support of such plea, reliance has also been placed on the decision of the Tribunal in the assessee's own case for A.Y. 2006-07 vide ITA No. 120/PN/2011 dated 4-1-2012, a copy of which is placed on record. On the aforesaid proposition, reliance has also been placed on the following decisions;

1 DCIT Vs, Firmenich Aromatics (I) P.Ltd. (ITA No. 2056/MUM/2006)

2. Lionbridge Technologies Pvt. Ltd. Vs. DCIT (ITA No. 9032/MUM/2010)

3. Emerson Process Management India Pvt. Ltd. Vs. ACIT (ITA No. 8118/MUM/2010)

4. IL Jin Electronics (I) P.Ltd. Vs. ACIT New Delhi (36 SOT 227)

5. DCIT Mumbai Vs. M/s. Starlight (2010 TII 28 ITAT Mum- TP)

6. Abhishek Auto Industries Ltd. Vs. DCIT New Delhi (2010) TII 54

7. ACIT Vs. wockhardt Lt. (6 Taxman.com 8 (Mum)ITAT

8. M/s Phoenix Mecano (I) Ltd. Vs. DCIT (2011) ITA No. 7646/MUM/.2011

9. Kodaik Networks India Pvt. Ld. Vs. ACIT (ITA no. 970/Bang/2011

13. On the aforesaid aspect of the dispute, there is no serious contest made out by the learned DR before us other than pointing out that such a contention was not raised before the lower authorities. However, the factual matrix brought out by the assessee has not been controverted.

14. We have carefully considered the rival submissions on this aspect and find ourselves inclined to uphold the plea of the assessee. Ostensibly, the objective of determining the arm's length price u/s 92C of the Act in relation to an international transaction carried out by an assessee with its AE is to supplant the provisions of Section 92(1) of the Act, which prescribes that income arising from an international transaction shall be computed having regard to the ALP, and the meaning of the expression "international transaction' is contained in sec. 92B of the Act to mean a transaction between two or more associated enterprises. Therefore, it is a natural corollary that the adjustment arising as a result of transfer pricing analysis is to be confined to international transactions undertaken with the AEs alone and not in relation to non-AE transactions. Similar point arose in assessee's own case for the A.Y. 2006-07 in ITA No. 120/PN/2011 (supra) wherein Tribunal after referring to sub-clauses (i) and (ii) of Rule 10B(1)(e) of the Rules and certain precedents by way of decisions of the co-ordinate Benches, finally accepted the plea of the assessee in the following words:

> *"49. All these cited decisions in general and the decision in the case of M/s. Jt. Jin Electronics I P. Ltd. Vs. ACIT 36 SOT 227, in particular are uniform in asserting that the TP adjustments are to be computed not considering the entity level sales. Rather it should be done ideally considering the relatable sales drawing the quantitative relationship to the imports from the AEs, i.e. controlled cost. The principle of proportionality is relevant here and it is a settled law in this regard. In the situation like the one in the instant case of the assessee, there is data relating to controlled and uncontrolled cost particulars. This undisputed data is suffice to arrive the proportionate sales relatable to the international transaction with the AEs i.e. controlled cost. Accordingly, the ground no. 10 relating to incorrect computation of transfer pricing adjustment to the manufacturing activity is allowed pro tanto."*

15. In view of aforesaid discussion we therefore, hold that the assessee has to succeed on the said plea and as a result Ground no. 7 raised by the assessee stands allowed.

16. By way of Ground of Appeal No. 5, the grievance of the assessee-company is that the lower authorities have erred in not providing adjustment to the unadjusted margins of the Comparable Companies on account of working capital differences. In relation to this Ground of Appeal, the preliminary plea of the assessee is that similar issue has been adjudicated by the Pune Bench of the Tribunal in the assessee's own case for the A.Y. 2006-07 (supra) whereby adjustment for working capital to the unadjusted margins of the Comparable Companies have been allowed. Accordingly, it is submitted that similar view be taken on this issue.

17. The learned DR appearing for the Revenue has contended that no such claim for adjustment for difference in working capital was made by the assessee before the TPO. It is pointed out that the claim can be accepted in case it can be established that (i) the difference has a material bearing on the pricing of the transactions in question; (ii) such adjustment can be accurately determined; and, (iii) such an adjustment would enhance its comparability. As per the learned DR, in the present case, the appellant has not established so, and therefore, the plea of the assessee is unjustified. In this connection, it has been emphasized, on the basis of Rule 10B(1)(e)(iii) of the Rules that the net profit margin arising in comparable uncontrolled transaction is permitted to be adjusted to take into account the differences between the international transaction and the Comparable uncontrolled transactions and that too, only if such differences would 'materially affect' the amount of net profit margin in the open market. The learned DR submitted that Comparable Companies were selected after comparing the functions, assets employed and risks assumed, and therefore, no adjustment is warranted in this case on account of working capital differences.

18. We have carefully considered the rival submissions. At the outset, it is noticeable from para 10 of the order of the DRP that the assessee had raised the issue of adjustment on account of working capital difference, but the same did not find favour with the DRP. The issue – whether or not working capital can constitute an item of difference so as to require an adjustment in the profit margin arising in comparable uncontrolled transactions while benchmarking the international transaction of the tested party, is no longer res integra and has been a subject matter of consideration of the Tribunal in assessee's own case for the assessment year 2006-07 (supra). The Tribunal has examined the provisions of Rule 10B(1)(e)(iii) of the Rules and other precedents and concluded that the aspect of working capital can constitute a subject matter of adjustment in matters relating to ALP in transfer pricing. In the context of Rule 10B(1)(e)(iii) of the Rules, the Tribunal has also concluded that in the assessee's case the aspect of working capital difference between the international transaction and the comparable uncontrolled transactions constituted a difference which materially affected the net profit margin of the relevant transactions in the open market. In para 33 of its order dated 4-1-2012 (supra) the Tribunal has finally concluded as under:

> *"33. We have already discussed in the preceding paragraphs, this issue of adjustment on account of WC was raised for the first time before the ld. DRP and the DRP has passively relied on the order of the TPO without realizing that the said issue was never dealt with by the TPO Therefore, the issue of granting of adjustment on account of 'working capital' for eliminating of the material effects and the issue of, if such adjustment @ 3.41% constitutes that difference, if any, which is likely to materially affect the price/profit margin, have not been examined. We find that there are written request of the assessee to the DRP to this extent and assessee furnished the relevant figures, which are enough to adjudicate the said request by the AO/DRP. It is not the case of the DRP that the above claims of the assessee are incorrect. Alternatively, it is not the request of the revenue's DR that these said issues should be remitted for another round of the proceedings before the revenue authorities. In our opinion, the existence of*

difference @ 3.41% which is worth Rs. 31,72,099/- attributable to the 'working capital' ought to amount to the 'material difference' considering the existing unadjusted operating margin of the comparables at 7.18%. In these circumstances, we are of the opinion that the said working capital differences constitutes quantitatively likely to materially affect the ALP / AL Operating Margin of the comparable. Therefore, the claims of the assessee are allowed. Accordingly, the grounds 4(a) is covered by the cited decisions and is allowed pro tanto."

19. In this background, the learned counsel for the assessee has put on record a calculation sheet showing that the margin of Comparable Companies, after considering working capital adjustment comes to 8.26% as against the unadjusted arm's length margin of the Comparable Companies adopted by the TPO at 10.64% considering the data of the single financial year 2006-07. It was therefore sought to be demonstrated that even in the instant assessment year the difference in working capital materially affects, the margins of the Comparable Companies for the purposes of benchmarking the assessee's international transactions. After considering the assertion of the appellant and the precedent in assessee's own case, we deem it fit and proper to restore this matter to the file of the Assessing Officer who shall verify, the plea of the assessee in the light of the order of the Tribunal dated 4-1-2012 (supra) and thereafter workout the adjustments, if any, that are required to be made in order to ascertain the ALP of the international transaction in question. Needless to say, the Assessing Officer shall allow the assessee a reasonable opportunity to put forth material and submissions in support of its stand and only thereafter the Assessing Officer shall pass an order afresh on the above aspect in accordance with law. Thus, on Ground of Appeal No. 5, assessee succeeds for statistical purposes.

20. By way of Ground no. 6, the grievance of the assessee is that the lower authorities have erred in not providing adjustment on account of additional expenses incurred for import of raw-materials, components and

spares. In this regard, before the TPO assessee pointed out that the import of components constituted 37.63% of the cost of material consumed in the assessee's case whereas the Comparable Companies had only 5.53% of imported components as compared to its consumption of raw-material, stores and spares. It was therefore, canvassed that on account of higher imports as compared to the Comparable Companies, assessee is bound to incur additional cost on basic custom duty, lending charges, clearing and forwarding charges, insurance and freight, etc. It was therefore, canvassed that a suitable adjustment be made for the additional cost so incurred by the assessee while benchmarking international transactions of the assessee vis-à-vis the comparable Companies. Before the TPO the assessee specifically relied upon the decision of the Tribunal in the case of Skoda Auto India P Ltd. 122 TTJ 699 (Pune) wherein the adjustment in respect of import duty additionally borne by the assessee was considered in order to facilitate benchmarking of international transaction with the Comparable Companies. The income-tax authorities have denied plea of the assessee for the reason that in terms of rule 10B(1)(e) of the Rules, the adjustments are permissible only in respect of the comparable uncontrolled transactions and not in the case of tested party.

21. Before us, the learned counsel for the assessee has pointed out that the adjustment has been denied by the lower authorities unjustly even when the commercial reasons were demonstrated. It has been pointed out that factually it was demonstrated before the TPO and the learned DRP that the raw-material, spares and components were imported from AEs of Rs. 10,93,36,384/- as against total material consumed in the manufacturing segment of Rs. 29,05,89,906/- i.e. 37.63% imports as percentage of total consumption of raw-material, spares and components during the year under consideration. The Comparable Companies had

import components of merely 5.53% thereby depicting that the assessee had 32.10% higher imports as compared to the Comparable Companies. It was therefore, contended that the additional cost incurred by the assessee as compared to the Comparable Companies on account of custom duty, lending charges etc. would require to be neutralized so as to facilitate the profit comparison with the Comparable Companies. In addition to the aforesaid factual position, reference has been made to page 133 and 134 of the Paper Book wherein is placed copies of the submissions put forth to the TPO as also the calculation sheet furnished during the hearing of the appeal whereby the import component in the cases of Comparable Companies have been depicted. Explaining further, the learned counsel pointed out that the assessee is still in the process of localizing its product and therefore, it has a high import content whereas the Comparable Companies are in existence for a number of years and they have already localized their products thereby resulting in lower imports. In this manner, it was sought to be made out that the adjustment has to be granted for additional cost of imports incurred by the assessee and that similar plea was upheld by the Tribunal in-principle in assessee's own case for A.Y. 2006-07 vide its order dated 4-1-2012 (supra).

22. On the other hand, the learned DR appearing for the Revenue has pointed out that the TPO has dealt with the aforesaid plea by pointing out that the adjustment in the profit margin can only be made as permitted in Rule 10B(1)(e) of the Rules and that too with respect to the profit margin of the Comparable Companies. It was therefore, contended that the plea of the assessee is not justified.

23. We have carefully considered rival submissions. Ostensibly the Tribunal in assessee's own case for A.Y. 2006-07 vide its order dated 4-1-2012 (supra) had considered a similar plea of the assessee and after

relying on the decision of co-ordinate Bench in the case of Skoda Auto India P. Ltd (supra) upheld the plea of the assessee relating to adjustment on account of additional import cost in order to facilitate benchmarking with the comparable companies. Following discussion in operative portion of the order is relevant:-

> *"The perusal of the impugned orders shows that the above cited guidelines by way of decision of this Bench of the Tribunal in the case of skoda auto India P. Ltd. (supra) were not available to the revenue authorities. Therefore, we are of the opinion, the issue should be set aside to the files of the TOP with direction to examine the claim of the assessee relating to the import cost factor and eliminate the difference, If any. However, the TPO/AO/DRP shall see to it that the difference in question is 'likely to materially affect' the price/profit in the open market as envisaged in sub rule (3) of Rule 10B of the Income-tax Rules 1962. Accordingly, ground 4(b) is allowed pro tanto."*

24. Following the aforesaid precedent, facts being similar in this year, , we deem it fit and proper to restore the matter back to the file of the Assessing Officer who shall adjudicate assessee's plea in the light of directions of the Tribunal contained in its order dated 4-1-2012 (supra). Needless to say, the Assessing Officer shall allow the assessee a reasonable opportunity to put forth material and submissions in support of its stand and only thereafter the Assessing Officer shall pass an order afresh on the above aspect in accordance with law. Thus, on this Ground, assessee succeeds for statistical purposes.

25. By way of Ground no. 8, the assessee has contended that the lower authorities have erred in computing the ALP of the international transactions pertaining to the manufacturing activity and export of components and spares without taking into account +-5% variation from the mean which is permissible and was also opted for by the assessee in terms of section 92C(2) of the Act.

26. On this Ground of Appeal, the assessee has not articulated its grievance at the time of hearing, primarily on account of the amendments made by Finance Act, 2012 in section 92C of the Act. In this view of the matter, we therefore, deem it fit and proper to direct the Assessing Officer to revisit such controversy in the light of legal position emerging as a result of amendments made to section 92C of the Act by the Finance Act, 2012. Thus this Ground is accordingly disposed off.

27. Now we may take up Ground of Appeal No. 3 whereby the grievance of the assessee is that the income-tax authorities have unjustly disagreed with the transfer pricing study conducted by the assessee for benchmarking its international transactions pertaining to supervision of material handling solutions to the customers on an aggregate basis. In this connection, we may briefly recapitulate the business activities carried out by the assessee. The assessee is carrying out activity of manufacturing material handling equipments viz. cranes and hoists in its manufacturing activity at Hinjewadi, Pune. The assessee assembles/manufactures material handling equipments in India and also provides entire range of products and support services for Demag material handling equipments. It also undertakes sales/distribution of material handling equipment imported by it and also components and spare parts to customers in India. The activities also include providing technical and after sales services to the customers. The International transactions carried out with AEs, within the meaning of section 92B of the Act, and which are the subject matter of consideration, are enumerated by way of items 1 to 7 in the tabulation in para 7 of this order. The assessee aggregated the aforesaid transactions for the purpose of benchmarking the same with Comparable uncontrolled transactions on the ground that all of them are closely interlinked to the activity of manufacture of

equipments. In other words, as per the assessee, the seven transactions viz. (i) import of raw materials, components and spares for assembly/manufacture of material handling products; (ii) import of equipment components and spares; (iii) export of components and spares; (iv) receipt of professional/consultancy services; (v) provision of marketing; (vi) provision of Engineering/Supervisory services; and (vii) development cost and/or remuneration for technical consultancy/know-how have been considered to be a part of manufacturing activity and benchmarked on an aggregate basis by adopting a combined transaction approach. The TPO on the other hand, has concluded that the benchmarking of the international transactions by adopting a combined transaction approach was not correct. The TPO proceeded to analyse the transactions separately, inasmuch as, according to the TPO the assessee's business was comprising of three different segments viz. manufacturing, trading and rendering of services.

28. Before us, the learned counsel for the assessee has vehemently pointed out that the assessee had adopted a combined transaction approach for the international transactions in relation to manufacturing of equipment. The same are closely interlinked and cannot be benchmarked separately. In this regard, reference was made to page 161 of the Paper Book wherein is placed an exhibit showing different activities carried out by the assessee which according to him all related to the manufacturing of material handling equipments and installation/commissioning thereof by way of providing complete material handling equipment solution to the customers. The learned counsel pointed out that the approach of the TPO is unjustified and according to him, if business operations of the assessee are perused it would show that the assessee enters into a consolidated negotiation with the customers in order to manufacture material handling equipments and cranes and also does erection/commissioning services

which is then followed by repairs/maintenance and other after sales services. It was vehemently pointed out that merely because invoices are separately raised at different point of time would not show that the transactions are not interlinked. The separate invoicing is on account of various factors and cannot be understood as reflecting different independent activities. The learned counsel submitted that the income-tax authorities have grossly erred in holding that the combined transaction approach adopted by the assessee was unjustified and in this regard pointed out that all the items of activities listed at Sr. No. 1 to 7 in para 7 of this order constitute 'a transaction' as defined in Rule 10A (d) of the Rules. Apart therefrom, the learned counsel submitted that the definition of TNM method, as explained in OECD guidelines specifies that all transactions which are similar in nature need to be aggregated for the purpose of transfer pricing analysis. In this manner, the approach of the lower authorities is sought to be assailed.

29. On the other hand, the learned DR appearing for the Revenue has submitted that undisputedly the assessee carries out distinct activities of manufacturing of material handling equipment; distribution of material handling equipment manufactured by its AEs after importing; export of components and spares to its AEs, providing technical and marketing services; supervisory services for erection; and commissioning of equipment, etc. The learned DR pointed out that separate invoices are raised for such activities and that the linkage between these activities, if any, is only incidental and not 'closely linked' so as to fall within the meaning of expression of "transaction" as per rule 10A(d) of the Rules on an aggregate basis. In this manner, the approach of the lower authorities has been defended.

30. We have carefully considered the rival submissions. Section 92B of the Act provides the meaning of expression “international transaction” as a transaction between two or more associated enterprises. Rule 10A(d) of the Rules explains the meaning of the expression “transaction” for the purposes of computation of ALP as to include a number of closely linked transactions. Rule 10B of the Rules prescribes the manner in which the ALP in relation to an international transaction is to be determined by following any of the methods prescribed. Shorn of other details, it would suffice to observe that on a combined reading of Rule 10A(d) and 10B of the Rules, a number of transactions can be aggregated and construed as a single ‘transaction’ for the purposes of determining the ALP, provided of course that such transactions are ‘closely linked’. Ostensibly the rationale of aggregating ‘closely linked’ transactions to facilitate determination of ALP envisaged a situation where it would be inappropriate to analyse the transactions individually. The proposition that a number of individual transactions can be aggregated and construed as a composite transaction in order to compute ALP also finds an echo in the OECD guidelines under Chapter III wherein the following extract is relevant:-

> *“Ideally, in order to arrive at the most precise approximation of arm’s length conditions, the arm’s length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Examples may include 1. Some long term contracts for the supply of commodities or services; 2. Rights to use intangible property; and 3. Pricing a range of closely linked products (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction. Another example would be the licensing of manufacturing know-how and the supply of vital components to an associated manufacturer; it may be more reasonable to access the arm’s length terms for the two items together rather than individually. Such transactions should be evaluated together using the most appropriate arm’s length method. A further example would be the routing of a transaction through another associated enterprise; it may be more appropriate to consider the transaction of which the routing is a part in its entirety, rather than consider the individual transactions on a separate basis.”*

31. In this background, considering the legislative intent manifested by way of Rule 10A(d) read with Rule 10B of the Rules, it clearly emerges that in appropriate circumstances where closely linked transactions exist, the same should be treated as one composite transaction and a common transfer pricing analysis be performed for such transactions by adopting the most appropriate method. In other words, in a given case where a number of closely linked transactions are sought to be aggregated for the purposes of bench marking with comparable uncontrolled transactions, such an approach can be said to be well established in the transfer pricing regulation having regard to Rule 10A(d) of the Rules. Though it is not feasible to define the parameters in a water tight compartment as to what transactions can be considered as 'closely linked', since the same would depend on facts and circumstances of each case. So however, as per an example noted by the Institute of Chartered Accountants of India (in short the 'ICAI') in its Guidance Notes on transfer pricing in para 13.7, it is stated that two or more transactions can be said to be 'closely linked', if they emanate from a common source, being an order or contract or an agreement or an arrangement, and the nature, characteristic and terms of such transactions substantially flow from the said common source. The following extract from the said Guidance Notes is worthy of notice:-

> *"13.7 The factors referred to above are to be applied cumulatively in selecting the most appropriate method. The reference therein to the terms 'best suited' and 'most reliable measure' indicates that the most appropriate method will have to be selected after a meticulous appraisal of the facts and circumstances of the international transaction. Further, the selection of the most appropriate method shall be for each particular international transaction. The term 'transaction' itself is defined in rule 10A(d) to include a number of closely linked transactions. Therefore, though the reference is to apply the most appropriate method to each particular transaction, keeping in view, the definition of the term 'transaction', the most appropriate method may be chosen for a group of closely linked transactions Two or more transactions can be said to be linked when these transactions*

emanate from a common source being an order or a contract or an agreement or n arrangement and the nature, characteristics and terms of these transactions are substantially flowing from the said common source. For example, a master purchase order is issued stating the various terms and conditions and subsequently individuals orders are released for specific quantities. The various purchase transactions are closely linked transactions.

13.8 It may be noted that in order to be closely linked transactions, it is not necessary that the transactions need be identical or even similar. For example, a collaboration agreement may provide for import of raw materials, sale of finished goods, provision of technical services and payment of royalty. Different methods may be chosen as the most appropriate methods for each of the above transactions when considered on a standalone basis. However, under particular circumstances, one single method maybe chosen as the most appropriate method covering all the above transactions as the same are closely linked." (Underlined for emphasis by us).

32. In this background, we may now examine the facts of the present case. The primary activity of the assessee is to manufacture material handling equipments viz. cranes and hoists. It is seen from the documents placed in the Paper Book that the assessee enters into a single negotiation with the customers, which, inter-alia, includes manufacturing and supply of the material handling equipment, provision of commissioning and installation services, etc. Though the assessee raises different invoices for supply of equipments and separately for erection and commissioning charges, however, it is evident that the negotiations for the same are carried on at one go. In fact, at the time of hearing, it was specifically queried from the learned counsel as to whether the assessee is undertaking installation/commissioning activities independent of its own-supplied material handling equipments. It was clarified that the servicing and commissioning charges are earned only in relation to services performed for own–supplied manufacture/assembled material handling equipments. The aforesaid factual assertion is not disputed. Factually, it is the activity of manufacturing/assembling of cranes etc. done by the assessee and sales thereof, which brings into play the activities of installation and commissioning of such products. Therefore, it

is quite evident that such services are not independent but in-effect are as a result of manufacturing of material handling equipment undertaken by the assessee and as a they arise from a single negotiation with the customers, the source of all such transactions is also to be understood as common.

33. The TPO in this regard has observed that assessee has invoiced separately for such activities and therefore, they have to be understood as different transactions. The TPO has also observed in his order that in a case where profits of each individual transaction can be segregated then the aggregation of transaction is not intended by the transfer pricing regulations. The learned TPO has also referred to the segmental profitability in this regard computed by the assessee during the course of transfer pricing proceedings before him. In our considered opinion, the point made out by the learned TPO is not justified, inasmuch as, separate invoicing of an activity, flowing from a singular contract/ negotiation, would not *ipso facto* lead to an inference that they are individual/independent transactions. In-fact, it is the nature and characteristic of the activities which would be required to be analyzed having regard to the facts and circumstances of each case as to whether they can be considered as individual/independent transactions or a single transaction for the purpose of transfer pricing regulation. In the present case, as we have noted earlier, it is only on account of the manufacturing activity that the activity of commissioning and installation of the equipment arises and pertinently all the aforesaid activities are negotiated and contracted for at one instance. With regard to the segmental profitability referred by the Assessing Officer, the position has been clarified by the assessee. According to the assessee, in the financial statements affirmed by the Auditors, the activities have been clubbed together in accordance with the Accounting Standards prescribed by the

ICAI. It was clarified that the segmental profits were worked out by the assessee only at the asking of the TPO during the proceedings before him. The learned counsel pointed out with reference to the chart in this regard placed in the Paper Book and submitted that the segmental profitability was not computed on the basis of any separately maintained records viz. books of account or vouchers but was computed by undertaking a statistical exercise. The costs were allocated as a proportion of sales/revenues and not an actual basis. In view of the aforesaid fact situation, we do not find that the availability of separate segmental profits in the present case can be a justifiable ground for the TPO to say that the transactions are not 'closely linked' within the meaning of Rule 10A(d) of the Rules. Thus, the activity of installation and commissioning/engineering services is 'closely linked' with the manufacturing activity and deserves to be aggregated and construed as a single transaction for the purposes of determining the ALP as per the method adopted.

34. In view of the aforesaid discussion, in our opinion, the approach of the TPO, in out-rightly rejecting the aggregation of all the transactions itemized at 1 to 7 in para 7 is flawed having regard to the facts and circumstances of the case. Further, it is noticed from the tabulation in para 7 of this order, that the assessee is also rendering marketing services, technical know-how and professional services, etc., which have also been aggregated. For such activities no specific point has been made out by the assessee as to why they can be classified as 'closely linked' transactions for the purposes of Rule 10A(d) of the Rules. Considering the entirety of the facts and circumstances, we are of the opinion that the issue be revisited by the AO/TPO in the light of our aforesaid discussion. The AO/TPO shall take into consideration the pleas and the material sought to be placed by the assessee in the light of the aforesaid

discussion and thereafter adopt a combined transaction approach after considering each of the transaction itemized at 1 to 7 as to whether the same are to be bench marked after aggregation or not. Needless to say, the Assessing Officer shall allow the assessee a reasonable opportunity to put forth material and submissions in support of its stand and only thereafter the Assessing Officer shall pass an order afresh on the above aspect in accordance with law. Thus, on this Ground, assessee succeeds for statistical purposes.

35. In the result, appeal of the assessee is partly allowed.

Decision pronounced in the open court on 31st December 2012.

Sd/- sd/-

(R.S. PADVEKAR) (G.S. PANNU)
Judicial Member Accountant Member

Pune dated the 31st December 2012.
Ankam
Copy of the order is forwarded to :
1. The Appellant
2. The Respondent
3. The DRP Pune
4. TPO – IV Pune
5. The D.R, 'A' Bench, Pune

By order

Sr. Private Secretary
Income Tax Appellate Tribunal
Pune Benches, Pune.