IN THE INCOME TAX APPELLATE TRIBUNAL,
KOLKATA 'B' BENCH, KOLKATA

Before Shri Mahavir Singh (Judicial Member)
and Shri Shamim Yahya (Accountant Member)

I.T.A. No. 1262/Kol./ 2010
Assessment year : 2005-2006

Deputy Commissioner of Income Tax,…………………………..Appellant
Circle-11, Kolkata,
P-7, Chowringhee Square,
Kolkata-700 069

-Vs.-
M/s. A T & S India Pvt. Limited,,…………………………….….Respondent
12A, Industrial Area,
Nanjangud,
Mysore,
Karnataka-571 301
[PAN : AAECA 2930 J]

&

I.T.A. No. 186/Kol./ 2011
Assessment year : 2005-2006

M/s. A T & S India Pvt. Limited,…………………………….….Appellant
12A, Industrial Area,
Nanjangud,
Mysore,
Karnataka-571 301
[PAN : AAECA 2930 J]

-Vs.-
Additional Commissioner of Income Tax,…………………Respondent
Range-11, Kolkata,
Aayakar Bhawan,
P-7, Chowringhee Square,
Kolkata-700 069

&

I.T.A. No. 2071/Kol./ 2010
Assessment year : 2006-2007

M/s. A T & S India Pvt. Limited,…………………………….….Appellant
12A, Industrial Area,
Nanjangud,
Mysore,
Karnataka-571 301
[PAN : AAECA 2930 J]

-Vs.-

Deputy Commissioner of Income Tax,…………………..Respondent
circle-11, Kolkata,
Aayakar Bhawan,
P-7, Chowringhee Square, Kolkata-700 069

&
I.T.A. No. 779/Kol./ 2012
Assessment year : 2007-2008

M/s. A T & S India Pvt. Limited,…………………………………Appellant
12A, Industrial Area,
Nanjangud,Mysore,
Karnataka-571 301
[PAN : AAECA 2930 J]
-Vs.-

Deputy Commissioner of Income Tax,…………………….Respondent
Circle-11, Kolkata,
Aayakar Bhawan,
P-7, Chowringhee Square,
Kolkata-700 069

Appearances by:
Shri Soumitra Choudhury, Advocate, for the assessee
Smt. Madhu Malati Ghosh, JCIT, for the Department

Date of concluding the hearing : December 16, 2014
Date of pronouncing the order : January 29, 2015

O R D E R

Per Mahavir Singh:

These cross appeals by revenue (ITA No.1262/K/2010) and by assessee (ITA No.186/K/2011) are arising out of order of CIT(A) in Appeal No. 614/CIT(A)-XII/Circle-11/09-10/Kol dated 30.03.2010. Assessment was framed by Addl. CIT, Range-11, Kolkata u/s. 143(3) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") for AY 2005-06 vide his order dated 29.12.2008. ITA No. 779/K/2012 by assessee is arising out of order of Dispute Resolution Panel, Kolkata passed u/s. 144C(5) of the Act vide F. No.DRP/Kol/2011-12/270-277 dated 23.09.2011. Assessment was framed by DCIT, Circle-11, Kolkata (order giving effect to DRP's direction) u/s. 143(3) r.w.s. 144C(13) of the Act vide his order dated 09.11.2011 for AY 2006-07. ITA No. 2071/K/2010 by assessee is arising out of order of Dispute Resolution Panel, Kolkata passed u/s. 144C(5) of the Act vide F. No. DRP/Kol/06/2010-11/107-111 dated 28/29.09.2010. Assessment was framed by DCIT, Circle-11, Kolkata (order giving effect to DRP's direction) u/s.

143(3) r. w. s. 144C(13) of the Act vide his order dated 04.10.2010 for AY 2007-08.

2. At the outset, it is noticed that assessee's appeal in ITA No.186/Kol/2011 is barred by limitation by 202 days and a condonation petition is filed qua that. The reasons stated are that such delay occurred on account of fire accident took place on assessee's business premises on 13.06.2010. The order of CIT(A) in appeal no. 614/CIT(A)-XII/Circle-XI/09-10/Kol for the AY 2005-06 was served on assessee on 14.05.2010 and the last date for filing of appeal before Tribunal against this order was 13.07.2010. As there was a fire accident on 13.06.2010, the papers relating to assessment for the above stated assessment year 2005-06 and orders in appeal passed by CIT(A) against the assessment order got dislocated during such fire. In this fire, computers, UPS and other assets were destroyed or damaged and records were dislocated. The assessee received a letter from the AO with regard to the demand raised for this AY 2005-06 and 2006-07 along with an order u/s. 226(3) of the Act dated 30.12.2010, attaching several bank accounts, it came to the knowledge of the assessee that appeal against assessment order for AY 2005-06 has not been filed because papers relating to that assessment year and order of CIT(A) has been mixed with the other records and lost sight of by the executives dealing with the tax matters. When it came to the knowledge of the assessee thereafter took steps for preparing the grounds of appeal and filed appeal before Tribunal on 31.01.2011 with a delay of 202 days. In view of the above, now Ld. Counsel for the assessee before us requested for condonation of delay for the reason that there is reasonable cause in view of the above reasons. Ld. CIT, DR, on the other hand, has not seriously objected to the condonation. In view of the above reasons, we are of the view that there is a reasonable cause due to fire occurred in the business premises of the assessee and due to that assessee's paper relating to CIT(A)'s order were lost sight off. There is a reasonable cause and hence, we condone the delay and admit the appeal.

3. The first common issue in these cross appeals (in ITA No.1262/Kol/2010 of revenue's appeal and ITA No. 186/Kol/2011 of assessee's appeal)is as regards to the order of CIT(A) restricting disallowance at Rs.2,26,84,459/- out of the total disallowance of payment for preliminary warranty and reworking costs of Rs.2,55,17,674/- made by AO by invoking the provisions of section 40(a)(i) of the Act for the reason of non-deduction of TDS u/s. 195 of the Act. According to AO, these payments are in the nature of fees for technical services. For deletion of Rs.28,33,215/-, revenue has raised the following two grounds:-

1. *On the facts in the circumstances of the case, ld. CIT(Appeals) has erred in deleting the disallowance of Rs.28,33,215/-, being the warranty claimed/payments in the nature of technical services as defined under section 9(1)(vii) of the I.T. Act hence liable for deduction of tax at source under section 40(a)(ia) which has been violated.*

2. *On the facts and in the circumstances of the case, ld. CIT(A) has erred in deleting the disallowance on the basis of fresh evidences produced thereby violating the provision of Rule 46A of I.T. Rules, 1962.*

Against confirmation of disallowance of warranty and reworking costs of Rs.2,26,84,459/- assessee has raised following ground no. 3(a), (b) and (c):

> "3. *(a) That the ld. CIT(A) erred in confirming the order of the AO disallowing the sum of Rs.22,684,459/- being reimbursement of reworking cost paid by the appellant to* M/s. AT & S Austria, by applying the provisions of section 40(a)(i) of the Act.
>
> *(b) That the ld. CIT(A) erred in confirming the order of the AO holding the aforesaid payment to be in the nature of fees for technical services under section 9(1)(vii) of the Act.*
>
> *(c) That the ld. CIT(A) erred in confirming the order of the AO holding that tax was required to be deducted at source from the aforesaid payment by applying the provisions of section 40(a)(i) of the Act."*

4. Brief facts relating to the above common issue are that the assessee is an Indian Company being subsidiary to its parent company AT&S Austria is engaged in the manufacture and sale of professional grade printed circuit boards. The AO noticed from audited accounts that the assessee has paid a

sum of Rs.2,55,17,674/ being payment for preliminary warranty and reworking costs, which are in the nature of payments for technical services as defined in section 9(1)(viii) of the Act. According to him, as the assessee failed to deducted tax at source, this sum is to be disallowed by invoking the provision of section 40(a)(i) of the Act. He disallowed the same. Aggrieved, assessee preferred appeal before CIT(A), who bifurcated this sum into warranty cost separately and reworking cost separately. He held that warranty costs to the extent of Rs. 28,33,215/ is in the nature of reimbursement payments and balance sum of Rs.2,26,84,459/ is in the nature of technical services being reworking costs. Accordingly, he held that the warranty costs are not liable to TDS but reworking costs being in the nature of technical services are liable to TDS. The observations of CIT(A) reads as under:-

> *"5.3.4 I have considered the appellants submissions as well as observations of the AO.*
>
> *My observations are a under:*

(i) From the above facts and circumstances of the case it is clear that the above mentioned payments made by the appellant to its parent company AT&S Austria are only in terms of the distribution agreement. As per the terms of the agreement the patent company paid the amount of warranty to the customers and reworking cost (repair cost) to the service providers and thereafter raised debit note on the appellant in respect of both these costs. This is purely internal arrangement of the group and it is established principle that a person cannot escape its legal tax liability through its internal arrangement. Since, the warranty claim directly paid to the customers in consideration of their claim regarding defective goods there is no income component in the hands of customers. However, in respect of reworking cost the true recipient of income are outside service provides who are doing the repair job. Therefore, the appellant is liable to deduct tax at source under section 195 of the Inc Tax Act, 1961at the time of entry in the books of accounts should be made in respect of debit notes raised by the AT & S Austria regarding reworking cost incurred by it on behalf of appellant.

(ii) Therefore, under the facts and circumstances of the case the discussion and judicial decisions including the decisions of the apex court regarding plea of the appellant that the expenses are only reimbursement as given in connection to ground ***no.2(a)***, ***(b)*** *and*

(c) *above are squarely applicable to this ground also in relation to reworking cost and therefore, the appellant is liable to deduct tax at source under section 195 of the Inc Tax Act, 1961 from payment towards reworking cost.*

(iii) Regarding plea of the appellant that the reworking costs are not in the nature of fees for technical service it may be noted that the appellant is engaged in the business of manufacture and sale of professional grade printed circuit board and in my opinion repair jobs of such sophisticated goods shall always be in the nature of technical services. In this regard reference is made to the case laws viz., Sahara Airlines Ltd. Vs. Deputy CIT (2002) 83 ITD 11, 41 (Del) *wherein it was held that the consideration for repair job amounted to for technical service as defined in section 9(1)(vii) of the Act. In the case of Mannesmann Demag Lauchhammer Vs. CIT (1988)* 26 ID 198, 202-03 *(Hyd), it was held fees for services rendered to repair of machinery already installed amounts to technical fees.*

(iv) Therefore based on the above facts and the cited case laws, in my opinion, there is no force in the submission of the appellant that the payments of reworking jobs are not in the nature of fees for technical services as per the meaning of the said term assigned under the provisions of section 9 of the Income Tax, 1961 and therefore, these payments are not chargeable to tax in India even in the hands of ultimate vendor/service providers.

*(v) Further, whether the amounts paid by the appellant are for the purposes of making or earning any income from any source outside India and, hence, covered within the excepting carved out in section 9(1)(vii)(b) of the Act. Sub-clause (b) of clause (vii) of section 9 carves out an exception to the taxability of fees for technical services paid by a resident. According to the '*__exception__*', the fees for technical services payable in respect of any services utilized; (a)* for the purpose of business or profession carried out by such person outside India or; (b) for the purpose of making or earning any income from any source outside India is not an income that falls within the net of section 9*. The appellant is relying on the second part of the exception, i.e.,* 'for the purposes of making or earning any income from any source outside India'*. It is the case of the appellant that its business principally comprises of export revenue in the sense that it sold its products to its parent company in Austria pursuant to a distribution agreement and in turn the parent company sold these goods to customers in Europe. Hence, the source of income in hands of the appellant company is not mere selling of the goods to the distributor, but the actual sale of the goods by the distributor and although its business is carried out from India, yet the income it get is from a source outside India and*

the payments made towards reworking cost is for the purpose of earning income from a source outside India. Hence, according to the appellant, the benefit of exception envisaged by section 9(1)(vii)(b) will be available to it.

It was difficult to accept the appellant's contention. The income which the applicant earns by export activities cannot be said to be from a source outside India. The 'source' of such income is very much within India and the entire business activities and operations triggering the exports take place within India. The source, which generates income, must necessarily, be traced in India. Having regarded to the fact that the entire operations are carried on by the appellant in India and the income is earned from such operations taking place in India, it would be futile to contend that the source of earning income is outside India, i.e., in the country of the customer. Source is referable to the staring point or the origin or the spot where something springs into existence. The fact that the customer and the payer is a non-resident and the end product is made available to that foreign customer does not mean that the income is earned from a source outside India.

(vi) The appellant has also submitted that the price of the product sold to AT & S Austria are fixed at fair market value compared with other distributors or customers of the appellant taking into account sales volume, competition and local market conditions etc., Therefore, the goods exported by the appellant to the AT & S Austria are not at cost price but at cost plus profit. Therefore, it could not be said that the source of income is outside India. Another hurdle that comes in the way of the appellant is that it cannot be said that the transfer has taken place outside India. The property could have very well passé in India. It may also be noted that the appellant has also claimed deduction under section 80HHC in respect of such export out of India up to the assessment years deduction was available under the provisions of the Act. Therefore, this plea of the appellant is not acceptable.

(vii) As regards the contention of the appellant that there is no element of income embedded in the payments made by the appellant company to parent company in addition to observations given above my observations at **para 4.3** *holds good.*

5.3.5 Decision

Therefore, based on the above discussion and the cited case laws the disallowances made by the AO of Rs.2,26,84,459/- on account of reworking cost u/s 40(a)(i) due to non deduction of Tax at source under section 195 of the Inc Tax Act, 961 is confirmed and of

Rs.28,33,215/- on account of warranty claim is deleted. The appellant's ground is partly allowed."

5. First, we will deal with the issue of revenue's appeal qua the first and second ground against the order of CIT(A) in deleting the disallowance of the warranty payments/costs on the ground that the same was in the nature of technical services as defined under section 9(1)(vii) of the Act and hence liable for deduction of TDS under section 195 and on account of the said non-deduction of tax under the provisions of sub-section 40(a)(ia). Ld. DR argued that in the course of assessment, it was noticed that the assessee had paid an amount of Rs.2,55,17,674/- for preliminary warranty costs and re-working costs and the same was liable for deduction under section 195 of the Act but the assessee had not deducted TDS, the provisions of section 40(a)(ia) had been invoked and the disallowance made. He stated that the assessee is in the business of manufacture and sale of printed circuit boards from its factory in Nanjangud and is a subsidiary of AT & S Austria. The assessee supplies its manufacturing Printed Circuit Boards to the parent company and the parent company had paid certain warranties for the defective products. The parent company had also made repairs to some of the products supplied by the assessee for sale to foreign parties. He stated that the assessee had paid to AT & S Austria on account of the warranty and the re-working costs, which was liable for TDS under section 195of the Act but CIT(A) deleted the addition representing the amount of Rs.28,33,215/- out of the total disallowance of Rs.2,55,17,674/- by holding that the reimbursement of the costs of warranty to AT & S Austria was not liable for TDS. Hence, he argued that the order of the CIT(A) was liable to be reversed. Ld. CIT-DR could not point out the nature of the fresh evidence filed before CIT(A) by the assessee in respect of the second ground raised by the Revenue that the deletion by CIT(A) was on the basis of fresh evidence produced in the course of the appeal proceedings.

6. In reply, Ld. Counsel for the assessee made argument that in order to reach the customers in Europe, the assessee had entered into a Distribution

Agreement with AT & S Austria whereby the assessee has granted exclusive rights to AT & S Austria to market, distribute and sell products in European countries. Under the aforesaid agreement, the goods manufactured by the assessee were sold to AT & S Austria which in turn sold the goods to final customers. The price for the products was fixed at fair market value compared with other distributors or customers of AT & S Austria taking into account various parameters. As per the aforesaid agreement, the warrant costs to the customers for the goods sold were lying with the assessee. Accordingly, AT & S Austria was entitled to deduct a preliminary warranty amount of 2% of the gross invoice price that AT & S Austria charged from its customers from the payments due to the assessee on account of the goods sold by the assessee to AT & S Austria. The above warranty amount was retained by AT & S Austria for the purpose of settlement of warranty claims in regard to customer complaints. At the end of the year, AT & S Austria would determine the costs actually incurred by it for meeting the warranty expenditure. Any amount in excess of 2% guarantee retained by AT & S Austria would be paid by the assessee to AT & S Austria. Hence, any excess of actual costs incurred by AT & S Austria over the retained 2% was required to be borne by the assessee and payable to AT & S Austria. The actual costs incurred would include journey and lodging expenses, re-work/chemical and other material costs. He argued that the Assessing Officer disallowed the warranty expenses reimbursed on the ground that essentially in the nature of technical fees. He explained that the payments to AT & S Austria were not on account of any services rendered by AT & S Austria but was only the reimbursement of warranty obligation which the assessee as a seller of the products is bound to discharge. Since the assessee is responsible for paying the warranty claims of the customers for defects in the goods sold, for the sake of convenience AT & S Austria is incurring such costs on behalf of the assessee and is claiming reimbursements of the same from the assessee. The payments made on cost to cost basis for the services rendered and did not involve any profit element. On this, Ld. Counsel for the assessee placed reliance on the decision of Hon’ble Supreme Court in the case of CIT v Tejaji

Farasram Kharawalla Limited (1967) 67 ITR 95 (SC) to support his contention that the reimbursement of the actual expenses would not be taxable in the hands of the person receiving the reimbursements. It was the further contented that a perusal of the provisions of section 195 of the Act clearly shows that TDS was liable to be made from the payments made to a non-resident in the event such payment is chargeable to tax under the provisions of the Act and the said reimbursements did not in any way represent an amount chargeable under the provisions of the Act in the hands of AT & S Austria and consequently no TDS was liable to be made. It was stated that the issue was squarely covered by the decision of the Hon'ble Coordinate Bench of this tribunal in assessee's own case for the assessment year 2004-05, wherein the Tribunal had set aside the issue to the file of the Assessing Officer as no agreement for payment of warranty was made available before the Tribunal. Ld. Counsel drew our attention to the copy of the order of the Tribunal at page 47 of assessee's paper book and stated that consequential order had been passed for the assessment year 2004-05 by the Assessing Officer wherein he has allowed the warranty costs incurred by the assessee by holding that the payments of warranty costs represent only reimbursement of actual cost and there was no need to deduct TDS before making payment to AT & S Austria. He drew our attention to page 49 of the paper book, which was the copy of the assessment order for the assessment year 2004-05 and stated the fact that while passing the consequential assessment order for the AY 2004-05, the AO had taken cognizance of the order of the CIT(A) for the AY 2005-06 being the impugned order of CIT(A) and had held that the fact relating to the AY 2005-06 was identical to that of AY 2004-05 and as such there was no need to deviate from the decision given by CIT(A) for the AY 2005-06. Hence, it was urged that consequently order of CIT(A) was liable to be upheld on this issue.

7. We have considered the rival submissions. A perusal of the decision of the Hon'ble Supreme Court in the case of Tejaji Farasram Kharawalla Limited, supra clearly shows that Hon'ble Supreme Court has categorically held that

the reimbursement of the actual expenses would not be taxable in the hands of the person receiving the reimbursements. Further Hon'bel Karnataka High Court in a recent judgment in the case of *DIT v. Sun Microsystems India P. Ltd.* (2014) 369 ITR 63 (Karn) exactly on the similar issue interpreting article 7 of the DTAA between India and Singapore, which is identically worded to article 7 of DTAA between India and Austria, and held as under:-

> *"The material on record discloses that the assessee entered into an agreement for availing of logistic service for Sun Microsystems Singapore P. Ltd. ("*Sun Singapore*" for brevity). In terms of the agreement, Sun Singapore is required to provide distribution, management and logistic services to Sun Microsystems India P. Ltd. ("Sun India" for brevity) and such services included providing spare management services provision of buffer stock, defective repair services, managing local repair centres, business planning to address service levels, etc., Sun Singapore is not having any place of business or permanent establishment in India. Entire services were rendered by Sun Singapore from outside India. Sun Singapore is not engaged in the business of providing logistic services in India. Sun India the assessee avails of services of Sun Singapore for which a service fee is paid. From the business description of the assessee, it is clear that the assessee is engaged in marketing and support system of hardware and software products. The material on record do not disclose that Sun Singapore has made available to the assessee its technical knowledge, experience or skill. Under these circumstances, the Tribunal held that, as Sun Singapore is not having any permanent establishment and that Sun Singapore has not made available the technical knowledge, experience or skill, the payments made by the assessee to Sun Singapore were not required to be taxed under the head "***Business***" and is not taxable in view of article 7 of the DTAA between India and Singapore. The Revenue is challenging the said finding on the ground that the terms of the agreement provides from making available inventory physical movement and self-control process, assistance to enable inventory transactions and management and business planning to address service level relating to the local business and customer needs. However, the assessee is not utilising the said services in order to avoid deduction tax at source.*
>
> *This court had an occasion to consider this agreement in the case of* CIT v. De Beers India Minerals P. Ltd. *Reported in[2012] 346 ITR 467 (Karn), where, after referring to various provisions of law, it was held that the question, whether along with rendering technical services, whether the technical knowledge with which the services was rendered was also made available to the assessee/customers is purely a question of fact which is to be gathered from the terms of the contract, the nature of services undertaken and what has transmitted in the end after rendering technical services. If along with technical services rendered, if the service*

> *provider also makes available the technology which they used in rendering services, then it falls within the definition of* "fees for technical services" *as contained in the DTAA. However, if technology is not made available along with technical services what is rendered is only technical services and the technical knowledge is withheld, then such a technical service would not fall within the definition of* "technical services" *in the DTAA and the same is not liable to tax.*
>
> *From the facts of this case, it is clear that Sun Singapore has not made available to the assessee the technology or the technological services which is required to provide the distribution, management and logistic services. That is a finding of fact recorded by the Tribunal on appreciation of the entire material on record. When once factually it is held the technical services has not been made available, then in view of the law declared in the aforesaid judgment, there is no liability to deduct tax at source and, therefore, the finding recorded by the appellate authority cannot be found fault with. In that view of the matter, the substantial question of law is answered in favour of the assessee and against the Revenue."*

From the above Judgement of Hon'ble Karnataka High Court it is clear that the parent company has not made available to the assessee the technology or the technological services which was required to provide the distribution, management and logistic services. In view of this judgment and perusal of the order of the AO giving effect to the order of Coordinate Bench of this Tribunal for the AY 2004-05 in ITA No. 1450/Kol/2008 dated 31.03.2010 clearly shows that the Assessing Officer after verifying the agreement with AT & S Austria has also taken into consideration the decision of CIT(A) for the AY 2005-06 and has held that the said warranty expenses are nothing but reimbursement of the actual cost and consequently there is no requirement of deduction of TDS under section 195 of the Act. We have gone through the orders of the coordinate Bench of this Tribunal in the assessee's own case in ITA Nos.1448 & 1449/Kol/2008 dated 24.07.2009 for AYs2002-03 and 2003-04 and ITA No. 1450/Kol/2008 dated 31.03.2010 for the AY 2004-05, wherein it has been held as under:-

> *"2.1. The facts of the case are that the assessee is a company which is deriving income from manufacture and sale of professional grade printed circuit boards. During the accounting year relevant to assessment year under consideration, the assessee made the payment of Rs.45,94,291/- to M/s. AT & S, Austria Technology &*

Systemtechnik, Aktiengesellschaft (hereinafter called 'AT & S, Austria"). The above payment was made by the assessee without deduction of tax at source. Before the AO, it was explained by the assessee that the amount has been paid at cost of inter-company services received. The assesese has entered into an agreement dated 13.03.2001 with M/s. AT & S, Austria. In the agreement, it is stated that M/s. AT & S, Austria has entered into different agreements with different providers of services. A part from these services rendered by the service providers relates to business operation of the assessee and are utilized by the assessee. M/s. AT & S, Austria makes the payment on behalf of the assessee to the service providers for those services which are rendered by the service providers for the business operation of the assessee. The assessee then reimburses M/s. AT & S, Austria for the payment made by it on behalf of the assessee to the service providers. The AO was of the view that the services provided are in the nature of fees for technical services u/s. 9(1)(vii) of the I.T. Act, 1961. He also rejected the assessee's contention that it is reimbursement of the expenditure to M/s. AT & S, Austria. He stated that M/s. AT & S, Austria is merely the conduit for making the payment of technical services rendered by the serviced providers. Since the asseessee did not deduct the TDS, the AO disallowed the entire payment of Rs.45,94,291/- u/s. 40(a)(i) of the Act. On appeal, the CIT(A) sustained the order of the AO on this issue. Hence, this appeal filed by the assessee.

2.2. At the time of hearing before us, the learned counsel for the assessee argued at length. His arguments were of two folds, viz.-
(i) That the payment made by the assessee to M/s. AT & S, Austria was only reimbursement. He pointed out that M/s. AT & S, Austria has entered into different agreements with different providers of service. Since part of the services were utilized by the assessee, M/s. AT & S, Austria has recovered such part from the assessee. He pointed out that the allocation of the actual expenditure incurred has been made on a rational basis, i.e. on the basis of number of PCs used by the assessee and other group concerns, the details of which were duly furnished before the lower authorities and the CIT(A) has also reproduced the same on page 6 of his order. He submitted that there is no liability of TDS for reimbursement of the expenditure. In support of this contention, he relied upon the following decisions:-
309 ITR 356 (AAR) – Cholamandalam Ms General Insurance Co. Ltd.

142 ITR 493 (Cal.) - CIT –vs.- Dunlop Rubber Co. Ltd.

(ii) That the services received by the assessee were in the nature of user of the copy right products. The licence to use copy right products does not amount to rendering of technical services within the meaning of section 9(1)(vii) of the Act. Therefore, merely

because M/s. AT & S. Austria *had permitted the assessee to use the copy right products, i.e. software of various services providers, it does not amount to rendering of any technical services by M/s. AT & S. Austria to the assessee within the meaning of section 9(1)(vii) of the Act. Thus no income has accrued in India and, accordingly, there is no liability to deduct the tax at source. In support of this contention, he has relied upon the following decisions:-*
251 ITR 53 (Mad/.)- Skycell Communications Ltd. –vs.- DCIT;

95 ITD 269 (Del-SB)- Motorola Inc. –vs.- DCIT, Non-resident Circle;

94 ITD 91 (Bang.) – Samsung Electronics Co. Ltd. –vs.- ITO (TDS).

2.3. The ld. Departmental Representative, on the other hand, relied upon the orders of the authorities below. He submitted that the assessee has utilized the services being provided by various service provider companies. The assessee made the payments for such services utilized by it. Therefore, in effect, the payment was made by the assessee to various service providing companies through M/s. AT & S. Austria. *M/s. AT & S. Austria was only a conduit through which payment was made. The services utilized by the assessee were highly technical and therefore, the same were within the meaning of technical services as provided u/s. 9(1)(vii) of the Act. He, therefore, submitted that the assessee was liable to deduct tax at source from the payments made by it. Since the assessee had failed to deduct tax at source, sec. 40(a)(i) of the Act was attracted. The same should be sustained. The ld. DR also stated that the facts of various cases relied upon by the ld. Counsel for the assessee are altogether different.*

2.4. In the rejoinder, it is stated by the ld. Counsel that the various service providers had an agreement with M/s. AT & S. Austria and not with the assessee-company. Therefore, the contention of the revenue that the payment is made by the assessee to the service providers through the conduit of M/s. AT & S. Austria is actually incorrect. As per the agreement with the various serviced provider companies, it was M/s. AT & S. Austria acquired the licence to use those services. In turn, M/s. AT & S. Austria permitted its group concern worldwide to use those services and the total payment made to service providers was recovered from the service user companies on the basis of services actually utilized by them. Thus, in the process, no income has accrued to M/s. AT & S. Austria. It has only recovered the actual expenditure incurred from all group concerns.

2.5. We have carefully considered the arguments of both the sides and perused the material placed before us. M/s. AT & S. Austria had entered into agreements with several companies for utilizing their *products. In turn, it permitted its group concerns to utilize those products and the total payments made to the service providers were allocated to the group companies who actually utilized the services, the details of which has given in page 6 of the CIT(A)'s order, read as under:-*

Sr. No.	Particulars of service	Code	Keys	Total cost incurred by HQ	Share of AT & 2001-02	Invoice/ agreement received
3.	Services provided by Microsoft Ireland Operations Ltd., see licenses for AT&S					
	A licence for Microsoft product. Charges will be based on number of PCs used per legal entity.	IN4	2	180,431	36,754	Yes
	Microsoft enterprise Lizenzen	IN5	2	0	0	No
	Microsoft Medien					
4	Services provided by SAP Osterreich GMbH, see contract with AT&S, Austria					
	A. SAP Maintenance, charges will be passed on the number of SAP users per legal entity.					
	Wartung my SAP.com	IN6	3	181,794	22,388	Yes
5.	Services provided by IBM Osterreich GmBH International Buromaschinen Gesselschaft					
	A. SAP maintenance. Charges will be passed on the number of SAP users per legal entity					
	mySAP.com Lizenzvertrag	IN7	3	20,315	2,502	No
	SAP R/3 Lizenzgebuhr	IN8	3	84,417	10,396	No
	SAP R/3 Einfuhurung	IN9	3	108,693	13,386	No
	B. Licences for					

	firewall software and hardware. Costs will be evenly spared among the total number of plants lin the AT&S group					
	Project Firewall Cisco PIX	*IN11*	*4*	*3,589*	*449*	*No*
	Wartung Firewall Cisco PIX		*4*	*0*		
7	*Not mentioned*					
	ND Charon Faxserver-Kauf	*IN11*	*2*	*7,885*	*1,606*	
	TOTAL				*87,481*	

2.6. From the above, it is evident that the allocation of expenditure for utilizing Microsoft products was on the basis of number of PCs used by the service receiver companies. Similarly, services provided by SAP, Austria were allocated on the basis of number of SAP users. In view of the above, we are of the opinion that the amount paid by M/s. AT & S. Austria *for using the products of various service provider companies was allocated amongst the group companies including the assessee on the basis of services actually utilized by them. Therefore, the nature of payment by the assessee to M/s. AT & S. Austria was in the nature of reimbursement of the expenditure actually incurred by M/s. AT & S. Austria.*

2.7. That the Hon'ble jurisdictional High Court has considered the similar issue in the case of Dunlop Rubber Co. Ltd. (supra) and held as under:-

> *"that the Tribunal was right in arriving at the view that the payment was for the recoupment of the expenses incurred for the technical data for which a research department was maintained by the assessee-company in London. The result of the research was for the benefit of all concerned including the head office and the subsidiary concerns. It was for the sharing of the expenses of the research which was utilized by the subsidiaries as well as the head office organization that the payments were made by the Indian company and received by the assessee-company. The fact that after the termination what was to happen to the information gathered was not mentioned, indicated that it could not be anything but sharing of the expenses. But the fact that the technical data was jointly obtained and the expenses were shared together indicated that*

> *it could not be treated as income. The fact that only 0.67 per cent of the turnover was allowed as research contribution to the assessee-company, was because of the restrictions imposed by the Government. Therefore, the amounts received by the assessee-company did not constitute income assessable to tax".*

The above decision of Hon'ble Jurisdictional High Court was also relied upon by the Authority for Advance Rulings in the case of Cholamandalam Ms General insurance Co. Ltd. (supra), wherein their Lordships held as under:-

> *"That the amount paid by the applicant could not be said to be in the nature of consideration for offering the services of I. The parties had entered into a mutually beneficial agreement, and incidental thereto, the applicant reimbursed a part of the salary of the employee payable by HMFICL. What the applicant paid went to reimbursement of the cost borne by HMFICL on account of employment I, that too, partly. In this process no income could be said to have been generated which answered the description of "fees for technical services".*

2.8. In view of the above decisions of Hon'ble Jurisdictional High Court as well as Authority for Advance Rulings, we hold that in the process of reimbursement of expenditure, no income can be said to have generated requiring deduction of tax at source. Since there was no liability of deduction of tax at source, section 40(a)(i) of the Act cannot be invoked. Accordingly, ground no. 2 of the assessee's appeal is allowed".

As the facts are similar for the AY 2005-06 considering the fact that for the AY 2004-05 the AO has accepted the claim of the assessee that the reimbursement of the warranty expenses is not liable for TDS u/s 195 of the Act and as the Revenue has not been able to dislodge this finding, the finding of CIT(A) deleting the disallowance made on account of non-deduction of TDS in respect of warranty expenses stands confirmed. This issue of revenue's appeal is dismissed.

8. The common issue in this appeal of assessee raised by way of above reproduced grounds 3(a) to 3(c), is against the partial confirmation of the disallowance made by the Assessing Officer in respect of the reimbursement of the reworking costs. Main contention of Ld. Counsel for the assessee in

respect of the balance amount of Rs.2,26,84,456/- the said amount was on account of reworking costs paid by the assessee to AT & S Austria, which the Assessing Officer had held, was liable for TDS under section 195 of the Act and on account of non-deduction of the TDS the provisions of section 40(a)(ia) had been invoked in respect of this payment. It was explained by Ld. Counsel that the assessee is inter alia engaged in the manufacture and sale of Printed Circuit Boards. During the previous year relevant to the assessment year under consideration, the assessee entered into an agreement with AT & S Austria whereby the assessee granted exclusive rights to AT & S Austria to market distribute and sell products in European countries. Under the aforesaid agreement, the goods manufactured by the assessee were sold to AT & S Austria which in turn sold the goods to final customers. During the course of the manufacture of the product, the assessee could not complete the full manufacturing of the goods. Certain parts of the manufacturing process which were critical for completion of manufacture and saleability of the product could not be done by the assessee. Accordingly the unfinished products were exported to AT & S Austria. Since it was essential to complete the manufacture of finished goods without which the customers would not accept the product AT & S Austria completed the manufacture of the product in Austria by using its manufacturing facilities and for the same it was mutually agreed by the assessee and AT & S Austria that the actual cost incurred by AT & S Austria in performing the aforesaid manufacturing activity to finish the production of PCBs would be reimbursed by AT & S India. It was also agreed that these costs would inter alia include direct materials cost, material overhead costs, production overhead costs, transportation costs, etc. incurred in Austria by AT & S Austria. Further, it was also agreed that the assessee would bear all the risks associated with the product defects or non-conformities that existed at the time of delivery of products by the assessee to AT & S Austria which in turn, after rework, would be sold to final customers. By virtue of the aforesaid agreement, the actual cost incurred by AT & S Austria in getting the products repaired in Europe in order to get the product sold was reimbursed from the assessee during the relevant previous year. In fact, the customers to whom the products were sold in Europe made complaint about the defects in the product sold and in order to make the product viable for sale as agreed, the customer themselves incurred cost on their own to remove the defects and got the same reimbursed from AT & S Austria and consequently got the cost reimbursed on actual basis from the assessee.

9. Ld. Counsel stated that during the relevant previous year, AT & S Austria raised debit notes on the assessee towards the said manufacturing costs incurred by it and the repairing cost reimbursed to the customers in Europe in order to get the products repaired before sale in Europe, amounting to RS. 2,26,84,459/-. The detailed break-up of the debit notes issued by AT & S Austria for reimbursement of actual cost is enclosed at pages 63 to 122 of the paper book. The said cost was debited in the books of accounts of the assessee under the head "Sub-contracting charges" during the previous year relevant to the AY under consideration. It was further explained by Ld. Counsel that while making the subject payment of Rs. 2,26,84,459/- to AT & S Austria in respect of the reimbursement of actual manufacturing and repair cost, the assessee did not deduct any tax under section 195 of the Act as payments constituted reimbursement of actual costs incurred by AT & S Austria. He stated that the AO disallowed the said payment under section 40(a)(ia) of the Act by rejecting the contention of the assessee that reimbursement of actual manufacturing/repairing cost would not constitute income in the hands of AT & S Austria. The Assessing Officer alleged that the aforesaid payment was essentially in the nature of payments for fees for technical services as defined in section 9(1)(vii) of the Act and as such, these payments were liable for deduction of tax at source.

10. Ld. Counsel stated facts that the CIT(A) confirmed the disallowance made by the AO on the grounds that payment for rework cost made to AT & S Austria were in nature of technical fees within the meaning of provisions of section 9(1)(vii) of the Act; and since the entire operations, i.e. manufacturing as well as repairing operations are carried out by the assessee

in India, the income earned from such operations by way of exports of the said products would be taxable in India and would not fall within the exception as stated in section 9(1)(vii)(b) of the Act. For the same he argued that as the assessee had only reimbursed the costs of the reworking, there was no income element in the payment to AT & S Austria and consequently the provisions of deduction of tax would not apply. As per him, the provisions of section 195 of the Act what is required is that the payment to the non-resident must be an amount chargeable under the provisions of the Act and the income, if any, of AT & S. Austria was not liable to tax in India under the Indian Income Tax Act, 1961 as AT & S Austria did not have any common establishment or any other presence in any manner whatsoever in India. He stated that though CIT(A) and AO was of the view that in view of the Explanation to section 195, the payment by the assessee to AT & S. Austria was liable for deduction of TDS as AT & S. Austria had no common establishment or residence or place of business or business connection in India nor any other presence in any manner whatsoever and the provisions of DTAA applied, the income of AT & S. Austria was liable to tax only in Austria. He explained that as per the provisions of section 9(1)(vii) of the Act, it is only the income by way of fees for technical services which is deemed to accrue or arisen in India but the work done by AT & S Austria fell within the Explanation to section 9(1)(vii) in so far as there was no managerial technical or consultancy services provided by AT & S Austria but what was being done under the re-working was mere in the nature of assembly. According to him, even as per the provisions of section 9(1)(i) and clause (a) of Explanation 1 thereto no part of the income earned by AT & S Austria was attributable to the operations carried on by the assessee in India in so far as the manufacturing operations and the repairing operations are carried out by AT & S Austria by using their manufacturing facilities located in Austria and there was no operation of the same attributable to any operation carried on in India by AT & S Austria. Hence, as per the DTAA agreement entered into between India and Austria as per Article 5 read with Article 7 as AT & S Austria did not have any permanent establishment in India, the income earned by AT & S Austria was liable to tax only in Austria and not in India. Moreover, the nature of the activities performed by AT & S Austria on the products sold by the assessee in Europe was in the following manner. The sale of the products in Europe consisted of two parts, the first part is the goods manufactured by the assessee in India and send to AT & S Austria and the second part is re-woke done by AT & S. Austria in Austria without which the customers would not accept the product. He stated that without the said re-working the products would not be saleable in Europe and re-working is done by AT & S Austria which is the Company situated outside India with manufacturing facilities situated only outside India and the ultimate sales to the final customers were also outside India. According to him, when the activities of AT & S Austria involved in the sale of products are carried out outside India from manufacturing the partly finished goods in the manufacturing facility situated outside India to sell the goods to final customers outside India, the exclusionary clause to section 9(1)(vii)(b) would come into play and as such the income earned by AT & S Austria from a source situated outside India would not be liable to tax in India under the Indian Income Tax Act, 1961. Consequently the payment by the assessee to AT & S Austria was outside the scope of section 9(1)(vii) and it could not be considered as income deemed to have accrued in India and consequently the provisions of section 195 could not be invoked in respect of the payments made to AT & S Austria. Accordingly it was urged that the disallowance made by the AO and confirmed by CIT(A) was liable to be deleted.

11. In reply, SR D.R. stated that in view of the amendment to Section 195 by the introduction of Explanation (2) thereto, any payments made by an Indian Company to a non-resident whether they have a residence or place of business or business connection or any other persons in any manner whatsoever made no difference and the assessee was liable to deduct TDS. She argued that re-working costs are in the nature of fees for technical services as the assessee itself is engaged in the business of manufacture and

sale of professional goods of Printed Circuit Boards and the repair jobs of such sophisticated goods could only be in the nature of technical services.

12. We have considered the rival submissions and gone through facts and circumstances of the case. Admittedly the assessee is dealing its business with its subsidiary company AT & S Austria. Undisputedly the assessee's transaction with the parent company AT & S Austria is also subject matter of Arm's Length Pricing under section 92C of the Act. Consequently it cannot be held that the assessee has common establishment of the parent company AT & S Austria. This is because the assessee has sold goods to AT & S Austria. A perusal of the provisions of section 195 of the Act alongwith Explanation (2) thereto as explained by the Ld. SR D.R. would give an indication that all types of payments made to a non-resident by an Indian Company would be liable for TDS under section 195of the Act. It would mean even that if an assessee in India makes any purchases from a foreign entity or a non-resident entity and the assessee in India makes the payment for such purchases even that would be hit by section 195 of the Act. This is because of the Explanation (2) to section 195 of the Act. However, this is not the true interpretation. The Explanation only explains the provision. The main provision of section 195(1) of the Act uses these specific words "any other sum chargeable under the provisions of this Act". Therefore, for the invocation of the provisions of section 195(1) of the Act, the main condition is that the payment must be of the sum chargeable under the provisions of the Indian Income Tax Act, 1961. Admittedly there is a DTAA between India and Austria. As per the Article 5 read with Article 7 of the DTAA, it is categorical in so far as if the assessee in the contracting State does not have a PE in the other State, then the income of the assessee in the contracting State is liable to tax only in that contracting State and not in the other State. Further, similarly, Hon'ble Karnataka High Court in a recent judgment in the case of *DIT v. Sun Microsystems India P. Ltd.* (2014) 369 ITR 63 (Karn) exactly on the similar issue interpreting article 7 of the DTAA between India and Singapore, which is identically worded to article 7 of DTAA between India and Austria held that the parent company has not

made available to the assessee the technology or the technological services which was required to provide the distribution, management and logistic services. Admittedly AT & S Austria does not have a PE in India. The DTAA is entered into India under section 90 of the Act. Once the DTAA is available under section 90 of the Act, then the same overrides the Indian Income Tax Act. Consequently the provisions of DTAA would override the Indian Income Tax Act. The facts in the present case clearly show that AT & S Austria is carrying out the re-working of the products of the assessee at its own manufacturing plant at Austria and there is no connection between the manufacturing activities done by AT & S Austria with the manufacturing process done by the assessee at its manufacturing facility in Nanjangud. Consequently the income, if any, generated by AT & S Austria on account of the repairing operations or manufacturing operations done by AT & S Austria at its manufacturing facility outside India cannot be held to generate any income taxable in India under the Indian Income Tax Act, 1961. Admittedly even as per the provisions of section 9(1)(vii) of the Act and the Explanation (2) thereto clearly excludes the consideration for the assembly undertaken by AT & S Austria from the rigours of section 9(1)(vii) of the Act. In these circumstances, as the income of AT & S Austria is not chargeable to tax under the Indian Income Tax Act, 1961, the requirement of deduction of tax at source under section 195 of the Act would not be applicable and consequently no disallowance under section 40(a)(ia) of the Act can be made. In the result, the addition as made by AO and as confirmed by CIT(A), to the extent of Rs.2,26,84,459/-, stands deleted. This issue of assessee's appeal is allowed.

13. The next issue in this appeal of assessee is against the order of CIT(A) confirming the action of AO in disallowing the payments made towards reimbursement of Information Technology costs being expenses on connectivity and software charges. For this the assessee raised following ground:-

> *"(2)(a) that the ld. CIT(A) erred in confirming the order of the Assessing Officer disallowing Rs.1,50,44,031/-, being payments made*

to M/s. AT & S Austria towards reimbursement of Information Technology costs being expenses on connectivity charges and software, without appreciating appellants contention.

(b) that the ld. CIT(A) erred in confirming the order of the Assessing officer disallowing the aforesaid sum of Rs.15,044,031 paid to M/s. AT & S Austria, by applying the provisions of section 40(a)(i) of the Act.

(c) That the ld. CIT(A) has not appreciated the fact that the impugned amount is not income chargeable to tax in the hands of M/s. AT & S Austria or respective vendors and consequently no tax was required to be deducted at source there from.

(d) That the CIT(A) erred in not following Jurisdictional Tribunal Order in the case of appellant for the AY 2002-03, 2003-04 and 2004-05, on the same ground."

14. Brief facts relating to the above issue are that the AO during the course of assessment proceedings noticed that the assessee has made payment of Rs.1,50,44,031/- on account of renting of technical services for information technology costs. According to him, as the assessee failed to deduct TDS u/s 194 of the Act, he disallowed this sum by invoking of the provisions of Sec. 40(a)(ia) of the Act by observing as under:-

*"The contention of the assessee has been considered and it is not acceptable since the payment will be in the nature of rendering of technical services and as such, the payment constitute fees for technical services as per Explanation 2 of clause (vii) of sub-section 9 of the Act and Article 12(4) of the DTAA between India and Austria. Hence, the said payments would be subject to withholding tax at source u/s 195 of the Act. As per section 195(1) of the Act, any person responsible for paying to a non-resident, any sum chargeable under the provisions of this Act shall deduct income tax thereon at the rates in force. It is important to note that the above mentioned section requires "***any sum***" (and not any income) chargeable to tax under the Income Tax Act, to be subjected to deduction of tax at source. The assessee's claim that the payments made were only in the nature of reimbursements and contained no element of income, and hence not subject to withholding of tax u/s 195 is found untenable in view of the decision of the Hon'ble Supreme Court in the case of* Transmission Corporation of AP Ltd. V CIT *where the Apex Court held that the sum here connotes gross sum and not merely the sum that represents income of the payee. The assessee-company, in the instant case has not made any tax deduction at source on the payments made to AT&S Austria. Hence, in view of the failure to*

> *deduct the tax at source the amount of Rs.1,50,44,031/- is disallowed u/s. 40(a)(ia) of the I.T. Act, 1961 and the same is added back to the total income of the assessee company."*

Aggrieved, assessee preferred appeal before CIT(A).

15. The CIT(A) also confirmed the action of the AO by giving the following three reasons:-

> i) "*Here the service provider highly technical/skilled services in the nature of information technology,, electronic data processing for WAN satellite link between Austria and Nanjangud and software license and up gradation to the parent company in Austria and also to the subsidiary companies including the appellant company. It is not that the parent company has received the above said services and in turn just passed on the same to the subsidiary companies. All the group concerns including the parent company and the appellant company simultaneously received the services from the service providers. It is only when the payment comes an internal arrangement among group companies has arrived at and the parent company being at the helm of the affairs controlling/supervising all the group concerns including the appellant company has taken up the responsibility to make the payments not only on its behalf but also on behalf of subsidiary companies including the appellant company.*
>
> *This is mere an arrangement and the facts remains that the appellant company received the services along with the group concerns and remitted the payments through its parent company. As said earlier this has been done for the sake of convenience and with a view to exempt itself for making TDS on such payments. By this kind of arrangement one cannot escape from the mandatory provisions of the Act. As such I am of the opinion that this is not an act of reimbursement but a deliberate arrangement to escape from the clutches of TDS provisions."*
>
> ii) *"It is clear from the above that though all such payments being 'royalty' in nature attract TDS provisions but such payments made in the curse of export business of computer software or under any approved scheme are exempt from TDS provisions as the same are not chargeable to tax in India.*
>
> *Therefore, in my opinion any payment for computer software [other than those mentioned in the Second proviso to Section 9(vi)] shall be treated as royalty.*

Further, in my opinion the right to use of / access of software and for up gradation of software is in the nature of 'Royalty' paid to a non-resident which is always taxable and more so u/s. 9(1)(vi) of the Act. …

Therefore based on the above legal provisions and the cited case laws, sin my opinion, there is no force in the submission of the appellant that the payments of rent lease towards electronic data processing for WAN satellite link between Austria and Nanjangud are not in the nature of fees for technical services and cost of software license and up gradation are not in the nature of royalty as per the meaning of the said term assigned under the provisions of section 9 of the Inc Tax Act, 1961 and the facts of the decisions as cited by the appellant are not identical to the facts of the instant case therefore, these payments are not chargeable to tax in India even in the hands of ultimate vendor/service providers namely, Austrian Telecom, Lotus Inc. Microsoft Corporation etc.,"

iii) As regards the contention of the appellant that there is no element of income embedded in the payments made by the appellant company to parent company in addition to observations given in para (i) when the whole of section 195 and Chapter XVII-B *are read, then the real picture would emerge. The provision of section 195(1) clearly shows that any person responsible for making payment to non-resident in respect of any interest or any other sum chargeable under the provisions of this Act has to deduct tax at the rates in force. Now what is the meaning of any other sum chargeable under the provisions of this Act. Obviously, it would mean that portion of the sum on which tax is payable by such non-resident. But how much, that portion is actually there? This needs investigation and there may be situations that 100 per cent of such sum is chargeable to tax and there may be situations where practically the whole of such sum is not chargeable to tax. This would depend on the facts and circumstances of each case. Now, whenever an assessee making payment to a non-resident finds that only a particular portion is chargeable, then obviously he has been given a right in terms of sub-section (2) which the assessee has called a beneficial section. As per sub-section (2), of section 195 whenever a person responsible for paying any sum chargeable considers that whole of such sum would not be income chargeable in the case of recipient, he may9 make an application to the AO to determine the appropriate portion of such sum so chargeable and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of sum which is so chargeable, which means, the person responsible for making payment, etc., cannot himself decide what is the appropriate proportion which is chargeable to tax. The expression "*by general or special order*" and the "*appropriate proportion*" in this sub[section*

> *are key words to understand the meaning in the sense that there may be situations where only one particular portion of such sum is taxable in case of similar assessees and the income-tax authorities may make a general order that in such type of assessees that a particular proportion of the sum has to be considered as income chargeable to tax and tax can be deducted accordingly. The Hon'ble Apex Court* Transmission Corporation of AP Ltd. And Another vs CIT *239 ITR 587 (SC); clearly observed that the provision of section 195(1) is for "*tentative deduction*" which means, the initial assumption should be that the tax has to be deducted on the whole of the amount because same is subject to regular assessment and it was specifically pointed out that the rights of the parties were not in any manner adversely affected, because wherever the assessee had any doubt that tax is to be deducted on the lower proportion, the such assessee had the option to make an application under section 195(2). Even the recipient of such payment can make an application to the AO that he may be allowed to receive the payment without any deduction of tax."*

Aggrieved, assessee came in appeal before Tribunal.

16. Before us Ld. Counsel for the assessee stated in respect of reimbursed to AT & S Austria that the actual cost of an amount of Rs.1,50,44,031/- was under the head "Information Technology Costs". He narrated facts that the assessee had entered into an agreement dated 13.03.2001 with AT & S Austria. AT & S Austria, in order to provide services to various group companies carrying out their business, in turn entered into different agreements with different service providers for acquiring licences of various products and payment of lease rent for connectivity charges. AT & S Austria made payments on behalf of the group companies to the service providers and thereafter claimed reimbursements of the payments made on cost to cost basis for the services rendered by Service providers, from group companies including the assessee. He stated that while making the subject payment of RS.1,50,44,031/- to AT & S Austria in respect of the reimbursement of actual cost, the assessee did not deduct any tax under section 195 of the Act, as payments for reimbursement of actual costs incurred by AT & S Austria was not chargeable to tax. He stated that the allocation of actual cost which was reimbursed by the assessee to AT & S Austria was made on the basis number

of PC's/laptop used, number of SAP user and time used in using the leased lines for connectivity charges but AO disallowed the aforesaid payment by rejecting the contention of the assessee that reimbursement of actual cost would not constitute income in the hands of AT & S Austria and further alleged that AT & S Austria was merely a conduit pipe for making the payment way of internal arrangements which could not escape tax liability under section 195 of the Act. And CIT(A) also confirmed the action of the AO. He stated that in the assessee's own case for the assessment years, 2002-03, 2003-04 and 2004-05, Coordinate Bench of this Tribunal had accepted the contention of the assessee that the reimbursement of the actual cost is not liable to tax. He drew our attention to pages 129 to 144 of the paper book, which were the copies of the orders of the Coordinate Bench of this Tribunal in the assessee's own case in ITA Nos. 1448 & 1449/Kol/2008 dated 24.07.2009 for the assessment years 2002-03 and 2003-04 and ITA No. 1450/Kol/2008 dated 31.03.2010 for the assessment year 2004-05. (These orders have already been relied upon in the appeal of revenue above in ITA NO. 1262/Kol/2010.) Hence it was urged that the disallowance as confirmed by CIT(A) be deleted.

17. In reply, SR DR vehemently supported the order of the AO and CIT(A). She stated that the agreement was a mere arrangement and the fact remains that the assessee had received services alongwith the group concerns and remitted the payments through its parent company. This had been done for the sake of convenience and with a view to exempt itself from making TDS on such payment. For this kind of arrangement one cannot escape from the mandatory provisions of the Act and CIT(A) had considered the nature of reimbursement of the payments of rent/lease towards electronic data processing for WAN Satellite link between AT & S Austria and Nanjangud and the same was not in the nature of fees for technical services and the cost of software licence upgradation are not in the nature of royalty as per the meaning of the said terms assigned under the provisions of section 9(1)(vi) of the Act. Hence, it was urged that order of CIT(A) be sustained.

18. We have considered the rival submissions and gone through facts and circumstances of the case. A perusal of the decision of the Coordinate Bench of this Tribunal referred to supra for the assessment years 2002-03 and 2003-04 clearly shows that the Tribunal has taken into consideration the agreement dated 13.03.2001 between the assessee and AT & S Austria. Further, similarly, Hon'ble Karnataka High Court in a recent judgment in the case of *DIT v. Sun Microsystems India P. Ltd.* (2014) 369 ITR 63 (Karn) exactly on the similar issue interpreting article 7 of the DTAA between India and Singapore, which is identically worded to article 7 of DTAA between India and Austria held that the parent company has not made available to the assessee the technology or the technological services which was required to provide the distribution, management and logistic services. We further noticed that in the said order the Tribunal has taken into consideration the decision of the Hon'ble Jurisdictional High Court in the case of CIT v Dunlop Rubber Co. Limited (1983) 142 ITR 493 (Cal) and in the similar circumstances that of the assessee to hold that the reimbursement of the expenditure does not generate any income in the hands of the recipient and consequently there was no requirement of deduction of TDS and consequently the provisions of section 40(a)(ia) could not be invoked. The facts being identical for this assessment year, respectfully following the decision of Coordinate Bench of this Tribunal in the assessee's own case for the assessment years 2002-03 and 2003-04 referred to supra, finding of CIT(A) stands reversed and the disallowance as made by the Assessing Officer in respect of the reimbursement of the payments made to AT & S Austria to the extent of Rs.1,50,44,031/- stands deleted. This issue of assessee's appeal is allowed.

19. The first common issue in ITA No. 2071/Kol/2010 & ITA No. 779/Kol/2012(assessee's appeals) for AY 2006-07 & 2007-08 is against the assessments framed by AO u/s. 143(3) read with section 144C(13) of the Act dated 04.10.2010 & 09.11.2011 for the AY 2006-07 and 2007-08 respectively and also the directions given by DRP u/s. 144C(5) of the Act dated

28.09.2010 & 23.09.2011 making an adjustment towards Arm's Length Price of Rs.20,14,14,448/- and Rs.22,80,03,914/-. For this, assessee has raised following 6 grounds in AY 2006-07:

> "1. *That the order of the learned Deputy Commissioner of Income Tax, Circle-11, Kolkata (Assessing Officer or Learned AO) which is in conformity with the directions of the Dispute Resolution Panel, Kolkata (DRP), to the extent prejudicial to the appellant, is bad in law and liable to be quashed.*
>
> *2. That the ld. DRP erred in not appreciating the fact that the appellant had prepared the TP documentation bona fide and in good faith in compliance with the Act and Income Tax Rules, 1962 and selected the comparable uncontrolled companies based on the detailed functional asset and risk analysis performed with due diligence, following a methodical and consistent benchmarking process in respect of various international transactions with associated enterprises.*
>
> *3. That the ld. DRP erred both in facts and law in making an adjustment to the transfer price of the appellant by Rs.201,414,448/- holding that the international transactions do not satisfy the arm's length principle envisaged under the Act and in doing so grossly erred in:*
>
> > *(3.1)Introducing additional quantitative filter of net fixed asset/sales ratio with threshold limit of similar ratio of the assessee, stating that it would lead to the exclusion of less capital intensive companies and thereby the learned DRP distorted the comparability analysis and incorrectly included only profitable entrepreneurial companies as uncontrolled comparables, while excluding comparable low margin companies from its comparability analysis.*
> >
> > *(3.2.) That the learned DRP erred in not appreciating the fact that there are significant differences in the levels of working capital employed by the comparables vis-a-vis that of the appellant and suitable adjustment for differences in working capital needs to be provided.*
> >
> > *(3.3.) That the learned DRP erred in appreciating the fact that cash operating margin earned by appellant from AT&S Group sales is higher than the cash operating margins earned from third party sales. Therefore, even from an internal comparability perspective, the profitability from the transactions with AT&S group compares favourably with sales made to third parties, establishing the transactions at arm's length.*
>
> *4. That the ld. DRP erred in disregarding the alternative economic analysis carried out by the assessee considering the overseas entity as the tested party an thereby justifying that international transactions undertaken by such overseas entity are at arm's length price. The learned DRP erred in not appreciating the fact that associated enterprise i.e. AT&S Austria functions as a distributor earning arm's length returns and AT&S* *Austria functions as a distributor earning arm's length returns and AT&S*

India is characterised as a full fledged licensed manufacturer which assumes significant business risks associated with carrying out its manufacturing activity.

5. The learned DRP erred in not appreciating the fact that the appellant had incurred operating losses in net level only for FY 2005-06 as compared to profit in previous and subsequent years. Such losses were due to various business reasons including rise in raw materials prices and also due to it being the first year of expansion. Also, the learned DRP erred in ignoring the business and commercial realities of the appellant.

6. That the learned DRP erred in concluding that the amended proviso to section 92C(2) of the Act under Finance (No.2) Act, 2009 would be applicable to assessment year 2006-07 and in not appreciating that even if the arm's length price falls outside the 5% tolerance band the adjustment would have to be reckoned after allowing the benefit of +/-5% variation as provided in proviso to section 92C(2) of the Act, while determining the arm's length price."

For AY 2007-08, on the above issue of transfer pricing adjustment, assessee has raised following ground nos. 3 to 7:

"3. *That the learned AO and the learned Panel erred in not appreciating the alternative economic analysis considering the overseas entity (AT&S Austria) as the tested party to justify that the international transactions of the appellant are at arm's length having regard to the contracting agreements between the parties.*

4. That the learned AO and the learned Panel erred in not appreciating the business model of the appellant in respect of its sales to uncontrolled and customers, wherein the international transaction is limited to the margin retained by the associated enterprise for the distribution functions performed.

5. That the learned AO and the learned Dispute Resolution Panel erred in upholding the adjustment to the arm's length price made by the learned Transfer Pricing Officer amounting to INR 21,69,02,417 in respect of the export transaction and INR 130,28,02,000 in respect of the import transactions of the appellant and in doing so erred in:

(a) Upholding operating profit/sales margin as the appropriate profit level indicator as against cash profit margin adopted by the appellant in determination of arm's length price;

(b) Disregarding the fact that the learned Panel had accepted the cash profit margin as an appropriate PLI in the proceedings for FY 2005-06 in view of the appellant being a capital intensive unit.

6.That the learned AO and the learned Panel erred in not providing appropriate economic adjustments while determining the arm's length price.

7.The learned AO and the learned Panel erred in not proving the benefit of lower range of +/-5% in determination of arm's length price."

20. As the Transfer Pricing issue in both these appeals are identical, this issue is being decided by this common order taking the facts, circumstances and issue from AY 2006-07.

21. Brief facts leading to the above issue are that the assessee filed its return of income on 23.11.2006 for the relevant AY 2006-07 a draft assessment order was passed on 24.12.2009 u/s. 143(3) read with section 144C(1) of the Act making following additions:

> *"i) Adjustment of Arm's Length Price as per TPO's order dated 30.10.2009 Rs.15,92,64,423,*
> *ii) Disallowance u/s. 14A read with Rule 8D Rs. 6810/-."*

Against this draft assessment order assessee filed objection in Form No. 35A before the Dispute Resolution Panel (DRP), Kolkata. DRP vide its order dated 28.09.2010 directed the AO u/s.144C(5) of the Act to make an adjustment towards Arm's Length Price at Rs.20,14,14,448/- as against the adjustment determined by TPO at Rs. 15,92,64,423/-. Aggrieved, assessee is in appeal before Tribunal. The Assessing Officer referred the computation of the Arm's Length Price in relation to the international transactions entered into by the assessee, which is Associated Enterprise for the relevant previous year to the Transfer Pricing Officer. The assessee had filed its transfer pricing study for the relevant previous year with the Transfer Pricing Officer. The assessee had adopted the TNMM method representing the transactional net margin method as the most reliable measure of arm's length result for the manufacturing segment. Under the TNMM method, the term specified in transactional net margin, the assessee had adopted the cash profit margin on sales as the profit level indicator for the TNMM analysis. The assessee had completed the search process in Prowess and capital line plus data-bases in adopting the filters for the search. One of the most filters of search criterion Companies with a ratio of net fixed assets to sales greater than 500% was rejected. Consequently the following comparable companies were found from the search:-

(i) Akasaka Electronics Limited;

(ii) Anand Electronics & Industries Limited;

(iii) Fine-Line Circuits Limited.

The arithmetic mean of the cash profit margin on sales of the aforementioned four comparables found as a result of the search for the comparable companies was 15%. The assessee's cash profit margin for the relevant previous year applying the method analogy as that applied in respect of comparables came to 10%. Consequently as the cost profit margin of the assessee was within the tolerance band of plus minus 5% as prescribed under the proviso to sub-section (2) of section 92C of the Act was called for. The Transfer Pricing Officer alleged that cash profit margin method did not indicate the true profit earned by the assessee as the assessee had not taken into consideration the cost incurred by the assessee in purchasing and installing plant and machinery and other fixed assets. Ld. Counsel explained that consequently the Transfer Pricing Officer rejected the assessee's contention to take the cash profit margin on sales as the appropriate profit level indicator and selected the operating profit margin as the appropriate profit level indicator for the assessee and the Transfer Pricing Officer computed the operating profit margin of the assessee at (-) 1.57308107% and the arithmetical mean of the operating profit margins of the comparable companies selected by the assessee at 7.80836917%. Consequently the Transfer Pricing Officer computed the transfer pricing adjustment at Rs.15,92,64,423/-. Against the said proposed draft assessment order, the assessee had approached the DRP, Kolkata. Before the DRP, it was stated that the methodology adopted by the Transfer Pricing Officer being the net fixed assets to sales ratio was not the correct method in so far as the ratio did not indicate as to whether the company was the capital intensive or otherwise. It was the submission that by adopting the net fixed assets to sales ratio, the comparables reduced from the four mentioned above to three in so far the Fine Line Circuits Limited got excluded from the list of comparable companies in so far as the NFA to sales in respect of the Fine Line Circuits Limited was also very low. It was the submission that the Dispute Resolution Panel vide an order dated 28.09.2010 accepted the assessee-company's claim for adoption of the cash profit margin on sales as the appropriate profit level indicator. However, the DRP directed for the exclusion of the Fine Line Circuits Limited from the list of comparable companies on the ground that the five year's average NFA to sales ratio of Fine Line Circuits Limited was significantly lower than that of the assessee as also on the ground that Fine Line Circuits Limited did not clear the text of the fixed assets ratio analysis as the ratio of assets employed to the total turnover was significantly lower as compared to that of the assessee. Consequently the DRP computed the Arithmetic Mean of the cash profit margin on sales of the remaining three comparable companies at 17.7433% based on the data for the financial year 2005-06 for the assessment year 2007-08 relevant to the financial year 2006-07. The Transfer Pricing Officer again applied the net fixed assets to sales ratio to exclude the Fine Line Circuits Limited and considered only two of the comparables being BCC Fuba India Limited and Precision Electronics Limited as comparable companies and consequently by applying the operating profit margin arrived at 13.22%.

22. In respect of the assessee's objections before the DRP, the DRP rejected the objections filed by the assessee by raising eight allegations. The said allegations are as follows:-

> *"The DRP, in the order issued under section 144C(5) of the Act, rejected the objections filed by the assessee-company on the following alleged grounds:-*
>
> ***First allegation**: The appellant company did not carry out separate arm's length price analysis for each of the international transactions but bench marked 10 international transactions as aforesaid on aggregate basis using cash profit margin on sales as the PLI.*
>
> ***Second allegation**: The DRP alleged that the appellant company had selected the comparable companies as per its own convenience, ignoring consistency and without any apparent reason for not selecting Akasaka Electronics Ltd. and Anand Electronics & Inds. Ltd., which were selected in the earlier year (previous year 2006-07) and also approved by the DRP.*
>
> ***Third Allegation**: So far as the use of multiple year data was concerned in the computation of PLI of comparable companies, the appellant company could not demonstrate as to how the proviso to*

rule 10B(4) of the Rules was to be invoked in the circumstances of the appellant company. Even otherwise also, no specific objection was filed by the appellant company before the DRP with regard to rejection of multiple year data by the TPO.

***Fourth Allegation**: The appellant company could not furnish any tenable explanation to defend its own PLI (i.e. cash profit margin on sales) and to enable the DRP to reject the TPO's contention that operating profit margin was more realistic PLI than cash profit margin on sales.*

***Fifth Allegation**: The appellant company's contention that the activities carried out by it required huge capital investment led to the conclusion that its true profit could not be determined on the strength of the cash profit and hence, pricing of the international transactions could not entirely be unconcerned with depreciation.*

***Sixth Allegation**: The DRP's decision for the previous year relevant assessment year 2006-07 in approving the PLI selected by the appellant company (i.e. cash profit margin on sales) was relevant to the context of the draft order passed by the AO for the earlier year only and therefore, the DRP's approval or disapproval was not necessarily a binding precedent. In this connection, the appellant company's plea that there was no change in the operations in the subsequent year (i.e. previous year 2006-07) had no relevant.*

***Seventh Allegation**: the appellant company had failed to demonstrate as to how in the circumstances of the appellant company cash profit margin on sales would be the most appropriate PLI of the six PLI pointed out by the appellant company itself.*

***Eighth Allegation**: The appellant company misplaced its reliance in explaining the moot point as to which of the ratios between cash profit margin on sales and operating profit margin in the circumstances of the appellant company truly indicated its profit level."*

23. Ld. Counsel argued that for the AY 2007-08, the methodology adopted by the DRP was erroneous in so far as for the AY 2006-07 the DRP itself had accepted the contention of the assessee that it is a cash profit margin on sales which was the appropriate profit level indicator under the TNMM method. Now for the AY 2007-08, it was the submission that the operating profit margin was more realistic profit level indicator than cash profit margin on sale was not correct. It was explained that for the AYs 2004-05, 2005-06 and

2008-09, transfer pricing study had been done. TNMM method had been applied and the methodology adopted was for the profit level indicator was the cash profit margin on sales and Fine Line Circuits Limited was considered as comparable for all the three years. It is only for the AYs 2006-07 and 2007-08 that a variation has been adopted so as to exclude Fine Line Circuits Limited and thereby create an upward transfer pricing adjustment resulting in the addition in the hands of the assessee. Ld. Counsel for the assessee rebutted various allegations made by the DRP, and filed written submissions and the relevant reads as under:-

Rebuttal of the First Allegation made by the DRP against the appellant company

4.3 The DRP alleged that the appellant company did not carry out separate arm's length price analysis for each of the international transactions from (1) to (10) as mentioned in Table No. (1) hereinabove, but benchmarked the aforesaid international transactions on aggregate basis using 'cash profit margin on sales' as the PLI.

4.4 Attention is invited to the rule 10A (d) of the Rules, wherein it has been provided that:

*"(d) '**transaction**' includes a number of closely linked transactions."*

*4.5 Reference is invited to the decision of the Hon'ble Pune Tribunal in the matter of Demag Cranes & Components (India) (P) Ltd. Vs. Deputy Commissioner of Income-tax reported in [2013] **30 taxmann.com 364** (Pune – Trib.). The Hon'ble Tribunal inter alia held that rule 10A (d) of the Rules explains the meaning of the expression 'transactions' for the purpose of computation of arm's length price as to include a number of closely linked transactions. On a combined reading of rule 10A(d) and 1-B of the Rules, it comes out that a number of transactions can be aggregated and construed as a single 'transaction' for the purpose of determining the arm's length price, 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 arm's length price also finds an echo in the OECD Transfer Pricing guidelines for Multinational Enterprises and Tax Administrations (hereinafter referred to as the 'OECD Guidelines'). 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 existed, 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. It may not be feasible to define the parameters in 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. As per an example noted by the Institute of Chartered Accountants of India (hereinafter referred to as 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 fro m the said common source. 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 may be chosen as the most appropriate method covering all the above transactions as the same are closely linked.*

4.6 In the instant case, the appellant company is engaged only in manufacture and sale of printed circuit boards. The international transactions from (1) to (10) as mentioned in Table No.(1) hereinabove generated from one common source, that is, the business of manufacture and sale of PCBs. We have briefly described the aforesaid international transaction hereinbelow:

- *Your Honours may please find in page no. 97 of the paper book that the raw materials/consumables/spares valued INR 9.24 Thousand were purchased by the appellant company from AT&S AG in a certain emergency situation to meet immediate requirement and to run the production smoothly.*
- *Your Honours may please find in page no 108 of the paper book that two second hand capital equipments valued INR 48.35 Thousand were purchased by the appellant company from AT&S AG for using the same in the production process.*
- *During the previous year 2006-07, a part of the finished products (PCBs) of the appellant company valued INR 1,28,98,46 Thousand was sold to associated enterprise.*
- *Your Honours may please find in page no. 108 of the paper book that in order to take advantage of economy of scale and operational convenience, AT&S AG entered into a global arrangement with various service providers in the area of information technology. The benefit of technology was shared by all the AT&S group companies including the appellant company. The total cost incurred by AT&S AG to provide the*

shared services to the group companies was distributed among the group companies based on actual usage of the information technology se54rvices. During the previous year 2006-07, the appellant company received shared information technology services from AT&S AG and made payment of INR 115.75 Thousand to the latter for satellite link charges and software used in running the business.

- *Your Honours may please find in page no.97 of the paper book that AT&S AG would charge the appellant company a preliminary warranty of 2% on the sales price relating to its sales of the appellant company's finished goods (i.e printed circuit boards) to end—customers as per the distribution agreement entered into between AT&S AG and the appellant company. During the previous year 2006-07, the appellant company received a sum of INR 113.38 Thousand as warranty claim and repair / re-working income which represented the sum released by the distributor (i.e AT&S AG) on account of no warranty claims arising out of printed circuits boards manufactured by the appellant company.*
- *Your Honours may please find in page no.97 of the paper book that the appellant company was sanctioned certain credit facilities i.e. working capital limits arrangement from Deustche and Amro Bank for which the appellant company was required to pay guarantee fee @ 1.5% per annum on the maximum amount drawn on any day in the relevant month to AT&S AG as per the guarantee fee agreement dated 01.04.2004. As per this agreement, the appellant company paid guarantee commission for a sum of INR 121.48 Thousand to AT&S AG for the previous year 2006-07.*
- *Your Honours may please find in page no98 of the paper book that as per the procurement support agreement dated 10.10.2003 AT&S HK was responsible for employing a professional team to identify suppliers, to evaluate alternative materials, to conduct risk assessment & quality audit and to co-ordinate the process, lead time and supply chain on behalf of the appellant company. To meet the expenses incurred by the team, a nominal 2% of purchase price was agreed to be paid by the appellant company to AT&SHK. As per this agreement, the appellant company paid procurement commission to AT&SHK for a sum of INR 98.52 Thousand during the previous year 2006-07.*
- *Your Honours may please find in* ***page no.99*** *of the paper book that as per the sales support agreement dated 10.10.2003. AT&SHK was responsible to identify and solicit customers on behalf of the appellant company in the overseas market (Asia except India, America and Australia) in return for a commission of 3% on sales per annum. The appellant company paid sales commission to AT&SHK for a sum of INR 61.80 Thousand for obtaining sales services under the aforesaid agreement during the previous year 2006-07.*
- *Your Honours may please find in page* ***no.108 & 109*** *of the paper book that according to the secondment agreement dated 17.9.2002, AT&S AG had undertaken to provide qualified employees to AT&S group companies including the appellant company. During the previous year 2006-07, the seconded employees worked for the appellant*

company as per the agreement. They received compensation from ATD&S AG, which was reimbursed by the appellant company to AT&S AG(INR 32.166 Thousand) without any mark-up thereto. Further, during the previous year 2006-07, the appellant company incurred travelling and personal expenses (mainly pertaining to airfare and visiting card charges) amounting to INR 16.18 Thousand for employees deputed to it under the aforesaid secondment agreement. AT&S AG reimbursed the aforesaid expenses to the appellant company without any mark—up thereto.

4.7 Your Honours may please appreciate that the aforesaid international transactions were directly linked to the business activity (i.e, production and sale of printed circuit boards) of the appellant company and generated from a common source i.e., manufacture and sale of printed circuit boards by the appellant company. Hence, the transactions were closely linked in view of the decision given by the ***Hon'ble Pune Tribunal*** *and the Guidelines issued by the ICAI. The aforesaid international transactions could therefore be treated as one composite transaction and a common transfer pricing analysis could be performed for such transactions by adopting the most appropriate method.*

4.8 Further, Your Honours may please note that the appellant company adopted the aggregate benchmarking method under the TNMM consistently for all the past assessment years and the later assessment years and the same was accepted by the TPO for all the assessment years and confirmed by the DRP for the assessment year 2006-07. In view of this, Your Honours may please appreciate that the allegation made by the DRP leads to the violation of the principle of consistency pronounced by the Hon'ble Supreme Court of India in the case of Radhasoami Satsang v Commissioner of Income Tax reported in 193 ITR 321 (SC).

4.9 In view of our above submissions, Your Honours may please appreciate that the first allegation made by the DRP has no leg to stand and hence, to be struck down.

<u>Rebuttal of the Second Allegation made by the DRP against the appellant company.</u>

4.10 The DRP alleged that the appellant company had selected the comparable companies as per its own convenience, ignoring consistency and without any apparent reason for not selecting Akasaka Electronics Ltd and Anand Electronics & Inds. Ltd which were selected in the earlier year (previous year 2005-06) and also approved by the DRP, although cash profit margin on sales was used as the appropriate PLI in the earlier year also and the same was approved by the DRP.

4.11 The DRP alleged that though the same PLI (i.e cash profit margin on sales) was selected by the appellant company in TP Report of two consecutive previous years (i.e previous years 2005-06 and 2006-07), two comparable companies viz., Akasaka Electronics Ltd and Anand Electronics & Inds. Ltd which were selected in the earlier *year (previous year 2005-06) and also approved by the DRP, were not included in the list of comparable companies by the appellant company in the following previous year (i.e. previous 2006-07). Hence, the DRP held that the appellant company selected the comparable companies as per its own convenience, ignoring consistency and without any apparent reason for not selecting Akasaka Electronics Ltd and Anand Electronics & Inds. Ltd.*

4.12 In this connection, reference is invited to page no. 108 of the OECD Guidelines (Chapter III – Comparability Analysis – July, 2010) which describes the comparability analysis as follows:

"Below is a description of a typical process that can be followed when performing a comparability analysis ... ...

Step 1: Determination of years to be covered.

Step 2: Broad-based analysis of the taxpayer's circumstances.

Step 3: Understanding the controlled transaction(s) under examination, based in particular on a functional analysis in order to choose the tested party (where needed), the most appropriate transfer pricing method to the circumstances of the case, the financial indicator that will be tested in the case of a transactional profit method), and to identify the significant comparability factors that should be taken into account.

Step 4: Review of existing internal comparables, if any

Step 5: Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.

Step 6: Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of a transactional net margin method).

Step 7: Identification of potential comparables: det4ermining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors set forth at paragraphs 1.38-1.63.

Step 8: Determination of and making comparability adjustments where appropriate.

Step 9: Interpretation and use of date collected, determination of the arm's length remuneration..."

4.13 As documented in the chapter 'Economic Analysis' of the Transfer Pricing Study Report for the assessment year 2007-08, the appellant company followed the process described hereinbelow to determine the arm's length margin under the TNMM:

Step 1: The appellant company evaluated the controlled transactions [described in (1) to (10) of Table No.(1)].

Step 2: Based on the aforesaid evaluation, the appellant company selected the most appropriate transfer pricing method ('TNMM') for benchmarking the controlled transactions.

Step 3: Depending upon the functional analysis of the parties to the controlled transactions, the appellant company selected itself as the tested party.

Step 4: After selection of the tested party, the search process was carried out by the appellant company in Prowess and CapitalinePlus applying the following filters (comparability criteria):

- *Universe: Total no. Of companies available in the databases. (Prowess: 9801 companies and 1233 segments and CapitalinePlus: 113,887 companies and 158 segments)*
- *Companies for which data were available in the foresaid databases for at least two financial years among the three financial years 2004-05, 2005-06 and 2006-07 were considered.*
- *Companies which were functionally comparable with the appellant company were selected.*
- *Companies with sales greater than zero were accepted.*
- *Companies with a ratio of total sales from manufacturing activity to total sales less than 90% were rejected.*
- *Companies with a ratio of research and development expenses to sales less than 3% were accepted.*
- *Companies with a ratio of net fixed assets to sales ratio greater than 500% were rejected.*
- *Companies with sales less than INR 1 Crore were rejected.*
- *Companies with net worth greater than zero were accepted.*
- *Companies manufacturing electronic components correlating to the activities of the appellant company were accepted. (3 companies selected such as BCC Fuba India Ltd. Fine-Line Circuits Ltd and Precision Electronics Ltd)*

Step 5: After selecting the comparable companies, the appellant company selected the appropriate PLI i.e., 'cash profit margin on sales'.

Step 6: The appellant company computed the PLIs of the afo5resaid comparable companies.

Step 7: The appellant company computed the arithmetic mean of the PLIs of the afo5resaid comparable companies which is termed as arm's length result.

Step 8: The appellant company computed its own PLI based on the financial information for the assessment year 2007-0 and compared the same with the mean PLI of the comparable companies in order to establish that the controlled transactions were at arm's length.

*4.14 In view of the above, Your Honours may please appreciate that the comparability analysis and the subsequent determination of arm's length result is a scientific and methodical process. <u>The search process carried out by the appellant company for the assessments year 2006-07 (earlier year) has no connection with the search process carried out by the appellant company for the current year (assessment year 2007-08).</u> The Prowess and CapitalinePlus databases, which are maintained and updated every year by the Centre for Monitoring India Economy (CMIE) Private Limited and Capital Markets Publishers Private Limited respectively (**independent bodies**), were used by the appellant company to get external comparables. Your Honours may please note that the PLI '**cash profit margin on sales**' was selected by the appellant company at **step 5**. The ratio had no role to play in the search process carried out by the appellant company in databases at **Step 4** by applying various comparability criteria to the companies forming the search universe. After selecting the final comparable companies, the appellant company computed the PLIs of the comparable companies at **step 6** and the arithmetic mean thereof at **step 7** in order to determine the arm's length result. Thereafter, at **step 8,** the appellant company computed its own PLI based on the financial information available for the assessment year 2007-08 and compared the same with the mean PLI of the comparable companies in order to establish that the controlled transactions were at arm's length. Hence, the fact that Akasaka Electrnics Ltd and Anand Electronics & Inds. Ltd were selected as comparables companies in the earlier year (i.e. assessment year 2006-07) and approved by the DRP had no role to play in determining the comparable companies for the assessment year 2007-08.*

4.15 In view of our above submissions, Your Honours may please appreciate that the second allegation of the DRP has no leg to stand and hence, to be struck down.

<u>Rebuttal of the Third Allegation made by the DRP against the appellant company.</u>

4.16 The DRP alleged that so far as the use of multiple year data was concerned in the computation of PLI of comparable companies, the appellant company could not demonstrate as to how the proviso to rule 10B (4) of the Rules was to be invoked in the circumstances of the appellant company. It was further alleged that even otherwise, no specific objection was filed by the appellant company before the DRP with regard to rejection of multiple year data by the TPO.

4.17 In this connection, attention may please be invited to the provision of rule 10B(4) of the Rules, which reads as under:

"(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into:

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared."

4.18 The aforesaid provision was explained by the Hon'ble Bangalore Tribunal in the matter of Philips Software Centre (P) Ltd v. ACIT reported in [20008] 26 SOT 226 (Bang.). The Hon'ble Tribunal has held that the Act and the Rules provided that while conducting the comparability analysis, the data to be used should be contemporaneous. In this regard, the requirement of law is two-fold:

- *As per rule 10B(4) of the Rules, the data to be used for analyzing the comparability of an uncontrolled transaction shall be the data relating to the financial year in which the international transaction has been entered into; and*
- *As per the rule 10D(4) of the Rules, amongst other things, the data which is used for the comparability analysis should exist latest by the specified date mentioned in section 92F (iv) of the Act.*

4.19 The Hon'ble Tribunal has further held that rule 10B(4) of the Rules casts an obligation on the taxpayer to conduct the comparability analysis using data for the relevant financial year. However, rule 10D(4) of the Rules makes it mandatory for the taxpayer to take into consideration the data that exists by the time specified by the Act under section 92F(iv) of the Act (i.e. in the March, 2007). Hence, the appellant company could not get current year data i.e. data for the financial year ended 31st March, 2007 for the companies available in the aforesaid databases at the cut-off date i.e. 15th February, 2007. Quarterly financial information, where available, was in abridged form and might be unaudited and hence, could not be used for comparability analysis. However, the appellant company, as far as possible, depending upon availability, also considered companies having their year ending anytime during the financial year 2006-07. Thus the only option available to the appellant company in the aforesaid circumstances was to invoke the proviso to rule 10B(4) of the Rules in regard to the use of financial information of companies relating to the period not being more than two years prior to the current financial year.

4.22 Your Honours may please further note that the purpose of using multiple-year data was to ensure that the outcomes for the relevant previous year were not unduly influenced by abnormal factors which are briefly described as under:

(i) the financial results of comparable companies for any one-year might be distorted by differences in economic or market conditions;

(ii) the participants in an industry might not be uniformly affected by business and product cycles and therefore, differences between dealings might reflected differences in circumstances; and

(iii) this approach of using multiple-year data was consistent with the OECD Guidelines and the Indian Transfer Pricing Regulation. The OECD Guidelines in page ***no. 129*** *(Chapter III – Comparability Analysis) has provided that:*

"3.76 In order to obtain a complete u9nderstanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price....

3.77 Multiple year data will also be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability.

3.78 Multiple year data can also improve the process of selecting third party comparables e.g. by identifying results that may indicate a significant variance from the underlying comparability characteristics of the controlled transaction being reviewed, in some cases leading to the rejection of the comparable, or to detect anomalies in third party information."

4.23 Your Honours may please note that the appellant company submitted the reasons for using multiple year data in respect of comparable companies to the DRP vide submission dated 25th July, 2011, which Your Honours may please find in Page no. 142 of the paper book.

4.24 Without prejudice to above, the appellant company submitted the current year data pertaining to financial year 2006-07 during the course of hearing before the TPO, based on which the T PO had made the transfer pricing adjustment in his order. In view of our above submissions, Your Honours my please appreciate that the aforesaid allegations made by the DRP are not relevant in the instant case and hence, to be struck down.

Rebuttal of the Fourth and Fifth Allegations made by the DRP against the appellant company.

4.25 Fourth Allegation: The DRP alleged that the appellant company could not furnish any tenable explanation to defend its own PLI (i.e cash profit margin on sales) *and to enable the DRP to reject the TPO's contention that operating profit margin was more realistic PLI than cash profit margin on sales.*

4.26 Fifth Allegation: The DRP alleged that the appellant company's contention that the activities carried out by it required huge capital investment led to the conclusion that its true profit could not be determined on the strength of the cash profit and hence, pricing of the international transactions could not entirely be unconcerned with depreciation.

*4.27 The appellant company applied the TNMM under section 92C of the Act, read with rule 10B and 10C of the Rules, in order to determine the arm's length margin in respect of the international transactions entered into between the appellant company and its associated enterprises for the relevant previous year. The appellant company selected '**cash profit margin on sales**' as the appropriate PLI for the reason that the same eliminated the impact on profitability of differences in the technology, age of assets used in production, differences in capacity utilization and the different depreciation policies adopted by different companies. The TPOO, however, did not accept the aforesaid PLI for the previous year relevant to the assessment year 2007-08. He selected '**operating profit margin**' as an appropriate PLI for the appellant company. The DP, in its order, approved the selection of PLI made by the TPO.*

*4.28 In this connection, reference is invited to the decision of the **Hon'ble Panaji Bench of the Income Tax Appellate Tribunal** in the matter of **Pentair Water India (P) Ltd. Vs. ACIT, Goa** reported in [2014] 47 taxmann.com 132 (Panaji). The Hon'ble Tribunal has inter alia held that:*

"..... We noted that different companies have adopted different method of depreciation. In fact, for charging depreciation to the Profit & Loss account there are different prevalent recognized methods of depreciation. Some Assessees opt for Straight Line method, some opt for Written Down method and some opt for Sum of Digit method or even Replacement Cost method. Selection of each method will affect the rate and quantum of depreciation even if the nature of the asset is the same and ultimately, the net profit derived by the company will vary. <u>For determining the fair and true profit, in our opinion, it is appropriate that the effect of the depreciation must be excluded out of the operating profit for determining the operating profit ratio. Therefore, the best way of computing the operating profit, in our opinion, will be to compute the profit before depreciation in respect of each of the company. This will take out the inconformity or the variation in the profit level of the comparables arising due to adoption of different method of charging depreciation ....</u>"

4.29 Reference may pleases be invited to the decision of the Hon'ble Delhi Tribunal in the matter of Schefenacker Motherson Ltd. V. Income-tax Officer reported in [2009] 123 TTJ 509 (DELHI). The Hon'ble Tribunal has inter alia held that:

"17 … … <u>There is no standard test for deciding what constitute operational income (or profit).</u> What receipts or expenditure would constitute operational income would depend upon facts and circumstances of the case and nature of business involved. Therefore, <u>Revenue's conclusion that operating profit or manufacturing cost must include "depreciation" irrespective of peculiar facts of case cannot prima facie be accepted as correct. If value of capital assets has got depleted then depleted value is to be taken into account to have commercial "true profit". Depreciation in such a case must be the actual value by which the asset has suffered depletion and not a notional amount under tax or company law or some policy or statutory provision.</u>…."

*4.30 In view of the above decisions, Your Honours may please appreciate that the best way of computing the operating profit is to compute the profit before depreciation (i.e cash profit), as the actual depletion in the value of depreciable fixed assets is never computed and presented in the audited financial statements of an Indian company. The provision for depreciation in respect of various fixed assets employed by a company is computed as per the rates prescribed by the Companies Act, 1956 and debited to the Profit & Los Account of the company. Accordingly, the cumulative depreciation figure is presented in the Balance Sheet of the company as a deduction from gross value of fixed assets employed by the company. Hence, the profit figure, net of depreciation, does not indicate the '**true profit**' of the company as explained in the aforesaid decisions. Going by the decisions given by the Hon'ble Tribunals as mentioned hereinabove, Your Honours may please appreciate that the higher the volume of investment in fixed assets and consequently, the higher the amount of provision for depreciation calculated a per the Company's Act, 1956, the higher will be the deviation from '**true profit**' which would have been computed had the actual amount of depletion of fixed assets been taken into consideration by a company in arriving at the profit net of depreciation.*

*4.31 Your Honours may please note that the appellant company filed detailed submission with the DRP in favour of selection of '**cash profit margin on sales**' as an appropriate PLI vide letter dated 20th May, 2011, which Your Honours may please find in page **no. 125** and **126** of the paper book.*

*4.32 <u>Your Honours may please further note that the appellant company had used the aforesaid PLI for assessment year 2004-05, assessment year 2005-06 and assessment year 2008-09 and the same was accepted by the Tax Authority for the aforesaid assessment years. The aforesaid PLI was also approved by the DRP for the assessment year 2006-07.</u> In view of this, Your Honours may please appreciate that the allegations made by the DRP leads to the violation of the principle of consistency pronounced by the Hon'ble Supreme Court of India in the case of **Radhasoami Satsang v Commissioner of Income Tax** reported in 193 ITR 321 (SC).*

4.33 In view of our above submissions, Your Honours may please appreciate that the DRP's allegations (fourth and fifth allegations) are not sustainable and hence to be struck down

Rebuttal of the Sixth Allegation made by the DRP against the appellant company

4.34 The DRP in the current year (assessment year 2007-08) alleged that the decision given by the DRP in the earlier year (assessment year 2006-07) in approving the PLI selected by the appellant company (i.e. cash profit margin on sales) was relevant in the context of the draft order passed by the AO for the earlier year only and therefore the DRP's approval or disapproval was not necessarily a binding precedent. In this connection, he further alleged that the appellant company's plea that there was no change in the operations in the subsequent year (assessment year 2007-08) had no relevance.

4.35 Your Honours may please note that the industry in which the appellant company operates is a technology-intensive industry. The appellant company selected the ratio of cash profit margin on sales as an appropriate PLI in order to eliminate the impact on profitability of differences in the technology adopted, age of assets used in production, differences in capacity utilisation and the different depreciation policies adopted by the comparable companies. The use of 'cash profit' as the numerator of PLI has been confirmed by the decision of the Hon'ble Panaji Tribunal in the matter of Pentair Water India (P) Ltd vs. ACIT, Goa (supra) and the decision of the Hon'ble Delhi Tribunal in the matter of Schefenacker Motherson Ltd. V. Income-tax Officer (supra). It was extremely difficult for the appellant company to have detailed information on comparable companies regarding technology used, ages of assets used in production process etc., from the annual reports and databases (Prowess and CapitalinePlus) and then to make reasonably appropriate adjustments in connection therewith too ensure comparability. Based on this principle, the aforesaid PLI was accepted by the Tax Authorities for the assessment years 2004-05, 2005-06 and 2008-09 and also by the DRP for the assessment year 2006-07. The DRP for the assessment yar 2007-08 could not appreciate the aforesaid principle and the benefits received by the appellant company from using this PLI in TNMM analysis. The DRP for the assessment year 2007-08, without application of mind, alleged that the selection of PLI would vary from year to year depending upon the facts and circumstances of the case. Your Honours may please appreciate that the aforesaid allegation of the DRP was misconceived because the determination of PLI, in the absence of any change in the functions performed / assets employed / risks assumed by the appellant company, would remain unchanged from year to year. In the instance case, there was no change in the functions performed / assets employed / risks assumed by the appellant company between the two consecutive assessment year (i.e assessment year 2006-07 *to assessment year 2007-08) and hence, the allegation made by the DRP for the assessment year 2008-09 was misplaced.*

*4.36 Further, Your Honours may please note that the appellant company selected the PLI '**cash profit margin on sales**' for the assessment year 2004-05, 2005-06 and 2008-09 and the same was accepted by the Tax Authorities for the respective assessment years. The search processes were documented in page **no. 207** of the paper book (Transfer Pricing Study Report for assessment year 2004-05), page **no. 213** of the paper book (Transfer Pricing Study Report for the assessment year 2005-06) and page **no. 219** of the paper book (Transfer Pricing Study Report for the assessment year 2008-09). In this connection, we would like to invite the attention of Your Honour to the facts that:*

- *There was no transfer pricing adjustment in the appellant company's case for each of the aforesaid assessment years (please refer to page no. **209, 215** and **221** of the paper book).*
- *Fine-Line Circuits Ltd was selected as a comparable company for each of the aforesaid assessment years by the appellant company and the same was accepted by the TPO/AO. (please refer to page **no. 205, 211** and **217** of the paper book)*

*4.37 In this connection, attention may please be invited to the judgment delivered by the Hon'ble Supreme Court of India in the matter of **Radhasoami Satsang v Commissioner of Income Tax** reported in 193 ITR 321 (SC) wherein the Hon'ble Supreme Court has inter alia held as under:*

"We are aware of the fact that, strictly speaking, res judicata does not apply to income tax proceedings. <u>Again, each assessment year being a unit, what is decided in one yaer may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year.</u> On these reasonings, in the absence of any material change justifying the Revenue to take a different view of the matter – and, of thee was no change it was in support of the assessee – we do not think the question should have been reopened and contrary to what had been decided by the Commissioner of Income-tax in the earlier proceedings, a different and contradictory stand should have been taken ... ...

"Parties are not permitted to begin fresh litigations because of new views they may entertain of the law of the case, or new versions which they present as to what should be proper apprehensions by the Court of the legal result either of the construction of the documents or the weight of certain circumstances. If this were permitted litigation would have no end, except when legal ingenuity is exhausted. It is a principle of law that this cannot be permitted, and there is abundant authority reiterating <u>that principle</u>.... "

4.38 In this connection, reference is invited to the decision of Hon'ble Mumbai Tribunal in the case of DCIT vs. Reuters India (P) Ltd reported in [2013] 33 taxmann.com 481 (Mumbai – Trib.) for assessment year 2005-06. The Department Representative argued before the Hon'ble Tribunal that the rule 19B (1)(e) of the Rules did not permit the adoption of cash profit. He accentuated on that the aforesaid rule provides for taking only the net profit in numerator with varying denominators whose selection depends upon the act and circumstances of each case. In the opposition, the Learned Counsel for the assessee argued that in the order passed by the TPO in assessee's own case for the assessment year 2007-2008, cash profit/operating cost was accepted as the PLI. Similar position was demonstrated in respect of the order passed by the TPO for assessment year 2008-2009 also. The Hon'ble Tribunal held that the TPO himself accepted the ratio of cash profit/operating cost as the correct PLI in assessee's own case for assessment years 2007-08 and 2008-2009 and in this regard, the principle of consistency could not be ignored. The Hon'ble Tribunal held that the learned CIT(A) was justified in applying cash profit/operating cost as the correct PLI under TNMM.

*4.39 In view of the above decision, Your Honours may please appreciate that <u>the DRP has violated the '**principle of consistency**' pronounced by the Hon'ble Apex Court in the matter of Radhasoami Satsang v Commissioner of Income Tax (Supra) and followed by the Hon'ble Mumbai Tribunal in the case of DCIT vs.Reuters India (P) Ltd. (supra).</u> Though there was no material change in the circumstances in which the appellant company operates, the DRP in the current year rejected the PLI (i.e '**cash profit margin on sales**') which was approved by the DRP in the earlier year and also approved by the TPO for the assessment year 2004-05, 2005-06 and 2008-09. Similarly, <u>Fine-Line Circuits Ltd was accepted as a comparable company by the TPO for the assessment year 2004-05, 2005-06 and 2008-09.</u> However, the DRP, in the current year, confirmed the action of the TPO in excluding the aforesaid company from the list of comparable companies based on the action of the DRP in the earlier year (i.e previous year 2005-06 / assessment year 2006-07).*

4.40 In view of this, Your Honours may please appreciate that the actions of the DRP inn confirming the rejection of cash profit margin on sales as an appropriate PLI and also in confirming rejection of Fine-Line Circuits Ltd as a comparable company were not sustainable as the aforesaid actions violate the principle of consistency pronounced y the Hon'ble Apex Court in the aforesaid decision. Your Honours may please further appreciate that the allegation made by the DRP in the current year s regards the non-binding effect of the DRP's decision in the earlier year in respect of selection of PLI has no leg to stand and hence, to be struck down.

4.41 Reference is further invited to the decision of the Hon'ble Calcutta High Court in the matter of Birla Corporation Ltd. V. Commissioner of Income-tax – II, *Kolkata reported in [2014] 43 taxmann.com 267 (Calcutta), which inter alia reads as under:*

"8 ... <u>He added that the department has to have some consistency in its views and it cannot below hot and cold at its sweet-will.</u>

11. After hearing the learned advocates appearing for the parties, <u>the question no.1 is answered in the negative and in favour of the assessee</u> ..."

*4.42 Reference is further invited to the decision of the Hon'ble Mumbai Tribunal in the matter of **Dr. Suryakant Nannalal Gandhi (Ind.) v. ITO** reported in [2012] 17 taxmann.com 207 (Mum.), wherein the Hon'ble Tribunal inter alia held that:*

"7. ....It cannot be open to the Assessing Officer to blow hot and cold at the same time................He ought to have at least dealt with the merits of the issue and examined if different considerations must apply here. There was thus clear incongruity in the approach of the AO and this intricacy is indeed erroneous and prejudicial to the interest of the revenue inasmuch as the very reasons for which the foreign travel expenses has been disallowed having not been taken into account for the purposes of examining the actual expenditure of such travel".

4.43. Your Honours may please note that the DRP in the current year alleged that the DRPs approval or disapproval for the aforesaid PLI in the earlier years was not necessarily a binding precedent. However, the DRP in the current year confirmed the following view of the TPO without any valid reason and further investigation that:

Further if the filter of NFA/sales is applied as done by DRP, Kolkata for AY 2006-07 the less intensive company Fine Line Circuits ltd. is automatically rejected. Hence, there is no further adjustment required for depreciation and working capital as the filter has resulted in elimination of less capital intensive comparables.

4.44. In view of the above, Your Honours may please appreciate that the DRP had not maintained consistency in view and it had been blowing hot and cold at the same time at its sweet will. On the one hand, when the question of accepting cash profit margin on sales as an appropriate PLI arose, the DRP in the current year stated that the DRP's approval or disapproval for the aforesaid PLI in the earlier year was not necessarily a binding precedent. On the other hand, when the TPO rejected Fine Line Circuits Ltd. based on the action of the DRP in the earlier year, the DRP approved the same without valid reason and further investigation. Your Honours may please further note that while conducting search process in Prowess and Capital line Plus databases, the appellant company applied the search criterion companies with a ratio of net fixed assets to sales ratio greater than 500% were rejected with a view to eliminating companies with excessive unutilised assets. Fine Line Circuits Ltd. satisfied the aforesaid comparability criterion.

The aforesaid comparability criterion was applied by the appellant company in the TP report for the assessment years 2004-05, 2005-06 and 2008-09 and the same was accepted by the Tax Authority.

4.45. In view of our above submissions, your Honours may please appreciate that the actions of the DRP in confirming the rejection cash profit margin on sales as an appropriate PLI and also in confirming the rejection of Fine Line Circuits Ltd. as a comparable company are not sustainable and the allegations made by the DRP as aforesaid have no leg to stand and hence to be struck down. We humbly pray to Your Honours to consider cash profit margin on sales as the appropriate PLI for the appellant company and Fine Line Circuits Ltd. as a comparable company.

Rebuttal of the Seventh and Eighth Allegation made by the DRP against the appellant company.

4.46. Seventh Allegation: The DRP alleged that the appellant company had failed to demonstrate as to how in the circumstances of the appellant company cash profit margin on sales would be the most appropriate PLIs out of the six PLIs pointed out by the appellant company itself.

4.47. Eighth Allegation: The appellant company misplaced its reliance in explaining the moot point as to which of the ratios between cash profit margin on sales and operating profit margin in the circumstances of the appellant company truly indicated its profit level.

4.48. Reference may please be invited to page no. 116 of the paper book, wherein Your Honours may please find that the appellant company submitted to the DRP some PLIs which could be used for determining arm's length price under the TNMM) prescribed by the Institute of Chartered Accountants of India in their 'Guidance Note on Report on International Transactions under section 92E of the Income Tax Act, 1961 (Transfer Pricing)". The ratios are as under:-

(i) Ratio of net profit before tax to sales,
(ii) Ratio of net profit before interest and tax to sales;
(iii) Ratio of cash profit to sales;
(iv) Ratio of net profit before tax to shareholders funds;
(v) Ratio of net profit before interest and tax to assets,
(vi) Berry ratio – ratio of operating cost to operating revenue.

4.49. We have described the aforesaid ratios in nutshell hereinbelow:
The ratio of net profit before tax to sales or the ratio of net profit before interest and tax to sales: Your Honour may please note that the rule 10B(1)(e) of the Rules provides for the application of net profit margin in relation to sales effected by an enterprise as a PLI. In the first ratio, the numerator represents net profit before tax, whereas in

the second ratio, the numerator represents net profit before interest and tax. The aforesaid ratios are good indicators of the total return to the business activity. As the appellant company is engaged in technology intensive industry, there is a need to take care of the factors such as differences in the technology used, age of assets used in production, differences in capacity utilisation and the different depreciation policies adopted by the companies to ensure comparability. However, it is extremely difficult for the appellant company to get detailed information on the aforesaid factors from the annual reports of the comparable companies and from the databases used by them, it is not appropriate to use the aforesaid ratios as PLI.

The ratio of cash profit to sales eliminates the impact on profitability of differences in the technology used, age of assets used in production, differences in capacity utilization and the different depreciation policies adopted by the companies. We have various judicial precedents in which the use of cash profit as numerator of PLI has been approved by the Hon'ble Tribunals of the country such as the decision given by the Hon'ble Delhi Tribunal in the case of Schefenacker Motherson Ltd. –vs.- Income tax Officer reported in [2009] 123 TTJ 509 (del.) and the decision given by the Hon'ble Panaji Tribunal in the case of Pentair Water India (P) Ltd. –vs. – ACIT, Goa reported in [2014] 47 Taxman.com 132 (panaji). As the appellant company is operating in a technology intensive industry, this is an appropriate PLI for the appellant company. Further, detailed submissions with respect to the acceptance of this ratio have been given herein above.

Your Honour may please note that the rule 10B91)(e0 of the Rules provides for the application of net profit margin in relation to assets employed or to be employed by an enterprise as a PLI. The ratio of net profit before tax to shareholders funds or the ratio of net profit before interest and tax to assets is used only when the tested party's ratio of fixed assets to total assets is quite high or if the tested party employs substantial working capital that plays significant role in generating operating capital. In the appellant company's case, the value of fixed assets (net block plus capital work in progress) as on 31st March, 2007 stood at INR 834,544 thousand, whereas the total assets (=next fixed assets+ investments + deferred tax assets + net current assets) stood at INR 1,334,660 Thousand. Hence, the ratio of the fixed assets to total assets ratio was not so high as to justify the use of the aforesaid ratios as PLI.

Berry ratio focuses on comparing the gross profitability of an activity and operating expenses necessary to carry it out. A situation where berry ratio can prove useful is for intermediary activities, where a taxpayer purchases goods from an associated enterprise and on-sells them to other associated enterprises. However, the appellant company *is engaged in manufacture and sale of printed circuit boards and as such berry ratio is not an appropriate PLI for the appellant company.*

4.50. In this connection, reference is invited to the decision of the Hon'ble Hyderabad Tribunal in the matter of BA Continuum India (P) Ltd. –vs.- ACIT reported in [2013] 40 Taxman.com 311 (Hyderabad-Trib.), wherein it has been held that :

The Tribunal in the case of Qual Core Logic Ltd. –vs.- Dy. CIT [2012] 22 taxman.com 4/52 SOT 574 (Hyd.) held as under:-

57. .....It is evident from statutory provisions that it is nowhere provided that deduction of depreciation is a must. Depreciation can be taken into account or disregarded in computing profit depending upon the context and purpose for which profit is to be computed. There is no formula which would be applicable universally and in all circumstances. Net profit used in Rule 10B can be taken to mean commercial profit......In the case in hand, revenue authorities went wrong in disregarding the context and purpose for which the net profit was to be computed. Depreciation, which can have varied basis and is allowed at different rates, is not such an expenditure which must be deducted in all situations.....Object and purpose of the transfer pricing to compare like with the like, and to eliminate differences, if any, by suitable adjustment is to be seen.....".

4.51. In view of the aforesaid decision, your Honours may please note that the net profit used in rule 10B(1)(e) of the Rules can be taken to mean commercial profit. Depreciation, which can have varied basis and is allowed at different rates, is not such an expenditure that must be deducted in all situations to arrive at the commercial profit. Your Honours may please further note that the industry in which the appellant company operated during the relevant previous year was a technology-intensive industry. The aforesaid PLI was selected by the appellant company in order to eliminate the impact on profitability of differences in the technology used, age of assets used in production, differences in capacity utilization and the different depreciation policies adopted by the comparable companies, as it was extremely difficult for the appellant company to have detailed information on comparable companies regarding technology used, ages of assets used in production process etc. from the annual reports and databases (Prowess and capital Line Plus) and then to make reasonably appropriate adjustments in connection therewith. Hence, Your Honours may please appreciate that in the instant case, the PLI selected by the appellant company, (i.e. cash profit margin on sales) indicated the true profit of the appellant company and the appellant company cannot be said to have violated rule 10B(1)(e) of the Rules in selecting cash profit as the commercial profit. Further, in view of the aforesaid decision, the objection of transfer pricing is to compare like with like and to eliminate differences, in the instant case, Your Honours may please note that depreciation was not deducted from profit while computing *the PLI of the appellant company as well as the comparable companies and hence, the object of transfer pricing to compare like with like and to eliminate differences has been fulfilled.*

4.52. Your Honour may please note that the Hon'ble DRP approved the selection of cash profit margin on sales as an appropriate PLI in the appellant company's case for the assessment year 2006-07. However, though there was no change in the circumstances, in which the appellant company operated in the subsequent year (i.e. previous year 2006-07/ assessment year 2007-08), the DRP rejected the aforesaid ratio as a PLI. Further, the aforesaid ratio was accepted as an appropriate PLI by the Tax Authority for the assessment years 2004-05, 2005-06 and 2008-09.

4.53. in view of our above submissions, Your Honours may please appreciate that the aforesaid allegations made by the DRP are not sustainable and hence to be struck down.

Computation of arm's length price

4.54. Your Honours may please find in page no. 71 and 72 of the paper book (please refer to Table No. X in the order) that the TPO in his order provided the cash profit margins of the comparable companies and that of the appellant company which were computed by the appellant company based on current year data (i.e. previous year 2006-07/ assessment year 2007-08). The aforesaid ratios are as follows:-

Table No. (2)- Computation of PLI

Name of comparable company	Cash profit margin on sales
BCC Fuba India Ltd.	18.49%
Fine Line Circuits Ltd.	11.33%
Precision Electronics Ltd.	19.45%
Arithmetic Mean	16.42%
Tested Party	13.39%

4.55. We have furnished hereinbelow the computation of arm's length operating income based on the data furnished in Table No. 2:

Table No. (3) – Computation of Arm's Length Operating Income

Particulars		Page reference of paper book
Arm's length cash profit margin on sales (A)	16,42%	71 and 72
Cash profit margin on costs : [16.42/(100-16.42)x100....(B)	19.65%	
	INR 000	
Cash expenses ☹C)	171,65,00	60

*Arm's Length Cash Profit: C*B*	*3,37,292*	
*Arm's Length Operating Income: [(C)=+ (C * B)]*	*20,53,792*	

4.56. We have furnished hereinbelow the tolerance band of +5% in view of the proviso to section 92C of the Income Tax Act, 1961 [prior to the amendment made by Finance (No. 2) Act, 2009]:

Table No. 4 – Tolerance Band : Finance Year 2006-07 (INR'000)

Particulars	*Actual*	*Page reference of paper book*	*Arm's Length*	*-5%*	*+5%*
Operating income	*19,81,839*	*60*	*20,53,792*	*19,51,102*	*21,56,482*
Less					
Cash expenses	*17,16,500*	*60*	*17,16,500*	*17,16,500*	*17,16,500*
Cash profit	*2,65,339*	*60*	*3,37,292*	*2,34,602.4*	*4,39,981.6*
Cash profit margin on sales (PLI)	*13.39%*	*60*	*16.42%*	*12.02%*	*20.40%*

4.57. In view of the above computation, Your Honours may please note that the arm's length PLI being 16.42%, the tolerance band of +5% would be in the range of 12.02% to 20.40%. the actual PLI of the appellant company is 13.39% falls within the range of 12.02% to 20.40%. Hence, Your Honours may please appreciate that the international transactions entered into by the appellant company with its associated enterprises during the relevant previous year were at arm's length".

24. In view of above submissions Ld. Counsel for the assessee argued that the NFA to sales being the methodology adopted by the Transfer Pricing Officer having been not found to be the correct method by the DRP for the assessment year 2006-07 and the assessee's method of computing the operating profit by considering the profit before depreciation being cash profit to sales method for arriving at the appropriate profit level indicator which had also been accepted by the DRP for the assessment year 2006-07 and which was also the methodology adopted for AYs 2004-05, 2005-06 and 2008-09, wherein no transfer pricing adjustment had been made. According

to him, the DRP ought not to have directed the AO to exclude Find Line Circuits Limited because the NFA to sales ratio was significantly lower than that of the assessee. He stated that the DRP having accepted the correctness of the methodology adopted by the assessee for arriving at the profit level indicator could not have used the discarded method just for the purpose of excluding one of the comparables. He admitted that each assessment year is a separate unit but when there are no change in these facts and circumstances, the methodology adopted for the earlier years and such possession having been sustained, the same could not be changed in a subsequent year and concept of consistency was to be considered and the methodology for arriving at the PLI could not be changed year after year unless there is any change in the facts for that relevant AY. He placed reliance upon the decision of the Hon'ble Supreme Court in the case of Radhasoami Satsang v CIT 193 ITR 321(SC) as also the decision of the Hon'ble Jurisdictional High Court in the case of Birla Corporation Limited (2014) 43 Taxman.com 267 (Cal). Hence, he urged that the addition made under transfer pricing adjustment was liable to be deleted.

25. In reply, SR DR vehemently supported the order of the Dispute Resolution Panel and the Assessing Officer.

26. We have considered the rival submissions and gone through facts and circumstances of the case. At the outset, perusal of the DRP's directions for the AY 2006-07, the DRP has directed for exclusion of Fine Line Circuits Limited on the basis of the NFA to sales. The DRP admittedly has not specified as to which is the appropriate profit level indicator? Whether it is a cash profit margin or whether it is operating profit margin. However, the DRP repeatedly talks of applying the cash profit margin. If cash profit margin is to be considered as the most appropriate profit level indicator, then obviously the NFA to sales ratio cannot be applied as that would be a filter which is more appropriate when adopting the operating profit to sales method for arriving at the PLI. Admittedly, perusal of Transfer Pricing Study and orders for AYs 2004-05, 2005-06 and 2008-09 show that the cash profit margin to

sales is the method adopted for arriving at the appropriate PLI for the said AYs. In these circumstances, admittedly the principles of consistency would have to be followed and the methodology followed for the earlier years cannot be tinkered with or modified just for the purpose of assessment years in between with no variation in the facts and circumstances are available for the two AYs. In these circumstances, we direct that in the assessee's case most appropriate PLI is to be arrived at by applying the cash profit margin to sales ratio. This admittedly is also in line with the requirements of TNMM method prescribed under section 92CA(2) of the Act read with Rule 10B and 10C of the Income Tax Rules, 1962. Once it is held that appropriate PLI is to be arrived at by applying the ratio profit margin to sales ratio, then obviously the filter representing the NFA to sales ratio for filtering the comparables cannot be applied. This is because NFA to sales has nothing to do with the cash profit margins generated by an assessee. Further for applying the filter of NFA to sales ratio of the comparables, an average of five years has been considered representing two years prior and two years subsequent. This again would derail the exact purpose and the applicability of the TNMM method in so far as the AY under dispute is the AYs 2006-07 and 2007-08. However, when the NFA to sales ratio for the five years average is considered, it takes into consideration the AYs 2004-05, 2005-06 and 2007-08 for which years in the Transfer Pricing Study the said computation itself had not been adopted and Fine Line Circuits Limited was considered and accepted as comparables by the Transfer Pricing Officer and the assessee. Here it is noticed that the NFA to sales filter has been applied exclusively for the purpose of exclusion of one of the comparables out of the four, which have been consistently adopted as a comparable for earlier and subsequent AYs. In these circumstances, we are of the view that the NFA to sales filter cannot be applied and result of Fine Line Circuits Limited is liable to be considered when computing the profit level indicator in the Transfer Pricing Study. Once Fine Line Circuits Limited is also considered and the same methodology as adopted for the earlier years being the cash profit margin to sales ratio is applied for arriving at the appropriate profit level indicator, then admittedly no addition remains in the hands of the assessee on account of the Transfer Pricing. In these circumstances, the AO is directed to delete the addition made on account of arm's length price for the AY 2006-07. As the facts are identical for the AY 2007-08 on similar grounds, the addition made by the Assessing Officer for the AY 2007-08 also stands deleted. Hence, this common issue in both AYs of assessee's appeal is allowed.

27. The next issue in this appeal of the assessee (in ITA No. 2071/Kol/2010 for AY 2006-07) is against the order of DRO & AO in disallowing the expenses of Rs.6,810/- by holding that the same are incurred for earning exempted income and thereby invoking the provisions of section 14A of the Act read with Rule 8D of the Rules. For this, assessee has raised following ground no. 7 to 12:

> "7.*That the learned Assessing Officer has erred in disallowing the business expenditure of Rs.6,810/- by invoking the provisions of section 14A of the Act read with Rule 8D of the Rules.*
>
> *8.That the learned AO has erred in stating that for earning income, expenses have to be incurred and income earning cannot be automatic.*
>
> *9.That the learned AO has erred in invoking provisions of section 14A(2) r.w. Rule 8D for the assessment year 2006-07 while the provisions are applicable only from assessment year 2007-08 and onwards.*
>
> *10.That learned AO has erred in disregarding the assessee's contention that dividend income was exempt under section 10(34) of the Act and that was earned through investment in equity shares made during the earlier years and no fresh investment was made and no expenditure was incurred in realising the dividend.*
>
> *11.That without prejudice to the above, the learned AO has erred in considering that the assessee earned dividend income of Rs.25,203/-, whereas factually, the assessee had earned Rs.24,570/- on this account.*
>
> *12.That without prejudice to the above, the AO has erred in considering the average value of investment of Rs.13,62,000/- under rule 8D(2)(iii) of the Rules, instead of Rs.3,84,000/- only."*

28. The facts are that the assessee has earned dividend income at Rs.24,570/- and not the sum of Rs.25,203/- as noted by the AO. None of the authorities i.e. the AO or the DRP has gone into the issue and summarily made disallowance by invoking the provisions of Rule 8D. This issue is covered by the decision of Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. vs. DCIT [2010] 328 ITR 81 (Bom.), wherein it is held that Rule 8D of the Rules as inserted by the I. T (Fifth Amendment) Rules, 2008 w.e.f. 24.3.2008 is prospective and not retrospective. Hence, this provision will not apply to relevant AY 2006-07, which is under dispute. The Tribunal is taking a consistent view that prior to AY 2008-09, when Rule 8D will apply, the disallowance be restricted at 1% of the exempted income u/s. 14A of the Act. We direct the AO accordingly. This issue of assessee's appeal is partly allowed.

29. The next issue in this appeal of assessee (in ITA No. 2071/Kol/2010 for AY 2006-07) is against the order of AO not allowing credit for TDS amounting to Rs.1,58,430/-. For this assessee has raised following ground no. 14"

> "*That the learned AO erred in not giving credit for taxes deducted at source amounting to Rs.158,430/- while determining the tax payable.*"

30. We direct the AO to give credit for TDS while giving appeal effect to this order after allowing reasonable opportunity of being heard to the assessee and in case assessee produces TDS certificates or in case it has already filed the same may be taken into consideration.

31. The next issue in this appeal of assessee (in ITA No. 2071/Kol/2010 for AY 2006-07) is against the order of AO charging interest u/s. 234B and 234D of the Act. For this, assessee has raised following ground no. 15:

> "*That the learned AO erred in levying interest of Rs.24,927,980/- under section 234B of the Act, and Rs.563,550/- under section 234D of the Act.*"

32. We are of the view that charging of interest u/s. 234B and 234D of the Act is procedural and consequential. Hence, the AO will recompute the interest under both the sections while giving appeal effect to this order as per law.

33. The next issue in this appeal of assessee (in ITA No. 2071/Kol/2010 for AY 2006-07) is against the order of AO not considering the issuance of refund order u/s. 143(1) of the Act. For this, assessee has raised following ground no. 16.

> *"The learned Assessing Officer erred in considering the effect of the refund order issued under section 143(1) of the Act, when in fact the same has never been issued to the assessee."*

34. We are of the view that the assessee can take up the issue with the AO and take appropriate step as per law.

35. The next issue in this appeal of assessee (in ITA No.779/K/2012) for AY 2007-08 is as regards to the order of AO & DRP disallowing the payments made to AT&S towards reimbursement of technology costs being expenses on connectivity and software charges. For this, assessee has raised following ground no. 8:

> *"(8)(a) That the learned AO and the learned Panel erred in disallowing Rs.1,15,74,726/- being payments made to AT&S Austria towards reimbursement of Information Technology costs being expenses on connectivity charges and software, without appreciating appellant's contention.*
> *(b) That the learned AO and the learned Panel erred in confirming the order of the AO disallowing the aforesaid sum of Rs.1,15,74,726/- paid to AT&S Austria, by applying the provisions of section 40(a)(i) of the Act.*
> *(c) That the learned AO and the learned Panel has not appreciated the fact that the impugned amount does not constitute income chargeable to tax in the hands of AT&S Austria or respective vendors and consequently no tax was required to be deducted at source therefrom.*
> *(d) That the learned AO and the learned Panel erred in not following the Jurisdictional Tribunal order in the appellant's own case for the AY 2002-03, 2003-04 and 2004-05."*

36. At the outset, it is to be mentioned that this issue has already been dealt with in assessee's appeal in ITA No. 186/K/2011 for AY 2005-06, in this very order at paras 13 to 18. The facts and circumstances are exactly identical in this relevant AY 2007-08 what was in AY 2005-06. Hence, taking

a consistent view, we direct the AO to delete this disallowance. This issue of assessee's appeal is allowed.

37. In the result, revenue's appeal in ITA No. 1262/K/2010 is dismissed. Assessee's appeal in ITA No. 186/K/2011 is allowed. Assessee's Appeal in ITA No. 2071/K/2010 is partly allowed. Assessee's appeal in ITA No. 779/K/2012 is allowed.

Order pronounced in the open Court on 29th January, 2015.

Sd/-	**Sd/-**
Shamim Yahya	**Mahavir Singh**
(Accountant Member)	(Judicial Member)

Kolkata, the 29th day of January, 2015

Copies to : *(1)* ***Deputy /Additional Commissioner of Income Tax,***
Circle/Range-11, Kolkata,
P-7, Chowringhee Square,
Kolkata-700 069

(2) ***M/s. A T & S India Pvt. Limited,***
12A, Industrial Area,
Nanjangud,
Mysore,
Karnataka-571 301

(3) Commissioner of Income-tax (Appeals)
(4) Commissioner of Income Tax
(5) The Departmental Representative
(6) Guard File

By order

Assistant Registrar
Income Tax Appellate Tribunal
Kolkata Benches, Kolkata

Laha/Sr. P.S.