

IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH 'I-1' NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT  
AND  
MS SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No. 5921/Del/2010  
Assessment Year: 2006-07

M/s Mitchell Drilling India  
Private Limited, C/o Nangia & Vs.  
Co. Suite-4A, Plaza M-6,  
Jasola, New Delhi

DCIT Circle-6(1),  
4<sup>th</sup> Floor, C.R.  
Building  
New Delhi

**PAN : AABCE2192H**

**(Appellant)**

**(Respondent)**

Appellant by

Sh. Piyush Kaushik, Advocate &  
Sh. Amit Arora, CA

Respondent by

Sh. Sanjay I Bara, CIT DR

Date of hearing

09-04-2018

Date of Pronouncement

11-04-2018

ORDER

PER R.S.SYAL, V.P.:

This appeal by the assessee is directed against the final assessment order passed by the Assessing Officer (AO) under Section 143(3) read with Section 144(C) of the Income-tax Act, 1961, (hereinafter also called 'the Act') on 26.10.2010 in relation to the Assessment Year 2006-07.

2. Briefly, stated the facts of the case are that the assessee is a joint venture between M/s Mitchell Drilling International Pty Limited and Rajbhara Consultants Pvt. Ltd. in such a way that Mitchell holds 61% of its share capital with Rajbhara holding the remaining 39%. The assessee is engaged in the development of burgeoning CBM industry, directional drilling and innovative turnkey management projects within the Oil & Gas industry. A return declaring total income of Rs.26,42,940/- was filed. The assessee reported five international transactions in Form No. 3CEB. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the arm's length price (ALP) of the international transactions.

3. The TPO observed that the first four international transactions, namely, 'Purchase of components and accessories'; 'Payment of interest under purchase agreement'; 'Payment of installments of principal under hire purchase agreement'; and 'Repossession of Rig' revolved around the assessee purchasing a drilling Rig from Mitchell Drilling Operations Pty. Ltd. on hire purchase under an agreement executed on 1.4.2004 for consideration of Rs. 4,88,79,856/- with interest at the rate of 10%. The TPO found that the Rig was in possession of the assessee company from 1.4.2004 till 30<sup>th</sup> June, 2005 and thereafter the same was repossessed by the seller.

The assessee was called upon to furnish a copy of invoice for purchase of Rig by the associated enterprise so that it could be seen as to whether any mark-up was charged on the transaction so entered into. In the absence of the assessee furnishing such evidence, the TPO did not get convinced with the assessee's determination of the ALP. It was noticed that the Repossession of the Rig at Rs. 3.02 crore, claimed at the ALP, was again unsubstantiated. Purchase of components and accessories at Rs. 43,015/- was also not accepted. Payment of interest made by the assessee under the hire purchase agreement at Rs.8,22,096/-, was also not found to be at the ALP. He still further did not accept the ALP of the international transaction of 'Repossession of Rig' with transacted value of Rs. 3,02,70,291/- and computed the same at Nil. In essence, the TPO determined the amount of Transfer Pricing Adjustment at Rs. 3,58,67,002/- as under :-

<i>International transaction</i>	<i>Transaction value</i>	<i>Arm's Length Price</i>
<i>Purchase of components and accessories</i>	<i>43,015/-</i>	<i>Nil</i>
<i>Payment of interest under purchase agreement</i>	<i>8,22,096/-</i>	<i>Nil</i>
<i>Payment of installments of principal under the purchase agreement</i>	<i>47,31,600/-</i>	<i>Nil</i>
<i>Repossession of Rig</i>	<i>3,02,70,291/-</i>	<i>Nil</i>

4. The Assessing Officer in the final Assessment Order found that the Rig was utilized for a limited period of one year and three months as against term of hire purchase agreement consisting of a few years. He opined that the impugned hire purchase agreement dated 1.4.2004 gave ample indication about the actual intention of the assessee and the owner company different from that actually shown through the documents. It was found that that there was no clause of penal payment or any compensation in case of default in payment of hire purchase charges. No hire purchase agreement, in his opinion, would contain such clauses without penal charges, more specifically, when the Rig was to be brought from Australia. He held that absence of such clauses clearly proved the initial intention of the parties was to have the Rig back without any pecuniary liability on the company. In the above factual backdrop, he held that the hire purchase agreement was a sham transaction purposefully designed to avoid not charging/withholding any tax on rental of Rig and also by claiming depreciation on Rig, which was actually not owned by it. Further, non-deduction of tax at source from payments to non-resident, in view of the AO, made the assessee liable for disallowance under Section 40(a)(i) of the Act. In the final analysis, he recomputed total income of the assessee by adding Depreciation on Rig

claimed at Rs. 17,78,123/-; Payment made to overseas entity disallowed u/s 40(a)(i) at Rs.822096/-; and Transfer pricing adjustment of Rs. 3,58,67,002/- as proposed by the TPO. The assessee is aggrieved against the additions made by the AO in the final assessment order impugned in the instant appeal.

5. We have heard both the sides and perused the material on record. It is manifest that the TPO determined Nil ALP of the international transactions as tabulated above without holding the hire purchase transaction as not genuine. It is the AO who held such hire purchase of Rig as a sham transaction and thereafter made transfer pricing additions as proposed by the TPO in addition to the disallowances of depreciation and invoking the provisions of section 40(a)(i) of the Act. Given the fact that the AO treated this transaction as non-genuine in his final assessment order, let us first examine the genuineness or otherwise of the international transaction of hire purchase. When we ventured to examine this aspect from varied perspectives, the learned AR did not press the ground challenging the hire purchase transaction treated as bogus. As such, we proceed to treat the hire purchase transaction as not genuine with necessary consequences arising there-from.

6. The first amount is disallowance of depreciation of Rig to the tune of Rs. 17,78,123/-. On our approval of the decision of the AO that the transaction of hire purchase of Rig was not genuine, as a corollary, no depreciation on Rig could have been allowed in the computation of total income. We approve the disallowance of depreciation on Rig, in principle. However, it is found that the AO has disallowed the amount of depreciation of Rig at Rs.17,78,123/- on the basis of a Schedule of depreciation as per Income-tax Act, whose copy is placed at page 114 of the paper book. First item under the head 'Plant and machinery' in such Schedule of Fixed Assets is Block 'A' with rate of depreciation at 15%. Opening balance of this block has been shown at Rs. 4,01,76,266/-. Then there are 'Additions' for more than and less than 180 days, with amounts of Rs. 5.16 lac and 28.62 lac. Next is 'Deletion' with a sum of Rs.3,02,70,053/-. Next column is 'Total' with a figure of Rs. 1,04,22,857/-, which has been computed by adding Additions to the Opening balance and then subtracting the amount of Deletion. Next column is 'Depreciation during the year' at Rs. 17,78,123/- on Block 'A'. It is this amount which has been disallowed by the AO, which is subject matter of the instant consideration.

7. The Rig was claimed to have been purchased by the assessee in the preceding year on 1.4.2004 and included in this block 'A'. It is vivid from the 'Deletion' column of Schedule of Fixed Assets, with amount of Rs. 3.02 crore, representing Rig transferred back to the AE during the year, that the assessee purchased further fresh assets amounting to Rs. 33.81 lac. The genuineness of the purchase of other assets made during the year or in the preceding year under this Block, except the Rig in question, has not been disputed by the AO. Under such circumstances, entitlement of the assessee to depreciation on all assets falling within this block, other than the 'Rig', cannot be marred. The AO's action has resulted into disallowing depreciation on all the assets under this block, which ought not to have been done. The impugned order is set aside to this extent and the matter is restored to the file of the Assessing Officer for allowing depreciation on other assets of block 'A' under the head 'Plant and machinery', except the Rig in question.

8. Before espousing the transfer pricing additions made in the impugned order, we deem it appropriate to note that it is elementary that the ALP is determined of an 'international transaction', which has been defined in section 92B of the Act. The term 'transaction', for the purposes of the

Chapter-X containing transfer pricing provisions, has been defined in clause (v) of section 92F to include an arrangement, understanding or action in concert. It shows that the ALP is always determined of an international transaction, which is genuine, but may be formal or in writing and whether or not intended to be enforceable by legal proceeding. If a transaction itself is not genuine, there can be no question of applying the transfer pricing provisions to it. In such an eventuality of a supposed genuine transaction turning out to be non-genuine, all the consequences which would have flowed for a real transaction, are reversed. In other words, certain deductions which would have been otherwise allowed in case of a genuine international transaction, are denied. Nitty-gritty of the matter is that only a declared and accepted genuine international transaction can be subjected to the transfer pricing regulations. If an international transaction is proved to be not genuine, the transfer pricing provisions are not triggered.

9. We have approved the view of the AO that the hire purchase was not a genuine transaction. Since transfer pricing additions have been made in the impugned order, which have been assailed in the instant appeal, we will have to deal with them one by one.

10. It is overt from the Table extracted *supra* that the amount of Transfer Pricing Adjustment of Rs.3.85 crore comprises of four items. First is a sum of Rs. 43,015/-, being, Nil ALP of the international transaction of 'Purchase of components and accessories'. The learned AR did not press this addition. The same is, therefore, upheld.

11. Second is a sum of Rs.8,22,096/-, which is on account of the international transaction of 'Payment of interest under hire purchase agreement'. Once we have treated hire purchase agreement as not genuine, it is but natural that the payment of interest made under such hire purchase agreement, cannot be allowed as deduction. However, it is noticed that apart from making addition of Rs. 3.58 crore on account of Transfer Pricing Adjustments in four international transactions, including, Payment of interest under hire purchase agreement at Rs. 8,22,096/-, the AO also separately disallowed the same amount by applying the provisions of Section 40(a)(i) of the Act. It deciphers that there has there resulted double disallowance of the same amount. We, therefore, order to delete Rs.8,22,096/- from the amount added twice by the AO, once separately and then through the total of transfer pricing additions, so that a single addition of Rs.8,22,096/- is sustained.

12. Third is 'Payment of installments of principal under hire purchase agreement' amounting to Rs. 47,31,600/-. The TPO determined Nil ALP of this international transaction and the AO accordingly made the addition. The learned AR submitted that no deduction of Rs. 47.31 lac was claimed in the computation of total income and hence no addition could have been made by taking Nil ALP of this transaction.

13. It is simple and plain that for a genuine international transaction of some Payment made, an assessee can either claim it as an expenditure or capitalize it in the Balance sheet or it can be some payment or repayment affecting some balance sheet item but not resulting into creation of an asset eligible for depreciation. In case the international transaction of Payment results into incurring of an expenditure, the Department's case can be that either its ALP is less than the amount of expenditure declared or Nil, so that the excess amount of expenditure over its ALP could be disallowed. In case the international transaction of Payment results into creation of an asset eligible for depreciation, the Department's case can be that either its ALP is less than the amount of expenditure declared or Nil, so that the amount of depreciation on the excess amount of the asset, being the difference between the transacted value of asset over its ALP, could be disallowed. In the third

scenario of Payment by the assessee, which is neither towards some expenditure debited to the profit and loss account nor results into creation of an asset eligible for depreciation, there can arise two situations, viz., one in which the assessee may have advanced loan to its AE on which the transfer pricing adjustment on account of interest income can be made; and the second in which the nature of transaction is such that there can be no possibility of earning any sort of income. Such later category of Payment does not attract the transfer pricing provisions, because these are not likely to affect the profit of the assessee in any manner, either directly or indirectly.

14. Adverting to the international transaction of 'Payment of installments of principal under hire purchase agreement' amounting to Rs. 47,31,600/-, the claim of this assessee is that it falls under the last category, being, the transaction of such a nature which is not likely to affect the profit of the assessee in any manner, either directly or indirectly. As there is no discussion on this aspect of the matter in the orders of the authorities below, we set aside the impugned order on this score and remit the matter to the file of the AO/TPO for examining the assessee's assertion in this regard of not having claimed any deduction of Rs.47,31,600/- in the computation of total income. If on such verification, it turns out that the assessee did claim

deduction, then the amount in question should be disallowed and in the otherwise scenario, the addition should be deleted.

15. The last component of the Transfer Pricing Adjustment is Rs.3,02,70,291/-, being, the international transaction of 'Repossession of Rig', whose ALP has been determined at Nil. The assessee declared it as an international transaction of Receipt of the amount. While discussing *supra* the issue of depreciation, we found that the assessee showed a sum of Rs.3,02,70,053/- under the head 'Deletion' in the Schedule of Fixed Assets in respect of Block 'A' under the head 'Plant and machinery'. It is this amount at which the Rig was repossessed by its AE. The assessee in computation of the amount of depreciation allowance at Rs. 17.78 lac reduced Rs. 3.02 crore from the 'Value of assets' eligible for depreciation.

16. It is fundamental that for a genuine international transaction of some Receipt, an assessee can offer such amount either as income chargeable to tax or incurring of liability, going to the balance sheet. In case the international transaction of Receipt results into earning of an income, the Department's case can be that its ALP is more than the transacted value, so that the amount of income declared below the ALP, could be added.

17. Coming back to the factual matrix, we find that the Department has computed Nil ALP of this transaction, which represents the amount covered under the 'Deletion' column in the Schedule of Fixed Assets, shown by the assessee at Rs.3.02 crore towards Repossession of Rig. Now let us see the sequitur of this action. If the amount of Rs.3.02 crore is substituted with Nil, the value of the assets under this block eligible for depreciation will go up to the extent of Rs.3.02 crore and a fortiori, the amount of depreciation allowance, will also correspondingly go up resulting in to reduction in the total income. We have noted above that in case of an international transaction of Receipt by the assessee, the Department can be interested in computing its ALP at a level higher than that declared, so that income could be increased. It cannot be a converse situation, as has happened instantly, in which the Revenue is seeking to determine the ALP of an international transaction of 'Receipt' at Nil, which would have the effect of putting the assessee in a more advantageous position *vis-à-vis* the non-application of the transfer pricing provisions.

18. In case the ALP of an international transaction of 'Receipt' turns out to be less than the amount of transacted value, the ALP determination is liable to be ignored and not given effect to. Sub-section (3) of section 92 of

the Act provides in this regard that : 'The provisions of this section *shall not apply* in a case where the computation of income under sub-section (1) or sub-section (2A) or the determination of the allowance for any expense or interest under that sub-section, or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.' As the determination of the ALP of the international transaction of 'Repossession of Rig' at Nil has the effect of increasing the claim of depreciation and accordingly reducing the income, rather than increasing the same, the transfer pricing provisions need not be given effect to as per the mandate of sub-section (3) of section 92. In any case, we cannot countenance the addition of Rs.3,02,70,291/-, as has been made by the authorities on determining Nil ALP of the international transaction of 'Repossession of Rig' by the AE. We, therefore, order to delete such an addition.

19. Having dealt with the four transfer pricing additions, we again come back to the view of the AO of a sham transaction of hire purchase of Rig, which has been approved above by us. The net effect of such an approval is that neither an income can arise nor any deduction can be allowed on account of such a transaction. On going through Schedule 9 attached to the assessee's Profit and loss account, it is seen that a deduction of Rs.13,86,684/- has been claimed under the head 'Loss on Rig Repo'. On a specific query, the learned AR accepted that this Loss is a part of the whole transaction of hire purchase and repossession of Rig, which we have held to be not genuine. He was fair enough to accept that no deduction should be allowed in respect of such Loss amounting to Rs. 13.86 lac. The AO is directed not to allow the deduction on account of such 'Loss of Rig Repo' in the computation of total income.

20. In the result, the appeal is partly allowed.

(Order pronounced in the open court on 11.04.2018.)

Sd/-

**(SUCHITRA KAMBLE)**  
**JUDICIAL MEMBER**

Sd/-

**(R.S. SYAL)**  
**VICE PRESIDENT**

Dt. 11.04.2018

*SH*

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

**ASSISTANT REGISTRAR,  
ITAT NEW DELHI**