

IN THE INCOME TAX APPELLATE TRIBUNAL "K" BENCH, MUMBAI

**BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND
SHRI D. KARUNAKARA RAO, ACCOUNTANT MEMBER**

ITA No. 4761/Mum/2013
Assessment year: - 2008-09

Manugraph India Ltd. Sidhwa House, N.A. Sawant Marg, Colaba, Mumbai – 400005.	Vs. `	The Deputy Commissioner of Income Tax -3(2), Aaykar Bhavan, Mharishi Karve Road, Mumbai - 400 020.
PAN:- AACCM7264H		
Appellant		Respondent

Revenue By	Shri R.R. Vora
Assessee By	Shri. S. D. Srivastava

Date of hearing	11.02.2015
Date of pronouncement	25.03.2015

ORDER

Per Vijay Pal Rao, JM

This appeal by the assessee is directed against the order dated 8.4.2013 of CIT(A) for the A.Y. 2008-09. The assessee has raised following grounds:-

PART 1- CORPORATE TAX GROUNDS:

Disallowance under section 14A of the Act of Rs 31,68,315/-

Revised Ground

1. in disallowing an amount of Rs.31 ,68,315/- under section 14A of the Act read with Rule 80 of the Income-tax Rule, 1962 in respect of dividend income, disregarding the suo-moto disallowance of Rs.63,917 offered by the Appellant and without recording satisfaction under section 14A of the Act;

PART II - TRANSFER PRICING GROUNDS:

Addition of Rs.67,56,491 on account of adjustment in respect of interest on loan given to Manugraph DGM (hereinafter referred as 'AE'):

Revised Ground

3. in making adjustment of Rs 67,56,491 on account of interest on loan given to AE by considering arm's length return on investment @ 17.26% p.a instead of Libor plus 2% (5% p.a) which the Appellant has charged to its AE;

4. Without prejudice to above, in not providing the benefit of the variation of 5 percent from the arithmetic mean as provided in the proviso to Section 92C(2) of the Act, while making the adjustment to the value of international transactions of the Appellant;

Addition of Rs.3,27,68,010 on account of adjustment in respect of cost of guarantees given to the bankers for wholly owned subsidiary Manugraph DGM:

Revised Grounds

5. in making adjustment of Rs 3,27,68,010 on account of guarantee executed by the Appellant in favour of overseas bankers in respect of loan taken by its AE from the bankers without appreciating the commercial and economic interest of the Appellant in the AE as well as disregarding the fact that the it was not providing any benefit to AE;

6. in making adjustment in respect of bank guarantee given by the Appellant applying arbitrary and adhoc method;

2. The assessee has also raised following additional grounds along with application dated 22.07.2014:-

ADDITIONAL GROUNDS OF APPEAL

Disallowance under section 14A of the Act of Rs 31,68,315/-

2. Without prejudice to above, while computing disallowance under section 14A of the Act by applying Rule 8D(2)(iii) of the Income tax Rules, 1962, in considering the investments made in mutual funds with growth scheme, income from which is chargeable to tax;

Adjustment of Rs.67,56,491/-in respect of interest on loan given to Manugraph DGM (hereinafter referred as 'AE'):

4. Without prejudice to above, in not providing the benefit of the variation of 5 percent from the arithmetic mean as provided in the proviso to Section 92C(2) of the Act, while making, the adjustment to the value of international transactions of the Appellant;

Adjustment of RS.3,27,68,010 in respect of cost of guarantees given to the bankers for wholly owned subsidiary Manugraph DGM:

7. Without prejudice to above, while computing adjustment on account of arm's length cost of guarantees, erred in applying the rate of guarantee commission to the entire amount of guarantee of RS.59.5782 crores (ie.USD 14.85 million), instead of restricting the adjustment only to the actual amount of loan availed by the AE from the overseas bank during the year.

8. Without further prejudice to above, in not providing the benefit of the variation of 5 percent from the arithmetic mean as provided in the proviso to Section 92C(2) of the Act, while making the adjustment to the value of international transactions of the Appellant.

3. Ground No. 1 is regarding disallowance u/s 14A of the Act. During the year, the assessee company has earned dividend income of Rs. 2,28,52,654/- from the investments in shares and mutual funds and the same has been claimed exempt from the tax. The Assessing Officer has disallowed an amount of Rs. 32,32,232/- u/s 14A by applying Rule 8D of the Income Tax Rules. On appeal, the CIT(A) has upheld the action of Assessing Officer and confirmed the disallowance made u/s 14A.

4. Before us, the Ld. Authorized Representative of the assessee submitted that during the course of assessment proceedings, the assessee itself suo-moto submitted a working showing the disallowance u/s 14A of the Act r.w.r 8D of Rs. 63,917/- on account of interest expenditure on borrowed fund. However the assessee did not consider the disallowance on account of administrative/general

expenses as per Rule 8D(2)(iii). The Ld. Authorized Representative has submitted that the provisions of section 14A are not applicable in the case of the assessee because there was no direct expenses incurred in respect of such income. The Assessing Officer had not given any reason with regard to the satisfaction of the same as required under section 14A(2) of the Act. He has further submitted that the Assessing Officer cannot reject the assessee's claim merely on the basis of presumption that some expenditure may have been incurred for earning the exempt income. The satisfaction has to be reached on a cogent basis and the onus is on the Assessing Officer to establish the nexus between the expenditure and exempt income. Alternatively, the Ld. Authorized Representative has submitted that the activity of investment were carried out by the executives of the Finance Department along with handling the accounts, banking and finance activity of the company. The assessee does not have separate treasury department to look after the investment portfolio of the company. He has further submitted that the total investments includes the investment made in the mutual funds with growth scheme which does not yield any dividend income. In support of his contention he has relied upon the decision of this Tribunal in the case of **Everest Kanto Cyliners Ltd. (ITA No. 7073/Mum/2012) dated 25.09.2014.**

5. On the other hand, the Ld. DR has relied upon the orders of authorities below and submitted that the assessee itself has made the disallowance u/s 14A, therefore, the applicability of Rule 14A cannot be disputed. Once section 14A is applied then the quantum of disallowance has to be worked out as per Rule 8D of the Income Tax Rules.

6. We have considered the rival submissions as well as relevant material on record . Since the assessee has earned the dividend income from the investment

in shares and mutual funds and also given the working of disallowance u/s 14A on account of interest expenditure, therefore, so far as the disallowance u/s 14A is concerned, it is not the case of the assessee that no expenditure on account of interest expenditure has been incurred. Further the activity of the investment is stated to have been looked after by the Finance Department of the assessee along with the accounts and finance, therefore, there may not be a separate expenditure incurred for the purpose of earning the dividend income. However the expenditure incurred on the activity resulting taxable and non taxable income has to be apportioned as required under provisions of section 14A. We note that the total investment comprising the investment in mutual fund and growth schemes / growth mutual funds as well as investment in foreign subsidiaries. The Assessing Officer itself has excluded the investment in foreign subsidiaries because the dividend from the foreign companies is taxable. However, the growth mutual fund does not yield any dividend/exempt income, therefore, the provisions of section 14A would not apply on the investment in growth mutual funds. A similar view was taken by the Co-ordinate Bench of this Tribunal in the case of **Everest Kanto Cyliners Ltd. (supra) in para 4 as under:-**

"4. Before us, the Ld. Authorized Representative of the assessee has submitted that up to the A.Y. 2007-08, the Tribunal has held that the assessee was having sufficient non interest bearing fund for making the investment. For the A.Y. 2008-09, the investment was made by the assessee in foreign subsidiaries, therefore, to the extent of investment made by the assessee in the A.Y. 2008-09, no disallowance is called for on account of balance interest expenditure in view of the order of this Tribunal in assessee's own case. Even for the A.Y. 2008-09, the Tribunal observed that disallowance under Rule 8D has been worked out by the Assessing Officer on the total investment which included investment made in the mutual funds with growth scheme does not yield any dividend income. Therefore, the Ld. Authorized Representative has submitted that no fresh investment was made for the A.Y. 2009-10 and accordingly no disallowance can be made on account of interest expenditure u/s 14A of the Income Tax Act. As far as the disallowance of administrative expenses is concerned, he has submitted that out of Rs. 92.74 crores, investment of Rs. 90.52 crores is in the

subsidiaries of the assessee which too in the foreign subsidiaries. Therefore, to the extent of investment in the subsidiary no disallowance is called for u/s 14A on account of administrative expenses. Thus the Ld. Authorized Representative has submitted that the disallowance if at all can be made on account of administrative expenses, the same may be by considering the investment to the extent of Rs. 2.23 crores only and should be restricted to Rs. 1.13 lakhs."

7. As regards the disallowance of administrative expenses in respect of the investment yielding exempt income the computation made under Rule 8D cannot exceed the total allocable expenditure for earning the exempt income debited the P&L Account. Accordingly, the Assessing Officer is directed to reconsider the disallowance u/s 14A by excluding the investment in the Growth mutual funds scheme and further to earmark and identify the item of expenditure debited by the assessee in the P&L Account which can be allocated in relation to earning the exempt income.

8. Ground no. 2 is regarding TP adjustment in respect of interest on loan given to AE.

9. The assessee company is engaged in the business of manufacturing and servicing of printing of allied machineries. . During the year under consideration, the assessee has given loan to its US based subsidiary MDGM from 26th October 2007 to 7th July 2008 on three occasions total amounting to Rs. 14.78 crores. The assessee charged interest for six months at LIBOR +2% on the loan advanced to the AE. The TPO did not accept the arm's length interest at LIBOR plus 2% adopted by the assessee and took the average yield rate on BB rated bond and

accordingly arrived at arm's length interest rate at of 17.26%. Accordingly, the TPO proposed the adjustment of Rs. 67,56,491/- on account of difference in ALP and interest charged by the assessed from its AE. The CIT(A) has upheld the ALP adopted ;by the TPO/AO and consequently the adjustment.

10. Before us, the Ld. AR of the assessee has submitted that the loan was granted by the assessee to its subsidiary from its internal accruals and thus, no cost was incurred by the assessee on such funds given by the assessee. The subsidiaries was facing temporary financial problems on account of slow down of economy in USA. Accordingly, in order to help the AE to tide over the financial problem, the assessee provided loan to the assessee. He has further contended that the activity of providing loan is in the nature of share holder activity. In support of his contention, he has relied upon para 7.9 of the chapter VII of OECD Transfer Guidelines. Alternatively, the Ld. AR has submitted that the assessee charged the interest from AE at LIBOR+2% which is equivalent to 5% which is at arm's length as held by this Tribunal in series of decisions. He has relied upon the following decisions:-

- (1) Everest Kanto Cylinder Ltd. (ITA No. 7073/Mum/2012) dated 25 September 2014
- (2) Bhansali & Co (ITA No. 825/Mum/2014) dated 5 December 2014
- (3) PMP Autocomponents P. Ltd. (ITA No. 1484/Mum/2014) dated 22 August 2014
- (4) Aurionpro Solutions Limited (36 CCH 6) (Mumbai Tribunal)
- (5) Great Eastern Shipping Co. LTd (ITA No. 397/Mum/2012) dated 10 January 2014
- (6) Hinduja Global Solutions Limited (36 CCH 131) (Mumbai Tribunal)

(7) Bharti Airtel Limited (ITA No. 5816/Del/2012) dated 11 March 2014 (AY 2008-09)

11. On the other hand, the Ld. DR has submitted that the loan was given by the assessee, therefore, the assessee is the tested party and the rate prevailing in the Indian market should be adopted as arm's length interest for the purpose of loan advanced by the assessee to AE. He has relied upon the order of authorities below.

12. We have considered the rival submissions as well as relevant material record. At the outset, we note that this issue of arm's length interest in respect of the loan provided by the assessee to its AE has been considered by the Tribunal in the series of decisions relied upon by the assessee. The Tribunal in the case of Everest Kanto Cylinder Ltd. (supra), has considered this issue in para 11 and 12 as under:-

"11 . We had considered rival contentions and gone through the orders of lower authorities. As per our considered opinion, appropriate international rates should be used for the purpose of the comparability analysis. For this purpose, the London Inter Bank Offer Rate (LIBOR) is an internationally recognized rate for benchmarking loans denominated in foreign currency. For this purpose, reliance may be placed on the following decision of the coordinate bench :-

- i) Great Eastern Shipping Co.Ltd (ITA No 397/M/2012) dated 10 January 2014;*
- ii) Mahindra & Mahindra Limited (ITA No 7999/M/2011) dated 8 June 2012;*
- iii) Hinduja Global Solutions Limited (ITA No 254/M/2013) dated 5 June 2013*
- iv) Aurionpro Solutions Limited (ITA No 7872/M/2011) dated 12 April 2013;*
- v) Aurobindo Pharma Ltd (ITA No 1866/Hyd/2012) dated 29 November 2013;*
- vi) Cotton Naturals (I) Pvt. Limited (ITA No 5855/Del/2012) dated 8 February 2013;*
- vii) Siva Industries and Holdings Ltd. vs ACIT, IT Appeal No. 2148 (Mds.) of 2010;*
- viii) Bharti Airtel Ltd (ITA No 581 6/0el/2012) dated 11 March 2014*
- ix) Infotech Enterprises Limited (ITA No 115/Hyd/2011) dated 16 January 2014;*
- x) Kohinoor Foods Ltd (ITA Nos 3688-3691/0el/2012 and ITA Nos 3868-3869/0el/2012) dated 21 July 2014; and*
- xi) Four Soft Ltd vs. OCIT, IT Appeal No. 1495 of 2011 (Hyderabad Tribunal)*

12. In light of the above decisions, the rate to be used for undertaking an adjustment should be LIBOR and not the average yield rates considered by the learned TPO. The LIBOR rate for March 2008 was 2.6798%. However the assessee has charged 7% from its AE as per the internal CUP available. Thus, the assessee has charged interest to EKC Dubai and EKC China at the rate higher than existing LIBOR rates. Accordingly, the said transaction of providing loan to EKC Dubai and EKC China is at arm's length. Additions made by the AO are accordingly set aside."

13. Following, the orders of this Tribunal, we direct the AO/TPO to adopt LIBOR +2% as arm's length interest in respect of loan provided by the assessee to its AE.

14. Ground No. 3 is regarding TP adjustment in respect of cost of guarantee given by the assessee to the bankers for obtaining loan by the wholly owned subsidiary/AE of the assessee.

15. During the year, the assessee has given corporate guarantee/letter of Rs. 59.58 crores to PNC Bank National Association for the working capital facilities to be availed by its wholly owned subsidiary MDGM, USA/AE. The assessee has not reported this transaction in the TP study report as an International transaction. During the course of transfer pricing assessment proceedings, the TPO proposed to bench mark the transaction of corporate guarantee provided by the assessee to its AE by adopting rate of return for risk bearing as arm's length price. The TPO considered the difference between the PLR rate and the bank rate as a risk bearing rate. Such difference was computed at 6% based on PLR rate and bank rate, accordingly, the TPO adopted the guarantee at 6% and proposed the adjustment of Rs. 3,27,68,010/-.

16. The CIT(A) confirmed the action of the TPO/AO in adopting the 6% as arm's length cost of guarantee/guarantee charges.

17. Before us, the Ld. AR of the assessee has submitted that the transaction of giving corporate guarantee to the bank is not an international transaction. In support of his contention he has relied upon the decision of Delhi Benches of this Tribunal in the case of **Bharti Airtel Ltd (ITA No 5816/Del/2012)** dated 11 March 2014. Alternatively, the Ld. AR has submitted that the arm's length guaranteed charges may be taken at 0.5% as held by this Tribunal in number of decisions. He has relied upon the following decisions:-

- (1) Everest Kanto Cylinder Ltd. (ITA No. 7073/Mum2012) dated 25 September 2014**
- (2) Everest Kanto Cylinder Limited (ITA NO. 542/Mum/2012) dated 23 November 2012(Mumbai Tribunal)**
- (3) Glenmark Pharmaceuticals Limited (ITA No. 5031/M/2012) dated 13 November 2013) (Mumbai Tribunal)**
- (4) M/s Godrej Household Products Ltd (ITA No. 7369/M/2010) (Mumbai Tribunal)**
- (5) Nimbus Communication Ltd (ITA No. 3664/M/2010) (Mumbai Tribunal) (dated 12 June 2013)**
- (6) Reliance Industries Limited (dated 13 September 2013) (Mumbai Tribunal)**
- (7) Prolific Corporation Limited (ITA No. 237/Hyd/2014 dated 31 December 2014 (Mumbai Tribunal).**

18. On the other hand, the Id. DR has relied upon the orders of authorities below and submitted that the assessee has undertaken the risk by providing the guarantee for the loan obtained by the AE from the bank, therefore, the differential rate adopted by the TPO is justified.

19. Having considered the rival submissions as well as relevant material on record, we agree with the alternative plea of the Ld. AR that the arm's length guarantee commission charges can be considered at the rate of 0.5% as held by this Tribunal in a series of decisions referred above. In the case of Everest Kanto Cylinder Ltd (supra), the Tribunal while considering an identical issue has held in para 9 as under:-

"9. Now, coming to the merit of the addition so made, we found that the issue has already been decided by the Tribunal in immediately preceding year in assessee's own case, wherein charging of 0.5% guarantee commission from AE was held to be quite near to 0.6%, where assessee has paid independently to the ICICI bank and charging of guarantee commission @0.5% from its AE was held to be at arm's length. The precise observation of the bench for the assessment year 2007-08 are as under :-

"The universal application of rate of 3 percent for guarantee commission cannot be upheld in every case as it is largely dependent upon the terms and conditions, on which loan has been given, risk undertaken, relationship between the bank and the client, economic and business interest are some of the major factors which has to be taken into consideration. "

"...in this case, the assessee has itself charged 0.5% guarantee commission from its AE, therefore, it is not a case of not charging of any kind of commission from its AE. The only point which has to be seen in this case is whether the same is at ALP or not. We have already come to a conclusion in the foregoing paras that the rate of 3% by taking external comparable by the TPO, cannot be sustained in facts of the present case. We also find that in an independent transaction, the assessee has paid 0.6% guarantee commission to IGIGI Bank India for its credit arrangement. This could be a very good parameter and a comparable for taking

it as internal GUP and comparing the same with the transaction with the AE. The charging of 0.5% guarantee commission from the AE is quite near to 0.6%, where the assessee has paid independently to the IGIGI Bank and charging of guarantee commission at the rate of 0.5% from its AE can be said to be at arms length. The difference of 0.1% can be ignored as the rate of interest on which IGIGI Bank, Bahrain Branch has given loan to AE (i.e. subsidiary company) is at 5.5%, whereas the assessee is paying interest rate of more than 10% on its loan taken with IGIGI Bank in India. Thus, such a minor difference can be on account of differential rate of interest. Thus, on these facts, we do not find any reason to uphold any kind of upward adjustment in ALP in relation to charging of guarantee commission."

As the facts and circumstances of the case during the year under consideration are pari materia, respectfully following the decision of the Tribunal in assessee's own case, we direct the AO to compute arm's length price of transaction as per the direction given by the Tribunal in the above order for A.Y. 2007-08.

20. Similar view has been taken by the Tribunal in all above referred decisions. Accordingly, following the earlier decisions of this Tribunal, we direct the AO/TPO to adopt the 0.5% as guarantee commission charges in respect of the guarantee provided by the assessee for obtaining the loan by the AE.

21. The additional ground raised by the assessee in respect of the guarantee commission is not a new ground but only a additional plea in respect of the ground number 3 of the main ground raised by the assessee. Since the guarantee commission is charged for assuming the risk for providing the guarantee to the bank in respect of loan availed by the AE, therefore, we find merits in the additional plea raised by the assessee that the adjustment on account of guarantee commission charges has to be only in respect of the amount of actual loan availed by the AE during the year. Accordingly, we direct the AO/TPO to compute the adjustment by taking into account actual loan amount availed by the AE during the year in this respect.

22. The second additional ground raised by the assessee is regarding the benefit of tolerance range of +/- 5% of the arithmetic mean margin. Since the arm's length price is adopted as CUP and single price and not as arithmetic mean, therefore, this additional ground of the assessee is devoid of any merit and hence rejected.

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

Order pronounced in the open court on this 25th day of March 2015

Sd/-

(D. Karunakara Rao)
(Accountant Member)

Sd/-

(Vijay Pal Rao)
(Judicial Member)

Mumbai dated 25.03.2015
SKS Sr. P.S,

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The concerned CIT(A)*
4. *The concerned CIT*
5. *The DR, "K" Bench, ITAT, Mumbai*

By Order

Assistant Registrar
Income Tax Appellate Tribunal,
Mumbai Benches, MUMBAI