

IN THE HIGH COURT OF KARNATAKA, BENGALURU

DATED THIS THE 26th DAY OF JUNE 2018

PRESENT

THE HON'BLE Dr.JUSTICE VINEET KOTHARI

AND

THE HON'BLE Mrs.JUSTICE S.SUJATHA

I.T.A.No.235/2016

Between:

M/s. Indigra Exports Pvt. Ltd.,

46, 2nd Floor, CC Villa

Ejipura Main Road

Viveknagar Post

Bengaluru-560095

(Represented by its Director

Sri. Stephan N.J. Lemaitre

Aged about 51 years

S/o Noel Jean)

...Appellant

(By Mr. Chythanya K.K. Advocate)

And:

Deputy Commissioner of Income-tax

Circle – 3 (1) (1), BMTC Building

80 Feet Road, 6th Block

Koramangala, Bengaluru-560 095.

...Respondent

(By Mr. K.V. Aravind, Advocate)

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This I.T.A. is filed under Section 260-A of Income Tax Act 1961, praying to 1. Formulate the substantial questions of law stated above. 2. Allow the appeal and set aside the impugned order (so far as same is prejudicial to the Appellant) of the Income Tax Appellate Tribunal, Bengaluru 'C' Bench bearing in IT (TP) A No.309/Bang/2015, dated 10-11-2015 & etc.

This I.T.A. coming on for Orders, this day **Dr. Vineet Kothari J.** delivered the following:-

JUDGMENT

Mr. Chythanya K.K. Adv. for Appellant - Assessee
Mr. K.V. Aravind, Adv. for Respondent - Revenue

1. The Assessee – **M/s. Indigra Exports Private Limited, Bangalore** has filed the present appeal under **Section 260-A** of the **Income Tax Act, 1961** against the Respondent – **Deputy Commissioner of Income Tax, Bangalore** purportedly raising the following purported substantial questions of law for our consideration under **Section 260-A** of the Act arising from the Order of the learned **Income Tax Appellate**

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Tribunal, Annexure A dated **10/11/2015** in
I.T(TP)A.No.309/Bang/2015 for **AY 2010-11** and
IT(TP)A.193/Bang/2015 for AY 2010-11 filed by the
Revenue.

2. The findings of the learned Tribunal with regard to the issues arrived at before this Court are quoted below for ready reference.

“ 11. Now we take up appeal of the assessee. Assessee in its appeal has taken four grounds of which ground 4 is general needing no adjudication.

12. Vide its ground 1 and 2 assessee is aggrieved that adjustment sought by it for under utilization of rated capacity was not allowed while comparing its results with that of the comparables selected for the TP study.

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13. *Facts apropos are that assessee had in its TP documentation worked out its PLI as under:*

	(Rs. in crores)
Sales	15.71
Less: Operating Cost	18.41
Operating Profit	-2.70
Add: Depreciation	3.30
	0.60
Less: Depreciation allowed (10%)	0.32
Adjusted operating profit	0.28
PLI (adj OP/Total Sales)	1.78%

14. *Assessee had in the above work-out **added back the actual Depreciation charged and deducted only 10% of such Depreciation for arriving at the PLI. Because of this adjustment, operation loss of 2.70% became positive operating profit of 1.78%.** For restricting the Depreciation to 10% of the actual debit in the profit and loss account, **argument of the assessee was that there was huge under utilization of the installed capacity.***

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According to the assessee, Depreciation on fixed assets that was to be considered while working out the operating profit **should only be in proportion** to the actual utilization of the installed capacity. Assessee pointed out that its turnover had gone down by 60% compared to that of the preceding year and **only 10% of the installed capacity was used.**

15. TPO required the assessee to give details of its claim of under utilization of capacity. To this assessee stated that **economic slow-down, frequent power disruptions, spiraling cost of the raw material all resulted in lower utilization of the capacity, leading to under absorption of fixed costs.** As per the assessee, its capacity utilization for the relevant previous year was only about 28,336 sq.mts of granite blocks though it installed capacity for 2,88,000 sq.mts. **However TPO was not impressed.** According to him, the reasons for under utilization stated by the assessee **applied equally for its**

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competitors also. Comparables also suffered from the same business negativities. As per the TPO for the previous year relevant to **A.Y.2009-10 assessee had claimed full Depreciation, but still it had substantial operating profit.** Thus, as per the TPO, assessee was not able to substantiate its claim for adjustment of Depreciation while working out its PLI. Though the assessee tried to elaborate on its objections stating that it did not own any granite quarry of its own but was dependent on third party supplies and difficulties faced due to Government restrictions on mining, **TPO was of the opinion that assessee could not effectively prove any under utilization.** TPO after studying the 14 comparable companies selected by the assessee came to a conclusion that these comparable companies which were facing the same business contingencies, had increased their sales volumes from that of the preceding previous year. **Thus as per the TPO assessee could not bring out a case for making any adjustment for the**

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Depreciation while working out its PLI.

AO/TPO thereafter computed the adjustment required u/s. 92CA of the Act, by working out the PLI of the assessee without making any adjustment for Depreciation.

16. *Assessee's application before the DRP on this issue also did not meet with any success. DRP noted that though there was a 57% decrease in the sales of the assessee when compared with its sales for the preceding year, **a similar trend existed in the case of Neelkanth Rock Minerals Ltd and Ceeta Industries Ltd which were in the list of selected comparables.** Or in other words as per the DRP the reasons for under utilization shown by assessee was adverse business environment, and this remained same for all similarly placed companies in this line of business.*

17. *Now before us, the Ld. AR strongly assailing the orders of authorities below submitted that its turnover had fell from Rs.36.51 crores to 15.7 crores when*

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compared to the preceding year. When the assessee was operating in a lower capacity it had to absorb the fixed cost on a lesser production. Ld. AR submitted that Rule 10B(3) required adjustment for differences that could materially affect the net profit margin. Capacity under utilization, according to him, was an important factum affecting the net margin in the open market. Ld. AR submitted that adjustments for differences, when it could be carried out with reasonable accuracy had to be done before attempting a comparison. Reliance was placed on the coordinate bench in the case of Genysis Integrating Systems India P. Ltd v. DCIT [64 DTR 225].

18. Per contra, Ld. DR Strongly supported the orders of authorities below.

19. We have perused the orders and heard the rival contentions. Case of the assessee is that it had a capacity for production of 1,22,233 sq.mts of granite but it had only produced 28,336 sq.mts during the year. As

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*per the assessee, because of this its sales went down by more than 60%. This does indicate underutilization of capacity and assets. Fixed cost remaining the same, irrespective of the actual utilization, such cost had to be charged the production and this is a costing principle that apply to all business and not assessee alone. **Among the comparables selected, we find that two companies namely, Neelkanth Rock Minerals Ltd and Ceeta Industries Ltd also had a trend of decreasing sales.** Reasons shown by the assessee for under utilization are that there were difficulties in procuring raw material, not owning any captive mines, and severe shortage of power. **These vagaries of business are nothing but adverse environment faced by all competitors who are selected as comparables.** Assessee's contention is that its fixed assets were under utilized and therefore there should be an adjustment in Depreciation. In our opinion it would only mean that wear and tear of the fixed assets were considered at a lower level than what it*

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would have been if such assets were used without respite. **Depreciation on fixed assets need not be directly proportional to utilization of machinery. Assets can get depreciated by non usage as well. Hence attempt of the assessee to have a lesser charge of Depreciation while working out its PLI in the guise of under utilization of capacity, in our opinion, was not correct.** No doubt, as mentioned by the Ld. AR, Rule 10B(1)(e) requires adjustment of differences between international transaction and the comparable uncontrolled transactions which would materially affect the net material margin. **However, assessee here was unable to establish that the comparables had claimed Depreciation after considering their capacity utilization.** Further assessee also could not establish the existence of a linear relationship between its Depreciation cost and machine utilization. We are therefore of the opinion that ground 1 and 2 of the assessee does not merit acceptance. Such grounds are dismissed.

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20. *Vide its ground 3 assessee is aggrieved that the AO while passing the order while giving effect to the DRP directions made an addition for the working capital adjustment whereas it was required to be reduced while working out the adjusted average PLI.*

21. *Assessee has produced before us a chart according to which the average working capital adjustment **that was required to be done for working out the average PLI of the comparables was (-) 2.85%. TPO had however added 2.85% to the unadjusted average PLI of the comparables. We are of the opinion that this issue also requires a fresh look by the AO/TPO. If the working capital adjustment was negative, AO/TPO should rework the adjusted PLI of the comparables after reducing the quantum of such adjustment from the average PLI of the comparables. Ordered accordingly. Ground 3 of the assessee is allowed for statistical purpose.***

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22. To summarise the result, **appeal of the Revenue is dismissed** whereas appeal of assessee is allowed for statistical purpose.

Order pronounced in open Court on 10th day of November 2015.”

3. The learned counsel for the Assessee, Mr. Chythanya has submitted before us that the assessee in the present case is engaged in the business of Manufacturing and Export of cut and polished Granite. During the year in question, on account of severe adverse economic conditions, the business of the assessee dipped to a large extent and the sales had gone down by more than **60%** and as against the production capacity of **2,88,000 Sq.Meters**, the Assessee could produce and export only **28,336 Sq.Meters** of Granite and since the manufacturing was only to the extent of **10%** of the installed capacity, the Depreciation claimed

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by the Assessee should have been proportionately reduced to determine the Operating Profits of the Assessee Company as compared with the other comparables by the learned **Transfer Pricing Officer (TPO)** and in such Transfer Pricing Analysis given by the Assessee Company before the learned Transfer Pricing Officer. The learned Transfer Pricing Officer had rejected the Transfer Pricing Analysis given by the Assessee on the ground that despite such adverse economic conditions which could be presumed to be available and present for all such similarly situated Companies engaged in the business of Granite manufacture and export, six of the comparable Entities had shown increase in the turnover and therefore, there was no justification for reducing the amount of Depreciation proportionately for determining the Operating Profits of the Assessee Company.

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4. The learned counsel for the Assessee further urged that when the matter was taken up to the learned Tribunal by the Assessee, the learned Tribunal while recording a finding in favour of the Assessee that there was under-utilization of the production capacity of the Assessee in this year, however it refused to reduce proportionately the amount of Depreciation for determining the Operating Profit Margins of the Assessee on the ground that two of such similarly situated comparable Companies, namely **M/s. Neelkanth Rock Minerals Limited and Ceeta Industries Limited** who had also shown decreasing trend of Sales but their Profit Margin was high and therefore, the Tribunal rejected the contention of the Assessee that there was a justification for proportionately reducing the amount of Depreciation to the extent of 10% on the basis of the capacity utilization by the Assessee in this year.

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5. The learned counsel for the Assessee also submitted before us that in the subsequent assessment year, viz. **AY 2012-13**, the Dispute Resolution Panel (DRP) comprising of Three Commissioners, had itself taken a view in their Order dated **30/09/2016** in the case of the Assessee itself that the profit margins in the case of the Assessee as well as the other comparables should be taken into account after excluding the Depreciation. He submitted that this was done to even out the differences of the different Depreciation Policies adopted by the different comparable entities and to even out the variations in the claim of Depreciation on account of different extent of capacity utilization by different comparables.

6. On the other hand, the learned counsel for the Revenue, Mr.K.V. Aravind justified and supported the impugned Order passed by the learned Tribunal.

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7. We have given our earnest consideration to the submissions made at the bar by the learned counsel for the parties.

8. At the outset, we may take note of the fact that this Court has dismissed the appeals filed by the Revenue in **ITA No.536/2015 c/w. ITA No.537/2015 (Pr. Commissioner of Income Tax, Bangalore and another Vs. M/s. Softbrands India P.Ltd.,)** on **25-06-2018**, holding that the finding of facts arrived at by the learned Income Tax Appellate Tribunal based on the relevant material are binding on the lower Authorities as well as this Court and unless an *ex-facie* perversity is established in the findings of the learned Tribunal, no substantial question of law arises to maintain the appeal before this Court under **Section 260-A** of the Income Tax Act, 1961.

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9. The relevant portion of the aforesaid judgment rendered on **25-06-2018** is quoted below for ready reference.

“Conclusion:

55. *A substantial quantum of international trade and transactions depends upon the fair and quick judicial dispensation in such cases. Had it been a case of substantial question of interpretation of provisions of Double Taxation Avoidance Treaties (DTAA), interpretation of provisions of the Income Tax Act or Overriding Effect of the Treaties over the Domestic Legislations or the questions like Treaty Shopping, Base Erosion and Profit Shifting (BEPS), Transfer of Shares in Tax Havens (like in the case of Vodafone etc.), if based on relevant facts, such substantial questions of law could be raised before the High Court under **Section 260-A** of the Act, the Courts could have embarked upon such exercise of framing and answering such substantial question of law. On the other hand, the appeals of the present*

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tenor as to whether the comparables have been rightly picked up or not, Filters for arriving at the correct list of comparables have been rightly applied or not, do not in our considered opinion, give rise to any substantial question of law

56. *We are therefore of the considered opinion that the present appeals filed by the Revenue do not give rise to any substantial question of law and the suggested substantial questions of law do not meet the requirements of **Section 260-A** of the Act and thus the appeals filed by the Revenue are found to be devoid of merit and the same are liable to be dismissed.*

57. *We make it clear that the same yardsticks and parameters will have to be applied, even if such appeals are filed by the Assessees, because, there may be cases where the Tribunal giving its own reasons and findings has found certain comparables to be good comparables to arrive at an '**Arm's Length Price**' in the case of the assesseees with which the assesseees may not be*

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*satisfied and have filed such appeals before this Court. Therefore we clarify that mere dissatisfaction with the findings of facts arrived at by the learned Tribunal is not at all a sufficient reason to invoke **Section 260-A** of the Act before this Court.*

58. The appeals filed by the Revenue are therefore dismissed with no order as to costs.”

10. The burden of the argument raised by the learned counsel for the Assessee is that while admitting the under-utilization of the capacity of the Assessee in this particular year, the learned Tribunal could not have computed the Operating Margins without proportionately reducing the quantum of Depreciation, only finding its justification in the case of two comparables, does not have much merit and we cannot hold the findings of the learned Tribunal to be perverse on the basis of this submission.

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11. The learned Tribunal is justified in its conclusion arrived at on the premise that the Depreciation of the Fixed Assets need not be directly proportional to the utilization of Plant and Machinery or production capacity. The said premise of the Tribunal's findings is not necessarily contrary to the finding in the case of the Assessee that in this particular year, there was under- utilization of capacity in the case of the Assessee. The claim of Depreciation does not depend merely upon the extent of wear and tear of the Plant and Machinery.

12. The claim of Depreciation does not have a direct, linear or proportionate relationship with the capacity utilization. The Tribunal has rightly held that even without actual utilization of the Plant and Machinery, Depreciation can still be claimed as a deduction from the Operating Profits.

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13. Not only the learned Tribunal has found similar situation in the case of two named comparables in the year but, the reason assigned by the learned Tribunal itself in the quoted portion of the Order above cannot be said to be *per se* incorrect or a wrong statement of Accounting Principles.

14. The Assessee Company could not have insisted upon a proportionate reduction of the claim of Depreciation in relation to the under-utilization of its capacity. The different comparables Entities may have different Depreciation Policies, Accounting Methods and despite general economic conditions being common to all, their Profit Margins and claim of Depreciation may differ.

15. Neither the Transfer Pricing Officer(TPO) nor the Tribunal, muchless this Court can undertake any such exercise of comparing the Operating Profit Margins down to the extent of a hair-splitting exercise. It is the

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broad comparison of the homogeneous comparables, which is envisaged and is done under **Section 92-CA** of the Act.

16. We are also not impressed with the arguments raised by the learned counsel for the Assessee that since the Dispute Resolution Panel (DRP) in the subsequent year **AY 2012-13** has taken a different stand which order was produced during the course of arguments for our perusal, therefore, on that basis a contrary view of the Tribunal taken in the present Order in this **AY 2010-11**, should be held to be perverse. There is no such legal connotation or statutory support for this submission. The final fate of the Order of Dispute Resolution Panel is also not known. The findings or the premise taken by the Dispute Resolution Panel (DRP) in the subsequent year does not render the findings in the previous years *per se* illegal or unsustainable merely because the Dispute

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Resolution Panel (DRP) takes a different view in the subsequent years.

17. As we have already held in the aforesaid judgment, this entire exercise is in the realm of fact finding exercise and unless on the face of it, the findings of the learned Tribunal or the Authorities below is found to be perverse and it can be said that the view taken by them is wholly unsustainable according to the legal provisions, we do not find that any substantial question of law would arise in the matter.

18. We have discussed in detail in the afore-quoted judgment rendered by this Court on **25-06-2018**, what is a substantial question of law and the parameters of Sections 100 and 103 of the Civil Procedure Code as *pari materia* and various Apex Court decisions have been discussed for interpreting the provisions of **Section 260-A** of the Income Tax Act, 1961, the two provisions being *pari materia*.

19. Therefore, in the present case also, we do not find any perversity in the Order of the learned Tribunal and we are of the opinion that the reasons assigned by the learned Tribunal in the afore-quoted portion of the Tribunal's Order are proper and sustainable and therefore, we do not find any substantial question of law raised in the present appeal filed by the assessee.

20. Accordingly, the present appeal filed by the Assessee is liable to be dismissed and the same is dismissed. No order as to costs.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

BMV*