आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ ।

IN THE INCOME TAX APPELLATE TRIBUNAL,
"D" BENCH, AHMEDABAD

BEFORE SHRI RAJPAL YADAV, JUDICIAL MEMBER
AND
SHRI AMARJIT SINGH, ACCOUNTANT MEMBER

आयकर अपील सं./ **ITA.No.954/Ahd/2012**
निर्धारण वर्ष/ Asstt. Year: 2007-2008

Schutz Dishman Biotech P.Ltd. Bhadraraj Chambers Nr. Swastik Cross Roads Navrangpura, Ahmedabad. PAN : AACCS 0988 C.	Vs.	DCIT(OSD) Cir.8, Ahmedabad.

आयकर अपील सं./ **ITA.No.1229/Ahd/2012**
निर्धारण वर्ष/ Asstt. Year: 2007-2008

DCIT(OSD) Cir.8, Ahmedabad.	Vs.	Schutz Dishman Biotech P.Ltd. Bhadraraj Chambers Nr. Swastik Cross Roads Navrangpura, Ahmedabad.

(Applicant)		**(Responent)**

Assessee by :	Shri T.P. Hemani, and Shri Parimal Parmar, AR
Revenue by :	Shri Vasundhara Upmanyu, CIT-DR Shri R.P. Maurya, Sr.DR

सुनवाई की तारीख/**Date of Hearing : 22/03/2018**
घोषणा की तारीख /**Date of Pronouncement: 05 /06/2018**

आदेश/O R D E R

PER RAJPAL YADAV, JUDICIAL MEMBER:

Revenue and assessee are in cross-appeals against order of the ld.CIT(A) dated 19.3.2012 passed for the assessment year 2007-08.

2. Assessee has taken ten grounds of appeal, whereas Revenue has taken nine grounds of appeal. However, all these grounds are argumentative and descriptive in nature. Sole issue involved in the appeal of the assessee is inter-connected with ground no.1 and 2 of the Revenue's appeal. Issue agitated in all these grounds relates to determination of arm's length price (ALP) of international transactions entered by the assessee with its associated enterprises ("AE"). In other words, whether adjustment recommended by the TPO is to be made in the value of international transactions with the AE or it is to be confirmed at the amount CIT(A) upheld it.

3. Brief facts of the case are that the assessee-company at the relevant time was engaged in the business of manufacture of bulk drugs. It has filed is return of income on 31.10.2007 declaring total loss at Rs.2,15,99,577/-. On scrutiny of the accounts, it revealed to the AO that the assessee entered into international transaction with its AE. Therefore, he made reference under section 92CA(1) of the Income Tax Act to the TPO for determining ALP of international transaction. The ld.TPO had noted the following international transactions undertaken by the assessee with its AE:

Sr. No.	*Name of AE*	*Nature of transactions*	*Value of transaction (in)*
1.	*Amati Packing Manufacturers GMBH, Germany*	*Purchase of Raw Material*	*2,64,77,444/-*
2.	*Schutz & Co. (Gmbh & Co.), Germany*	*Sale of various products*	*9,63,10,736*
	Total		*12,27,88,180*

4. The ld.TPO did not make any adjustment so far as transaction with Amati Packaging Manufacturing (Germany) is concerned. He has recommended adjustment *qua* sale of various products. In order to determine

ALP of international transaction, the assessee has adopted TNMM (Transactional Net Margin Method) which has been accepted by the TPO. In other words, he did not dispute selection of appropriate method for determining international transaction. Hence, TNMM has been selected as an appropriate method. Similarly, the assessee has selected Schutz Dishman Biotech Ltd. as tested party keeping in view the complexity of functions performed, availability of comparable data and required minimum adjustment. Treatment given in the TP documents by the assessee has not been disputed by the ld.TPO. The assessee in its TP documentation has selected four comparables which were not accepted by the ld.TPO because the ld.TPO was of view that comparable selected by the assessee were engaged in manufacturing of formulations i.e. tablets, capsules, syrups etc. whereas the assessee is in the business of manufacturing of bulk drugs. These functions performed by the comparables were not similar to that of assessee. Hence, comparable selected by the assessee have been rejected. The ld.TPO thereafter selected four more comparables who were engaged in bulk drug manufacturing. It is also pertinent to note that the ld.TPO has accepted selection of profit level indicator ("PLI") adopted by the assessee i.e. operative profit divided by operative cost (OP/OC). We will be going to take note of the details with respect to all these four comparables in subsequent part of this order. On the basis of PLI of four comparables selected by the TPO, he recommended an upward adjustment of Rs.4,10,40,877/- in the value of international transaction undertaken by the assessee.

5. The recommendation of the ld.TPO has been given effect in the assessment order and an addition of Rs.4,10,40,877/- has been made to the total income of the assessee. Dissatisfied with the addition, the assessee carried the matter in appeal before theld.CIT(A). The assessee mainly impugned order of the ld.TPO on the ground that turnover of the comparables

either very low or it is very high. Therefore, the ld.TPO ought to have applied a turnover filter before selecting comparables. The assessee further contended that Welcure Drug & Pharmaceuticals Ltd., one of the comparables selected by the assessee, which is engaged in manufacturing of bulk drugs. Similarly, Ishita Drugs Ltd. selected by the assessee was also engaged in bulk drug manufacture. Thus, these two comparables have wrongly been excluded by the ld.TPO. The ld.CIT(A) has gone through the contention of the assessee and observed that turnover filter is one of the essential filters which ought to have been applied by the TPO. The ld.CIT(A) has observed that companies having sales in the range of Rs.8 crores to 23 crores are to be taken for comparison. This exercise has eliminated three comparables out of four selected by the TPO. Only comparable left is Gennex Laboratories Ltd. On the basis of PLI of this company, the ld.CIT(A) upheld adjustment required to be made in the value of international transactions undertaken by the assessee. This exercise has reduced the adjustment in the value of international transactions to Rs.2,83,07,144/- as against the adjustment recommended by the TPO at Rs.4,10,40,877/-. Revenue is impugning the reduction of such adjustment in its appeal, whereas the assessee is impugning retention of adjustment in the value of international transactions.

6. While impugning the order of the ld.CIT(A), the ld.counsel for the assessee contended that basically, stand taken by the assessee in TPO documentation has not been disputed by the ld.Revenue authorities i.e. TP has accepted TNMM as most appropriate method. He has also accepted selection of the assessee as tested parties and he has also accepted working of PLI on the basis of operating profit divided by operating cost (OP/OC). The only dispute between the assessee and the Revenue is, whether turnover filter is to be applied nor not. The assessee is not disputing application of turnover filter, rather supporting the order of the ld.CIT(A). He further contended that

during the course of hearing before the ld.CIT(A), the assessee has contended that Welcure Drug & Pharmaceuticals Ltd. is engaged in the business of bulk manufacturing of drugs, and therefore it is comparable. Its sale is also Rs.18.79 crores within the range of turnover filter. Thus, according to the ld.counsel for the assessee, the ld.CIT(A) ought to have included this comparable before determining ALP of international transactions. In his next fold of contentions, he submitted that since the assessee does not have any market risk and hence normal profit margin attributable to market/distribution function, ranging from 1.5% to 3% are not earned by the assessee and adequate adjustment ought to be made. He further contended that the assessee has been supplying bulk drags under a long term supply agreement in substantial quantities, where there would be atleast 10% to 15% quantitative discount on account of certainty of supply and certainty of cash flow vis-à-vis the orders for specific similar volume of dispatch. Thus, he contended that adjustment on that account ought to be made. Apart from the above, he worked out details exhibiting that no adjustment would be required, if Welcure Drug & Pharmaceuticals Ltd. has been taken into consideration.

7. On the other hand, the ld.CIT-DR has submitted that Shri Jigar Raval, DCIT, TPO-I, Ahmedabad has filed written submissions vide letter dated 7.7.2015 which is available on record. She relied upon this letter. She contended that only issue on behalf of the Revenue involved in this appeal is with regard to the application of turnover filter. If that filter has not been allowed, then the comparable selected by the TPO are not being disputed by the assessee, otherwise on merit. On the strength of order of the ITAT, in the case of Symantech Software Solutions P.Ld. 46 SOT 48(Mum), she contended that assessee should demonstrate as to how the difference in the turnover has influenced the result of comparable. Low turnover does not necessarily mean high margin in competitive market condition. Therefore,

unless and until it has been brought in the record by the assessee that turnover of such comparable has undue influence in the margin, it should not be applied in order to exclude the comparables.

8. We have duly considered rival contentions and gone through the record. As observed earlier, the Revenue and the assessee have not disputed selection of appropriate method i.e. TNMM; selection of tested party i.e. assessee; selection of profit level indicator i.e. operative profit/operative cost. They are only disputing on selection of comparables. The assessee has selected four comparables viz. Advik Laboratories Ltd., Gujarat Terce Laboratories Ltd., Zyden Gentc Ld., and Welcure Drug & Pharmaceuticals Ltd. All these comparables were not accepted by the TPO because according to him, they were not engaged in manufacturing bulk drug, rather they are manufacturing formulations i.e. tablets, capsules, syrups etc. Thus, the ld.TPO selected comparables which were engaged in manufacturing of bulk drugs. The comparables selected by the TPO and working of their PLI reads as under:

Name of Company	*Economic Activity*	*Sales Cr.*	*Export Cr.*	*Export % of the total sales*
Advik Laboratories Ltd.	*Drug Formulations*	*9.74*	*0.0*	*0%*
Gujarat Terce Laboratories Ltd.	*Drug Formulations*	*11.22*	*0.04*	*0.36%*
Zyden Gentec Ltd.	*Drug Formulations*	*7.12*	*1.2*	*16.85%*
Welcure drug & Pharmaceutical Ltd.	*Drug Formulations*	*18.79*	*0.07*	*0.37%*

9. On the basis of above PLI, the ld.TPO has worked out adjustment required to be made in the value of international transactions entered by the assessee with its AE. The first question for our determination is whether turnover filter is to be applied or not. According to the ld.DR, this filter ought

not to be applied. She made reference to the decision of ITAT, Mumbai. However, we are of the view that in large number of decisions, it has been held that turnover filter is one of the essential filter in order to select comparables when acted in same atmosphere. It is pertinent to observe that while conducting transfer price analysis an effort is being made to compare related party transactions undertaken by the assessee with the uncontrolled transactions undertaken by the comparable, and thus arrive at a conclusion as to whether transaction bench mark is at arm's length or not. For example, a chosen company, though functionally comparable has entered international transactions beyond a percentage with related parties, it is quite possible that its overall profit may have distorted due to such transaction rendering it as un-comparable. There are so many other circumstances which are required to be examined under FAR analysis, and due to this, adjudicator is required to apply appropriate filter in order to work out comparables which have not under any influence of the related party transactions. Hon'ble Bombay High Court in the case of CIT Vs. Pentair Water India (P.) Ltd., 381 ITR 216 concluded that turnover is obviously a relevant factor to be considered for comparability. Hon'ble High Court has relied upon the decision of Hon'ble Delhi High Court in the case of CIT Vs. Agnity India Technologies (P.) Ltd., (2013) 36 taxmann.com 289. Thus, there are conflicting decisions in favour or against the application of turnover filter. However, the ld.Revenue authorities have not brought to our notice of any judgment of the Hon'ble jurisdictional High Court which prohibits application of turnover filter. Therefore, we are of the view that the ld.CIT(A) has rightly made an analysis that smaller companies having turnover of Rs.3 crores could not be considered as comparable with the assessee who has turnover of Rs.15.84 crores. Similarly, the company who has turnover of more than Rs.30 crores could not be compared with the assessee. Thus, we do not find any error in the order of the ld.CIT(A) on this aspect, and if we uphold the turnover filter then the ground of appeal raised by the Revenue is required to be rejected. Accordingly, we reject the grounds of appeal raised by the Revenue.

10. So far as adjustments confirmed by the ld.CIT(A) is concerned, we find that the assessee has demonstrated that Welcure Drug & Pharmaceuticals Ltd. was engaged in the manufacturing of bulk drugs. Hence, it was a comparable. It has been excluded by the TPO as well as no reason has been assigned by the ld.CIT(A) in the impugned order. Working made by the ld.counsel for the assessee in the synopsis reads as under:

Particulars	*Gennex*	*Welcure*	*Total*
Sales	*10.98*	*18.79*	*29.77*
Operating Cost	*9.70*	*21.21*	*30.91*
Operating Profit	*1.28*	*-2.42*	*-1.14*
OP/OC (%)	*13.20*	*-11.41*	*-3.69*

11. Sales of Welcure Drug & Pharmaceuticals Ltd. are less than the turnover filter of Rs.23 crores. Thus, it falls in the criteria of consideration and ought to be included in the list of comparable. Once it is included in the list of comparable, then the profit level indicator would be (-) 3.69% and no adjustment would be required in the value of international transaction as per section 92(3) of the Act, because it will go to reduce the value of the international transaction as declared by the assessee. Considering this aspect, we allow appeal of the assessee and delete adjustment made in the value of international transactions.

12. In the Revenue's appeal, next issue agitated by the ld.Revenue authorities is that the ld.CIT(A) has erred in law and on facts in deleting additions of Rs.1,43,79,263/- and Rs.62,63,591/- which was added by the AO on account of inflation of purchase of raw-material.

13. Brief facts in this regard are that the ld.AO noticed that there was a variation in actual consumption of raw-material and standard consumption of material. To the show cause, assessee explained reasons for the variations in the consumption of the raw material as also extent of and how the variations arisen. However, the ld.AO did not accept the explanation of the assessee and basing his earlier order for the assessment year 2002-03 to 2006-07, an addition of Rs.62,63,591/- on account of items consumed less than the standard norms and further addition of Rs.1,43,79,263/- on account of items consumed more than the standard norms were made. These two additions were challenged before the ld.First Appellate Authority, who following his order of the assessment year 2006-07 while following the order of the Tribunal in the case of assessee for the assessment years 2002-03, 2003-04 and 2004-05 deleted the impugned additions.

14. At the outset, ld.counsel for the assessee has placed on record copy of the order of the Tribunal passed in the assessment year 2005-06 an 2006-07 in ITA No.2060/Ahd/2009 and 3141/Ahd/2011 wherein similar addition has been deleted. The ld.First Appellate authority has followed the order of the Tribunal passed in the assessment years 2002-03, 2003-04 and 2004-05. The relevant observation of the ld.CIT(A) reads as under:

"4.3 <u>Decision:</u>

I have carefully perused the assessment order and the submissions given by the appellant. The addition was made by the A. O. by following the order of the A. O. for A. Y. 2002-03. The similar addition was also made by the A. O. for A. Y. 2006-07 while deciding of the appellant for that year. The addition have been deleted by me by following the order of the ITAT, Ahmedabad in the case of the appellant for A. Ys. 2002-03, 2003-04 & 2004-05. Accordingly, the addition made by the A. O. in this year is also directed to be deleted. Therefore, the additions of Rs.1 ,43,79,2637-on account of inflation of purchase of raw materials and Rs.62,63,591/- u/s. 69 of the Act is *directed to be deleted. The grounds of appeal are accordingly allowed."*

15. We have considered rival submissions and gone through the record. We find that the Tribunal has discussed this issue from para 4 to 4.1 in the assessment year 2005-06 and in para 9 in assessment year 2006-07. Basically the Tribunal has followed order passed in the assessment year 2003-04 and 2005-06 on this issue and confirmed the order of the ld.CIT(A). Considering the similarity of the issue, we do not find any error in the order of the ld.CIT(A). This ground of appeal of the Revenue is rejected.

16. In the result, the appeal of the Assessee is partly allowed, and whereas the appeal of the Revenue is dismissed.

Order pronounced in the Court on 5th June, 2018 at Ahmedabad.

Sd/-	**Sd/-**
(AMARJIT SINGH)	**(RAJPAL YADAV)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Ahmedabad; Dated 05/06/2018