

IN THE INCOME TAX APPELLATE TRIBUNAL  
PUNE BENCH “C”, PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND  
SHRI PARTHA SARATHI CHAUDHURY, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.157/PUN/2018

निर्धारण वर्ष / Assessment Year : 2013-14

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|---------------------------------------------------------------------------------------------------------------|-----|--------------------------|
| MTU India Private Limited,<br>159/1, Tathawade,<br>Pune-Mumbai Highway,<br>Pune – 411 033<br>PAN : AABCD2233N | Vs. | DCIT, Circle-14,<br>Pune |
| Appellant                                                                                                     |     | Respondent               |

Assessee by

Shri Ketan Ved

Revenue by

Shri Sangram Gaikwad

Date of hearing

03-03-2021

Date of pronouncement

05-03-2021

आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 08-11-2017 passed by the Assessing Officer (AO) u/s.143(3) r.w.s.144C(13) of the Income-tax Act, 1961 (hereinafter called ‘the Act’) in relation to the assessment year 2013-14.

2. The assessee has raised the following additional grounds:

“Not restricting the transfer pricing adjustment to the proportionate value of international transactions between Associated Enterprises.”

“The AO/DRP erred in not granting the Appellant deduction of ‘education cess on income-tax’ and ‘secondary and higher education cess on income-tax’ while computing the Appellant’s total income for the year under consideration”.

3. The Hon'ble Supreme Court in *National Thermal Power Company Ltd. Vs. CIT (1998) 229 ITR 383 (SC)* has observed that “the purpose of the assessment proceedings before the taxing authorities is to assess correctly the tax liability of an assessee in accordance with law. If, for example, as a result of a judicial decision given while the appeal is pending before the Tribunal, it is found that a non-taxable item is taxed or a permissible deduction is denied, we do not see any reason why the assessee should be prevented from raising that question before the tribunal for the first time, so long as the relevant facts are on record in respect of that item”. Answering the question posed before it in affirmative, their Lordships held that on the facts found by the authorities below, if a question of law arises (though not raised before the authorities) which has bearing on the tax liability of the assessee, the Tribunal has jurisdiction to examine the same.

4. Having gone through the subject matter of the additional grounds taken by the assessee, it is discernible that they raise pure questions of law. We, therefore, admit the same.

5. The first assail by the assessee in its Memorandum of appeal is to the transfer pricing adjustment of Rs.4,28,63,019/- made by the AO in Distribution activity, described as ESAS (Engine sale, Spares sale and After-sale service).

6. Briefly stated, the facts of the case are that the assessee is a Tognum Group company, a wholly owned subsidiary of Tognum Asia Pte Ltd., Singapore (formerly known as MTU Asia Pte Ltd.). The assessee is engaged in the business of marketing and distribution of MTU, Detroit Diesel and Mercedes Benz (Off highway) diesel engines and spare parts including associated equipments. The assessee filed its return declaring total income of Rs.7.48 crore. Certain international transactions were reported 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. The TPO observed that the assessee aggregated the international transactions relating to Distribution division (ESAS) and Engineering division (EARC) and had applied the Transactional Net Marginal Method (TNMM) accordingly. Without disputing the selection of the TNMM as the most appropriate method, he segregated Engineering services segment from the Distribution segment for benchmarking. Instantly, we are considering transfer pricing adjustment in the Distribution activity. The assessee selected certain comparable companies and tried to demonstrate with the help of multiple-year data that the price charged by it was at ALP. The TPO required the assessee to furnish single year margin of the comparables. As against ten companies

chosen by the assessee, the TPO, after certain alterations, brought down the number of comparables to nine and computed their mean Profit Level Indicator (PLI) - Operating Profit (OP)/Operating Revenue (OR) - at 8.15%. The TPO observed from the assessee's final accounts that Commission revenue on indent sales included 'Prior period income of Rs.5,65,08,314/-'. He held that such prior period income was not liable to be included in the operating revenue of the assessee company for benchmarking. Accordingly, he computed the assessee's PLI at (-) 2.95%. This led to the transfer pricing adjustment of Rs.4,80,08,677/-. The assessee challenged the working done by the TPO before the Dispute Resolution Panel (DRP). Certain directions were given by the DRP. However, no reprieve was allowed on the question of exclusion of Prior period commission income of Rs.5.65 crore. While giving effect to the directions, the TPO, vide his letter dated 07-11-2017 addressed to the AO, worked out the amount of transfer pricing adjustment at Rs.4.28 crore with seven comparables and their fresh mean adjusted profit margin at 6.96%. The assessee is before the Tribunal urging, *inter alia*, that Prior period commission income ought to have been included in the operating revenues of the assessee.

7. We have heard both the sides and gone through the relevant material on record. It is seen that the international transactions

under the Distribution division comprise of Purchases from Associated Enterprises, which were sold to non-AEs; Receipt of Commission on sale of the AEs' products in India; Receipt of income on rendering Global procurement services; and Income from rendition of warranty services. Here again, the dispute is chiefly *qua* the Receipt of commission on sales amounting to Rs.13,83,56,599/-, which is further restricted to a sum of Rs.5.65 crore included in the above amount, that was designated as 'Prior period income' in the annual accounts of the assessee. This amount was taken by the assessee as a part of the operating revenue but excluded by the TPO. The transaction of depiction of 'Prior period commission income' of Rs.5.65 crore is a consequence of the assessee changing reference point for recognizing commission income on sales from that of receipt of credit notes from group companies after their receipt of payment from the customers in the earlier years, to the raising of invoices by the AEs, namely, before receiving payments or issuing credit notes in the year under consideration. Detail of Rs.5.65 crore has been set out at pages 431 to 433 of the paper book. The first transaction has Customer name of Indian Navy; AE's Invoice No. for sale of goods; Date of sale of goods (01-11-2010); Amount of sale in Indian rupees at Rs.22,305/-; Credit Note number; and Date of receipt of Credit Note

(20-06-2012). On a specific query, the Id. AR stated that the assessee was not raising any bills or debit notes on rendering marketing support services. It was only the AE which was issuing credit notes at the time of accrual of income to the assessee in terms of the Agreement. From this year, the assessee started recognizing income at the time of raising of invoices by the AEs. The first transaction got concluded on receipt of credit note in 20.6.2012 for which the invoice was raised by the AE on 1.11.2010, the assessee recognized corresponding commission income in this year. As the event of raising invoice by the AE got already over in the year 2010 and the income was not recognized earlier because the credit note was not received as per the past practice, the assessee recorded commission income in the current year by treating it as 'Prior period income'. Similar is the position of all the transactions on these three pages giving total of Rs.5.65 crore. Invoices in all such cases were raised by the AEs in earlier year(s), but the credit notes were received in the year under consideration. Now, the case of the assessee is that such commission income of Rs.5.65 crore should be included in its operating revenue base in determining the ALP of the transaction of rendering Marketing support services under the overall Distribution segment. On the other hand, the Department has

made out a case that prior period income cannot be considered as a part of the operating revenue for the current year.

8. At this stage, it is pertinent to note that the assessee adopted the TNMM as the most appropriate method for this transaction, which has not been disputed by the TPO. In order to properly appreciate the rival contentions, it would be apt to take note of the prescription of Rule 10B(1)(e) of the Income-tax Rules, 1962 governing the ALP determination under the TNMM as under :

“(e) transactional net margin method, by which,—

- (i) *the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;*
- (ii) *the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;*
- (iii) *the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;*
- (iv) *the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);*
- (v) *the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction”*

9. It can be seen from the above that sub-clause (i) of rule 10B(1)(e) deals with determination of the assessee's Net Profit margin realized from an international transaction. Thereafter, the Net Profit margin realized by the comparables is found out, which is adjusted on account of differences. By considering such adjusted operating profit margin of the comparables and that of the assessee, the ALP of the international transaction is determined. Thus, the sub-clause (i), as a first step in the entire process, requires determining the operating profit margin of the assessee from an *international transaction*, which means that all the operating costs *qua the international transaction* are to be reduced from all the operating revenues of the *international transaction*. Extantly, we are concerned with the operating revenue component. The requirement is to consider all the items of the operating revenue of the international transaction. Any item of revenue, which is *not in relation to the international transaction*, goes out of reckoning in the ALP determination. One can find out whether or not a particular item of operating revenue is in relation to the international transaction of rendering service, by first identifying the scope of the international transaction. Such scope can be easily ascertained from the agreement under which the service, requiring ALP

determination, was rendered. The agreement spells out as to when the service commences and gets completed. Only thereafter, the process of discovering the operating revenue/costs *qua* such scope of the international transaction can be undertaken. There are two factors germane to the ALP. One is the time at which the ALP of the international transaction is to be determined and second is the coverage of the period for including the operating costs/revenue in the ALP determination. Insofar as the timing is concerned, it has to be on the completion of the transaction when income accrues. But for the coverage of the period for the ALP determination, it is the period of continuation of the international transaction and not the year in which it gets completed. Thus, it is manifest that the criterion for qualifying as operating revenue/costs and then entering into the ALP determination is the scope of the international transaction and not the *per se* year of completion of the international transaction. If a transaction commences and completes in a single year, then there can be no question of including the prior period expense or incomes in the ALP determination. If, however, various steps of an international transaction of rendering service breach one accounting year, then it becomes incumbent to consider all the operating revenue/costs spreading over more than one year for determining its ALP at the time of completion of the transaction. In

such a case, when the international transaction gets concluded in year two, then the costs/revenue of the international transaction from year one also qualify for consideration in determining the ALP even though characterized as 'Prior period costs/revenue'. A method of accounting employed by an assessee for computing total income needs to be harmoniously aligned, modified and fine-tuned for the limited purpose of determining the ALP of the international transaction, so as to comply with the prescription of rule 10B(1). In this manner, if certain operating revenue/costs do not fit into the scheme of the method, they require exclusion and *vice-versa*. The corollary is that the operating revenue/costs earned/incurred by an assessee in the year under consideration or an earlier year, which relate to the currency of international transaction under consideration, warrant inclusion and those not relating to it should be excluded. *Raison d'être* for exclusion of any item of operating cost/revenue from the cost/revenue base is not that it does not pertain to the year of completion of the transaction of rendering service when the ALP is being determined but that it is not in relation to the international transaction under consideration.

10. The dispute revolves around Rs.5.65 crore, which is commission income earned by the assessee on transactions of rendering marketing services for which the credit notes were issued

by the AEs during the year under consideration, but invoices were raised in earlier year(s). In order to appreciate the inclusion or otherwise of the amount of Rs.5.65 crore in the operating revenue base, we need to examine if it is in relation to the international transaction under consideration. This can be done by examining the scope of the transaction from the Agreement under which such services were rendered. A copy of the same has been placed on record. The Agreement dated 01-10-2010 is between the assessee (called herein as 'Sales representative') and its AE, Tognum AG (called herein as 'Company'). Obligations of the Sales representative (assessee) have been set out in Part II which provide that the assessee will pursue the interest of its AE by actively developing business between its AE and third parties. Clause (11) of Part II of the Agreement is quite material for us which states that the : *'Sales representative will assist PRINCIPAL (S) in placing and handling orders until all payments due and payable will have been made by the customers'*. Part III of the Agreement concerns with 'Sales Commissions'. Clause (4) of Part III states that the: *'Sales representative will not receive a Sales Commission or other compensation if. . . . (c) the customer is unable to make payments.'* Clause 7 of Part III of the Agreement states that: *'Sales*

*commissions will be paid in the currency of the final contract and will be due within thirty days after receipt of customer payments...’.*

11. On going through the above extracted clauses from the Agreement, it becomes ostensibly clear that the scope of the international transaction of rendering marketing services broadly commences with the doing of background work for sale as a step one, followed by actual sale as a step two and ending with the realization of the invoice value by the AE from the Indian customers as a step three. It is only on the completion of the step three that the international transaction of rendering marketing support services comes to an end resulting into accrual of income therefrom and the consequential ALP determination. Thus all the operating costs/revenue pertaining to the above broad activities running into three steps leading to the international transaction of rendering marketing support services are to be considered for determining its ALP under rule 10B(1)(e). To put it differently, only the costs/revenue which are either anterior to the step one or exterior to the step three need to be ignored.

12. The assessee received credit notes worth Rs.5.65 crore for rendering marketing support services, which got concluded on the realization of sales value and the consequential issuance of the credit notes by the AEs in the year under consideration, which is

step three as discussed above. Thus, we have no hesitation in holding that such an amount is liable to be included in the operating revenue base of the transaction for its ALP determination subject to discussion in the immediately three succeeding paras of this order.

13. It is seen from the reproduction of the assessee's without prejudice submission before the DRP that if it had not changed the reference point and continued to record commission income on the basis of receipt of credit notes from AEs, as it was done in earlier years, then its commission income would have been Rs.10.81 crore as against total commission income recognized in the accounts at Rs.13.83 crore (including Rs.5.65 crore in dispute) because credit notes worth Rs.3.02 crore were not received by 31-03-2013.

14. We have held *supra* that commission income on the completion of the international transaction of rendering marketing support services, namely, the step three on issuance of credit note by the AE, needs to be included in the operating revenue base for determining its ALP. The rationale is that the income is to be recognised on performing the last step falling within the scope of the marketing support service. Now, if the sum of Rs.3.02 crore represents the credit notes not issued by AE during the year, the same *ex facie* needs to be excluded from the total commission of Rs.13.83 crore because the issuance of credit notes coincides with

the completion of the above referred step three and non-issuance of credit note may be an indicator of the transaction not getting completed during the year. However, before excluding it, one needs to ascertain if the credit notes were not issued because the transaction of rendering marketing services itself was incomplete on the year ending, namely, step three was yet to be fully or partly performed on one hand, or that the assessee completed all that was required from it, namely, the payment was also received by the AE, but the AE failed to timely issue the corresponding credit notes in terms of the Agreement. Commission income in such first scenario cannot be included in the operating revenue base and would require exclusion as the income has not accrued inasmuch as the transaction itself is incomplete. But the commission income in such second scenario will be included in the operating revenues because the transaction of rendering marketing services is over and the resultant income has accrued. This exercise needs to be done by the AO/TPO.

15. Once we are obliged to include the above referred commission in the revenue base, that was characterized by the assessee as 'Prior period income', the sequitur is that in the same way all the operating costs – direct or indirect; close or remote - in relation to such international transaction incurred in earlier years should also be

included in the cost base for determining the ALP of the transaction in the current year. The obvious reason is that all the operating costs/revenue in relation to the international transaction need to be considered at the time of determining the ALP of the international transaction. It is clear from the details of Rs.5.65 crore given by the assessee that it carried out the above referred first two steps of rendering marketing support services in the earlier years, which is evidenced from the fact that the invoices were raised by the AEs in preceding years. A fortiori, all the operating costs incurred by the assessee in earlier years on such rendition of services are also required to be included in the operating cost base while determining the ALP of the transaction on its completion in the year under consideration. Necessary details in respect of the commission income of Rs.3.02 crore as discussed in the earlier para and the amount of operating expenses incurred in preceding years towards the international transaction under consideration are wanting. We, therefore, set-aside the impugned order and direct the AO/TPO to decide the issue accordingly.

16. The Id. AR objected to two comparables, not on their inclusion but on the determination of their PLI. The first is Cuprum Bagrodia Ltd., whose OP/OR was taken by the TPO at 18.33%. The assessee contended before the DRP that the calculation of the PLI was not

correct inasmuch as this company was into two business segments, namely, Trading segment and Mining segment and only the Trading segment was to be considered as comparable. As against that, the TPO had computed the PLI by taking entity level figures. The DRP on page 13, directed the AO to consider the segmental data. While giving effect to the direction of the DRP, the TPO in his letter to the AO, took adjusted PLI of this company at 6.12%. The case of the assessee is that the PLI of this company is 0.50%. Under these circumstances, we direct the AO/TPO to verify the contention of the assessee and adopt the correct PLI of Cuprum Bagrodia Ltd.

17. The second company is George Oakes Limited. The TPO adopted the PLI of this company at 5.45%. The DRP observed that the TPO computed operating profit by also considering non-operating revenue and costs. While giving effect to the direction of the DRP, the TPO determined PLI of this company at 4.77%. The case of the assessee is that the PLI of this company should be (-) 0.22%. The AO/TPO is directed to verify the assessee's contention and adopt correct PLI while determining the ALP.

18. The next issue urged on behalf of the assessee is that the TPO did not apply correct turnover filter. In this regard, it is seen that the TPO applied a particular turnover filter, which was modified by the DRP in para 11.2.3 of its direction. The AO, while giving effect to

the direction of the DRP, inadvertently overlooked the same. The AO is directed to comply with the direction given by the DRP.

19. The assessee has raised an additional ground urging that the transfer pricing adjustment should be restricted to the international transaction alone. Such an additional ground has been admitted above.

20. Section 92 is the first section of the Chapter-X containing special provisions relating to avoidance of tax. Sub-section (1) of section 92 provides that: 'Any income arising from an international transaction shall be computed having regard to the arm's length price'. Thus it is graphically clear that the ALP and the consequential transfer pricing adjustment are contemplated only in respect of the international transactions and not the entity level transactions. The TPO, in the instant case computed transfer pricing adjustment in respect of entity level transactions. We direct to restrict it to the AE transactions under consideration and not the entity level transactions.

21. To sum up, we set aside the impugned order on ALP determination of the international transactions of the 'Distribution activity' and restore the matter to the file of the AO/TPO for a fresh determination of the ALP in accordance with our above

observations/directions. Needless to say, the assessee will be allowed a reasonable opportunity of hearing.

22. The TPO initially proposed transfer pricing adjustment of Rs.95,97,343/- in his order passed u/s.92CA(3) in the international transaction of 'Engineering division (EARC)'. Giving effect to the direction given by the DRP, NIL adjustment has been worked out in this international transaction. Thus, the grounds challenging the transfer pricing addition in respect of this international transaction have become academic, not requiring any specific adjudication at our end.

23. The second additional ground is about deduction of education cess on income tax and secondary and higher education cess on income tax for the year under consideration.

24. We find that this issue is no more *res integra* in view of the judgment of Hon'ble jurisdictional High Court in *Sesa Goa Lt. Vs. JCIT (2020) 423 ITR 426 (Bom.)* in which it has been held that Education Cess is not disallowable expenditure u/s.40(a)(ii) of the Act. Similar view has earlier been taken by the Hon'ble Rajasthan High Court in *Chambal Fertilisers and Chemicals Ltd. and Another Vs. JCIT (2018) 102 CCH 0202 (Raj-HC)*. We direct to allow deduction for such an amount after verification.

25. In the result, the appeal is partly allowed for statistical purposes.

Order pronounced in the Open Court on 05<sup>th</sup> March, 2021.

Sd/-  
(PARTHA SARATHI CHAUDHURY)  
JUDICIAL MEMBER

Sd/-  
(R.S.SYAL)  
VICE PRESIDENT

पुणे Pune; दिनांक Dated : 05<sup>th</sup> March, 2021  
सतीश

**आदेश की प्रतिलिपि □ ग्रेषित/Copy of the Order is forwarded to:**

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr.CIT-V, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे “सी” /  
DR ‘C’, ITAT, Pune;
6. गार्ड फाईल / Guard file.

**आदेशानुसार/ BY ORDER,**

**// True Copy //**

Senior Private Secretary  
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

|     |                                                  | Date       |       |
|-----|--------------------------------------------------|------------|-------|
| 1.  | Draft dictated on                                | 03-03-2021 | Sr.PS |
| 2.  | Draft placed before author                       | 05-03-2021 | Sr.PS |
| 3.  | Draft proposed & placed before the second member |            | JM    |
| 4.  | Draft discussed/approved by Second Member.       |            | JM    |
| 5.  | Approved Draft comes to the Sr.PS/PS             |            | Sr.PS |
| 6.  | Kept for pronouncement on                        |            | Sr.PS |
| 7.  | Date of uploading order                          |            | Sr.PS |
| 8.  | File sent to the Bench Clerk                     |            | Sr.PS |
| 9.  | Date on which file goes to the Head Clerk        |            |       |
| 10. | Date on which file goes to the A.R.              |            |       |
| 11. | Date of dispatch of Order.                       |            |       |

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