

**IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH “C”, PUNE – VIRTUAL COURT**

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

आयकर अपील सं. / ITA No.640/PUN/2017

निर्धारण वर्ष / Assessment Year : 2012-13

Delval Flow Controls Private Limited, 8, Dhanashree Apartments, S.No.133/1-2, off ITI Road, Aundh, Pune – 411 007 PAN : AACCD2898L	Vs.	DCIT, Circle-1(2), Pune
Appellant		Respondent

Assessee by

Ms. Sonalee Godbole

Revenue by

Shri Sardar Singh Meena

Date of hearing

19-01-2021

Date of pronouncement

20-01-2021

आदेश / ORDER

PER R.S.SYAL, VP :

In this appeal, the assail is to be legal tenability of the final assessment order dated 16-01-2017 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 2012-13.

2. The only issue raised in this appeal is against the confirmation of transfer pricing adjustment of Rs.1,03,98,000/-.

3. Succinctly, the factual panorama of the case is that the assessee is engaged in manufacturing of butterfly valves, actuators and ball valves. The products of the assessee company are used in oil, gas and petrochemical industries. The assessee filed its return declaring total income of Rs.4.06 crore. The assessee also filed Form No. 3CEB detailing international transactions, *inter alia*, Sale of valves and actuators, Purchase of raw material and Sale of valves and accessories to its associated enterprises (AEs). 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 selected the Transactional Net Marginal Method (TNMM) as the most appropriate method by using both internal and external comparables for this set of transactions. For the reasons set out in the order, the TPO did not accept the internal TNMM. The TPO proceeded with the external TNMM having six companies as comparable giving average Profit Level Indicator (PLI) of Operating profit to Total cost (OP/TC) at 16.64%. The assessee's own Profit Level Indicator (PLI) was computed at 11.81%. This is how, the TPO computed the transfer pricing adjustment as under :

Particulars	Amt. in lakhs
Sales (A)	6097.94
AE sales=B	1530.98
Non AE sale=C	4566.96
Cost=D	5453.68
Profit=P	644.26
PLI=OP/OC=P/D	11.81%
PLI of comparable	16.64%
ALP=E=D*PLI of comparable	6364.17
ALP of AE Transactions =F=E-C	1797.21
G1=B*95%	1454.43
G2=B*105%	1607.52
Since F is more than G2. Therefore, Adjustment =F-B	266.23

4. The assessee assailed the above determination before the Dispute Resolution Panel (DRP), but with partial success. This led to the transfer pricing addition of Rs.1,03,98,000 in the final assessment order, which is under challenge before the Tribunal.

5. We have heard the rival submissions through Virtual Court and scanned through the relevant material on record. Before proceeding further, we want to clarify that the assessee applied the TNMM as the most appropriate method for the set of transactions of purchase and sale to its Associate Enterprises (AE), which has not been disputed by the TPO. The assessee benchmarked the transactions by applying internal as well

external TNMM. The TPO rejected the internal TNMM, which has not been disputed by the assessee. Similarly, there is no dispute on comparables nor their PLI of OP/TC at 16.64%. The only short point raised before the Tribunal is the calculation of the amount of transfer pricing adjustment.

6. We have extracted above the methodology adopted by the TPO for computing the transfer pricing adjustment. There is no quarrel on the figure of total sales of the assessee at Rs.6097.94 lakh comprising of AE sales at Rs.1530.98 lakh and non-AE sales at Rs.4566.96 lakhs. Similarly, total cost of the assessee at Rs.5453.68 lakh is also not under challenge nor is the amount of profit of Rs.644.26 lakh deduced by reducing the total operating cost from the total sales revenue. In the same way, the computation of PLI of the assessee, insofar as it is relevant for this issue, at 11.81% is also not disputed along with that of comparables at 16.64%. The TPO determined the arm's length cost of the assessee at Rs.6364.17 lakh by multiplying total cost of the assessee at Rs.5453.68 with 1.1664, being, the average OP/OC of the comparables. The difference of opinion has arisen primarily on the next figure of the ALP of AE transactions computed by the TPO at Rs.1797.21 lakh and the consequential

figures. The TPO computed this figure by reducing non-AE sales of Rs.4566.96 lakh from the figure of total arm's length costs of the assessee worked out at Rs.6364.17 lakhs. This calculation has gone awry. There is no need to highlight that it is only the international transaction which calls for transfer pricing adjustment and not the entity level transactions of the assessee. On one hand, the TPO took arm's length *cost* of the entity at Rs.6364.17 lakh and on the other, he reduced the figure of non-AE *sales* of Rs.4566.96 lakhs, which also contains the profit element apart from cost. What ought to have been done was to first compute the total cost in relation to the AE transactions and then increase it with the PLI of comparables for ascertaining the arm's length sale price. The resultant total cost in relation to the AE transactions, under this mechanism, comes to Rs.1369.23 lakh, which is obtained by multiplying total cost of Rs.5453.68 lakh with AE sales of Rs.1530.98 lakh as divided by total sales of Rs.6097.94 lakh. It is this cost of the transactions with AE which needs to be loaded with the margin of the comparables at 16.64% to find out ALP of the AE transactions at Rs.1597.06 lakh (Rs.1369.23 lakh x 1.1664 lakhs), calling for further action.

7. The Id. AR espoused the next issue by submitting that the TPO erred in computing the assessee's PLI and that of the comparables by treating foreign exchange fluctuation gain as non-operating revenue, which also got echoed at the level of the DRP.

8. We find no discussion in the TPO's order on the exclusion of the foreign exchange fluctuation gain from the operating revenue in computation of the assessee's operating profit margin. The DRP has held at para 3.4 of its direction that foreign exchange fluctuation gain cannot be considered as operating income by mainly relying on Rule 10TA(k) of the Safe Harbour Rules.

9. The Honble Delhi High Court in *PCIT Vs. B.C. Management Services Pvt. Ltd. (2018) 403 ITR 45 (Delhi)* has held that foreign exchange fluctuation, prior to the Safe Harbour Rules, 2013, is operating gain or loss. As we are instantly dealing with the assessment year 2012-13, going with the *ratio decidendi* in the case of *B.C. Management Services Pvt. Ltd. (supra)*, foreign exchange fluctuation is liable to be treated as operating gain or loss in view of the categorical finding returned by the DRP at para

3.2 to the effect that: 'the foreign exchange gain has taken place on realization of debtors arisen from the business operations of the assessee'. Once it is proved that the foreign exchange gain emanated from the regular business transactions of the assessee with its AEs, the same, therefore, needs to be taken as an item of operating revenue.

10. The ld. DR vehemently argued that the definition of the 'operating revenue' as given in clause (k) of Rule 10TA needs to be applied to the instant case, which explicitly makes foreign exchange gain as non-operating. He tried to fortify his view point by referring to section 92CB providing that the ALP determination shall be subject to the safe harbour rules. In the hue of this provision, it was argued that the ALP determination needs to be carried out in the extant case in the light of the safe harbour rule requiring exclusion of forex gain from operating revenue.

11. Section 92CB(1) of the Act at the material time provided that the determination of ALP u/ss 92C or 92CA shall be subject to safe harbour rules. Sub-section (2) states that : 'the Board may, for the purpose of sub-section (4), make rules for Safe Harbour'. The relevant rules from 10TA to 10TG came to be inserted by the

Income-tax (Sixteenth Amendment) Rules, 2013 w.e.f. 18-09-2013. Rule 10TD(1) provides that the transfer price declared by the assessee in respect of eligible transaction shall be accepted by the income-tax authorities at ALP, if it is in accordance with the circumstances as specified in sub-rules (2) or (2A). A chart has been given in these sub-rules in which the safe harbour has been provided for the eligible international transactions. For example, the first entry in Rule 10TD(2) is the eligible international transaction of 'Provision of software development services' and the safe harbour, requiring acceptance of the declared transaction value, has been prescribed as the operating profit margin of not less than 20% of operating expenses. Explanation to section 92CB itself provides the meaning of "safe harbour" as 'circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.' It is for the purpose of calculating value of various components under the safe harbour rules, such as, operating profit or operating expense etc. that one needs to knock on the door of rule 10TA for finding out their respective connotation. Clause (l) of Rule 10TA defines "operating profit margin" in relation to operating expenses to mean the ratio of operating profit, being operating revenue in excess of operating

expenses, to operating expense. So, for determining the operating profit margin under the safe harbour rules, one requires figures of operating expenses [defined in Rule 10TA(j)] and operating revenue [defined in Rule 10TA(k)]. It is this definition of operating revenue which has been evoked by the DRP for construing foreign exchange fluctuation gain as non-operating revenue.

12. At this juncture, it is apposite to take note of rule 10TD(1), which underscores that the exercise of option for safe harbour rules by an eligible assessee [as defined under Rule 10TB] in respect of an eligible international transaction [as given in Rule 10TC] is optional. Thus, it is self-evident that the safe harbour rules are simply optional for an eligible assessee. One assessee may opt, another may not. The entire mechanism under the safe harbour rules, including the calculation of 'operating revenue', comes into play only when the option of the safe harbour rules is exercised by an assessee under due process mandated under Rule 10TE. A fortiori, where an assessee has not exercised option for the safe harbour, the entire set of Rules from 10TA to 10TG gets freezed and cannot be operationalised. This conclusion is further corroborated by the opening language of rule 10TA giving

meaning to various expressions through clauses (a) to (m), including clauses (j) and (k) defining 'operating expense' and 'operating revenue' as not treating foreign exchange fluctuations loss or gain as part of operating expense/revenue. It unambiguously mandates that the definitions given hereunder apply only for the purposes of this rule and rule 10TB to 10TG. Thus the definition clause in rule 10TA has its force of operation only within the ambit of the safe harbour rules and not beyond that. As against that, determination of ALP under the TNMM is governed by rule 10B(1)(e). This rule has no reference whatsoever to rule 10TA. Neither rule 10TA anywhere provides for its extension to rule 10B. Thus, it is axiomatic that in determination of the ALP under the TNMM, or for that matter any other method, clause (k) of rule 10TA providing for exclusion of foreign exchange gain from the purview of operating revenue does not get magnetized.

13. The emphatic contention of the Id. DR - that section 92CB providing that the arm's length price under section 92C or section 92CA shall be subject to safe harbour rules and hence the application of rule 10TA(k) across the board is essential whether

or not the assessee opts for the safe harbour - in our considered opinion does not merit acceptance. Section 92CB unequivocally states that the arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. It only means that if there is an eligible assessee, who has exercised option to be governed by the safe harbour rules in respect of an eligible international transaction after complying with the due procedure, then the determination of the ALP shall be done in accordance with the safe harbour rules in terms of section 92CB of the Act and *ex consequenti*, the application of other rules will be ousted. The sequitur is that where such an option is not availed, neither section 92CB gets triggered nor the relevant rules including 10TA(k). In that scenario, determination of the ALP is done *de hors* the safe harbour rules. Once these rules are kept out of compass, the otherwise settled position by virtue of the judgment of the Hon'ble Delhi High Court in *B.C. Management Services Pvt. Ltd. (supra)* and various Benches of the Tribunal across the country holding foreign exchange gain/loss as operating revenue/loss in the ALP determination, comes to the fore. We, therefore, hold that the foreign exchange gain/loss earned/incurred by the assessee and the other comparables needs

to be considered as a part of operating revenue/cost not only for the reason that the assessment year under consideration is prior to the applicability of the safe harbour rules but also that there can be no question of applying Rule 10TA(k) in the absence of the assessee having or exercising option to be subjected to the safe harbour Rules.

14. To sum up, we set aside the impugned order on this issue and send the matter back to the file of AO/TPO for fresh determination of the ALP of the international transactions under consideration in accordance with the above directions.

15. No other ground was pressed by the ld. AR. The same, therefore, stand dismissed.

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

Order pronounced in the Open Court on 20th January, 2021.

Sd/-
(**PARTHA SARATHI CHAUDHURY**)
JUDICIAL MEMBER

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

पुणे Pune; दिनांक Dated : 20th January, 2021
सतीश

आदेश की प्रतिलिपि अग्रेषित/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	19-01-2021	Sr.PS
2.	Draft placed before author	20-01-2021	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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