

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH : BANGALORE
BEFORE SHRI. B. R. BASKARAN, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

IT(TP)A No.203/Bang/2014
Assessment Year : 2009-10

M/s Sigma Aldrich Chemicals Pvt. Ltd., Plot No.12, Bommasanadra Jigani Link, Anekul Taluk, Bengaluru-560 100. PAN : AAHCS 1882L	Vs.	The Dy. Commissioner of Income Tax, Circle-12(3), Bengaluru.
APPELLANT		RESPONDENT

IT(TP)A No.155/Bang/2014
Assessment Year : 2009-10

The Dy. Commissioner of Income Tax, Circle-12(3), Bengaluru.	Vs.	M/s Sigma Aldrich Chemicals Pvt. Ltd., Plot No.12, Bommasanadra Jigani Link, Anekul Taluk, Bengaluru-560 100. PAN : AAHCS 1882L
APPELLANT		RESPONDENT

Appellant by	:	Shri Chythanya K.K, Advocate
Respondent by	:	Shri Muzaffar Hussain, CIT (DR)

Date of Hearing	:	30-06-2020
Date of Pronouncement	:	15 -09-2020

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present cross appeals has been filed by assessee as well as revenue against final assessment order dated 21/01/2014 passed by Ld.DCIT Circle 12 (3) under section 143 (3) read with section 144C(13) of the act for assessment year 2009-10 on following grounds of appeal:

IT(TP)A No.203/Bang/2014(assessee's appeal)

The Hon'ble Dispute Resolution Panel, Bangalore ('DRP') / Learned Assessing Officer ('AO')/ learned Transfer Pricing Officer ('TPO') erred in not accepting the transfer pricing analysis undertaken by the Appellant in accordance with provisions of the Income-tax Act, 1961 ('the Act') read with Income-tax Rules, 1962 ('the Rules').

2. The Hon'ble DRP/ learned AO / learned TPO erred in making an addition of Rs.67,437,268/ (Catalogue Manufacturing including Custom Synthesis / research services segment - Rs. 64,497,705/- and Information Technology ('IT') enabled services - Rs. 2,939,563/-) to the total income of the Appellant on account of adjustment in the arm's length price ('ALP') of the international transactions with its Associated Enterprises ('AE').

3. Without prejudice to the above, the action of the Assessing Officer in passing draft assessment order which in substance is final assessment order is contrary to section 144C(1) of the Act and hence, liable to be quashed.

4. The Hon'ble DRP / learned AO/ learned TPO erred in not considering the multiple year financial data of comparable companies while determining the ALP of the international transactions of the Appellant.

5. The Hon'ble DRP/ learned AO/ learned TPO erred in using data as at the time of assessment proceedings, instead of that available as on the

date of preparing the Transfer Pricing ("TP") documentation for comparable companies while determining the ALP of the international transactions of the Appellant.

6. Catalogue Manufacturing Operations including Custom Synthesis I research services

6.1. The Hon'ble DRP/ learned AO/ learned TPO erred in not appreciating that its catalogue manufacturing operations and custom synthesis/ research services are intertwined and inter-related warranting a combined transaction approach in determination of arm' length price.

6.2. The Hon'ble DRP/ learned AO/ learned TPO erred not giving cognizance to the commercial and business reasons for losses in its manufacturing operations (including the custom synthesis / research services) by attributing the losses incurred to the transfer pricing of the international transactions entered by the Appellant with its AEs and thereby not appreciating the principles laid down in the Organization for Economic Cooperation and Development guidelines ('OECD Guidelines').

6.3. The Hon'ble DRP/ learned AO/ learned TPO erred in rejecting the adjustments made on account of underutilized capacity for manufacturing operations (including the custom synthesis / research services), disregarding the fact that unlike the comparables, the manufacturing business of the Appellant was in a start-up stage, and also disregarding the information submitted by the Appellant to enable the computation of such an adjustment and while doing so grossly erred in:

6.3.1. Stating that except the higher depreciation, there is hardly any variation in the costs incurred by the Appellant and the comparable selected;

6.3.2. Stating that the Appellant has not demonstrated that an accurate adjustment has been made in the instant case for the impact of the variation in the capacity utilized.

6.4. The Hon'ble DRP / learned AO/ learned TPO erred in not appreciating the fact that the Appellant operates as entrepreneurial entity exposed to normal risks associated with carrying out its business and thereby erred in;

6.4.1. Concluding that the Appellant is wholly dependent on its AEs for its market strategy and therefore it cannot incur losses; and

6.4.2. In not appreciating the fact that the Appellant is not contractually bound to undertake its manufacturing operations (including the custom synthesis / research services) exclusively to its AEs.

6.5 Without prejudice, the Hon'ble DRP/ learned. AO/ learned TPO erred in. not considering the Cash Profit Margin as an appropriate Profit Level Indicator ('PLI') for the custom synthesis / research services having accepted the same in case of catalogue manufacturing operations to eliminate the impact of high depreciation cost in case of Appellant.

6.6 Without prejudice to the ground that appellant is entitled for adjustment of under-utilisation of capacity, the learned authorities below

ought to have granted adjustment towards abnormal costs, in respect of manufacturing and alleged R & D segment.

6.7 The Learned TPO / DRP have erred in law and on facts in not applying export filter in manufacturing segment although said filter was applied in the case of alleged R&D segment and ITES segment.

6.8 The Hon'ble DRP erred in law and on facts in upholding the rejection of certain comparables selected by the appellant while carrying out its TP study in respect of manufacturing segment.

6.9 The Hon'ble DRP erred in law and on facts in upholding the selection of certain comparables finally selected by TPO in respect of manufacturing and alleged R & D segment.

6.10 The learned TPO erred in law and on facts in adopting Vimta Labs as comparable though the output of the activity is goods in case of appellant and services in case of Vimta Labs and turnover of Vimta Labs is very high as compared to the appellant, in respect of alleged R & D segment.

6.11. The learned DRP / TPO erred in law and on facts in treating abnormal forex loss / gain as operational in nature in respect of manufacturing segment although the same was treated as non operating in the case of alleged R&D segment.

7. Information Technology (IT) Enabled Services Segment

7.1. The Hon'ble DRP/ learned AO/ learned. TPO erred in rejecting the TP documentation maintained by the Appellant by invoking provisions of sub-section (3) of 92C of the Act contending that the information or data used in the computation of the arm's length price is not reliable or correct and while doing so erred in:

7.1.1. Rejecting the comparability analysis carried in the TP documentation and in conducting a fresh comparability analysis by introducing various filters in determining the arm's length price.

j7.1.2. Rejecting companies that comparable to the Appellant while performing the comparability analysis. Specifically, the following companies should have been included as comparables:

- Lee & Nee Software (Exports) Limited
- Caliber Point Business Solutions Limited
- R Systems International Limited

7.1.3. Including companies that do not satisfy the test of comparability. Specifically, the following companies selected comparable should have been rejected;

- Infosys BPO Limited;
- Accentia Technologies Limited;
- Cosmic Global Limited.
- Eclerx Services Limited

7.1.4. Computing the operating margin for Ailsec Technologies Limited wherein the provision for bad and doubtful debts has erroneously been considered as non-operating expenditure.

7.1.5. The learned TPO erred in law and on facts in treating provision for doubtful debts as non-operational in nature while computing the margin of eClerx Services Limited and Infosys BPO Ltd.

7.1.6. The learned TPO erred in law and on facts in considering the enterprise level margin of Microland Limited instead of considering its margin from ITES segment

7.1.7. The learned TPO erred in law and on facts in applying RPT filter at 25% instead of 15%.

7.1.8. The Hon'ble DRP/ learned, AO/ learned TPO erred in not appreciating the difference in the risk profile of the Appellant vis-a-vis the comparables and thereby not allowing the benefit of appropriate adjustment towards the risk differential, when the comparables selected are full-fledged entrepreneurial companies.

8. That the appellant ought to have been allowed the benefit of proviso to section 92C(2) in respect of each segment of the appellant.

9. Without prejudice to the above, the learned TPO erred in law and on facts in making adjustment u/s 92CA in respect of non-AE transactions also instead of restricting it to AE transactions alone in respect of alleged R&D segment or manufacturing, if integrated with R&D.

10. The Hon'ble DRP ought to have held that the observations of the learned TPO that the appellant didn't raise any objection to the comparables selected by the TPO are perverse and hence, liable to be quashed.

11. Corporate Tax - Disallowance of Stock write-off on account of physical difference and errors in receipt of stock amounting to Rs. 689,875

11.1. That on the facts and in the circumstances of the case and in law, the Hon'ble DRP / learned AO has erred in disallowing the amount of Stock write-off on account of physical difference and errors in receipt of stock.

11.2. The Hon'ble DRP/ learned AO ought to have allowed the amounts written off by the Appellant towards shortage in the inventory, arising due to cycle count, wrong receipting difference over shipping of certain items, which has been determined during the physical inventory verification.

11.3. The Hon'ble DRP/ learned AO ought to have appreciated the fact that the expenditure was incurred wholly and exclusively in the normal course of business of the Appellant.

12. Non-granting of Minimum Alternate Tax ('MAT') credit of Rs.1,310,861

12.1. The Hon'ble DRP / learned AO ought to have allowed the claim of Minimum Alternate Tax ('MAT') credit amounting to Rs. 1,310,861 under section 11 5JAA in computing tax liability in the final assessment order

12.2. The Hon'ble DRP / learned AO ought to have appreciated that the Appellant is entitled to claim the credit for taxes paid under section 1 15JB in the earlier years against the tax liability for AY 2009-10 computed under the normal provisions of the Act.

13. *The Hon'ble DRP/ learned AO have erred in levying interest under section 234B of the Act.*

14. *The Hon'ble DRP / learned AO) has erred in levying interest under section 234C of the Act without appreciating the fact that interest under section 234C can be levied only on returned income.*

The Appellant craves leave to add, alter, rescind and modify the grounds herein above or produce further documents, facts and evidence before or at the time of hearing, of this appeal.

IT(TP)A No.155/Bang/2014 (revenue's appeal)

1. *The directions of the Dispute Resolution Panel are opposed to law and facts of the case.*

2. *On the facts and in the circumstances of the case the Dispute Resolution Panel erred in law in directing the AO to allow the claim of the assessee under the head "Quality Rejects" without appreciating the fact that the assessee company is making huge claim under the head every year without any substantiation.*

3. *On the facts and in the circumstances of the case the Dispute Resolution Panel erred in directing the AO to allow the claim of the assessee under the head 'Breakage leakage & Damage' without appreciating the fact that the assessee company is making huge claim under the head every year without any substantiation.*

4. *On the facts and in the circumstances of the case, the DRP erred in directing the AO to allow the claim of the assessee under the head "Expired Inventory" without appreciating the fact that the assessee company is making huge claim under the head every year without any substantiation.*

5. *On the facts and in the circumstances of the case, the DRP erred in directing the TPO to adopt Profit before Depreciation Interest and Taxes (PBDIT) on cost instead of Profit before Interest and taxes (PBIT) on cost without appreciating that Depreciation is not an operating expenditure.*

6. *On the facts and in the circumstances of the case, the DRP erred in deleting the comparable Clingine International Ltd, despite it being mainly focusing on clinical trials and research works and rightly selected by the TPO as a comparable to the assessee company.*

7. *On the facts and in the circumstances of the case, the DRP erred in deleting the comparable Cyber Media Research Ltd, despite it being in the business of research and survey services and products and rightly selected by the TPO as a comparable to the assessee company.*

8. *For these and other grounds that may be urged at the time of hearing, it is prayed that the directions of the Dispute Resolution Panel in so far as it relates to the above grounds may be reversed.*

9. *The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above."*

Brief facts of the case are as under:

2. Assessee is engaged in manufacturing and trading of broad range of biochemicals for end-users laboratory and research activity. These chemical products are used in scientific and geometric research, biotechnology and pharmaceutical development, diagnosis of diseases and as key components in pharmaceutical and other high-technology manufacturing. It also imports finished products from its associated enterprises situated abroad for distribution in India and a game export.

3. For year under consideration assessee filed its return of income on 24/09/2009 declaring total income of Rs.6,62,75,366/-. Book profits computed by assessee was at Rs.4,56,82,699/-. The return was processed under section 143(1) of the Act and was selected for scrutiny. Notice under section 143(2) was issued to assessee in response to which representative of assessee appeared before Ld.AO and filed requisite details as called for.

4. Ld.AO observed that, assessee entered into international transaction exceeding Rs.15Crores, with its associated enterprises, and accordingly reference was made under section 92CA of the Act, to transfer pricing officer for computing arm's length price of the international transactions.

5. On receipt of reference under section 92CA, Ld.TPO called upon assessee to file economic details of international transactions in form 3 CEB.

6. Ld.TPO observed that, assessee had following international transaction for year under consideration:

Description	Amount Paid (Rs.)	Amount Received (Rs.)
Sales from the EOU Unit - 117484079		11,75,44,772
Sales from Non EOU Unit - 60693		
Sales from the EOU Unit	8,33,805	
Purchase of Chemicals	130,77,47,372	
Purchase returns of chemicals, non- moving materials		5,08,26,238
Q/C testing charges from chemicals	27,191	
Management Fees	9,87,760	
Customer Support services (ITES)		2,45,50,074
Payment of interest on loan	1,65,68,520	
Reimbursement of SAP & IP Costs	5,19,00,175	

7. Ld.TPO observed that, assessee had following segmental details recorded in TP documentation:

Segment details	Operative Revenue	OP/OC
Manufacturing (EOU unit)	11,03,57,902/-	(-)52.2%
Trading	215,84,97,500/-	7.93%
R &D	1,22,10,111/-	(-)79.49%
ITES	2,45,50,073/-	12.72%

8. Ld.TPO did not object to margin computed by assessee under trading segment. Since taxpayers margin was not less than margin computed by Ld.TPO, the transaction was treated to be at arms length.

9. In respect of other 3 segments, Ld.TPO recomputed the margins.

ITES segment:

10. Ld.TPO noted that, assessee followed TNMM as most appropriate method by using OP/OC as PLI. Ld.TPO noted that assessee used 8 comparables with average margin of 14.34%. Not agreeing with comparables selected by assessee, Ld.TPO finalised following set of 8 comparables with an average margin of 25.03%.

ITES FINAL COMPARABLES AY 09-10		
Sl.no	Name of the Company	Margin
	Infosys B P O Ltd.	24.41%
2	Aditya Birla Minacs Worldwide Ltd.	23.86%
3	Microland Ltd.(both segments)	1.53 %
4	Allsec Technologies Ltd.	-16.63%
5	Accentia Technologies Ltd.	46.40%
6	Informed Technologies India Ltd.	22.61%
7	Cosmic Global Ltd.	40.61%
8	Eclerx Services Ltd.	57.46%
	AVERAGE PLI	25.03%

11. Ld.TPO granted working capital adjustment however rejected the risk adjustment.

He thus proposed an adjustment of Rs.29,39,563/- being shortfall.

Manufacturing segment-EOU unit:

12. Ld.TPO noted that assessee has treated itself as engaged in distribution and manufacture of chemicals in India. Assessee used TNMM as most appropriate method and OP/TC as PLI. Assessee computed its margin at (-) 52.20% on cost and (-) 109.20% on sales. It was noted that assessee used 31 comparables TPO retained 9 comparables from assessee's following list and included 3 new

comparables totalling to 12 companies having an average margin of 9.60%.

SI N	Company Name	OP/ OC
1	Laffans Petrochemicals Ltd.	5.67%
2	Caprolactam Chemicals Ltd.	17.93%
3	Kilburn Chemicals Ltd.	4.73%
4	Alufluoride Ltd.	22.11%
5	Tanfac Industries Ltd.	2.01%
6	Gulshan Polyols Ltd.	5.90%
7	Alkyl Amines Chemicals Ltd.	8.12%
8	Narmada Gelatines	15.66%
9	Vishnu Chemicals Ltd.	6.24%
10	Mysore Petro Chemicals Ltd.	1.16%
11	Amines & Plasticizers Ltd.	5.34%
12	Vinati Organics Ltd.	20.32%
	ARITHMETIC MEAN MARGIN	9.60%

13. Under this segment assessee did not seek any risk adjustment, however sought adjustment in terms of capacity underutilisation, as assessee operated only at 20% of the installed capacity. Ld.TPO rejected submissions of assessee by holding that, it is wholly dependent upon its associated enterprises and cannot bear any losses for deficiency on account of AE.

14. Ld.TPO thus computed shortfall being Rs.15,84,66,540/- as proposed adjustment under this segment.

R&D Segment:

15. Ld.TPO noted that assessee had shown profit margin of R&D along with manufacturing segment and did not furnish any

separate segmental analysis. Ld.TPO, accordingly, called upon assessee in respect of 5 comparables selected under this segment. After considering the objections raised by assessee Ld.TPO, finalised following comparables with average margin of 10.45% with PLI OP/OC under TNMM.

SI No	Company Name	OP / OC
1	Vimta Labs Ltd.	10.98%
2	Clinigene International	18.97%
2	Research Support Intl. Pvt.	5.85%
4	Cyber Media Research Ltd.	10.78%
5	Max Neeman Medical Intl. Ltd.	5.67%
	ARITHMETIC MEAN MARGIN	10.45%

He thus proposed adjustment of Rs.5,32,74,095/-.

16. Ld.TPO thus proposed total adjustment of Rs.21,46,80,201/- to the arms length price.

17. Ld.AO while passing the draft assessment order observed that assessee has disclosed total turnover of Rs.20236,00,99,176/- and has shown net profit of Rs.4,46,00,706/- and gross profit of Rs.68,37,07,135/-. Ld.AO, thus worked out GP rate at 28.97%. And the net profit at 1.89%. Ld.AO noted that, in immediately preceding assessment year net profit declared by assessee was at 8.97% and that there was a fall in the net profit rate for the current year. Ld.AO, thereafter on examination of profit and loss account observed that, assessee debited sum of Rs.22,11,63,722/-, as stock write-off the bifurcations of which are as under:

Particulars	Amount in Rs.
<i>Quality rejects</i>	<i>8492223</i>
<i>Breakage,leakage & damage</i>	<i>4110416</i>
<i>Expired inventory</i>	<i>8075287</i>
<i>Genosys</i>	<i>739794</i>
<i>Physical Difference d Error in receipt</i>	<i>689875</i>
<i>Sales promotion samples</i>	<i>56127</i>
<i>Total</i>	<i>22163722</i>

Ld.AO disallowed claims made by assessee, and made addition of Rs.1,80,69,951/-.

18. Aggrieved by proposed additions, assessee preferred objections before DRP.

19. In respect of transfer pricing adjustment proposed by Ld.TPO, DRP directed as under:

Manufacturing Segment:

20. DRP directed Ld.TPO to verify applicability of various filters adopted by him in respect of 2 comparables, namely, Indian Oxides and Chemicals Ltd and Insilco Ltd. In respect of remaining 12 comparables DRP upheld their inclusion.

21. DRP noted that assessee operates in 3 different segment and has incurred significant loss in its manufacturing and R&D segment while it has made profits in the trading segment. DRP also noted that in manufacturing segment assessee incurred loss of Rs.13.38 crore on total turnover of Rs.12.25 crore, clearly signifying the risk faced by assessee, even in transaction with its AE's. DRP has thus observed that there is no insulation of assessee as regards

market risk. However DRP upheld Ld.TPO's observation that, assessee was not successful in either demonstrating any clear risk differential with respect to various comparables selected or quantify such risk differential with respect to such comparables.

22. As regards working capital adjustment DRP observed that Ld.TPO restricted adjustment at (-)1.19%. DRP noted that on principle TPO has agreed to the claim of assessee for granting working capital adjustment however the same was restricted. In regards to this DRP directed Ld.AO to carry out working capital adjustment as per actual figures without putting any And also directed to verify PLR adopted by Ld.TPO.

23. As regarding depreciation adjustment to be provided to assessee for eliminating difference in depreciation cost between assessee and the comparable companies, DRP agreed to the submissions of assessee that being the 2nd year of operation in contradistinction to the comparables resulting in higher impact of depreciation on profitability. DRP acknowledged that in order to offset higher cost on account of depreciation, it would be in the interest of Justice if PLI is charged from PBIT on cost, as against, adopted by Ld.TPO to PBDT. DRP thus directed Ld.TPO to compare margins by adopting the PLI to PBDT.

24. Assessee had also challenged exclusion of certain comparales, amongst which DRP rejected.

R&D segment:

25. DRP noted that, Ld.TPO did not provide any adjustment for underutilisation of capacity and depreciation adjustment. DRP

observed that assessee transfers both the process as well as intangible developed by it to the person for whom work is done. It was therefore of the opinion that the transfer should include all cost incurred by assessee. And that, assessee did not separately benchmark R&D function, though admittedly, it could perform independently of manufacturing activity. For R&D segment DRP rejected capacity underutilisation and depreciation adjustment.

Assessee also challenged exclusion of certain comparables, amongst which DRP directed Ld.AO to verify RPT of Clinigene International Ltd., and observed that in the event RPT is more than 25% the comparable needs to be rejected. And in respect of Cyber Media Research Ltd., DRP was upheld for exclusion.

ITES segment:

26. Assessee challenged certain comparables for exclusion and proposed certain comparables for inclusion. Assessee submitted before DRP that PBDD should be treated as operating, while computing margins.

27. Assessee had also challenged exclusion of certain comparables, amongst which DRP rejected.

Corporate tax issues:

28. DRP directed Ld.AO to delete addition made in respect of disallowance made under stock right off and also directed Ld.AO to grant MAT credit available to assessee.

29. On receipt of DRP directions, Ld.AO passed order by making addition in the hands of assessee at Rs.6,81,27,143/- against the

order passed by Ld. AO, assessee as well as revenue are in appeal before us.

30. Revenue is aggrieved by addition deleted on account of stock write-off. Revenue is also aggrieved for adopting PBDDIT on cost instead of PBIT on cost, thereby holding depreciation to be operating expenditure. Revenue is also aggrieved by exclusion of 2 comparables, being Cyber Media Research Ltd., and Clingine International Ltd

31. Assessee in its appeal for not granting capacity underutilisation adjustment to assessee under manufacturing as well as R&D segment. It has been submitted that, under manufacturing segment DRP directed depreciation to assessee as operating expenses for computing margin, whereas similar direction was not given under R&D segment. Assessee has also alleged that adjustment should be restricted to international transaction, since Ld.TPO considered entity level, which includes non-AE transaction also. Assessee also seeks exclusion of 3 comparables under manufacturing segment on turnover filter. Under ITES segment assessee seeks inclusion of 3 comparables and exclusion of 4 comparables. Assessee also submits that depreciation must be granted to assessee after computing the margin under ITES Segment.

We shall 1st take up appeal filed by revenue.

32. Ground No.1 raised by revenue is general in nature and therefore do not require adjudication.

33. Ground Nos.2-4 is in respect of disallowances made on account of quality rejects, breakage leakage etc, expired inventory, stock of Genosys, stock difference in error.

Ld.AR submitted that, all these disallowances have been considered by coordinate bench this *Tribunal* in assessee's own case for assessment year 2005-06 to 2008-09 by order dated 27/07/2015. He placed reliance on copy of order placed at page 1421 of paper book volume 3.

34. On the contrary, Ld.CIT DR placed reliance on observations of Ld.TPO.

35. We note that Ld. AO has rejected the entire claim of assessee under the head quality rejects, breakage leakage and damage, stock to Genosys physical differences in error in receipt of stock.

36. In respect of expired inventory Ld. AO noted that assessee debited a sum of Rs.80,75,287/- as shelflife expiry, due to oxidation, chemical break down, drying or moistening, microbial growth etc. Ld.AO was of the opinion that, assessee manufactured chemicals on need basis and on demand and it is not possible that company will manufacture more than that is required thereby leading to transpiration loss. Ld.AO accordingly, on assumption basis, disallowed 50% of the claim and added back to the income of assessee.

37. We note that all these disallowances have been addressed by coordinate bench of this *Tribunal* in assessee's own case in preceding assessment years. This tribunal while considering the

disallowances has referred to various statistics to consider the reasonability of such claim.

Breakage, Leakage etc;

38. Assessee in order to establish breakage leakage etc had filed a chart showing the ratio of the law is on such breakage to sales during the relevant years which is negligible as compared to huge turnover of assessee. We therefore direct assessee to file identical details for year under consideration to establish the claim in view of the observations made by this tribunal in immediately preceding years.

39. Ld.AO is directed to verify the same and allow the claim of assessee is signed in accordance with the observations of this tribunal in assessee's own case for immediately preceding assessment years.

Expired inventory:

40. It is noted that this *Tribunal* dealt with this disallowance, based observations in following decisions:

Alpha level India Ltd vs DCIT (2003) 133 Taxmann 740 (Bom)

CIT vs Wolkem India Ltd (2009) 315 ITR 111 (Raj.)

41. This *Tribunal*, based on ratio laid down in these decisions, observed that, ratio of such expired inventory to sale was only 0.12% on sales and 0.18% on cost of goods sold. Further it has not been disputed that, goods of assessee nearing expiry date have to be written off. We therefore, direct assessee to file requisite details in order to ascertain percentage of expired inventory on sales and on cost of goods sold. Ld.AO is directed to verify the same and allow

the claim of assessee is signed in accordance with the observations of this *Tribunal* in assessee's own case for immediately preceding assessment years.

Stock issued for Genesis production as consumables:

42. We note that this *Tribunal* while considering this disallowance observed as under:

“(iv) having regard to the rival contentions and the materials on record we find that though the assessee has claimed that Genesis production has manufactured the products and offered income from sale of these products as assessee's income, the CIT has not verified the same and has accepted the contentions of assessee at the face value and allowed relief to assessee. In view of the same, we deem it fit and proper to remit this issue to the file of AO to verify the assessee's contentions and if it is found to be correct, then no disallowance shall be made. This ground of appeal is accordingly treated as allowed for statistical purposes.”

43. We note that DRP while allowing claim of assessee, held that the substance and spirit of transaction is more important than the form and as income from production has been booked the cost of consumables also needs to be allowed to assessee.

In the present facts also the DRP accepted assessee's contentions without verifying the same.

44. Accordingly, respectfully following the view taken by this *Tribunal* in assessee's own case for preceding assessment years, we direct Ld.AO to verify contentions of assessee and if found correct no disallowance shall be made.

Quality rejects:

45. We note that, Ld.AO denied claim on assumption that, as assessee is in the business of high-quality organic and inorganic chemicals for a long time it should be meeting the quality standards which are usually known beforehand and also the process goes through different levels of checks before entering the market.

46. We note that in preceding years assessee had filed charged highlighting the ratio of on sales and on cost of goods sold quality rejection. Assessee is directed to provide such details for year under consideration. Ld.AO is directed to verify the same and allow the claim of assessee in accordance with observations of this *Tribunal* in assessee's own case for immediately preceding assessment years.

Accordingly these grounds raised by revenue stands allowed for statistical purposes.

47. Ground No. 5 is in respect of the direction to Ld.AO to adopt profit before depreciation interest and taxes on cost as against profit before interest and taxes.

48. Ld.CIT.DR submitted that, depreciation is not an operating expenditure and DRP erred in directing Ld.AO to consider it as operating expenditure. It has been submitted that DRP has not given any basis for adopting the PLI to PBDIT.

49. Learnt CIT DR placed reliance on orders passed by learnt TPO. On the contrary, Ld.AR submitted that, this being second year of full operation, there has been capital infusion and investment by way of capital asset consequentially has incurred huge initial depreciation cost. It was submitted that, comparable companies

were early entrants and hence are in the operation for substantially long period of time whereas assessee have attained an optimal level of operations and is still in its nascent stages. It has been submitted that assessee therefore requires some time before it can reach to such level. Therefore, Ld.AR submitted that, considering the fact that, assessee has high depreciation cost, comparing net margins of assessee with net margin comparables, will not be justified.

He placed reliance on observations of DRP.

50. We note that, DRP considered depreciation to be an operating expense for year under consideration, for the reason that, this year is second full year of operation.

51. Attention was drawn to decision of *Hon'ble Hyderabad Tribunal* in case of *BA Continuum India (p.) Ltd vs ACIT* reported in (2013) 40 *taxmann.com* 311, wherein identical issue arose. Relying upon various decisions of this *Tribunal*, it was held therein that, all facts which impact the final results of a comparable company should be taken into account and reasonable accurate adjustments should be made for the same.

52. We also note that, in the present case the claim that assessee is having a high rate of depreciation has not been considered by Ld.TPO. This aspect has been considered by DRP wherein assessee has established the comparison in respect of depreciation to sales for year under consideration between assessee and the comparables. It was based upon these Tata that DRP allowed the claim of assessee.

53. Further, Ld.AR placed before us decision of *Hon'ble High Court of Hyderabad*, wherein, view taken by *Hon'ble Hyderabad Tribunal*, in case of *BA Continuum India (P.) Ltd vs ACIT (supra)* stands upheld in *ITTA No.440/2014 by order dated 16/07/2014*. Further Ld.AR submitted that, for assessment year 2011-12, assessing officer accepted depreciation to be and operating expense for purpose of computing margin.

54. We do not find any infirmity in such observations of DRP as it is in consonance with the Transfer Pricing regulations for computing arm's length margin of international transaction.

Accordingly these grounds raised by revenue stands dismissed.

55. Ground No.6-7 are in respect of exclusion of 2 comparables by DRP.

56. The outset Ld. CIT DR placed reliance on orders passed by learnt TPO.

57. Ld.AR submitted that assessee challenged exclusion of certain comparables, under R&D segment, amongst which DRP directed Ld.AO to verify RPT of Clinigene International Ltd., and observed that in the event RPT is more than 25% the comparable needs to be rejected. He submitted that related party transaction of this comparable admittedly is 32% of transaction with related parties as against gross revenue.

58. Ld.AR submitted that, it was On verification of all these facts that the directions by DRP have been followed by Ld.AO, thereby excluding this comparable.

59. And in respect of Cyber Media Research Ltd., DRP upheld exclusion since this company was into media research and functionally different from assessee.

60. He thus relied on observations and directions of DRP in respect of the 2 comparables.

61. We have perused submissions advanced by both sides in light of records placed before us.

62. We note that, nothing contrary to observations of DRP has been brought to our notice by revenue. Ld.AO excluded Clinigene International Ltd., after verifying RPT being more than 25% which was in consonance with the directions of DRP. And in respect of cyber media research Ltd., has been excluded for being functionally different which has not been objected before us.

63. Under such circumstances we do not find any infirmity in rejection of these 2 comparables by Ld.AO.

Accordingly these grounds raised by revenue stands dismissed.

IT(TP)A No.203/Bang/2014(ASSESSEE'S Appeal)

64. Assessee has raised additional grounds being 16-30 by stating that, these were inadvertently missed out in the original appeal of memorandum. However at the time of arguments none of these grounds have been pressed and hence these are dismissed. We are therefore only adjudicating the grounds only generally filed by assessee.

65. Ld.AR submitted that, **Ground 1-5 & 6.1** are general in nature and therefore do not require adjudication

66. Ground 6.2-6.6: Ld.AR submitted that, main grievance raised by assessee is non-granting of under capacity utilisation for manufacturing segment and R&D.

67. It was submitted that as the manufacturing and R&D segment were interlinked with each other assessee had benchmarked these transactions together. Ld.TPO dissatisfied with such approach, segregated both segments, which has not been objected by assessee. It was submitted that, assessee claimed adjustment for exclusion of depreciation on fixed costs since, capacity utilisation of company during the year was only 20%. It was submitted that DRP when agreed for exclusion of depreciation for computation of margin, under capacity utilisation cannot be denied to assessee as they are interlinked with each other. This being the initial year of manufacturing, assessee was not in a position to fully utilise the equipments purchased because of which an adjustment is warranted. He placed reliance on decision of coordinate bench of this *Tribunal* in case of *M/s SKF Technologies India Pvt.Ltd vs DCIT* in *IT(TP)A No.341/Bang/2014* for assessment year 2004-05 *by order dated 15/02/2019* in support of his contention.

68. On the contrary Ld. CIT DR placed reliance on the observations of DRP. She submitted that assessee transfers entire process as well as intangible developed by it under R&D segment, shows that the cost price should include price of such facilities created. And therefore there is no requirement to provide capacity utilisation to assessee.

69. We have perused submissions advanced by both sides in light of records placed before us

70. During the year under consideration, assessee has entered into international transaction with its AE in manufacturing segment and R&D segment. Under manufacturing segment admittedly assessee has utilisation of 28% and under R&D segment assessee has utilisation of 20%. This position has not been disputed by Ld.TPO.

Assessee wide submission dated 08/01/2013 and 03/01/2013 placed at page 540 and 568 of paper book volume 1 submitted before authorities below that it has installed 220 products out of which actual capacity utilised was only in respect of 62 products. Further it has been submitted that assessee hired 52 chemists but utilised only 9 of them.

71. DRP admittedly granted depreciation as an operating expenses for manufacturing segment considering the fact that this was the 2nd full year of operations for assessee and that assessee had a higher depreciation cost on sales as against the comparables. It has also been submitted that the comparables considered under these segments have achieved a higher capacity utilisation and therefore while computing margin of assessee both depreciation as well as capacity utilisation adjustment has to be granted.

72. It is an admitted fact that, adjustment on account of difference in capacity utilisation is one of the recognised adjustment under Rule 10B(1)(e)(iii) of Income Tax Rules, as observed by *Hon'ble Bombay High Court* in case of *CIT vs Petro Araldita (P) Ltd.*, reported in (2018) 93 *Taxmann.com* 438. It has been held that, adjustment

should be made in the hands of comparable companies to iron out the differences.

73. We also refer to and rely upon the decision of *Hon'ble Delhi Tribunal* in case of *DCIT vs Claas India Pvt Ltd.*, reported in (2015) 62 *Taxmann.com* 173, wherein *Hon'ble Tribunal* observed as under:

"Capacity utilization adjustment

6. The second segment of Ground no. 1 of the Revenue's appeal is against the allowing of capacity adjustment in respect of certain items of expenses, which was denied by the TPO.

7. The facts apropos this issue are that the assessee claimed to have worked at a capacity of 29% during the year in question. It was further claimed that the three comparables chosen by it worked at the average capacity utilization of 44%. That is how, the assessee claimed capacity utilization adjustment by reducing its operating costs accordingly. In support of deduction, the assessee filed a report of Mr. Chandra Wadhwa, a Cost Accountant. As per this report, the capacity utilization of the assessee as well as the comparables was initially raised to 100%. The TPO partly accepted the claim of the assessee. He considered VST Tractors and Tillers and Punjab Tractors Ltd. (Seg.) for the purposes of allowing capacity adjustment with an average capacity utilization taken at 54%. Thereafter, he restricted the reduction in operating costs of the assessee due to capacity utilization, to some Administrative costs and other expenses. As against the assessee's actual deduction of Rs. 6,65,79,916 for such selective items of administrative and other expenses, the TPO adjusted such costs to Rs. 6,30,30,739 by applying the factor of 29/54 (29%, being, the assessee's capacity utilization and 54%, being, the average capacity utilization of comparables chosen by him). Similarly, he reduced the amount of Depreciation claimed by the assessee at Rs. 1,19,60,921 to Rs. 64,23,458 by applying the same factor of 29/54. After allowing this capacity utilization adjustment, he determined OP/TC of the assessee at a loss of (-) 7.78%. Total cost of the assessee was taken at Rs. 36.88 crore. By applying the arithmetic mean of the profit rate of comparable companies chosen by him at 11.92%, he proposed a transfer pricing adjustment of Rs. 7,26,60,103/-, for which addition was made by the AO. The ld. CIT(A) accepted the assessee's contention about not making any TP adjustment in relation to non-AE transactions. The Revenue is not aggrieved to that extent. As regards adjustment for capacity utilization, the ld. CIT(A), by considering the companies finally held by him as comparable, applied the factor of 29/46 for reducing the operating costs actually incurred by the assessee. Apart from the adjustments allowed by the TPO on Administration expenses

and Depreciation, the ld. CIT(A) also reduced Advertisement & Marketing expenses, Employee cost (by taking entire employee cost, other than bonus, at Rs. 35515709 as fixed). The Revenue is aggrieved against the allowing of capacity utilization adjustment to this extent by the ld. CIT(A).

8. We have heard the rival submissions and perused the relevant material on record. Before embarking upon the question of allowability and extent of capacity adjustment under the TNMM, we want to make it clear that the assessee reduced its operating costs by considering its capacity utilization vis-à-vis that of comparables and resultantly claimed that its increased profit as a result of such reduced operating costs be compared with that of the comparables. The TPO has also agreed in principle with the otherwise availability of the capacity adjustment. The issue of allowing capacity adjustment before us can be divided into two sub-issues for consideration, viz., first, whether the adjustment should be allowed in the hands of the assessee as has been done by the authorities below or comparables and second, how to compute capacity utilization adjustment under the TNMM. We will deal with these aspects one by one.

i. Capacity adjustment should be allowed in whose hands ?

9.1 It has been noticed above that the assessee claimed idle capacity adjustment by reducing its own operating costs. It is further observed that the authorities below have reduced the amount of adjustment by excluding certain costs from the ambit of the costs qualifying for adjustment. However, the adjustment has been ultimately allowed from the operating costs incurred by the assessee. In such circumstances, the question arises as to whether the action of the authorities in allowing the reduction of the operating costs incurred by the assessee, is in accordance with law? In order to find answer to this question, we need to refer to the manner of computation of the arm's length price under TNMM, which has been set out in Rule 10B(1)(e) as under:—

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

(i) the net profit margin realised by the enterprise from an international 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, form where between the international 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."

9.2 *Sub-clause (i) in the process of determination of the ALP under the TNMM talks of the computation of net operating profit margin realized by the assessee from an international transaction. Sub-clause (ii) is the computation of net operating profit margin realized by an unrelated enterprise from a comparable uncontrolled transaction. This refers to determining the operating profit margin of comparables with the same base as that of the assessee. Sub-clause (iii) provides that the net profit margin realized by a comparable company, determined as per sub-clause (ii) above, 'is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions,. which could materially affect the amount of net profit margin in the open market.' It is this adjusted net profit margin of the unrelated transactions or of the comparable companies, as determined under sub-clause (iii), which is used for the purposes of making comparison with the net profit margin realized by the assessee from its international transaction as per sub-clause (i).*

9.3 *Sub-rule (2) of Rule 10B provides that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to certain factors which have been enumerated therein. Rule 10B(3) states that an uncontrolled transaction shall be comparable to an international transaction, if either there are no differences between the two or a 'reasonably accurate adjustment can be made to eliminate the material effects of such differences.' When we read sub-clauses (ii) & (iii) of Rule 10B(1)(e) in juxtaposition to sub-rules (2) & (3) of rule 10B, the position which emerges is that the net operating profit margin of comparable companies calls for adjustment in such a manner so as to bring both the international transaction and comparable cases at the same pedestal. In other words, if there are no differences in these two, then the average of the net operating profit margin of the comparable companies becomes a benchmark. However, in case there are some differences between the comparables and the assessee, then the effect of such differences should be ironed out by making suitable adjustment to the operating profit margin of comparables. That is the way for bringing both the transactions, namely, the international transaction and the comparable uncontrolled transactions, on the same platform for making a meaningful and effective comparison. The above analysis overtly transpires that the law provides for adjusting the profit margin of*

comparables on account of the material differences between the international transaction of the assessee and comparable uncontrolled transactions. It is not the other way around to adjust the profit margin of the assessee. In other words, the net operating profit margin realized by the assessee from its international transaction is to be computed as such, without adjusting it on account of differences with the comparable uncontrolled transactions. The adjustment, if any, is required to be made only in the profit margins of the comparables.

9.4 Reverting to the facts of the instant case, we find that the authorities below have adjusted the operating costs of the assessee in allowing the capacity adjustment. As against that, the correct course of action provided under the law is to adjust the operating costs of the comparable and their resultant operating profit. There is hardly need to accentuate that there can be no estoppel against the law. Once the law enjoins for doing a particular thing in a particular manner alone, it is not open to anyone to adopt a contrary or different approach. As the authorities below have adopted a course of action in allowing adjustment, which is not in consonance with law, we cannot approve the same. The impugned order is set aside and the matter is restored to the file of the TPO/AO for giving effect to the amount of idle capacity adjustment in the operating profit of the comparables and not the assessee.

ii. How to compute capacity utilization adjustment under TNMM :

10.1 Under the TNMM, the ALP of an international transaction is determined by computing and comparing the percentage of operating profit margin realized by the assessee with that of the comparables. We have noticed above that the difference in the capacity utilizations is an important factor, which needs to be adjusted. No mechanism has been given under the Act or the rules for computing the amount of capacity utilization adjustment.

10.2 On an overall understanding, we feel that under the TNMM, the first step in granting capacity utilization adjustment is to ascertain the percentage of capacity utilization by the assessee and comparables. There can be no difficulty in working out these percentages. The second step is to give effect (positive or negative) to the difference in the percentage of capacity utilizations of the assessee vis-à-vis comparables, one by one, in the operating profit of comparables by adjusting their respective operating costs. Operating costs can be either fixed or variable or semi-variable. One needs to split semi-variable costs into the fixed part and variable part. In so far as the variable costs and the variable part of the semi-variable costs are concerned, these remain unaffected due to any under or over utilization of capacity. Accordingly, such variable operating costs remain unchanged. The adjustment is called for only in respect of the fixed operating costs and fixed part of semi-variable costs. Such costs are scaled up or down by considering the percentage of capacity utilization by the assessee and such comparable. It can be illustrated

with the help of a simple example. Suppose the fixed costs incurred by a comparable (say, A) are Rs. 100 and it has capacity utilization of 50% as against the capacity utilization of 25% by the assessee. The above percentages show that the assessee has incurred full fixed costs with 25% of the utilization of its capacity, as against A incurring full fixed costs with 50% of its capacity utilization. This divulges that the assessee has incurred relatively more fixed costs and A has incurred lower costs. In order to make an effective comparison, there arises a need to obliterate the effect of this difference in capacity utilizations. It can be done by proportionately scaling up the fixed costs incurred by A so as to make it fully comparable with the assessee. This we can do by increasing the fixed costs of A to Rs. 200 (Rs. 100 into $50/25$) as against the actually incurred fixed costs by it at Rs. 100. When we compute operating profit of A by substituting the fixed costs at Rs. 200 with the actually incurred at Rs. 100, it would mean that the fixed costs incurred by the assessee and A are at the same capacity utilization. There can be converse situation as well. Suppose the fixed costs incurred by a comparable (say, B) are Rs. 100 and it has capacity utilization of 25% as against the capacity utilization of 50% by the assessee. The above percentages show that the assessee has incurred full fixed costs at 50% of the utilization of its capacity, as against B incurring full fixed costs at 25% of the capacity utilization. This deciphers that the assessee has incurred relatively lower fixed costs and B has incurred higher costs. This difference in capacity utilizations can be eliminated by proportionately scaling down the fixed costs incurred by B so as to make it fully comparable. This we can do by reducing the fixed costs of B to Rs. 50 (Rs.100 into $25/50$) as against the actually incurred fixed cost by it at Rs.100. When we compute operating profit of B by substituting the fixed costs at Rs. 50 with the actually incurred at Rs. 100, it would mean that the fixed costs incurred by the assessee and B are at the same capacity utilization level.”

74. We note that this *Tribunal* in case of *M/s SKF Technologies India Pvt.Ltd vs DCIT (supra)*, relying on above observations, upheld adjustment towards differences level of capacity utilisation. This view has also been affirmed by *Hon’ble Karnataka High Court* by order dated 26/06/2018 in *ITA No.229/2017*.

We understand that assessee has not filed details for examining in accordance with the observations made by *Hon’ble Delhi Tribunal* in above in support of its claim which requires examination by Ld. AO/TPO. Accordingly, we remand this issue back to Ld.AO/TPO for

examining the claim of assessee in light of observations made by *Hon'ble Delhi tribunal (supra)*.

Accordingly these grounds raised by assessee stands allowed for statistical purposes.

75. Ground 6.7-6.10 are in respect of comparables alleged for exclusion and not considering depreciation as an operating expense for computing margin in case of comparables under R&D segment.

Ld.AR submitted that, Ld.TPO adopted export earning filter of 25% for ITES and R&D segments, however the same principle has not been granted a defect applied for manufacturing segment.

Ld.AR alleged for exclusion of following 3 comparables for having high export filters as compared to assessee:

- Tanfac Industries Ltd
- Amines & Plasticizers Ltd
- Vinati Organics Ltd

It is submitted that, above comparables have high export earning as compared to assessee.

76. Ld.AR submitted that Tanfac Industries Ltd, Amines & Plasticizers Ltd., and Vinati Organics Ltd., have been selected by learnt TPO/DRP in respect of manufacturing segment without applying export earning filter of less than 25% that was adopted to ITES and R&D segment. The Ld.AR submitted that, these companies do not have export sales as compared to assessee and that they primarily cater only to domestic market.

77. Ld. CIT DR submitted that this aspect has not been examined by the authorities below as assessee primarily did not adopt this filter. He also referred to the order passed under 92CA for assessment year 2010-11, wherein assessee is not adopting export filter for manufacturing segment.

78. We have perused submissions advanced by both sides in light of records placed before us.

79. We note that, Ld.TPO selected 12 comparables for manufacturing segment is by applying the same filters adopted by assessee with certain modifications. Now at this stage before this *Tribunal* in assessee is alleging that companies with export income less than 25% needs to be excluded. Further we note from the records placed before us that assessee manufactures its products for its group entities on need basis. No ground has been raised before DRP in respect of this issue. Assessee has raised additional ground in respect of not applying export filter in manufacturing segment. As we note that this issue has not been dealt with by authorities below, in the interest of Justice we remand this issue back to Ld. AO/TPO in respect of comparables alleged by assessee here in. The Ld. AO/TPO shall verify applicability this filter and then consider alleged comparables accordingly.

Accordingly comparables raised by assessee are remanded to Ld.AO/TPO for verification.

80. As regards considering depreciation as operating expense, Ld.AR submitted that, DRP granted depreciation as operating

expense under manufacturing segment, however did not give identical directions for R&D segment. It has been argued that TNMM has not been disputed as most appropriate method and therefore the net profit only needs to be compared for computing the margins. Ld.AR thus submitted that, depreciation for year under consideration has been high in case of assessee being initial years of activity being carried out. It has also been submitted that there has been a lot of products and capital infused into the working of the segment and therefore depreciation needs to be eliminated in the present case.

81. On the contrary Ld.CIT.DR placed reliance on observations of learnt TPO/DRP.

82. We have perused submissions advanced by both sides in light of records placed before us.

83. At the outset we note that assessee had considered manufacturing and R&D segment as composite unit, which was subsequently separated by Ld.TPO in transfer pricing proceedings. It has not been disputed by authorities below that both segments are interrelated to each other and that there will be overlapping of products/machineries/manpower being used under 2 segments. When DRP directed depreciation as an operating expense to manufacturing segment, R&D segment cannot be looked contrary. We therefore direct Ld.AO/TPO to grant depreciation as operating expense while computing margins to determine the arm's length price under R&D segment.

Accordingly these grounds raised by assessee stands allowed as indicated hereinabove.

84. Assessee has alleged in ground 6.10 that comparable Vimta Labs should be excluded from R&D segment due to high turnover as compared to assessee. It is also been submitted that this comparable is a contract research service provider and its research activities not as same as that of assessee.

85. On perusal of orders passed by authorities below, we note that this aspect has not been verified by DRP/AO/TPO.

86. Accordingly we remand this comparable to Ld. AO/TPO to verify contentions alleged by assessee in respect of this comparable. In the event the claim alleged by assessee is found to be correct, this comparable deserves to be excluded.

Accordingly this ground raised by assessee stands allowed for statistical purposes.

87. Ground 7 is in respect of ITES segment wherein assessee seeks exclusion of certain comparables alleged in ground 7.13. It has been submitted that, in respect of other grounds assessee do not press the issues raised.

88. Gr.7.1.3: Assessee seeking exclusion of following for comparables for having functional dissimilarities:

Infosys BPO Ltd

Accentia technologies Ltd

Cosmic Global Ltd

e-Eclerx services Ltd

89. It has been submitted by the Ld.AR that, all these comparables have been considered by coordinate bench of this Tribunal in case of *e-4-e Business Solutions India Ltd* reported in (2015) 67 Taxmann.com 60 as under:

Accentia Technologies Ltd.

The learned AR of the assessee has submitted that though the TPO has recorded the business profile of the assessee, however, the international transactions of the assessee are carried out only in respect of service of contact centre outsourcing to its AE as per the service agreement. The learned AR of the assessee has referred to Annual report of Accentia Technologies Ltd., and submitted that this company has acquired M/s.Oak Technologies Inc, USA during the year under consideration and therefore, there is an extraordinary event of acquisition of another company. He has thus submitted that in view of the extraordinary event of acquisition, this company cannot be considered as a good comparable of the assessee. Apart from this objection, learned AR of the assessee has submitted that even otherwise this company is not functionally comparable with the assessee so far as services provided to the AE. He has referred to various business transactions and services provided by Accentia Technologies Ltd., and submitted that this company is in the various segments of activities like medical transcription, medical coding, medical billing, etc. The activity of medical transcription and medical coding is entirely different from the service of contact centre service provided by the assessee to its AE and therefore, this company cannot be considered as functionally comparable with the assessee. The learned AR of the assessee has referred to the revenue earned by the said company and submitted that substantial revenue has been earned by the said company from the business activity of medical transcription apart from billing and collection as well as medical coding activity.

- (i) On the other hand, learned Departmental Representative has submitted that this company satisfies the filter test applied by the TPO for selecting companies in the category of Information Technology Service (ITES) company. The assessee is also engaged in the activity of providing ITeS to its AE and therefore, both the assessee as well as Accentia Technologies Ltd., are engaged in the similar business activity. He has referred to the findings of the TPO and the DRP and submitted that the DRP has rejected the objections raised by the assessee against this company. Therefore, this company is a good comparable for determination of the ALP in respect of international transactions of the assessee.*

- (ii) *We have considered the rival submissions as well as relevant material on record. The first objection has been raised by the learned AR of the assessee on account of extraordinary event of acquisition/purchase of business by Accentia Technologies Ltd., whereby M/s. Oak Technologies Inc, USA has been acquired by this company during the year under consideration. Though the extraordinary event of merger or acquisition, if influenced the business as well as the revenue of a company then said company is not considered as a good comparable for the purpose of determination of the ALP however, in this case, it is not clear from the Annual Report whether the business of M/s. Oak Technologies Inc has been acquired and merged with the said company during the year under consideration. It appears that Accentia Technologies Ltd., has purchased up to 96% of the share holding of M/s. Oak Technologies. If it is only a transaction of purchase of shares of the said company then it may be a case of purchase of ongoing business and may not be a case of merging the same with the business of Accentia Technologies Ltd. In the absence of the relevant fact that the business of the said company has been merged with Accentia Technologies Ltd., it may be a case of acquiring the shares and M/s. Oak Technologies still remains an independent entity and business activity. Therefore, in the absence of complete relevant facts, it cannot be held that the so- called acquisition of M/s. Oak Technologies can be considered as an extraordinary event having impact on the revenue as well as business activity of Accentia Technologies Ltd. Accordingly, this argument of the learned AR of the assessee is rejected for want of complete facts.*
- (iii) *As regards the functional dissimilarity, we note that Accentia Technologies Ltd is engaged in diversified activity of medical transcription, medical coding, billing, receivable management. Thus it is clear that the said company is engaged in the healthcare activity and providing BPO service in the healthcare sector, that too by providing specific services of medical transcription, medical coding, medical billing etc. We note that these activities are quite different from the service of contact centre provided by the assessee to its AE which is purely in the nature of call centre. Therefore, we are of the view that the company Accentia Technologies Ltd cannot be considered as a functionally comparable company with the services provided by the assessee to its AE. The TPO is directed to exclude this company from the set of comparables.*

11.2 Eclerx Services Ltd.

The learned AR of the assessee has submitted that this company is engaged in the high-end services and therefore, this company is basically a KPO and not a BPO. He has referred to Annual Report of this company at page 26 of the paper book -II and submitted that as it is clear from the Annual Report that this

company is a knowledge process outsourcing (K. P. O) providing data analytics and data process solutions to global enterprise clients. This company supports core and complex activities for its clients using proprietary processes and a scalable offshore delivery model. This company has access to the capital market and therefore, this company is a public listed KPO company in India. The company is also engaged in consulting services and process outsourcing as well as in the activity of process re- engineering and automation apart from middle office and back office support to capital market. Therefore, keeping in the diversified high-end services, this company cannot be considered as functionally comparable with the assessee. In support of his contention, he has relied upon the decision of the Special Bench of the Mumbai Tribunal in the case of *Maersk Global Centres (India) (P.) Ltd. v. Asstt. CIT* [2014] 43 taxmann.com 100/147 ITD 83.

- (i) On the other hand, learned Departmental Representative has submitted that this company is undisputedly in the business of ITeS and therefore, the nomenclature that of KPO will not make it functionally different from the assessee. He has relied upon the orders of the authorities below.
- (ii) We have considered the rival submissions as well as relevant material on record. We find that the company Eclerx Services Ltd. is engaged in diversified activity of providing services including analytic services and data process solutions to its global clients. The service provided by Eclerx Services Ltd., is in various areas including capital market and therefore, the services are in the nature of consultancy and end to end support through trade centre including trade confirmation, settlement, transaction, maintenance and analytic and reporting. Thus it is apparent from the nature of the activity of this company that it is not providing a simple service of data processing but it is engaged in the activity of providing high-end services involving decision making analysis which requires thought process and evaluation of various facts and factors. Functional comparability of this company with that of simple BPO's service providing company has been examined by the Special Bench in the case of *Maersk Global Centres (India) (P.) Ltd.* (supra) in paras.82 & 83 as under :

82. In so far as M/s eClerx Services Limited is concerned, the relevant information is available in the form of annual report for financial year 2007-08 placed at page 166 to 183 of the paper book. A perusal of the same shows that the said company provides data analytics and data process solutions to some of the largest brands in the world and is recognized as experts in chosen markets-financial services and retail and manufacturing. It is claimed to be providing complete business solutions by combining people, process improvement and automation. It is claimed to have employed over 1500 domain specialists working for the clients. It is claimed that eClerx is a different company with industry specialized

services for meeting complex client needs, data analytics KPO service provider specializing in two business verticals financial services and retail and manufacturing. It is claimed to be engaged in providing solutions that do not just reduce cost, but help the clients increase sales and reduce risk by enhancing efficiencies and by providing valuable insights that empower better decisions. M/s eClerx Services Pvt. Ltd. is also claimed to have a scalable delivery model and solutions offered that include data analytics, operations management, audits and reconciliation, metrics management and reporting services. It also provides tailored process outsourcing and management services along with a multitude of data aggregation, mining and maintenance services. It is claimed that the company has a team dedicated to developing automation tools to support service delivery. These software automation tools increase productivity, allowing customers to benefit from further cost saving and output gains with better control over quality. Keeping in view the nature of services rendered by M/s eClerx Services Pvt. Ltd. and its functional profile, we are of the view that this company is also mainly engaged in providing high-end services involving specialized knowledge and domain expertise in the field and the same cannot be compared with the assessee company which is mainly engaged in providing low-end services to the group concerns.

83. For the reasons given above, we are of the view that if the functions actually performed by the assessee company for its AEs are compared with the functional profile of M/s eClerx Services Pvt. Ltd. and Mold-Tec Technologies Ltd., it is difficult to find out any relatively equal degree of comparability and the said entities cannot be taken as comparables for the purpose of determining ALP of the transactions of the assessee company with its AEs. We, therefore, direct that these two entities be excluded from the list of 10 comparables finally taken by the AO/TPO as per the direction of the DRP.

Thus it is clear that the Special Bench found that this company is not comparable with BPO company which are engaged only in low end services of data processing. Accordingly, we direct the AO/TPO to exclude Eclerx Services Ltd. from the list of comparables for the purposes of determining ALP.

11.3 Infosys BPO Ltd.

The learned AR of the assessee has referred to the Annual Report of this company at page 57 of the paper book and submitted that though this company was initially selected by the assessee, however, the assessee has raised objections against this company even before the TPO and further before the DRP. Therefore, this company, if found functionally different, has to be excluded from the list of comparables. The learned AR of the assessee has pointed out that this company is having more than 17000 employees in comparison to only 6 employees of the assessee. Therefore, even on the parameter of the scale and

strength of employees, this company cannot be considered as functionally comparable with that of the assessee. Further, he has referred to the Annual Report of the company and submitted that during the year under consideration, there is amalgamation of PAN Financial Services India Pvt. Ltd. w.e.f. 1/4/2008. The scheme of amalgamation has been approved by the Hon'ble High Court on 6/4/2009 and 10/3/2009. Therefore, there is an extraordinary event of amalgamation during the year under consideration and hence this company cannot be considered as a good comparable for the purpose of determining the ALP. Apart from the above objections, learned AR of the assessee has further submitted that this company is engaged in providing business process management services to organizations with outsourcing their business process. Therefore, this company is in a different kind of business activity in providing the management service of business processes and is not directly providing any business process outsource services. Thus, this company cannot be considered as a functionally comparable.

- (i) On the other hand, the learned Departmental Representative has submitted that this company is in the business activity of providing ITeS and therefore, it satisfies all the tests and filters applied by the TPO. The functional comparability has been examined by the DRP and it was found that this company is in the same line of activity under the category of ITeS. He has relied upon the order of the authorities below.
- (ii) We have considered the rival submissions as well as relevant material on record. We note that in para 16.2.15 of the Annual Report of this company, it has been reported that there was amalgamation w.e.f. 1/4/2008. The relevant part of the information provided in the Annual Report reads as under:

"Amalgamation of PAN Financial Services India Private Limited

The Board of Directors in their meeting held on October 6, 2008, approved, subject to the approval of the Honorable High Courts of Karnataka and Chennai, a Scheme of amalgamation ("the Scheme") to amalgamate PAN Financial Services India Private Limited ("PAN Financial"), a wholly owned subsidiary of the Company engaged in providing business process management of services, with the Company with effect from April 1, 2008 ("effective date"). The approval of the High Court was received on April 6, 2009 and filed with the respective Registrar of Companies of Karnataka and Tamilnadu on April 6, 2009 and March 10, 2009 respectively. Accordingly on the scheme becoming effective, the financial statement of PAN Financial has been merged with the company."

It is clear that there was extraordinary event of amalgamation during the year under consideration. Therefore, in view of the extraordinary development of amalgamation of another company, this company cannot be considered as a

good comparable for the assessment year under consideration. Apart from this, we further note that as per the segment reporting in para.16.2.21 this company is providing business process management services as under:

"Segment reporting

The company's operations primarily relate to providing business process management services to organizations that outsource their business processes. Accordingly, revenues represented along industry classes comprise the primary basis of segmental information set out in these financial statements. Secondary segmental reporting is performed on the basis of the geographical location of customers.

The accounting principles consistently used in the preparation of the financial statements are also consistently applied to record income in individual segments. These are set out in the note on significant accounting policies."

Thus it is clear that the revenue earned by this company is from the activity inclusive of operation primarily relates to providing business process management services to other organization engaged in outsourcing business process. This company is not engaged in direct activity of BPO but it provides service to BPOs and that too management service to BPO. Therefore, in our considered view, this company is engaged in a different nature of activity to that of the assessee provided to its AE. Accordingly, we direct the AO/TPO to exclude this company from the list of comparables.

11.4 Cosmic Global Ltd.

The learned AR of the assessee submitted that the assessee raised objection against inclusion of this company in the list of comparables before the TPO on the ground that this company has major revenue from translation services. Therefore, this company is functionally different from the services provided by the assessee to its AE. The learned AR of the assessee has referred to the Annual report of this company and submitted that that out of the total revenue of Rs. 7,37,02,584/-, this company has earned revenue from translation charges to the tune of Rs. 6,99,35,756/-. Therefore, substantial part of the revenue has been earned from the activity of translation. The learned AR of the assessee has further pointed out that even otherwise this company is outsourcing the work of translation as it is evident from the profit and loss account of this company that an amount of Rs. 3,00,25,326/- has been paid on account of translation charges. Thus, learned AR of the assessee has submitted that this company cannot be considered as functionally comparable with the assessee for the purpose of determining the ALP. In support of his contention, he has relied upon the decision of the co-ordinate bench of this Tribunal in the case of Lam Research (India) (P.) Ltd. v. Dy. CIT in ITA No. 1437/Bang/2014 dated 30/4/2015.

(i) On the other hand, learned Departmental Representative has submitted

that the comparability of this company has been examined by the TPO as well as by the DRP. The TPO has rejected the objections raised by the assessee in respect of this company by holding that the translation service are in the nature of ITeS and therefore, it qualifies all the filters applied by the TPO. He has relied upon the orders of the authorities below.

- (ii) *We have considered the rival submissions as well as the relevant material on record. There is no dispute that this company is in the business of providing service of medical transcription and consultancy services, translations services and accounts BPO. The segmental revenue from the operations are given in schedule 8 to the Profit & Loss account which reveals that major revenue of Rs. 6,99,35,756/- out of total revenue of Rs. 7.37 crores has been earned by this company from the activity of translation services. We further note that the company has debited an expenditure of more than Rs. 3 crore on account of translations charges paid. Thus it is clear that this company is outsourcing its services of translation work which is the main activity of this company yielding major revenue earned during the year. Thus it is manifest from the record that this company is in the entirely different nature of activity and cannot be compared with the activity of providing contact centre of the assessee to its AE. In the case of Lam Research (India) (P.) Ltd. (supra) the co- ordinate bench of this Tribunal had occasion to examine the comparability of this company in para. 34 as under:*

"34. With respect to Cosmic Global Ltd., Hyderabad bench of ITAT in the case of Capital IQ Information Systems (India) P. Ltd., in para 19 of its order, had held as under

Cosmic Global Ltd.

19. The main objection of assessee with reference to the inclusion of this company is with reference to outsourcing of its main activity. Even though this company is in assessee's TP study, it has raised objection before the TPO that this company's employee cost is less than 21.30% and most of the cost is with reference to the outsourcing charges or translation charges, and as such this is not a comparable company. The TPO, though considered these submissions, rejected the same, on the reason that this does not impact the profit margin of the company. Opposing the view taken by the TPO, it is submitted that this company cannot be selected as comparable, as M/s. Capital IQ Information systems (India) Pvt. Ltd., Hyderabad similar issue was discussed by the coordinate Bench of the Tribunal(Delhi) in the case of Mercer Consulting (India) P. Ltd. (supra), vide paras 13.2 to 13.3 which read as under-

13.2. Now coming to the factual matrix of this case, we find from the material on record that outsourcing charges of this case constitute 57.31% of the total operating costs. This does not appear to us to be a valid reason for eliminating this case from the list of comparables. On going through the Annual accounts of Cosmic Global Limited, a copy of which has been placed on record, we find that its total revenue from operations are at Rs. 7.37 crore divided into three segments, namely, Medical transcription and consultancy services at Rs. 9.90 lacs, Translation charges at Rs. 6.99 crore and Accounts BPO at Rs. 27.76 lac. The Id. AR has made out a case that outsourcing activity carried out by this company constitutes 57% of total expenses. The reason for which we are not agreeable with the Id. AR is that we have to examine the revenue of this case only from Accounts BPO segment and not on the entity level, being also from Medical transcription and Translation charges. When we are examining the results of this company from the Accounts BPO segment alone, there is no need to examine the position under other segments. The entire outsourcing is confined to Translation charges paid at Rs. 3.00 crore, which is strictly in the realm of the Translation segment, revenues from which are to the tune of Rs. 6.99 crore. If this segment of Translation is not under consideration for deciding as to whether this case is comparable or not, we cannot take recourse to the figures which are relevant for segments other than accounts BPO. Thus it is held that this case cannot be excluded on the strength of outsourcing activity, which is alien to the relevant segment.

13.3 However, we find this case to incomparable on the alternative argument advanced by the Id. AR to the effect that total revenue of the Accounts BPO segment of Cosmic Global Limited is very low at Rs. 27. 76 lacs. We have discussed this aspect above in the context of CG-VAK's case and held that a captive unit cannot be compared with a giant case and thus excluded CG-VAK with turnover from Accounts BPO segment at Rs. 86.10 lacs. As the segmental revenue of BPO segment of Cosmic Global Limited at Rs. 27. 76 lac is still on much lower side, the reasons given above would fully apply to hold Cosmic Global Limited as incomparable. This case is, therefore, directed to be excluded from the list of comparables.

In view of the detailed analysis of the coordinate Bench of the Tribunal in the above referred case, in this case also we accept the contentions of assessee and direct the Assessing Officer/TPO to exclude this comparable for the same reasons.

90. Nothing has been brought on record by revenue to establish any functional difference between assessee and e-4-e Business

Solutions India Ltd. In view of the above discussion by coordinate bench, we hold these comparables as not functionally similar to assessee.

Accordingly ground 7.1.3 stands allowed.

91. Ld. A.R. submitted that assessee had sought inclusion of following comparables in ground 7.1.2:

Lee & Nee software (exports) Ltd

Calibre Point Business Solutions Ltd

RS Systems International Ltd.

Ld. A.R. submitted that TPO rejected these comparables for having different year ending.

92. Ld. CIT DR submitted that these comparables may be remanded to learnt AO/TPO for verification in respect of objections raised for considering its inclusion.

93. We have perused submissions advanced by both sides in light of records placed before us.

94. We note that in respect of Lee & Nee Software (exports) Pvt.Ltd., there has been no finding in respect of whether this company is having functions that of ITES a software developer.

Insofar as 2 comparables are concerned, reason for its exclusion by Ld.TPO is only because, they have a different year ending. Ld.TPO do not object functional dissimilarities with assessee. Therefore, In our view, in the event results could be extrapolated, these comparables needs to be included.

95. We therefore remand these comparables back to Ld.AO/TPO to ascertain financial results by extrapolating from the annual

accounts. Also in respect of Lee& Nee Software, Ld.AO/TPO is directed to ascertain functions performed being whether ITES or software development company. In the event it is found to be having ITES segment, the same may be considered for purpose of comparability with assessee.

Accordingly these grounds raised by assessee stands allowed for statistical purposes.

96. Insofar as ground No. 7.1.6 and 7.1.7 is concerned Ld. A.R. has not advanced any arguments and accordingly no finding has been recorded herein.

Accordingly these grounds are dismissed.

Accordingly Ground No.7 stands allowed as indicated hereinabove.

97. Ground No.9 is in respect of adjustment proposed by Ld.TPO/AO on entity level u/s.92.CA of the Act.

98. Referring to Form 3CEB, Ld.AR submitted that Ld.AO made addition u/s.92CA which includes non AE transaction. He submitted bifurcation of revenue earned as under:

Particulars	Amount in Rs.	%
AE	62,92,374/-	51.53%
Non-AE	59,17,111/-	48.47%

99. He also submitted that, adjustment under section 92CA cannot exceed value of International transaction.

We note that this issue has not been verified by Ld.AO/TPO.

Therefore in the interest of justice, we remand this issue to Ld.AO/TPO to consider documents filed by assessee to support its claim. Assessee is directed to file requisite evidences/details in support. Ld.AO/TPO shall consider various decisions to decide this issue in accordance with law.

Accordingly this ground is allowed for statistical purposes.

100. Ground No.11 is in respect of disallowance of stock write off on account of physical difference and errors in receipt of stock amounting to Rs.6,89,875/-. We have remanded stock write off issue raised by revenue to Ld.AO, herein above. This being related issues is also remanded to Ld.AO for verification in accordance with law. Accordingly this ground raised by assessee stands allowed for statistical purposes.

101. Ground No.12 is in respect of not allowing MAT Credit.

Ld.AR submitted that details of MAT credit has been placed at pages 121 & 121 of paper book. He submitted that, MAT credit amounting to Rs.13,10,861/- in computing tax liability was claimed in its return dated 29/09/2009, however, Ld.AO while computing tax liability for year under consideration was not taken into account. It has been submitted that MAT credit paid by it during earlier u/s.115JB is allowable to assessee, as it was assessed under normal provisions of the Act for year under consideration,

102. Ld.AO is directed to verify and allow the claim in accordance with law.

Accordingly this ground is allowed for statistical purposes.

103. Ground No.13-14 are against levy of interest u/s.234B. &C
These are consequential in nature and needs to be levied in
accordance with law.

Accordingly, these grounds are remanded to Ld.AO.

**In the result appeal filed by Revenue and assessee stands partly
allowed for statistical purpose.**

Order pronounced in the open court on 15th September, 2020.

Sd/-
(B. R. BASKARAN)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 15th August, 2020.
/Vms/*

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,
Income-Tax Appellate Tribunal.
Bangalore.

		Date	Initial	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	10-03-2020		Sr.PS
3.	Draft proposed & placed before the second member	10-03-2020		JM/AM
4.	Draft discussed/approved by Second Member.	10-03-2020		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	20-03-2020		Sr.PS/PS
6.	Kept for pronouncement on	-03-2020		Sr.PS
7.	Date of uploading the order on Website	-03-2020		Sr.PS
8.	If not uploaded, furnish the reason	--		Sr.PS
9.	File sent to the Bench Clerk	-03-2020		Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS