IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE – VIRTUAL COURT

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND
SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER

ITA No.1823/PUN/2018
निर्धारण वर्ष / Assessment Year : 2014-15

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| M/s. Tasty Bite Eatables Limited,<br>201/202, Mayfair Towers,<br>Wakdewadi, Shivajinagar,<br>Pune – 411005<br>PAN : AAACT2317A | Vs. | ACIT,<br>Circle-7, Pune |
| Appellant | | Respondent |

Assessee by S/Shri Ajit Jain and Siddhesh Chaugule

Revenue by Shri Avadesh Kumar

Date of hearing 02-06-2021
Date of pronouncement 03-06-2021

## आदेश / ORDER

PER R.S.SYAL, VP :

This appeal by the assessee is directed against the final assessment order dated 19.9.2018 passed by the Assessing Officer (AO) u/s.143(3) read with section 144C(13) of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2014-15.

2. Succinctly, the factual matrix of the case is that the assessee, who is engaged in the manufacture and sale of ready to eat foods, filed its return declaring total income of

Rs.1,88,570, which was subsequently revised to the total income of Rs.9,38,410. The assessee reported certain international transactions in Form No.3CEB. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of international transactions. Instantly, we are concerned with the Ready to Serve Food (RTSF) segment, albeit the assessee has two other segments also, namely, Frozen Foods and Sauces. The assessee reported export of finished goods to its Associated Enterprises (AEs) in the USA and Australia amounting to Rs.71.04 crore and Rs.8.20 crore respectively under this segment. The Transactional Net Marginal Method (TNMM) was applied for demonstrating the international transaction of exports under RTSF segment at ALP. For doing so, the assessee selected six comparable companies with an average Profit Level Indicator (PLI) of Operating profits to Operating Costs at 6.33% with the data of the F.Ys. 2012-13 and 2013-14 as against its own segmental PLI at 14.58%. Though the books of accounts were maintained on a consolidated basis for all the three segments and there was a combined Profit and loss account, the assessee tried to justify RTSF segmental

claim by submitting a separate income statement allocating costs and income on a certain basis as mentioned on page 4 of the TPO's order. The TPO did not accept such allocation as the same was found to be vague and unreliable. Such a segmental Income statement was rejected by the TPO, who went ahead with the PLI determination of the RTSF segment on the basis of entity level Profit and loss account. He computed the assessee's PLI at 0.83% and average of the four shortlisted comparables for the relevant year only at 8.08%. This led to proposing a transfer pricing adjustment of Rs.9,91,05,228. The AO notified the draft order with the above referred transfer pricing adjustment. The Dispute Resolution Panel (DRP) did not provide any succor to the assessee which resulted in passing of the final assessment order with transfer pricing addition of the above amount. Aggrieved thereby, the assessee has come up in appeal before the Tribunal.

3. We have heard rival submissions through Virtual Court in the hue of relevant material on record. The first issue is about the computation of the ALP on the basis of entity level data taken by the TPO as against the assessee's plea for taking

segmental level data. The assessee claimed to have appropriated certain direct expenses to the RTSF segment and allocated remaining expenses on the basis of certain allocation keys. Page 4 of the TPO's order records that the assessee made RTSF segmental Income statement by using the three principles: "i) Direct cost objective which are in economically feasible manner; ii) Traceability to cost drivers; iii) `Cause and effect' or `benefits received' manner." Before proceeding further, it is pertinent to mention that the international transaction requiring the ALP determination is only the RTSF segment and not the others. Thus, it becomes more important to ensure that all the relevant costs relating to the RTSF segment are properly accounted for in the segmental Income statement. Any attempt to allocate more costs to this segment at the cost of the other segments needs to be eschewed. On our examination of the relevant material on record, it transpired that some of the important raw material costs were common to RTFS and Frozen Foods segments. The ld. AR could not substantiate that such common material costs were properly allocated segment-wise. In other words, the ld. AR could not demonstrate a rational allocation of costs to RTSF segment.

Faced with such a scenario, he gave up this argument and did not press the grounds challenging the order of the TPO determining the ALP on the combined accounts approach rather than the split approach adopted by the assessee. We, ergo, hold that the authorities below were justified in proceeding with the ALP determination on the basis of combined accounts approach.

4. The ld. AR argued for inclusion of Madhur Industries Limited in the list of comparables. The assessee, in its transfer pricing study report, included this company in the list of comparables with the financial figures relating to the preceding year only and not the year under consideration. The TPO refused to accept the companies with the financial data of the preceding year and stuck to the comparables companies with the financials concerning the current year only. During the course of the proceedings before the TPO, the assessee submitted Annual report of this company which the TPO did not accept on the ground that this company was not included by the assessee in the list of comparables for earlier years. The DRP did not countenance the so-called consistency approach of the TPO but approved the exclusion of the

company by observing that business of this entity was not correctly spelt out or legible. Another reason given by the DRP was about the higher turnover of this company *vis-a-vis* the assessee company. The assessee is aggrieved by non-inclusion of this company in the list of comparables.

5. We have heard the rival submissions and gone through the relevant material on record. The DRP refused to accept this company as comparable, *inter alia,* on its lower turnover. Our attention was invited towards turnover filter adopted by the assessee at equal or less than Rs.1.00 crore and equal to or less than Rs.1000 crore. Turnover of Madhur Industries Limited is Rs.9.97 crore as against the assessee's turnover from RTSF segment at Rs.86.00 crore. When the turnover filter has been accepted by the TPO, in our considered opinion, a mere higher turnover, but within the permissible filter, cannot be a valid reason for its exclusion.

6. Another reason advanced by the DRP is that *"the business of this entity is not correctly spelt out or legible".* On a pointed query, the ld. AR could not point out the nature of business carried on by this company from the Annual report to merit its inclusion or otherwise in the list of comparables. It is

just elementary that a company must be functionally similar in order to qualify for inclusion. All other filters come afterwards only when the functional similarity is established. We have also gone through the Annual report of this company from which its business profile cannot be deduced. The ld. AR submitted that the assessee be given one more chance to establish the functional comparability of this company before the TPO in the light of other attending evidence. Considering the totality of the facts and circumstances of the case, we overturn the impugned order on the exclusion of this company and direct the AO/TPO to re-decide the issue afresh. As it is a comparable chosen by the assessee, the onus is upon it to prove the functional comparability of this company in addition to other filters. If the assessee succeeds in doing so, the TPO will include it in the list of comparables and *vice-versa*. Needless to say, the assessee will be allowed a reasonable opportunity of hearing.

7. The next issue raised in this appeal is against the treatment of export incentives as non-operating. The facts apropos this issue are that the assessee treated export incentive under RTSF segment as operating revenue. The TPO

abrogated the assessee's contention and treated the same as non-operating. The DRP did not allow any relief even though it categorically noted that for the A.Ys. 2012-13 and 2013-14, it had directed to consider export incentive as operating revenue.

8. We have heard the rival submissions and perused the relevant material on record. The export incentives pertain to the exports made by the assessee under the RTSF segment. A copy of the Profit & Loss Account of the assessee has been placed at page 363 of paper book, from which it is discernible that there is an item of "Other operating income" at Rs.7.986 crore, whose detail has been given at page 377 of paper book, which includes export incentive of Rs.7.62 crore. The assessee, while calculating its segmental PLI, considered operational income of Rs.7.00 crore as per Appendix F, copy given at page 220 of paper book. The ld. AR pointed out that out of total export incentives of Rs.7.62 crore, a sum of Rs.7.00 crores pertained to the exports from RTSF segment to its AEs, which was considered by the assessee as a part of the operating income. There can be no doubt that export incentives are part and parcel of export revenue. The

Government of India allows incentives with a view to encourage exports and make Indian exporters more competitive in the world market. While finalizing the price at which the goods are to be exported in the foreign markets, the exporters take into consideration the export incentives permitted by the government of India and announce the sale price accordingly so as to remain in fray in the competitive world market. No export incentive can be earned without making exports. In that view of the matter, export incentives are nothing but an integral part of export revenue. Once the position is so, we fail to comprehend as to how export incentive can be treated as non-operating in nature. The DRP recognized this fact that it had earlier directed to consider the export incentive as operating revenue for the preceding two years and still found expedient to take a departure from its own stand without any cogent reason. In fact, while rendering its "Findings" in para 5.2 of the directions, the DRP went on to discuss some subsidy issue for setting up of industry in backward area and held that such subsidy was definitely not related to operations of the assessee, as the same was a type of financial assistance to tide over the crisis during initial period

of operations in the industry and eventually agreed with the analysis made by the TPO and came to hold it to be in the nature of an extraordinary income. Firstly, the issue before the DRP was export incentive and not any subsidy. Secondly, it is not any initial period of operations of the assessee as taken note of by the DRP. It appears that the DRP mixed up the facts of some other case, which eventually resulted in miscarriage of justice. It has been brought to our notice that for the A.Y. 2011-12, the TPO took similar view by treating export incentive as non-operating. When the matter came up before the Tribunal, it directed to consider the export incentives as part of operating income. A copy of the Tribunal order dated 24-07-2019 passed in ITA No.449/PUN/2016 at pages 762 onwards of paper book has been placed on record. Relevant discussion has been made at para 7.C of the Tribunal order. In view of the foregoing discussion, we are of the considered opinion that the amount of export incentives is liable to be considered as part of operating revenue. The assessee succeeds to this extent.

9. The next issue raised before the Tribunal is about not granting proportionate adjustment. We have noted that the

TPO rejected the assessee's segmental level benchmarking and went ahead with the entity level approach. The case of the assessee is that proportionate adjustment ought to have been given and the transfer pricing addition restricted only to the extent of international transactions.

10. This issue is fairly settled by a judgment of the Hon'ble jurisdictional High court in *CIT Vs. Phoenix Mecano (India) Pvt. Ltd. (2019) 414 ITR 704 (Bom.)*, holding that the transfer pricing adjustment made at entity level should be restricted to the international transactions only. It is pertinent to mention that the Department's SLP against this judgment has since been dismissed by the Hon'ble Supreme Court in *CIT Vs. Phoenix Mecano (India) Pvt. Ltd. (2018) 402 ITR 32 (St.).* Similar view has been espoused by the Hon'ble Bombay High Court in *CIT Vs. Thyssen Krupp Industries Pvt. Ltd. (2016) 381 ITR 413 (Bom.)* and *CIT Vs. Tara Jewels Exports (P). Ltd. (2010) 381 ITR 404 (Bom.)*. We, ergo, direct to restrict the transfer pricing addition only to the extent of international transactions in this segment.

11. The next issue raised before the Tribunal is about not granting working capital adjustment. Shorn of unnecessary

details, it is noted that the DRP vide para 7.2 of its directions directed the AO/TPO to allow working capital adjustment after verification. While giving effect to the directions of the DRP, the AO failed to give effect to the same. The ld. AR submitted that a rectification application dated 09-10-2018 was filed for carrying out the rectification on this aspect, which was still pending.

12. We find that the TPO originally did not grant the working capital adjustment in his order u/s 92CA(3), against which the assessee raised objection before the DRP. On page 49 of directions, the DRP has held that "the AO/TPO is directed to examine the computation of working capital adjustment worked out by the assessee and re-compute the same, if necessary. In case of dispute, the AO is directed to follow the methodology of the adjustment provided in example given in the Annexure to Chapter III of OECD transfer pricing guidelines, 2010." There is no manner of doubt that the direction given by the DRP is binding on the AO who has to necessarily pass the assessment order in conformity with the directions. This is amply clear from the language of section 144C(13) of the Act, which provides in

unambiguous terms that: "Upon receipt of the directions issued under sub-section (5), the Assessing Officer shall, *in conformity with the directions,* complete, …. the assessment." The AO has not only failed to follow the direction given by the DRP in this regard but is still sitting over the rectification application filed by the assessee for over two and half years. Such an approach needs to be corrected. In such circumstances, we direct the AO/TPO to grant working capital adjustment to the assessee as per the methodology suggested by the DRP, against which the assessee is not aggrieved, in principle.

13. To sum up, we set-aside the impugned order and remit the matter to the file of AO/TPO for re-determining the Arm's Length Price of the international transactions of RTSF segment in accordance with the discussion made herein above.

14. The assessee has raised the following additional ground:

> "That the education cess paid during the relevant Assessment Year amounting to INR 373,48 be allowed as deductible expense which is not covered under the provisions of section 40(a)(ii) of the Act."

15. The Hon'ble Supreme Court in *National Thermal Power Company Ltd. Vs. CIT (1998) 229 ITR 383 (SC)* has observed

that "the purpose of the assessment proceedings before the taxing authorities is to assess correctly the tax liability of an assessee in accordance with law. If, for example, as a result of a judicial decision given while the appeal is pending before the Tribunal, it is found that a non-taxable item is taxed or a permissible deduction is denied, we do not see any reason why the assessee should be prevented from raising that question before the Tribunal for the first time, so long as the relevant facts are on record in respect of that item". Answering the question posed before it in affirmative, their Lordships held that on the facts found by the authorities below, if a question of law arises (though not raised before the authorities) which has bearing on the tax liability of the assessee, the Tribunal has jurisdiction to examine the same. Having gone through the subject matter of the additional ground taken by the assessee, it is apparent that the same raises a pure question of law. We, therefore, admit the same.

16. On merits, it is found that the issue raised through the additional ground is no more *res integra* in view of the judgment of Hon'ble jurisdictional High Court in *Sesa Goa Lt. Vs. JCIT (2020) 423 ITR 426 (Bom.)* in which it has been held

that Education Cess is not disallowable expenditure u/s.40(a)(ii) of the Act. Similar view was earlier taken by the Hon'ble Rajasthan High Court in *Chambal Fertilisers and Chemicals Ltd. and Another Vs. JCIT (2018) 102 CCH 0202 (Raj-HC).* We, therefore, direct the AO to ascertain the correct amount of education cess and then allow a deduction for it, after allowing opportunity of hearing to the assessee.

17. In the result, the appeal is partly allowed.

Order pronounced in the Open Court on 3rd June, 2021.

| Sd/- | Sd/- |
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| **(S.S. VISWANETHRA RAVI)** | **(R.S.SYAL)** |
| **JUDICIAL MEMBER** | **VICE PRESIDENT** |

पुणे Pune; दिनांक Dated : 3rd June, 2021
*GCVSR*

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

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The DRP-3, Mumbai
4. The CIT (IT/TP), 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

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| | | Date | |
| 1. | Draft dictated on | 02-06-2021 | Sr.PS |
| 2. | Draft placed before author | 03-06-2021 | 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 |
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| 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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