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

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

आयकर अपील सं. / ITA No.29/PUN/2019

निर्धारण वर्ष / Assessment Year : 2014-15

A Raymond Fasteners India Pvt. Ltd., G.No.259, 276/8B, Nighoje, Taluka Khed, Pune 410 501 PAN : AAGCA7184G	Vs.	DCIT, Circle-8, Pune
Appellant		Respondent

Assessee by	Shri M.P. Lohia
Revenue by	Ms. Divya Bajpai
Date of hearing	29-10-2021
Date of pronouncement	01-11-2021

आदेश / ORDER

PER R.S. SYAL, VP :

This appeal by the assessee emanates from the final assessment order dated 24-10-2018 passed by the Assessing Officer (AO) u/s.143(3) r.w.s.144C(13) of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2014-15.

2. The assessee is aggrieved by the transfer pricing addition of Rs.8,96,78,966/- made by the AO in the impugned order. Succinctly, the facts of the case are that the assessee filed its return declaring total loss of Rs.19.51 crore. Certain international transactions were declared in Form No.3CEB. The AO made a

reference to the Transfer Pricing Officer (TPO) for determining the arm's length price (ALP) of the international transactions. Instantly, we are concerned with two international transactions, namely, (1) Purchase of material with transacted value of Rs.20,86,13,739/-; and (2) Sale of finished goods amounting to Rs.79,28,917/-. The assessee benchmarked these two transactions by applying the Transactional Net Margin Method (TNMM). The assessee selected two Associated Enterprises (AEs) as tested parties for the international transaction of `Purchase of material', and for the `Sale of finished goods', it chose itself as a tested party. In fact, the assessee made total purchase of material worth Rs.24.01 crore from its 13 AEs including Rs.3.14 crore capitalized as `Purchase of Mould'. However, the benchmarking analysis was done for the international transaction of Purchase of raw material worth Rs.20.86 crore by considering only two AEs, namely, (i) A Raymond (France); and (ii) A Raymond (Germany) as tested parties. Eight comparable companies were chosen with average Operating Profit (OP)/Operating Cost (OC) determined at 10.28% as against the AEs' mark up of 10% to show that the transaction was at ALP. The TPO, in principle, concurred with the assessee's submission that there was no restriction on considering the Foreign/AE as tested

party. He, however, held that Foreign/AE could be considered as tested party only subject to certain conditions. Considering the relevant United Nations Transfer Pricing Manual, OECD Transfer Pricing guidelines and US TP Regulations, the TPO came to hold that the Foreign/AEs chosen by the assessee did not satisfy the requisite criteria. He, therefore, rejected the selection of the two AEs as tested parties and proceeded with the ALP determination by taking the assessee as a tested party. He picked up four comparables, as were chosen by the assessee for the international transaction of `Sale of Finished goods', and determined the ALP of the aggregate transactions of Purchase of raw material and Sale of finished goods in a combined basis under the TNMM. The assessee's contention of taking gross margins was rejected. The arithmetic mean of the OP/OR of the comparables was computed at 1.96% which was compared with the assessee's OP/OR at (-) 16.56%. This resulted into recommending a transfer pricing adjustment of Rs.10,04,36,123/-. The AO notified the draft order accordingly and reduced the amount of loss to be carried forward at Rs.9.47 crore. The assessee unsuccessfully assailed the matter before the Dispute Resolution Panel (DRP), which has brought it before the Tribunal.

3. We have heard both the sides through Virtual Court and gone through the relevant material on record. The following issues arise in this appeal:-

I. Whether TPO rightly rejected foreign/AEs as tested parties?

II. `Any other method' for ALP determination

III. Comparables

IV. TP adjustment on proportionate basis

We will espouse these issues one by one for consideration and decision.

I. WHETHER TPO RIGHTLY REJECTED FOREIGN/AE AS TESTED PARTY?

4.1. The first issue raised in this appeal is against the adoption of the assessee as tested party as against the Foreign/Associated Enterprise (AE) chosen by it. The assessee benchmarked the international transaction of Purchase of raw material under the TNMM as the most appropriate method by taking two AEs as tested parties. Purchase of raw material was made from 13 AEs, but the assessee selected only two AEs as tested parties. The TPO did not dispute that the Foreign/AE could not be considered as tested party, which view rightly accords with the judgment delivered by the Hon'ble Madras High Court in the case of *Virtusa Consulting*

Services Private Ltd. Vs. DCIT (124 taxmann.com 309) accepting the assessee's contention that a foreign/AE can also be taken as a tested party provided it is least complex party to the controlled transaction and facilitates the ALP determination in a proper manner. In the ultimate analysis, the Hon'ble High Court sent the matter back to the TPO by observing that: `The issue regarding the assessee's plea to consider foreign AE as tested party to determine the Arm's Length nature of the underlying international transactions stands remanded to the Transfer Pricing officer for a fresh decision on merits and in accordance with law ...'. The TPO in the instant case did accept the assessee's contention that Foreign/AE can be taken as a tested party. He, however, went ahead with the exercise of finding out if the Foreign/AE satisfied the relevant criteria to be adopted as a tested party. After examining the relevant facts, he came to hold that the Foreign/AE did not qualify as a tested party.

4.2. In this regard, it is relevant to note the United Nations Practical Manual on Transfer Pricing (2017). Para B.2.3.3., with the heading `Selection of the tested party', runs as under :

> `The tested party normally should be the less complex party to the controlled transaction and should be the party in respect of which the most reliable data for comparability is available. It may be the local or the foreign party. *If a taxpayer wishes to select the foreign associated enterprise as the tested party, it must ensure that the necessary relevant information about it*

> *and sufficient data on comparables is furnished to the tax administration and vice versa in order for the latter to be able to verify the selection and application of the transfer pricing method.*'

4.3. From the above U.N. Transfer Pricing Manual, it is clear that a Foreign/AE can also be taken as tested party provided the assessee furnishes to the TPO the necessary relevant information about it and also comparables. This information is crucial for enabling the TPO to verify the correctness of the ALP determination done by the assessee. In other words, if the desired information about the foreign/AE or comparables is not furnished, then the TPO gets handicapped to benchmark the international transaction, thereby rendering the selection of foreign/AE meaningless.

4.4. Para 3.18 of the OECD TP Guidelines, 2010 states that 'As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis.'

4.5. Further, the US Transfer Pricing Regulations discusses the concept of tested party at § 1.482-5(b) which is reproduced as under:

> "The tested party will be the participant in the controlled transaction whose operating profit attributable to the controlled transactions can be verified using the most reliable

> data and requiring the fewest and most reliable adjustments, and for which reliable data regarding uncontrolled comparables can be located. Consequently, in most cases the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables."

4.6. A bird's eye view of the above transfer pricing guidelines clearly transpires that a tested party is normally the one which is least complex or performs simpler functions and assumes minimum risks without owning any valuable intangibles or unique assets; and for which reliable and verifiable information of self and comparables is available for perusal and analysis by the Revenue authorities. The idea is that the relevant information about tested party - be it the assessee itself or the foreign/AE – should be available and the same should be made available to the Department for making the transfer pricing assessment. The thrust is on the relative easiness of the computation of the ALP, which pre-supposes its accuracy. If accuracy itself is compromised in the process, then easiness of the computation is of no avail.

4.7. The assessee harped on the contention before the authorities below that the two Foreign/AEs were least complex entities and hence were chosen as tested parties. It is pertinent to note that the two Foreign/AEs are in manufacturing of raw material/moulds. As

against that, the assessee has simply purchased such raw material, for which the ALP determination is warranted. It goes without saying that manufacturing a product cannot be considered as least complex vis-à-vis the *per se* purchase of such goods. The TPO has noted in his order that the assessee in its transfer pricing study report indicated that it is French AE: "*is the operating entity for the French market that performs production and distribution activities. . .... It generates the turnover of approximately EURO 122 million. The entity is manufacturing, developing and selling fasteners and quick connectors and employed 683 employees"*. Insofar as the German entity is concerned, the assessee in its transfer pricing study report mentioned that it: "operates in the metal working and the plastic processing industry. The Germany subsidiary has a leading market position in the engineered fastener market by developing sophisticated products from the first draft to the finished components for its customers. It has a broad product range from plastic and metal fasteners to quick connectors and screen washer nozzles up to cable channels and air deflectors. The entity employs 1610 employees". As against the above two AEs, the assessee, as per its own version in transfer pricing study report, as captured in the TPO's order, was set up `in 2008 to address the fast growing

Indian Automotive market and started to produce in 2009. The entity employs 113 persons.' On a *ex facie* comparative analysis of the profile of the two Foreign/AEs *vis-à-vis* the assessee, it is pellucid that it is the assessee itself which is least complex rather than the other two Foreign/AEs.

4.8. Be that as it may, it is significant to mention that the assessee purchased raw material from thirteen AEs but carried out the entire benchmarking analysis only with respect to two AEs situated in Germany and France. There is no whisper about the remaining eleven entities in the ALP determination and the transactions with them have also been benchmarked by considering the other two AEs as tested parties, which have actually no relation whatsoever with these transactions. Thus benchmarking of transactions with such eleven Foreign/AEs has proceeded with without taking the assessee itself or the concerned AE as tested party, which exercise does not commend of the proper ALP determination.

4.9. An essential ingredient for the adoption of a tested party is that the reliable and verifiable information about it and the comparables should be available which should be furnished. Insofar as the two foreign/AEs are concerned, the TPO has recorded in his order that the assessee furnished only their financials and not the

complete Annual reports. Even the financials were incomplete which were in the form of extracts only. Further, the assessee claimed that AEs charged 10% markup on operating cost. It is by reason of this 10% markup that the assessee claimed the margin of comparables at 10.28%, bringing the transactions within the arm's length range. On a perusal of the TPO's order, which has not been controverted on behalf of the assessee, it clearly transpires that the assessee was called upon to furnish the details of operating costs of the foreign/AEs on which the alleged 10% mark-up was added. The assessee `*expressed inability to submit the actual calculation of costs for AEs'*. The assessee even failed to furnish any cost certificate and documents or working sheets which could demonstrate the operating costs incurred by the AEs for enabling the TPO to proceed to the next step of applying 10% markup thereon. Thus it is established that the claim of 10% mark-up is in vacuum as even the figures of operating costs of the AEs were not substantiated in any manner.

4.10. Now we turn to the other aspect, being, the availability and correctness of information concerning the comparables. Here again, only the extracts of financial statements from AMADE US database of such comparable companies were furnished. In the absence of

the corresponding Annual reports, the TPO found himself unable to find out if such companies were really qualifying. It is with the help of the Annual reports that the TPO could find out the precise functionality of the companies; whether the transactions of the concerned entities were controlled or uncontrolled?; whether the RPT and other filters were satisfied?; and whether there were any extraordinary financial events?; so on and so forth. Unless Annual report of a company is furnished, a logical decision on its inclusion in the list of comparables cannot be made. What to talk of others, even the fundamental requirement of functional comparability of the company with that of the tested party is not possible. Thus, it is evident that the assessee failed to furnish not only the reliable and demonstrable information of the Foreign/AEs but also those of the comparables chosen.

4.11. The above discussion boils down that neither the foreign/AEs are least complex nor could the assessee place before the TPO relevant and verifiable information of the foreign/AEs and comparables for enabling him to determine the ALP of the transaction. There is no improvement in the situation before the Tribunal as well. In fact, the ld. AR candidly admitted that he had nothing to add further on this score and the ground was taken just to

keep the issue alive. We, therefore, countenance the view taken by the TPO in this regard and hold that he was fully justified in rejecting the Foreign/AE as tested party and adopting the assessee itself as a tested party.

II. `ANY OTHER METHOD' FOR ALP DETERMINATION

5.1. The next issue taken up on behalf of the assessee is that the TPO erred in rejecting the adoption of gross margins of the tested party and comparables for benchmarking. The ld. AR submitted that when the TPO rejected the selection of Foreign/AEs as tested parties and proceeded with the ALP determination under the TNMM, a request was made to him vide letter dated 12-10-2017 for adopting the gross margins as PLI for both the assessee as a tested party as well as the comparables. The TPO rejected such contention vide para 9.2 of his order by holding that the assessee was requesting to use Cost Plus method as most appropriate method in the guise of adoption of gross margins as PLI, which was not acceptable. He further noted that in the transfer pricing study report at page 35, the assessee had itself rejected Cost Plus method. He still further observed that in the calculation furnished by the assessee taking gross margin as the PLI, there was no uniformity in the type of costs included because in some cases freight was

included while in others it was excluded. The DRP also did not allow any succour to the assessee.

5.2. We have heard both the sides and gone through the relevant material on record. The TPO accepted the TNMM as the most appropriate method, which was applied by the assessee also, but changed the tested party from Foreign/AEs to the assessee itself. He adopted four comparables as were given by the assessee for the second international transaction of `Sale of finished goods' and determined the ALP by taking the assessee as the tested party. Now the question is whether the authorities were justified in rejecting the assessee's request for adoption of gross margin ratio for benchmarking.

5.3. It is seen that the assessee took up the contention before the TPO that the gross margins should be considered as PLI. By making such a request, the assessee indirectly requested for adoption of "any other method" as the TNMM admits of taking operating profit margin in the formula for the ALP determination. At this juncture, it is relevant to note that rule 10AB of the Income-tax Rules, 1962 refers to "*any other method*", which has been inserted by the IT (Sixth Amdt. Rules, 2012 w.e.f. 1.4.2012, which reads as under: -

> `For the purposes of clause (f) of sub-section (1) of section 92C, the other method for determination of the arms' length price in relation to an international transaction or a specified domestic transaction shall be *any method which takes into account the price which has been charged or paid*, or would have been charged or paid, *for the same or similar uncontrolled transaction*, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.'

5.4. Instantly we are concerned with the A.Y. 2014-15. As such, there is no legal embargo on adoption of this method. In support of the gross margins, the assessee furnished a detailed working, a copy of which has been placed at page 426 onwards of the paper book. In this working, the assessee calculated its gross margin and that of the four comparables by considering cost of goods sold, that is, the raw material cost and other direct costs. The contention now before the Tribunal is that the gross margins should be computed with reference to purchase cost of raw material only to the exclusion of other direct costs *vis-a-vis* the sale price of finished goods. A slight modification has been made by the assessee before the Tribunal urging that gross margins should be considered with reference to purchase cost of raw material only.

5.5. Rule 10AB permits taking recourse to any method which takes into account, *inter alia,* the price paid in an international transaction `*considering all the relevant facts*'. We need to delve

into the *relevant facts* in the instant case. It is noticeable from the submissions made before the TPO that the assessee utilized only 11% of its capacity in Injection press moulding unit and 9% in Quick connector assembly unit. Consequence of this gross underutilization of capacity is that the fixed costs of production could not be properly recovered. Any two companies can be considered as comparable if they are not only functionally similar but also pass other tests of comparability including the capacity utilization. If a company purchases raw material at ALP but because of its working at a low capacity, the other direct costs are not fully recovered leading to low gross margin, can it be said that the purchase of raw material was not at ALP? The way forward is to allow capacity utilization adjustment in the profit margin of the comparables under the TNMM by considering the difference in the extent of capacity utilizations. That is the precise reason for allowing capacity utilization adjustment. However, to carry out capacity utilization adjustment, necessary data of the capacity utilization by the comparables must be available, without which no such adjustment can be granted. But the mere fact that the capacity utilization adjustment cannot be granted under the TNMM for lack of necessary data of comparables, a transaction of purchase of raw

material, otherwise at ALP, does not cease to be so. In such a scenario, the assessee can validly adopt "any other method" by considering the purchase price of raw material alone *de hors* other direct expenses *vis-à-vis* the sale price of finished goods for computing the resultant gross profit margin of self and the comparables for making effective comparison. In the given facts when admittedly the capacity utilization figures of the comparables are not available and any other method as per rule 10AB is in vogue, there can be no difficulty in countenancing the assessee's contention of the ALP determination with the gross margin only *qua* the raw material cost to the exclusion of other direct expenses.

5.6. The ld. AR furnished calculation of gross profit margins by taking only the figures of raw material purchases *vis-a-vis* the sale price of self and four comparables chosen by the TPO. Since such figures have not been examined by the authorities below, we cannot straight away take cognizance of the same. We, therefore, set aside the impugned order and remit the matter to the file of AO/TPO for re-determining the ALP under "any other method" as per Rule 10AB by considering purchase price of raw material *vis-a-vis* sale price of the finished goods of the assessee as well as the comparables.

III. COMPARABLES

6.1. The next issue raised by the ld. AR is against the inclusion of ITW India Limited in the list of comparables by the TPO. We have noted above that the assessee selected four companies as comparable for the transaction of `Sale of finished goods'. The TPO aggregated this transaction with the transaction of Purchase of raw material and adopted the same companies as comparable for benchmarking. The ld. AR submitted that the TPO erred in including ITW India Limited in the list of comparables.

6.2. Having heard the rival submissions and gone through the relevant material on record, it is seen that the assessee *suo motu* selected ITW India Limited as a comparable in its transfer pricing study report and now it is seeking its exclusion. The same way in which TPO is entitled to abort a company taken by the assessee as comparable, if it is really not so, there is no impediment in an assessee claiming exclusion of a company wrongly inducted by it in the list of comparables. A party cannot be debarred in law seeking withdrawal of a company which was included on account of a mistaken notion. We, therefore, reject the preliminary contention of the ld. DR on this score.

6.3. The ld. AR cited high turnover of ITW India Limited as a *raison d`etre* for its exclusion. For this proposition, he relied on the judgment of Hon'ble Bombay High Court in the case of *CIT Vs. Pentair Water India Pvt. Ltd. (2016) 381 ITR 216 (Bom)*. The ld. AR relied on a remand report of the TPO, copy placed at page 1460 onwards of the paper book, to argue that the TPO himself adopted filter of 10 times turnover.

6.4. The Hon'ble Bombay High Court in the above case approved exclusion of three companies from the list of comparables by noticing that their turnover was more than 23 times, 65 times and 85 times of the assessee therein. The Hon'ble Punjab & Haryana High Court in *Pr. CIT and another Vs. Equant Solutions India Pvt. Ltd. and Ors. (2020) 421 ITR 655 (P&H)* also excluded a company whose turnover was 24 times. To bolster his point of view, the ld. AR contended that turnover of ITW India Limited for the year under consideration was Rs.1033.44 crore as against the assessee's turnover of Rs.54.23 crore. However, on a perusal of the figure of turnover of ITW India Ltd. from the Statement of profit and loss account, a copy placed at page 1438 of the assessee's paper book, it can be seen that such turnover includes not only revenue from sale of products but also sale of services and other operating revenues.

We are concerned only with the assessee's turnover from sale of products. The equivalent of ITW India Limited is the revenue from sale of products at Rs.915.72 crore (Rs.992.08 crore minus Excise Duty of Rs.76.36 crore). Thus, it can be seen that the turnover of ITW India Limited is only 16.88 times of the assessee, which is far below the exclusion approved by the Hon'ble Bombay High Court at minimum of 23 times. At this stage, it is relevant to mention that the assessee chose another company, namely, Lifelong India Limited and included it in the list of comparables. Turnover of Lifelong India is Rs.532.94 crore, which is about 10 times that of the assessee.

6.5. Insofar as the reliance of the ld. AR on the remand report of the TPO applying 10 times turnover filter is concerned, we find that such a remand report pertains to the proceedings for the A.Y. 2012-13. In fact, no remand proceedings took place for the A.Y. 2014-15 under consideration. It goes without saying that facts and circumstances change every year. What is relevant for one year need not necessarily be relevant for all the years to come. The ALP for each year has to be determined independently in the hue of the facts and circumstances relevant for such year only. The assessee's Transfer pricing study report indicates that it applied turnover filter

with lower limit only without any upper limit. In fact, it is the assessee who selected ITW India Ltd. by applying the requisite filters including that of the turnover. The TPO neither disturbed the turnover filter nor the inclusion of the company. In view of the fact that ITW India Ltd. satisfies the turnover filter as applied by the assessee itself and the difference in the turnover of the assessee and ITW India Limited is not as substantial as was considered germane for exclusion by the Hon'ble jurisdictional High Court in *Pentair Water India Pvt. Ltd. (supra)* and the further fact that the assessee itself included Lifelong India as a comparable with 10 times turnover, we hold that ITW India Ltd. cannot be excluded on this count. But for that, the assessee has not disputed the otherwise functional and other similarities with ITW India Limited. We, therefore, jettison the assessee's contention for exclusion of ITW India Limited from the list of comparables. The impugned order is accorded imprimatur on this issue.

IV. PROPORTIONATE ADJUSTMENT

7.1. The last issue which survives in this appeal is against the proportionate transfer pricing adjustment. It is seen that the TPO recommended the transfer pricing adjustment by considering the

entity level figures of the assessee under the TNMM without restricting it to the international transactions.

7.2. The issue of restricting the transfer pricing adjustment to the transaction level rather than the entity level is no more *res integra* in view of several judgments rendered by various higher forums including the Hon'ble jurisdictional High Court holding that the transfer pricing adjustment should be restricted only to the international transactions and not the entity level transactions. The Hon'ble jurisdictional High Court in *CIT Vs. Phoenix Mecano (India) Pvt. Ltd. (2019) 414 ITR 704 (Bom.)* has held that the transfer pricing adjustment made at entity level should be restricted to the international transactions only. Here, it is pertinent to mention that the Department's SLP against the judgment in the case of *Phoenix Mecano (India) Pvt. Ltd.* 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 taken 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, therefore, set aside the impugned order on this score and direct that the transfer

pricing adjustment should be restricted only to the value of international transactions.

8. To sum up, the impugned order on the issue of transfer pricing adjustment of the international transactions of Purchase of raw material and Sale of finished goods is set aside and the matter is remitted to the file of the AO/TPO for a fresh determination in the terms indicated above. Needless to say, the assessee will be allowed reasonable opportunity of hearing in such fresh proceedings.

9. In the result, the appeal is allowed for statistical purposes.

Order pronounced in the Open Court on 1st November, 2021.

Sd/-	Sd/-
(PARTHA SARATHI CHAUDHURY)	**(R.S.SYAL)**
JUDICIAL MEMBER	**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 1st November, 2021
सतीश/*GCVSR*

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

1. अपीलार्थी / The Appellant;
2. The Respondent
3. प्रत्यर्थी / The CIT(A)-13, Pune
4. The PCIT-5, Pune
5. DR, ITAT, 'C' Bench, Pune
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

// True Copy //

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

		Date	
1.	Draft dictated on	29-10-2021	Sr.PS
2.	Draft placed before author	01-11-2021	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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