

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH '1-2', NEW DELHI
BEFORE SH. KULDIP SINGH, JUDICIAL MEMBER
AND
SH. PRASHANT MAHARISHI, ACCOUNTANT MEMBER
(Through Video Conferencing)

ITA No.3834/DEL/2017
Assessment Year: 2011-12

Toyoda Micromatic Machinery India Private Limited, 7, Barakhamba Road, New Delhi PAN No. AADCT0116G (APPELLANT)	Vs	DCIT Circle – 25 (2) New Delhi (RESPONDENT)
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Appellant by	Shri Ajit Korde Adv Shri Arun Bhadauria, Adv Shri Prashant MeharChandani, Adv
Respondent by	Sh. Rakesh Kumar, SR. DR

Date of hearing:	16/10/2020
Date of Pronouncement:	10/12/2020

ORDER

PER PRASHANT MAHARISHI, AM:

1. This appeal is filed by the assessee against the order of The Commissioner Of Income Tax (Appeals) – 44, New Delhi [The 1d CIT A] dated 27th of December 2016 for assessment year 2011 – 12 wherein the appeal filed by the assessee against the order of The Deputy Commissioner Of Income Tax, Circle – 25 (2) New Delhi [The Ld AO] passed u/s 143 (3) read with Section 144C of the income tax act 1961 [The Act] dated 28th of April 2015, was partly allowed.
2. The assessee has raised the following grounds of appeal :-
 1. *The order passed by the Learned Commissioner of Income Tax (Appeals) is bad in law and void ab-initio as it confirms the order of the Assessing Officer (AO) who has failed to record any valid and substantive reasons in concluding that it was expedient and necessary to refer the matter to the Transfer Pricing Officer (TPO) for*

computation of arm's length price, as required under section 92CA(1) of the Income-tax Act, 1961 ("Act").

2. *That on facts and in law, the CIT (A) has erred in confirming that Learned TPO/AO has discharged his statutory onus by establishing that the conditions specified in clause (a) to (d) of Section 92C (3) of the Act have been satisfied before disregarding the arm's length price determined by the Appellant and proceeding to determine the arm's length price himself.*
 3. *The Learned CIT(A) has erred on facts and in law by treating the expatriate cost as part of the expense while providing for the computation of the Profit Level Indicator (PLI) for Resale Price Method (RPM) which is in violation of the Rule 10B(1)(b) of the Income - tax Rules 1962 ("Rules").*
 4. *The Learned CIT(A) did not provide the Appellant an opportunity to put forth arguments against the approach adopted by the CIT(A) in including the expatriate cost as part of cost of goods sold while computing gross profit margin, thereby, violating the principle of natural justice.*
 5. *The Learned CIT(A) has erred in appropriating the entire expatriate cost only to the trading business of the Appellant without considering that the Appellant has other business activities as well.*
 6. *The Learned AO has erred on facts and in law in initiating the penalty proceedings under section 271(1)(c) of the Act.*
3. Brief facts of the case shows that assessee is a company primarily engaged in the business of distribution in providing delivery and/or installation services of the machines tools and assessee sold it directly or through third parties to the customers. Assessee company is jointly owned by a Japanese and an Indian company. It filed its return of income declaring a total loss of ₹ 22,932,000 on 24/11/2011.
 4. As the assessee has entered into certain international transactions, the learned assessing officer referred the matter to the learned Deputy Commissioner Of Income Tax, Transfer Pricing Officer –iii (1) (1), New Delhi [The Ld TPO] for determination of the arm's-length price. The main international transaction entered into by the assessee is a purchase of traded goods amounting to ₹ 57,600,378/-. This is benchmarked by the assessee adopting the Resale Price Method. The assessee has stated that assessee purchased the machine tools from its associated enterprise and it has been sold for ₹ 63,128,791/-. However the learned assessing officer further noted that assessee has incurred

substantial personal expenses of Rs 260,83,480/- out of which salaries and wages are ₹ 25,057,843/-. It was noted by the learned transfer pricing officer that if the assessee is performing only trading functions, these expenses were not justified in relation to the total turnover of ₹ 89,857,542/-. Learned TPO further noted certain expenses and stated that assessee is undertaking other functions like advertising, sales promotion and having a distribution network and incurring of these other costs are also indicate that assessee is not acting as a mere trader but taking on significant other functions also. Therefore the learned TPO issued the showcause notice to the assessee that the choice of the most appropriate method of resale price method is not a right choice and transactional net margin method should have been adopted. Based on this he computed the operating profit margin of the assessee for the trading segment considering the trading sales of ₹ 63,128,791/- and reducing there from the expenses of cost of goods sold is of ₹ 54,529,022, personal cost of Rs 182,58,436, administration and other cost of Rs 1,71,18,519/- resulting into the operating cost of ₹ 89,905,977/-. Thus he determined the operating loss of Rs 1, 67,77,186/- which resulted into the operating profit/operating revenue margin of (-) 42.42%. He further found that assessee has submitted seven comparable is whose margin was 4.16%. The assessee submitted that rejection of the resale price method used by the taxpayer is not proper and transactional net margin method could not have been adopted. Assessee submitted that it is not carrying out any value addition activities. The learned transfer pricing officer rejected the argument of the assessee and stated that the transactional net margin method is the most appropriate method in this case. The learned transfer pricing officer held that resale price margin/cost plus method is accurate when it is realised within a short time of the resellers purchase of the goods. The more time between original purchases and resale , more likely that many factor changes, like changes in market rates of exchanges, in cost etc will need to be taken into account. He referred to the OECD transfer pricing guidelines at paragraph number 2.23. He further noted that assessee has incurred

substantial personnel expenditure of Rs 2.60 crores. If assessee is performing only trading functions these were not justified in relation to the total turnover of ₹ 8.98 crores. He further noted that the assessee has maintained a huge inventory of Rs 2.23 crores against the sale of 8.98 crores. It has also incurred foreign exchange fluctuation loss of ₹ 24.31 lakhs. Thus, he held that in resale price method all these expenses cannot be captured and it is necessary to consider all these expenses for proper comparability. He stated that the same can be captured only when the transactional net margin method is used. He also noted that assessee has incurred advertising and sales promotion expenditure of ₹ 36.58 lakhs which is a significant amount of expenditure and show that the function of the assessee is not that of a mere trader but something more. Thus he selected the transactional net margin method as the most appropriate method. With respect to the comparability he accepted the filter suggested by the assessee that as assessee is a very small player in the industry in terms of sales turnover, turnover filter shall be allowed. Accordingly he considered seven comparable companies whose margin was computed at 4.16% and compared with the margin of the assessee of (-) 42.42 percentage. Accordingly the arm's-length price of the international transaction on the operating revenue was determined at Rs 6,05,02,633/- against price charged by the assessee of ₹ 8,99,05,977/- and thereafter the adjustment was proposed at ₹ 29,403,344/- as per order u/s 92CA on 28th of January 2015. Based on this the learned assessing officer passed the draft assessment order on 25th of February 2015 determining total income of the assessee at ₹ 6,471,044/- against the return of income filed at the loss of ₹ 22,932,000/-. Consequently the final order was also passed u/s 143 (3) read with Section 144C (3) of the act on 28th of April 2015 after granting the adjustment of the loss of Rs 7,932,835 at RS Nil. Against this assessee preferred an appeal before The Commissioner Of Income Tax (Appeals) – 44, New Delhi. He passed an order on 27 December 2016 wherein against the most appropriate method adopted by the learned transfer pricing officer of the transactional net margin

method but by the assessee at resale price method held by him that he did not approve the application of transactional net margin method without establishing that assessee is doing deemed manufacturing or value addition. Thus the most appropriate method adopted by the assessee was upheld. With respect to the manpower cost amounting to Rs 2.60 crores against the turnover of Rs 8.98 crores, assessee submitted that the appellant has employed three expatriates employees whose total employee cost is above ₹ 1 crores and therefore assessee justified that such salary cost is prevalent widely followed by the worldwide for MNC enterprises. Rational for having expatriates employees that the client of the appellant is predominantly Japanese companies such as Toyota micro metric machinery private limited and others. However the learned CIT – A held that such employee cost of these expatriates are closely linked with the distribution functions and is not in the ordinary sense engaged in doing routine job. Therefore according to him these employees' cost should be considered while computing the gross profit margin of the assessee. He directed the learned transfer pricing officer to select resale price method as the most appropriate method for distribution function, however, while computing the profit level indicator for resale price method the expenditure paid to these expatriates is to be treated as the expenses and AO/TPO was directed to recompute the arm's-length adjustment of international transaction for distribution functions. The appeal of the assessee was partly allowed. Therefore assessee aggrieved with the order of the learned transfer pricing officer has preferred this appeal before us.

5. Subsequently the order of the learned CIT – A assessee preferred an application u/s 154 of the income tax act to the assessing officer who passed an order dated 14 July 2017 wherein the adjustment was reduced to Rs. 268,56,886/-. This adjustment has resulted because the expatriate expenses of Rs 260,83,480 was considered as the direct expenses and consequent gross loss was determined at Rs 1,74,83,711 and consequently the margin of the assessee of gross loss was 27.70% against the profit margin of the comparable company at 12.25%.

6. As per ground number 3 – 5 the assessee is aggrieved with the computation of the profit level indicator as directed by the learned CIT – A. The learned authorised representative submitted before us the job profile of three expatriates employees and stated that cost of these employees cannot be reduced while computing the profit level indicator when resale price method is to be applied. It was stated that Mr Hideo Matsuko has the job requirement of after sale support to the machine users in India and also providing training to customers and local staff over troubleshooting, application and maintenance of special-purpose cylindrical and crankshaft machines. It is also for coordination with Japan for warranty parts, technical support and arrangement for drawings as and when required. The rationale for recruiting such a person was that the machines that were supplied, skills for these machines were not available in India and therefore he was recruited as he was having a vast experience and superior capabilities. With respect to the job profile of Mr Y Hibi, it was stated that his job profile is for support to sales operations like planning, organising, scheduling, resource management, implementation of sale system, interaction with customers in India, coordination with Japan and to import sales training to local staff and perform all other associate assignment for smooth sales flow. With respect to the job profile of Mr Mamarou Nagasawa it was stated that he is appointed as a vice president of the company for a period of three years. Therefore it was stated that all these employees are not at all are part of the cost for computing the PLI Under resale price method.
7. The learned departmental representative vehemently supported the order of the learned TPO and CIT – A.
8. We have carefully considered the rival contention and perused the orders of the lower authorities. It is a fact that the learned assessing officer has not challenged the order of the learned CIT – A stating that resale price method is the most appropriate method as assessee does not engage in any deemed manufacturing or further value addition. It is also the method selected by assessee as MAM. Therefore only issue is how to

compute PLI when RSP Method is applied in this peculiar case. According to the provisions of rule 10 B for the determination of the arm's-length price u/s 92C, the resale price method computation shall be determined according to subrule (1) (b) of the income tax rules. Mostly looking at the profile of the expatriates provided by the ld AR, it is apparent that either those are for providing Warranty services or after sales services. When the goods are sold all the price of these items/ services are already embedded in the sales price. Therefore naturally when sales price consists of price for warranty and After sales services, which are promised at the time of sales, naturally corresponding expenses are also to be considered while computing the margin of the assessee. After sale support services, training to customers and local staff for troubleshooting and service coordination expenses are thus, required to be included for determining the gross profit margin in resale price method. In view of this, we do not find any infirmity in the order of the ld TPO and CIT (A). Accordingly Ground no 3 to 5 of the appeal are dismissed.

9. Ground no 1 and 2 are generally in nature and Ground no 6 against initiation of penalty is premature and hence those grounds are dismissed.
10. Accordingly appeal of the assessee is dismissed.

Order pronounced in the open court on 10/12/2020.

-Sd/-
(KULDIP SINGH)
JUDICIAL MEMBER

-Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

AK Keot

Date:10.12.2020

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI