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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA 11/2015**

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr Ashok Manchanda and Mr Arjun Harkauli, Standing Counsels.

Versus

KEIHIN PANALFA LTD. ..... Respondent
Through: Mr Satyen Sethi and Mr Arta Trana Panda, Advocates.

AND

\+ **ITA 12/2015**

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr Ashok Manchanda and Mr Arjun Harkauli, Standing Counsels.

Versus

KEIHIN PANALFA LTD. ..... Respondent
Through: Mr Satyen Sethi and Mr Arta Trana Panda, Advocates.

CORAM:
HON'BLE DR. JUSTICE S.MURALIDHAR
HON'BLE MR. JUSTICE VIBHU BAKHRU

O R D E R

% 09.09.2015

1. These appeals have been preferred by the Revenue under Section 260A of the Income Tax Act, 1961 (hereafter the 'Act') impugning a

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common order passed by the Tribunal in ITA 3287/Del/2011 and 5546/Del/2012. The said appeals were also preferred by the Revenue against the orders passed by the Commissioner of Income Tax (Appeals) [hereafter 'CIT(A)'] on 29/03/2011 and 27/08/2012 allowing the appeals preferred by the Assessee against the assessment orders passed by the Assessing Officer (hereafter 'AO') in respect of the Assessment Years 2004-05 and 2005-06 respectively.

2. The controversy involved in the present case relates to the Transfer Pricing Adjustment (hereafter 'TP Adjustment') made by the AO in respect of international transactions relating to the purchases made and the royalty paid by the Assessee to Keihin Corporation, Japan (hereafter 'KC').

3. The relevant facts relating to the assessment year 2004-05 are narrated as under:-

3.1 The Assessee is engaged in the manufacture and sale of air-conditioners for cars manufactured by Honda Siel Cars India Ltd. During the relevant previous year, the Assessee entered into 'international transactions' for purchase of parts and components; payment of guidance fee; payment of royalty; and payment of fees for technical know-how. As the international

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transactions were more than Rs.5 crores in value, a reference was made to Transfer Pricing Officer (hereafter 'TPO') for determining of the Arm's Length Price (hereafter 'ALP') under the provisions of Section 92CA of the Act.

3.2 The Assessee submitted a Transfer Pricing Report calculating the ALP by using Transactional Net Margin Method (hereafter 'TNMM') and using the ratio of Operating Profit to Capital Employed as the Profit Level Indicator (hereafter 'PLI'). The TPO accepted TNMM as the appropriate method but rejected the PLI adopted by the Assessee. He used Operating Profits to Total Cost as the appropriate PLI and computed the PLI of comparables at 8.29% as against the Assessee's PLI of 6.22%.

3.3 The total operating income/revenue of the Assessee for the relevant period was Rs.72,24,22,000/-. Applying the margin of 8.29% – as determined by the TPO on the basis of selected comparables – the TPO concluded that the total operating expenses ought to have been Rs.66,71,17,924/-. Since the actual operating expenses incurred by the Assessee during the period were Rs.68,00,88,000/-, the TPO held that a TP Adjustment of Rs.1,29,70,076/- ought to be made in respect of expenses

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attributable to the international transactions. Insofar as the payment of royalty of Rs.1,24,41,118/- is concerned, the TPO had held that no royalty would be payable if the transactions were on Arm's Length basis as according to the TPO, the Assessee was functioning as a contract manufacturer. The TPO observed that all the sales were being made by the petitioner to Honda Siel Cars India Ltd. and 99.99% of the said company were held by Honda Motors Co. Ltd. (Japan), which also held 41.33% of KC (the AE in the present case). KC in turn held 74% shares in the Assessee. The TPO reasoned that since the products being manufactured by the Assessee were specifically designed for Honda Cars Produced by Honda Siel Cars India Ltd. and the technical designs and intellectual property rights were held by their parent/group companies, the Assessee was in effect manufacturing for its related enterprise and, therefore, payment of any royalty on sales would be unreasonable. The TPO made observations to the effect that the payment of royalty had, in fact, inflated the operating costs and was "villain of the piece".

3.4 The Assessing Officer passed an Assessment Order dated 26th December, 2006 making an addition of Rs.1,29,70,076/- on account of TP Adjustment made by the TPO. The Assessee had reflected Rs.1,24,41,000/-

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as expenses on Royalty. The TPO computed the ALP for royalty as Nil, which was subsumed in the TP Adjustment of Rs.1,29,70,076/-. In addition, the AO disallowed 25% of the expenses on account of royalty amounting to Rs.22,53,000/- as being capital in nature.

4. With respect to the Assessment Year 2005-06, the TPO did not draw any adverse inference with respect to the international transactions except the transaction relating to payment of royalty. The TPO followed a similar reasoning as adopted in respect of Assessment Year 2004-05 and passed an order dated 24th October, 2008 directing the AO to make an addition of a sum of Rs.1,97,40,726/- being the amount of royalty, for the Financial Year 2004-05. The AO, following the directions of the TPO, made an addition of the aforesaid sum and passed an assessment order dated 29th December, 2008.

5. The Assessee preferred appeals before the CIT(A) against the assessment orders dated 26th December, 2006 in respect of the Assessment Year 2004-05 and assessment order dated 29th December, 2008 in respect of the Assessment Year 2005-06.

6. The CIT(A), by an order dated 29th March, 2011 allowed the

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Assessee's appeal against the assessment order dated 26th December, 2006. Before the CIT(A) the Assessee contended that the computation of the TP Adjustment was flawed, inasmuch as, the TPO had also attributed TP Adjustments relating to uncontrolled third party transactions to the international transactions. The international transactions in issue constituted only 23.38% of the total expenses and, therefore, the adjustment on account of operating expenses attributable to international transaction would necessarily be in the same proportion. According to the Assessee, the same would amount to Rs.30,33,593/-. The expenses attributable to the international transaction (i.e. 23.38% of the total expenses) amounted to Rs.15,90,66,935/- and after the TP Adjustment, the expenses on Arm's Length basis were computed at Rs.15,60,33,342/- (i.e. 15,90,66,935/- – 30,33,593/-). The Assessee further contended that 5% of the ALP computed as above would amount to Rs.78,01,667/-. The Assessee urged that the TP Adjustment fell within the aforesaid range and, therefore, by virtue of second proviso to Section 93CA, no TP Adjustments were liable to be made. This contention was accepted by the CIT(A) and the TP Adjustments made by the AO were deleted.

7. The CIT(A) also held that the TPO was in error in holding that no

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royalty was payable. The CIT(A) held that the functions performed by the Assessee included procurement and inventory management, production and manufacturing planning, co-ordination of production and sales, import of goods, maintenance of production facilities and quality control functions; therefore, the Assessee could not be considered as a contract manufacturer. The CIT(A) also held that the TPO exceeded its jurisdiction by rejecting the agreements entered into between the Assessee and the KC and not computing the ALP in accordance with the Act.

8. The CIT(A) also allowed the appeal preferred by the Assessee against an order dated 29th December, 2008 passed by the AO in respect of Assessment Year 2005-06 for the same reasons as indicated in respect of the appeal relating to Assessment Year 2004-05.

9. The Revenue appealed against the decisions of the CIT(A) before the Tribunal. Before the Tribunal, the Assessee conceded that it had no objection to the decision of the TPO regarding the adoption of PLI of Operating Profit to Total Cost. However, the Assessee urged that the adjustments computed in respect of the entire expenses could not be loaded on the international transactions. The Tribunal upheld the orders passed by

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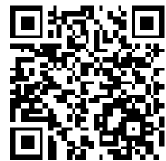

the CIT(A) and rejected the appeals by a common order dated 6th May, 2014.

10. The learned counsel appearing for the Revenue contended that the Tribunal has grossly erred in apportioning the adjustment on account of expenses over the uncontrolled transactions and international transactions. He urged that in respect of the Assessment Year 2004-05, the entire adjustment on account of the difference in operating expenses of Rs.1,29,70,076/- as determined by the TPO ought to have been adjusted only against the international transaction, which admittedly constituted only 23.38% of the operating income/revenue. He next referred to the technical collaboration agreement dated 12th September, 1997 entered into between KC and the Assessee and contended that the royalty paid by the Assessee was in excess of the amounts as computed under the said agreement.

11. Insofar as the contention that the amounts paid were not in accordance with the agreement between the Assessee and the KC is concerned, we find that no such contention had been urged by the Revenue either before the CIT(A) or before the Tribunal. Therefore, in our view, no such plea can be permitted to be taken for the first time in these proceedings.

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12. The contention that the adjustment on account of expenses as determined by the TPO must be attributed entirely to the international transaction is bereft of any merits. During the Financial Year 2003-04 relating to the Assessment Year 2004-05, the Assessee had reported an operating income of Rs.72,24,22,000/-. The total expenses for the said period amounted to Rs.68,00,88,000/-. Admittedly, the international transactions in question amounted to Rs.15,90,66,935/- which were only 23.38% in value of the total expenses. The TPO had determined the PLI (Operating Profit over Total Cost) of comparable cases at 8.29% against 6.22% as declared by the Assessee. Applying the PLI of comparable cases, the adjusted total expenses were computed at Rs.66,71,17,924/-, thus, indicating an adjustment of Rs.1,29,70,076/-. As is apparent from the above, the said adjustment related to entire expenses and not just the international transactions alone. Since the international transactions only constituted 23.38%, a TP Adjustment proportionate to that extent could be made in respect of such international transactions. Thus, only an adjustment of Rs.30,33,593/- could be attributed to the international transactions in question. The same was accepted by the CIT(A) as well as the Tribunal. We do not find any infirmity with their decision.

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13. We also find no infirmity with the view of CIT(A) and the Tribunal that the Assessee had acted like any other Original Equipment Manufacturer (OEM) and could not be treated as a job worker or a contractor.

14. We find no substantial question of law that arises for our consideration in these appeals. Accordingly, the appeals are dismissed. No order as to costs.

S.MURALIDHAR, J

VIBHU BAKHRU, J

SEPTEMBER 09, 2015
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