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आयकर अपीलीय अधिकरण, मुंबई न्यायपीठ 'के' मुंबई

IN THE INCOME TAX APPELLATE TRIBUNAL
"K" BENCH, MUMBAI

श्री बी. रामकोटय्य, लेखा सदस्य, एवं श्री अमित शुक्ला, न्यायिक सदस्य के समक्ष

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER AND
SHRI AMIT SHUKLA, JUDICIAL MEMBER

आयकर अपील सं. / ITA no. 7868/Mum./2010
(निर्धारण वर्ष / Assessment Year : 2006–07)

Hindustan Unilever Limited
(Formerly known as Hindustan Lever Ltd)
Hindustan Lever House
165/166, Backbay Reclamation
Mumbai 400 020

……………………. अपीलार्थी / Appellant

बनाम v/s

Addl. Commissioner of Income Tax
Range–1(1), Mumbai

………………. प्रत्यर्थी / Respondent

स्थायी लेखा सं./ Permanent Account Number – AAACH1004N

निर्धारिती की ओर से / Assessee by : Mr. P.J. Pardiwala
राजस्व की ओर से / Revenue by : Mr. Ajit Kumar Jain a/w Mrs. Sasmita Misra

सुनवाई की तारीख / Date of Hearing – 18.10.2012	आदेश घोषणा की तारीख / Date of Order – 10.12.2012

आदेश / ORDER

प्रत्येक पीठ
PER BENCH

This appeal preferred by the assessee, is directed against the final assessment order dated 7th October 2010, passed by the Addl. Commissioner of Income Tax, Range-I(1), Mumbai, in pursuance of the directions given by the Dispute Resolution Panel (for short *"DRP"*), for the

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quantum of assessment passed under section 143(3) r/w 144C of the Income Tax Act, 1961 (for short *"the Act"*) for assessment year 2006–07.

2. In grounds no.1 to 15, which also includes various sub-grounds, the assessee has challenged the transfer pricing adjustment of ₹ 368,79,26,000, on the international transaction values. The assessee, Hindustan Unilever Ltd., in which, 51.55% stake is held by Unilever PLC is India's largest Fast Moving Consumer Goods Company (for short *"FMGC"*). The main business of the company is export and import of home and personal care products, beverages, export of rice and marine products, export and import of soap and toiletries. The assessee has also been paying royalty to Unilever PLC on domestic and export sales. During the year, the assessee had made following international transactions with the Associate Enterprises (for short *"A.Es"*).

S.no.	*Name of Transaction*	*A.Y. 06–07 (₹)*	*Method Used*
1.	*Purchase of raw materials*	*41,73,50,931*	*TNMM*
2.	*Import of finished goods*	*2,86,74,892*	*TNMM*
3.	*Sale of raw material*	*128,23,81,580*	*TNMM*
4.	*Export of rice & marine products*	*23,37,76,216*	*TNMM*
5.	*Export of manufactured home and personal care products*	*267,38,18,733*	*TNMM*
6.	*Export of manufactured beverages*	*270,91,33,327*	*TNMM*
7.	*Import of machineries*	*218,165*	*TNMM*
8.	*Export of machineries*	*65,730*	*TNMM*
9.	*Royalty paid to Unilever*	*66,72,53,896*	*TNMM*
10.	*Recovery of expenses for common corporate resources (corporate audit)*	*67,20,96,855*	*TNMM*
11.	*Recovery of expenses for common corporate resources (intra group services)*	*2,92,68,445*	*TNMM*
12.	*Recovery of expenses for common corporate resources (intra group services)*	*38,87,91,905*	*TNMM*
13.	*Training course fees & reimburse–ment of other expenses made*	*3,69,21,201*	*CUP*
14.	*Training course fees & reimbursement of other expenses received*	*14,72,14,089*	*CUP*
	Total	*928,69,65,605*	

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3. In order to examine the computation of Arm's Length Price (for short "*ALP*") in relation to the international transaction, a reference under section 92CA(1) was made by the Assessing Officer to the Transfer Pricing Officer (for short "*TPO*") on 8th October 2007 and copy of audit report in form 3CEB was forwarded. For the purpose of determining the average operating profit to the sales ratio, the assessee has taken the data of 12 FMCG companies which formed the BSE – FMGC index and the arithmetical mean of PLI of such companies worked out at 12.87% as against the assessee's operating profit on total sales at 12.28%. In the T.P. study report, the assessee has adopted Transactional Net Marginal Method (for short "*TNMM*") to bench mark the international transaction for determining the ALP. The assessee has taken following 12 companies as comparables with arithmetic mean of operating profit margin at 12.87%.

S.no.	*Company's Name*	*O.M (%)*
1.	*I.T.C. Ltd.*	*19.13*
2.	*Bata India Ltd.*	*1.30*
3.	*Nestle India Ltd.*	*17.60*
4.	*Tata Tea Ltd.*	*13.73*
5.	*Colgate–Palmolive (I) Ltd.*	*14.71*
6.	*Britannia Industries Ltd.*	*9.21*
7.	*Dabur India Ltd.*	*17.27*
8.	*Glaxosmithkline Consumer Health Care Ltd.*	*13.08*
9.	*Godrej Consumer Products Ltd.*	*18.35*
10.	*Radico Khaitan Ltd.*	*8.41*
11.	*Mc dowell & Co. Ltd.*	*4.97*
12.	*Nirma Ltd.*	*14.10*
	Mean	*12.87*

4. Before the TPO, detail objections / submissions were made to justify the profit margin on account of international transactions with the A.Es.

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However, the TPO rejected the assessee's entire contentions and finally selected eight comparables whose average profit margin on operating profit / total cost (for short *"OP / TC"*) worked out at 17.48%. Accordingly, an adjustment of ₹ 356.44 crores was made vide order dated 7th March 2008. Apart from this, adjustment of ₹ 5.85 crores on account of undercharging of Common Corporate Audit Services and reimbursement of expenses received from intra group services was also made and final adjustment of ₹ 362,29,41,800, was made in the value of international transactions. The other adjustment which was made on account of royalty, R&D cess, advertisement and sales promotion expenses, etc., the TPO held that the same would get subsumed by the adjustment of ₹ 356.44 crores. Against the said order of the TPO, the assessee filed a Writ Petition before the Jurisdictional High Court, being WP no.2244 of 2008, inter-alia, on the ground that the same has been passed in violation of natural justice as proper opportunity of filing the document before the TPO was not given and additional reply and submissions were to be filed. The Jurisdictional High Court set aside the TPO's order dated 7th March 2008, with a direction that opportunity of placing of the documents and hearing be given to the assessee and the fresh order should be passed following the cannon of natural justice after considering the assessee's fresh statements.

5. In the fresh transfer pricing proceedings, the assessee raised various objections which included preliminary objection of making the reference to the TPO without satisfying the conditions laid down under section 92CA. The sum and substance of the assessee's objection before the TPO were – (i) multiple year data should be accepted to work out the PLI, which has been dealt in Para-7.2 of the impugned TP order; (ii) only such data of comparables as was available in the public domain during the financial year of transactions can be used for comparability analysis; (iii) the TPO may determine the ALP on the basis of material and information available to him only if any of the four conditions stipulated in section 92C(3) are fulfilled and not otherwise; (iv) the assessee has given detail reason for

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use of operating profit upon sales as PLI to determine the arm's length price, looking to the nature of international transactions and that the company's business is driven more by sales volume rather than cost and accordingly, sale should be the appropriate factor to evaluate the profitability of the relevant segment; (v) besides aforesaid objections, the main objection of the assessee during the course of fresh TP proceedings was that instead of bench marking the profits with the entity level, segmental profit of the A.E. transaction falling in various segment should be bench marked separately to justify the ALP and, accordingly, the assessee provided detail segmental analysis of various segments like soap and detergents, home and personal care products, beverages, food, exports, etc., along with the operating profit of every segment vis-à-vis the comparable companies in the respective fields; and (vi) lastly, the assessee submitted that in view of proviso to section 92C(2), the operating margin of the comparables and the operating profit disclosed by the assessee falls within the safe harbour of +/- 5%, therefore, no adjustment in ALP was required.

6. The TPO rejected all the objections and contentions of the assessee in a very detail manner which has been discussed from Para-7.1 to 9 i.e., Pages-4 to 24 of his order. The sum and substance of rejection of assessee's contention were that – (i) Multiple year data cannot be made applicable in assessee's case, as for proper comparability the data of comparables should be taken on multiple year basis and the comparable data of the assessee must also be taken on multiple year basis. However, this will not serve the purpose as one has to bench mark the transactions relating to the relevant year under consideration and the data can only be matching by the relevant year's data of the industry. In support of his conclusion, he relied upon the decision of the Tribunal, Delhi Bench, in Mentor Graphics and other decisions; (ii) Regarding the assessee's argument that only such data of comparables as was available in public domain during the financial year of the transaction can be used for

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comparability analysis, he held that the assessee has nowhere taken a stand that transfer pricing were fixed on the basis of profitability of comparable cases. Further, Indian transfer pricing regulation nowhere refers to the requirement of availability of data in public domain, the assessee being in particular business activity is expected to know profitability of that business at different point; (iii) Regarding compliance of conditions laid down under section 92C(3) of the Act, he held that the assessee does not satisfy these conditions laid down as the transfer pricing has not been determined by the assessee in accordance with the TNMM; (iv) Regarding bench marking at segmental level, he held that the assessee has not substantiated the identification and allocation of head office expenses and over heads and has failed to provide classification of exports into A.E. and non-A.E. It has also failed to segregate the income and cost relating to various activities being undertaken by the assessee which have been aggregated, over all margin. He further pointed out anomalies and discrepancies in the figures of Profit & Loss Account and the sales figure of A.E. as well as non-A.E. sales given in the segmental data and in the entity level data. He further noted that independent transaction-wise bench marking by TNNM will give the correct result only if authentic segment account for independent line of business is prepared by the assessee i.e., accurate data is available for each segment of the business. Grossing up of the data or apportioning the expenditure in the segmental analysis will throw up absurd results and will be inaccurate and unreliable. It was due to various anomalies and non-authentic segmental account, the assessee was compelled to use the entity level profit for bench marking and determining the ALP by way of TNNM at the entity level and not at the independent transaction level during the course of assessment proceedings before the TPO. After having rejected the segmental accounts, he proceeded to analyse the segmental details filed by the assessee in view of the directions of the High Court. These analysis have been given from Pages-11 to 15 and came to the following conclusions:-

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""The assessee's segmental margins are low when compared to comparable companies

Conclusion:– Therefore, in view of the extensive discussion above and failure of the assessee to submit duly audited reliable data on segmental level and categorically establishing that the approach of the assessee in benchmarking on segmental level is faulty and that it can never give the correct figure. In absence of any cogent segmental benchmarking by the assessee, this office has to preforce go by the entity level benchmarking furnished by the assessee carried out vide order dated 7.3.2008 at ₹ 356.44 crores to arrive at the ALP."

7. Regarding determination of arm's length operating results at company level, the assessee had submitted following comparable companies and their operative margins.

S.no.	Company's Name	O.M (%)
1.	I.T.C. Ltd.	19.13
2.	Bata India Ltd.	1.30
3.	Nestle India Ltd.	17.60
4.	Tata Tea Ltd.	13.73
5.	Colgate–Palmolive (I) Ltd.	14.71
6.	Britannia Industries Ltd.	9.21
7.	Dabur India Ltd.	17.27
8.	Glaxosmithkline Consumer Health Care Ltd.	13.08
9.	Godrej Consumer Products Ltd.	18.35
10.	Marico Ltd.	10.95
11.	Mc dowell & Co. Ltd.	4.97
12.	Nirma Ltd.	14.10
	Mean	**12.87**

In comparison to that the assessee company's operating results were as under:-

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Particulars	*Amount (₹ in lakhs) for the year ended 31.3.2006*
Sales	*12,27,106*
Add: Other income from services rendered	*12,667*
Total Operating Income (A)	*12,39,773*
Less: Operating Expenses	*(10,74,649)*
Less: Depreciation	*(12,882)*
Operating Profit (B)	*152,242*
Add: Other income	*20,022*
Less: Interest	*(1,678)*
Profit for the year	*1,70,586*
OM (B/A)	***12.28%***

8. The TPO noted that the assessee has not carried out product comparability and FAR analysis. For example, the assessee has included companies like Bata India Ltd., Mc Dowel & Co. Ltd., which are prima-facie engaged in manufacturing of entirely different products. The TPO thereafter issued a show cause notice after pointing out the discrepancies in the comparables included by the assessee and also the working of the PLI. The contents of the show cause notice has been reproduced in Pages-17 and 18 of the TPO's order and required the assessee to show cause as to why the adjustment of ₹ 343.95 crores may not be done after taking the following comparables:–

Name of the Company	*₹ (crores)*	*₹ (crores)*	*₹ (crores)*		
	March 2006	*March 2006*	*March 2006*		
	Sales	*PBIT (NOI,NNRT)*	*TC*	*OP/TC (%)*	*OP/Sales (%)*
Britannia Industries Ltd.	*1821.17*	*167.76*	*1653.41*	*10.15*	*9.21*
Colgate Pal–molive (I) Ltd.	*1249.73*	*186.53*	*1063.20*	*17.54*	*14.93*

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Dabur India Ltd.	*1372.39*	*217.66*	*1154.73*	*18.85*	*15.86*
Glaxomithkline Consumer Healthcare Ltd.	*1117.09*	*146.10*	*970.99*	*15.05*	*13.08*
Godrej Consumer Products Ltd.	*692.26*	*127.00*	*565.26*	*22.47*	*18.35*
ITC Ltd.	*15795.88*	*3021.70*	*12774.18*	*23.65*	*19.13*
Marico Ltd.	*1047.04*	*114.09*	*932.95*	*12.23*	*10.90*
Nestle India Ltd.	*2643.96*	*465.24*	*2178.69*	*21.36*	*17.60*
Nirma Ltd.	*2244.18*	*313.65*	*1930.53*	*16.25*	*13.98*
Tata Tea Ltd.	*970.89*	*134.44*	*836.45*	*16.07*	*13.85*
			Average	***17.36***	*14.69*
Hindustan Unilever Ltd.	*12271.79*	*1522.42*	*10748.65*	***14.16***	*12.41*

9. In response, the assessee has given a detail reply which has been incorporated in Pages-19 to 21 of the TPO's order which for the sake of ready reference is reproduced herein below:-

"1) Choice of comparable companies for the purpose of benchmark:

"As your goodself is aware, Hindustan Unilever Limited is one of the large FMCG companies operating in India and deals in several products which fall under the Home and Personal Care category and the Foods category. These include soaps, detergents, oral care, hair care, skin care, household care, beverages, culinary products, ice creams and other processed foods.

We had vide our letter dated 8.2 .2008 we had provided your goodself with data in respect of 12 FMCG companies, copy of which is enclosed in Annexure 1, for the purposes of determining the average "operating profit to sales ratio". These companies were considered on the basis that they formed the BSE-FMCG Index.

At the outset, we would like to state that out of the 12 companies considered by us in the above submission inadvertently Marico Limited was wrongly considered as forming a part of the BSE FMCG Index as on 31.3.2006 instead of Radico Khaitan Limited. The correct composition of the BSE FMCG Index as on 31.3.2006 and the respective margins of the companies comprising BSE FMCG Index as on 31.3.2006 are as under:

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S.no.	*Company's Name*	*O.M (%)*
13.	*I.T.C. Ltd.*	*19.13*
14.	*Bata India Ltd.*	*1.30*
15.	*Nestle India Ltd.*	*17.60*
16.	*Tata Tea Ltd.*	*13.73*
17.	*Colgate–Palmolive (I) Ltd.*	*14.71*
18.	*Britannia Industries Ltd.*	*9.21*
19.	*Dabur India Ltd.*	*17.27*
20.	*Glaxosmithkline Consumer Health Care Ltd.*	*13.08*
21.	*Godrej Consumer Products Ltd.*	*18.35*
22.	*Radico Khaitan Ltd.*	*8.41*
23.	*Mc dowell & Co. Ltd.*	*4.97*
24.	*Nirma Ltd.*	*14.10*
	Mean	*12.87%*

We request you to consider the above data for the Company Level Benchmarking.

Your goodself vide your above letter proposes to exclude Bata India and Mcdowell & Co. Ltd. from the said list on the basis that these companies are engaged in product categories which are different from those dealt with by Hindustan Unilever Limited. In the matter we would like to state that we are unable to locate any single FMCG company which is engaged in all the activities in which we are engaged. However, for the purpose of a meaningful comparison of the operating margin at company level, we had short listed 12 companies forming part of Bombay Stock Exchange (BSE) FMCG Index for that year. We also enclose herewith in Annexure 2 the list of companies which have been included/excluded from the FMCG Index from the year 2005 to 2007. Your goodseif will notice that Bata India Ltd and McDowell & Co. Ltd. were very much a part of the BSE FMCG Index and therefore there is absolutely no reason why these should be excluded in determining a comparable benchmark of companies engaged in the FMCG business.

These two companies are considered as FMCG companies because they are engaged in the manufacture and sale of products which are purchased by consumers across the counter for their daily consumption / use and therefore in that sense, they are no

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different from Hindustan Unilever Limited which is also engaged in manufacturing products of daily need.

The purpose of the exercise is to determine a fair return earned by FMCG companies. If one were to pick and choose companies which are required to be included, and exclude companies, though classified as FMCG companies by the BSE, an external body, merely because these have a lower margin profile then the result would be vitiated. It is therefore submitted that there is absolutely no justification in excluding Bata India Ltd. and McDowell & Co. Ltd. from the list of comparables.

Without prejudice to the aforesaid, if you choose to exclude Bata India Ltd. and McDowell & Co. Ltd then we would like to submit that you must also exclude ITC Ltd, which is predominantly engaged in manufacture and sale of tobacco based products and hospitality business, with 70% of their turnover coming from cigarettes and 24% from non-FMCG categories like hotels, agriculture and paper is, strictly speaking, not comparable with the products manufactured by us and include certain other companies which has common products as ours like Procter and Gamble Home Products Ltd., Lotte India Corporation Limited, Parle Biscuit Pvt. Limited and Agro Tech Foods Limited. We enclose herewith in Annexure 3 a revised statement of comparable companies with their operating margins.

Further we would like to point out that our margin for the current financial year was lower largely because the company was engaged in afierce battle with another competitor in the topend detergents business which constitutes about 20% to 25% of the company's turnover and as a result of the said business was incurring losses. It is therefore submitted that we should also be allowed to make suitable adjustments to the operating margin to reflect the margin in respect of the company by excluding the detergents business since our international transactions in respect of export of goods do not include export of detergents.

Therefore, for the above reasons, we urge you to accept the list of comparable companies used by us for the purpose of determining the benchmark, as correct and proceed accordingly."

10. The assessee's submissions were rejected and finally the TPO made the adjustment in the following manner:-

"9. The operating profit margins in case of 8 companies (after excluding the company I.T.C. Ltd. and Britannia Industries Ltd., for the reasons given earlier) as mentioned in the Annexure with the show cause notice dated 21.2.2008, reproduced on Pages–5 to 6 of this order, will have to be considered. The position is as under:–

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Name of the Company	*₹ (crores)*	*₹ (crores)*	*₹ (crores)*	
	March 2006	*March 2006*	*March 2006*	
	Sales	*PBIT (NOI,NNRT)*	*TC*	*OP/TC (%)*
Colgate Palmolive (I) Ltd.	*1249.73*	*186.53*	*1063.20*	*17.54*
Dabur India Ltd.	*1372.39*	*217.66*	*1154.73*	*18.85*
Glaxomithkline Consumer Healthcare Ltd.	*1117.09*	*146.10*	*970.99*	*15.05*
Britannia Industries Ltd.	*692.26*	*127.00*	*565.26*	*22.47*
Godrej Consumer Products Ltd.	*1047.04*	*114.09*	*932.95*	*12.23*
Marico Ltd.	*2643.96*	*465.27*	*2178.69*	*21.36*
Nestle India Ltd.	*2244.18*	*313.65*	*1930.53*	*16.25*
Nirma Ltd.	*970.89*	*134.44*	*83645*	*16.07*
Tata Tea Ltd.				
			Average	***17.48***
Hindustan Unilever Ltd.	*12271.79*	*1522.42*	*10748.65*	***14.16***

"Amount of T P Adjustment	*(₹ in crores)*
Total Sales of the assessee	*12271.79*
Total costs of assessee	*10748.64*
Operating Profit (I)	*1522.42*
Operating Profit / Total costs	*14.16%*
Benchmarking OP/TC	*17.48%*
Benchmarked Operating Profit (II)	*17.48% of ₹ 10748.65 + 1878.86*
Difference between II & I	*356.44 (x)*
Total sales to AEs (sr. no.3 to 6 of page–1 of this order)	*689.89 (y)*
ALP of sales to AEs	*= x + y = 1046.33*
95% of ALP	*= 994.01"*

11. Regarding assessee's contention for the safe harbour benefit of +/- 5% in respect of adjustment in terms of proviso to section 92C, the TPO concluded as under:-

> *"The proviso to section 92C(4) has two limbs.*
>
> *i) Its first limb deals with the situation where the Most Appropriate Method leads to more than one Arm's Length Price and in that situation the Arm's Length Price should be the arithmetic mean.*

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ii) Second limb of the provision, provides the facility of option to the taxpayer if price varies by an amount not exceeding ±5% of such mean.

Thus, the option is available to the taxpayer in the case where variation in price is only upto 5% as found through arithmetic mean. If the variation in price is more than 5%, the taxpayer has no option and Arm's Length Price shall be determined as per the first limb of the proviso.

Circular No. 12 of CBDT dated 23.8.01 issued in the shape of press note by the Ministry of Finance (Depth Of Revenue), Government of India, makes its intention clear for not making any adjustment if the price adopted by the taxpayer was upto 5% less or upto 5% more than the Arm's Length Price determined by the AO. In effect, transfer pricing shown by the taxpayer was not disturbed if such price fell within the range of ±5% of determined price. But if the variation in the disclosed price and the determined Arm's Length Price was more than the above limit, then the Circular provided that transfer price declared by the taxpayer was not to be accepted and adjustment for the variation was required to be made.

This view has now further been clarified by the amendment to the proviso to Section 92C(4), by the Finance Act 2009 w.e.f. 1.10.2009."

12. Even after making the adjustment at the entity level, he made further adjustment on account of research innovation development related services. The assessee has rendered research innovation development related services group companies and has shown the mark up of 15.5% in the operating cost and the assessee has selected seven comparable companies for working out arithmetic mean of 18.47% in the following manner:-

S.no.	*Company's Name*	*Average adjusted OP/TC (%)*
1.	*Alphageo (I) Ltd.*	*24.74*
2.	*Dolphin Medical Services Ltd.*	*11.46*
3.	*N.G. Industries Ltd.*	*29.60*
4.	*Vimta Labs Ltd.*	*69.49*
5.	*Neeman Medical International (Asia) Ltd.*	*–0.89*
6.	*A D S Diagnostic Ltd. – seg.*	*–9.20*
7.	*Pfizer Ltd. – service seg.*	*4.07*
	Arithmetic mean	*18.47*

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13. The TPO rejected the comparables like Neeman Manner International Asia Ltd., ADS Diagnostic Ltd. and also the Pfizer Ltd. He included Choksi Laboratory Ltd., Transgene Biotech Ltd. (segmental) and Medonova Diagnostic Services Ltd. and analysed the following comparables:-

S.no.	***Company's Name***	***Average adjusted OP/TC (%)***
1.	***Alphageo (I) Ltd.***	***47.79***
2.	***Dolphin Medical Services Ltd.***	***14.52***
3.	***N.G. Industries Ltd.***	***31.26***
4.	***Vimta Labs Ltd.***	***57.68***
5.	***Choksi Laboratory Ltd.***	***32.22***
6.	***Transgene Biotech Ltd – segmental***	***8.16***
7.	***Medinova Diagnostics Ser. Ltd.***	***7.26***
	Arithmetic mean	***28.41***

He also rejected the assessee's contention for adjustment of risk and made an adjustment in this account in the following manner:-

Cost of service rendered	***₹ 5034.32 lacs***
Mark up as per the comparables (28.41)	***₹ 6464.57 lacs***
Actual Amount received	***₹ 5814.72***
Adjustment	***₹ 649.85 lacs***

14. The TPO further suggested adjustment on account of following payments:-

S.no.	*Particulars*	*Amount*
1.	*Adjustment on account of royalty payment made to Uniliver PLC*	*₹ 30,32,40,660*
2.	*Adjustment on account of income tax paid on royalty*	*₹ 10,00,14,000*
3.	*Adjustment made out of R&D cess*	*₹ 1,73,79,000*
4.	*Adjustment made on account of payment on service tax*	*₹ 398.72 lakhs*
5.	*Adjustment made on account of Royalty receivable from Nepal Liver Ltd.*	*₹ 20,29,222*

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6.	*Adjustment made on account of payment of royalty to Uniliver N.L.*	*₹ 1,63,649*
7.	*Adjustment made on account of advertisement and sales promotion expenses*	*₹ 27.09 lakhs*
8.	*Advertisement and sales promotion expenses*	*₹ 27.09 lakhs*

15. However, he observed that these additions are not to be separately made as the same will get subsumed on account of adjustment of ₹ 356.44 crores.

16. Lastly, he made an adjustment of under-charging for common corporate audit service and intra-group service for a sum of ₹ 5,85,41,008. Thus, finally, the total adjustment was made at ₹ 3,68,79,26,000, comprising of the following:-

(i) TP adjustment at the entity level – ₹ 356.44 crores;

(ii) Research innovation and development related services – ₹ 6,49,85,000;

(iii) Undercharging of common corporate audit services and intra group services – ₹ 5,85,41,000.

17. Aggrieved by the adjustment made by the TPO, the assessee filed its objection before DRP wherein detail objection with regard to each and every finding of the TPO and the adjustment made were submitted. The DRP rejected the entire contentions of the assessee and upheld the entire findings of the TPO as it is. The assessee, being aggrieved, is in further appeal before the Tribunal.

18. Before us, the learned Sr. Advocate, Mr. P.J. Pardiwala, after referring to the entire facts as discussed by the TPO vis–a–vis the contentions and objections raised by the assessee before the TPO as well as before the DRP with reference to the voluminous paper book filed before us, raised a very preliminary objection / submissions, that the TPO

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has ultimately carried out the bench marking at the entity level after taking the entire sales of the assessee company i.e., A.E. transactions as well as non–A.E. transactions and has made the adjustment of ₹ 356.44 crores, which has been worked out after taking the percentage of operating profit on total cost at 17.48% of the eight comparable companies short listed by him, as against the 14.16% of the operating profit upon total cost of the assessee. Even if such an adjustment is accepted at the entity level, then the same falls in a safe harbour range of +/– 5%. This was demonstrated in the following manner:–

	(₹ in crores)
Cost base as per TPO's order (Page-24)	*10748.64*
Add: Mark-up as per TPO – 17.48%	*1878.86*
Arm's length price for sales (ALP)	*12627.50*
95% of ALP as per proviso to section 92C(2)	*11996.13*
HUL's sales as per TPO's order (page 24 of the TP order)	*12271.79*

Thus, the entire adjustment made by the TPO falls within the range of +/- 5%. After referring to the above, he further submitted that the TPO, in fact, was required to bench mark only the transactions with the A.Es and not the entire sales. In support of this contention that TP adjustment should be restricted to value of international transactions only he relied upon various decisions of the Tribunal in IL Jin Electronics India Pvt. Ltd. v/s ACIT, 36 SOT 227 (Del.), M/s. Lionbridge Technologies Pvt. Ltd. v/s DCIT, 148 TTJ 265 (Mum.), Penzoil Quaker State India Ltd. v/s DCIT, ITA no.8885/Mum./2010. He submitted that if mark up of 17.48% is applied on A.E. transactions, then also it falls within the range of +/– 5%. This was illustrated by way of following working:–

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	(₹ in crores)
HUL Transactions with A.E.	*689.89*
Margin of HUL @ 12.28% (OP/Sales)	*84.72*
Total cost of HUL	*605.17*
Arm's length margin by TPO @ 17.48% (OP/cost)	*105.78*
Arm's length price of the export transaction as per TPO	*710.96*
Range @ 95%	*675.41*
Range @ 105%	*746.50*
HUL Transactions with AE at 689.89 crores is within the range of 675.41 crores and 746.50 crores. Therefore, the transactions are at arm;s length.	

Thus, under both the scenario, he submitted that at the very thresh hold, the entire adjustment of ₹ 356.44 crores gets deleted. In support of this contention that only A.E. transactions are to be looked into for the purpose of bench marking, he relied upon various Tribunal decisions.

19. He further submitted that if a comparison of operating margin at segmental level is taken into consideration vis–a–vis A.E. and non–A.E. transactions, then the assessee has earned more operating profit margin in relation to A.E. transaction as compared to non–A.E. transaction. In support of this, he submitted a detail statement of segmental level accounts analysis of sales / operating cost, operating margin on sales as well as on cost of various segments like home care products, beverages, rice and marine, crabsticks, etc., and pointed out that in all the segments, the profit margin on sales as well as on cost in A.E. transactions are much higher than non-A.E. transactions and, therefore, if one goes by internal comparables, then the assessee's profit margin on A.E. transactions are at arm's length. The summary of segmental operating margin as submitted by the learned Sr. Counsel are as under:–

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H.P.C.

Particulars		*A.E. ₹ INR*	*Non–A.E. ₹ INR*	*Total ₹ INR*
Sales		*3,138,252*	*727,673*	*3,865,925*
Add: DEPB / Export Licences				
Sales		*3,138,252*	*727,673*	*3,865,925*
Operating Cost		*2,722,538*	*652,778*	*3,499,818*
Operating Margin		*415,714*	*74,895*	*366,107*
Operating Margin (%) on sales	*OP/OS*	***13.25%***	***10.29%***	*9.47%*
Operating Margin (%) on cost	*OP/OC*	***15.27%***	***11.47%***	*10.46%*

BEVERAGES

Particulars		*A.E. ₹ INR*	*Non–A.E. ₹ INR*	*Total ₹ INR*
Sales		*33,804,065*	*1,076,219*	*4,880,284*
Add: DEPB / Export Licences		*(31,234)*	*620*	*(30,614)*
Sales		*3,772,831*	*1,076,839*	*4,849,670*
Operating Cost		*3,587,559*	*1,084,452*	*4,672,011*
Operating Margin		*216,506*	*(8,233)*	*208,273*
Operating Margin (%) on sales	*OP/OS*	***5.74%***	***–0.76%***	*4.29%*
Operating Margin (%) on cost	*OP/OF THE CASE*	***6.03%***	***0–76%***	*4.46%*

RICE & MARINE

Particulars		*A.E. ₹ INR*	*Non–A.E. ₹ INR*	*Total ₹ INR*
Sales		*124,118*	*1,743,206*	*1,867,324*
Add: DEPB / Export Licences				
Sales		*124,118*	*1,743,206*	*1,867,324*
Operating Cost		*116,500*	*1,691,732*	*1,808,232*
Operating Margin	*OP/OS*	*7,618*	*51,474*	*59,092*
Operating Margin (%) on sales	*OP/OC*	***6.14%***	***2.95%***	*3.16%*
Operating Margin (%) on cost	*OP/OS*	***6.54%***	***3.04%***	*3.27%*

CRABSTICKS ***OTHERS***

Particulars		*A.E. ₹ INR*	*Non–A.E. ₹ INR*	*Total ₹ INR*	*Others ₹ INR*
Sales		*109,659*	*180,857*	*290,516*	*1,907,851*
Add: DEPB / Export Licences					
Sales		*109,659*	*180,857*	*290,516*	*1,907,851*
Operating Cost		*112,638*	*192,074*	*304,712*	*2,006,543*
Operating Margin		*(2,979)*	*(11,217)*	*(14,196)*	*(98,692)*
Operating Margin (%) on sales	*OP/OC*	*–2.72%*	*–6.20%*	*–4.89%*	*–5.17%*
Operating Margin (%) on cost	*OP/OS*	*–2.64%*	*–5.84%*	*–4.66%*	*–4.92%*

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HUL

Particulars		*A.E. ₹ INR*	*Non–A.E. ₹ INR*	*Total ₹ INR*
		56.01%	*43.99%*	
Sales		*7,176,094*	*5,635,806*	*12,811,900*
Add: DEPB / Export Licences		*(31,234)*	*620*	*(30,614)*
Sales		*7,144,860*	*5,636,426*	*10,873,435*
Operating Cost		*6,539,235*	*5,627,579*	*12,29,316*
Operating Margin		*636,859*	*8,227*	*520,584*
Operating Margin (%) on sales	*OP/OC*	***8.87%***	***0.15%***	*4.06%*
Operating Margin (%) on cost	*OP/OS*	***9.74%***	***0.15%***	*4.24%*

20. In support of this contention that internal comparables are preferable over external comparables even under the TNMM, the learned Sr. Counsel heavily relied upon the Third Member decision of the Tribunal in **Technimont ICB Pvt. Ltd. v/s ACIT, ITA no.4608 & 5085/Mum./2010, order dated 12th July 2012**, and drew our attention to Para–10 of the said order. He submitted that without going into the merits of various findings of the TPO as well as inclusion and exclusion of comparable companies, the entire adjustment made by the TPO gets vitiated. Once the TPO has made the adjustment on entire sales and at entity level, the other adjustments automatically gets subsumed and no further adjustments even on account of research innovation and development related services and under–charging for common corporate audited services and intra group services can be made.

21. The learned Sr. Counsel submitted that various objections and the conclusions drawn by the TPO with regard to the authenticity of segmental accounts, he submitted that the assessee had submitted audited segmental accounts before the DRP which was confronted to the TPO and no adverse remarks were given on such audited accounts. He submitted that most of the direct expenses have been apportioned to the respective segments based on actual expenditure incurred and other over heads expenses which were allocated in proportion to sales. Regarding the discrepancies pointed out by the TPO in his order, he clarified each and

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every point and also the so called discrepancies and drew our attention to Annexure-N to letter dated 28th September 2009, given before the TPO giving the segmental details and method of determining the cost. Thus, the allocation of the expenses were perfectly correct and, therefore, going by the results of A.E. transactions at the segmental level, no adjustment is required to be made in the ALP. Accordingly, the entire adjustment made by the TPO should be deleted at the very thresh hold level without going into the merits of inclusion and exclusion of comparable companies and other adjustments.

22. The learned Sr. Counsel, after making these preliminary submissions also made a very elaborate submission not only with regard to each and every objections and conclusions drawn by the TPO but also with regard to various adjustments made on account of various royalty payments, royalties received, sales promotion and advertisement expenses, R&D cess, etc., as discussed by the TPO, with reference to the material placed on record before the TPO as well as the DRP. These submissions are, however, not discussed by us.

23. The Bench required the learned Departmental Representative to make submissions on the preliminary submissions made by the learned Sr. Counsel which, in our opinion, goes to the very root of the issue involved. The learned Departmental Representative submitted that if the nature of international transactions taken by the assessee company is taken into consideration then it would be seen that the same are on income as well as expenditure side. The assessee itself has bench marked its international transactions at the entity level which shows that original approach of the assessee was to bench mark international transactions at the entity level by aggregating all the international transactions. The assessee came out for the first time the idea of bench marking at the segmental level before the TPO in the second innings only. These segmental results furnished before the TPO were un–audited and the assessee was unable to substantiate even a single segment. For this, he referred to the findings of

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the TPO given at Page–10. He submitted that the TPO has analyzed the segmental data and has given a detail reasons for rejecting the same. The so called audited segmental data which was provided to the DRP on 16th September 2010, the DRP has rejected the same after calling the comments of the TPO. Regardless of that, he submitted that the audited segmental data cannot be considered by this Bench on account of following discrepancies.

(i) The assessee could not brought on record that there was only the approval of the board of directors to appoint M/s. M.L. Puri & Co., as auditors for auditing statement of operating margin of each segment;

(ii) The report of M/s. M.L. Puri & Co. has to be seen in the light of guidance note of ICAI on audit report and certificate for special purpose;

(iii) Nowhere the report states that expenditure in different segment is allocated based on some keys;

(iv) There are some exceptional adjustments in the operating margin for human and personal care segment;

(v) Thus, the report prepared by M/s. M.L. Puri & Co., cannot be said to be reliable;

24. Insofar as reliance of Third Member decision of the Tribunal in Technimont (supra) is concerned, the same can only be relied if reliable data is available for the internal comparable.

25. On the issue of bench marking at the entity level and application of safe harbour range of +/– 5%, the learned Departmental Representative submitted that the assessee has bench marked its margin at the entity

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level and has computed margin on operating profit upon operating revenue at 12.28%, whereas the mean margin of 12 comparable companies taken by the assessee was computed @ 12.87%. Thus, the original approach of the assessee was to bench mark the international transaction on the entity level by aggregating all the international transactions. Therefore, the plea taken by the learned Sr. Counsel that only A.E. transaction should be taken into account, now cannot be entertained. He further submitted that the arm's length price of the transactions with associated enterprises is to be computed following the provisions of the Act and the law does not require computing the arm's length price of the transactions with independent parties. There is an inherent presumption that the transactions with the independent parties shall always be at arm's length. So if the transactions with the independent parties are at arm's length then what is pulling the margin of the assessee company down? It is obvious that the margin of the assessee is down vis-a-vis the arm's length margin only because of the transactions with the associated enterprises. Thus, whatever is the shortfall that is attributed to the transactions with the associate enterprises. Since the margin from the independent transactions and international transactions cannot be computed separately, unless the margin is applied on the entity level, the arm's length price of the international transaction cannot be computed. In view of the above, he submitted that the adjustment made by the TPO is justified and ought to be confirmed.

26. After making the aforesaid submissions, he also submitted the statement for the ALP determination of the international transactions to counter assessee's submissions on account of safe harbour range of +/– 5%.

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	Total		*AE Transaction*	*Non AE Transaction*
Sales of the assessee	*12271.79*	*A*	*689.89*	*11581.9*
Since non–AE transactions are at arm's length hence apply the arm's length margin i.e., 17.48% to arrive at the cost				*11581.90 / 117.48%*
Cost	*10748.65*	*B*	*890.03*	*9858.61*
Apply the arm's length margin on the cost used to earn the AE sales		*C*	*155.58*	
Arm's length price of sales made to the AEs		*D=B+C*	*1045.61*	
Difference of Arm's length price and the price at which the international transaction has taken place		*E=D–A*	*355.72*	
95% of Arm's length price			*993.33*	

27. In the rejoinder, the learned Sr. Counsel, Mr. P.J. Pardiwala, submitted that so far as the learned Departmental Representative's contention that segmental accounts have not been audited in accordance with the ICAI guidelines, it is nobody's case neither of the TPO nor of the DRP, that the same is not in accordance with the ICAI guidelines. The assessee has submitted the audited segmental accounts before the DRP which was also confronted to the TPO and no such adverse remarks have

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been given by any of the authorities. Even before the TPO, the assessee, vide letter dated 5th March 2009, a copy of which is placed at Paper book at Pages–433, has submitted the basis of allocation of expenses for segmental accounts in the following manner:–

> *In relation to the keys of allocation of expenditure between the segments, please note the following:–*
>
> > *"Direct expenditure like raw material and packing cost, power and fuel, etc., incurred for manufacturing activities are apportioned to the respective segment based on actual expenditure incurred. Over head expenditures are allocated in proportion to sales*."

From this, he submitted that the basis for allocation of expenditure which was the main reason for rejecting the rejection of segmental account by the TPO becomes baseless. Moreover, once an audited segment accounts have been furnished and no fault has been found, the same cannot be rejected on the reasoning given by the learned Departmental Representative and, hence, it should be accepted. Regarding exceptional adjustments in the Human care segment products, the learned Sr. Counsel had provided the relevant details to clarify the said adjustments. He also referred to Annexure–N to letter dated 28th September 2009, giving segmental details and method of determining the cost and pointed out, that most of the expenses have been identified on factory actuals based on factory products and head office based sales value and bill of material. Thus, there was no basis for doubting the allocation of pro–rata expenses and the operating margin of the various segments. Regarding entity level adjustment, he submitted that what the assessee has been objecting is that the entire transactions should not be taken into account and thereby applying operating margin of 17.48%, otherwise it will lead to absurd results. The TPO should have taken only the A.E. transactions i.e., international transactions for the purpose of bench marking and not the entire turnover. Regarding the working of +/– 5% given by the learned Departmental Representative, he submitted that

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there is inherent contradiction while working out the cost as he has worked out the cost in proportion to the entire sales of the assessee. Even otherwise also, by whatever yardstick, whether bench marking the operating margin at the entity level for the entire transactions (i.e., A.E. or non–A.E) or whether going by A.E. transactions, the assessee's case falls within the range of +/– 5% as stated in the foregoing paragraphs and no fault has been found in such a working even by the learned Departmental Representative. Thus, on the thresh hold itself, the entire adjustment made by the TPO should be deleted.

28. Both the parties have also addressed us in detail with regard to the adjustment which has been added separately by the TPO and also the various other adjustments relating to royalty, etc., which has been subsumed by the TPO in the figure of ₹ 356.44 crores, with reference to the material placed in the paper book, however, the same are not discussed.

29. We have carefully considered the rival submissions with reference to the material placed on record and also the orders passed by the TPO as well as by the DRP. The assessee has shown total turnover of ₹ 12271.79 crores from all its segments and total operating income has been shown at ₹ 12379.73 crores after including other income from services on which, the operating profit margin have been shown at 12.28%. In the T.P. study report, the assessee has mainly followed TNNM for its international transactions and has taken 12 comparable companies on the basis of BSE–FMCG Index. The arithmetic mean of such comparables worked out at 12.87%, as per the details given in the foregoing paragraph no.3. Thus, it was claimed that the assessee's international transactions were at arm's length. The TPO, in his original order dated 7.3.2008, passed u/s 92CA(3), made an adjustment of ₹ 356.44 crores, after taking assessee's profit margin at 14.16% (OP/TC) and comparing the same with the comparable short listed by him wherein the arithmetic mean worked out at 17.48% (OP/TC). Further, addition of ₹ 5.85 crores was also made on account of

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undercharing of certain services. This order was set aside by the High Court in a Writ Petition filed by the assessee, mainly on the ground that no proper opportunity was given to the assessee to corroborate the facts and various other arguments specifically with regard to segmental accounts which have not been taken into consideration. In compliance with the directions of the High Court, the TPO carried out fresh transfer pricing proceedings and rejected all the assessee's contentions specifically with regard to bench marking the transactions on segmental basis, which has been discussed in detail in the foregoing paragraphs. The TPO has virtually repeated the same adjustment made by the earlier TPO in his order dated 7th March 2008, by taking the average operating profit of the comparables at 17.48% as compared to the assessee's operating profit / total cost at 14.16%. The TPO has bench marked the transactions at the entity level after taking the entire turnover i.e., transactions with A.E. as well as non–A.E. The main contention of the learned Sr. Counsel before us is that the TPO was required to bench mark the A.E. transactions only, which were at ₹ 689.89 crores and if the arm's length margin taken by the TPO at 17.48% is applied, then the same falls within the safe harbour range of +/– 5%. Even otherwise also, if the said markup of 17.48% is applied at the entity level, then also, the difference is 3.32% which also falls within the safe harbour range of +/– 5%. The said working submitted by the learned Sr. Counsel has already been reproduced in the foregoing paragraph no.18. We have to examine firstly, as to whether the bench marking should be done at A.E. transactions only or for the entire transactions (including A.E. as well as Non–A.E.) and secondly, whether the adjustment in ALP by the TPO falls within the safe harbour range of +/– 5%.

30. Provisions of section 92 provides that "*any income arising from an international transaction shall be computed having regard to the ALP*". Thus, the ALP has to be on international transaction and not in relation to assessee's entire sales or turnover. The *second proviso* to section 92C,

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though brought in statute by the Finance Act, 2009, w.e.f. 1st October 2009, provides that *"if the variation between ALP so determined and the price at which international transaction has actually been undertaken shall be deemed to be the ALP"*, however, the same is indicative of the preposition that the ALP is to be determined only on international transaction. This, inter–alia, means that the statute itself provides that the adjustment arising out of ALP should be with regard to international transaction and not on the entire turnover of the assessee. The transfer pricing mechanism revolves around international transaction where it has to be seen whether such transactions are at arm's length price or not. The presumption is that transactions with the independent parties are always at arm's length price, however, it is with regard to related parties i.e., A.Es, only one has to see whether such a transaction is at arm's length. The profit margin from the international transaction with the A.E. has to be seen in relation to the uncontrolled transaction with the independent parties. What is to be compared is the international transactions of the assessee with its related parties and not for its entire transaction with non–related parties also. Therefore, ALP has to be seen only with regard to international transaction with A.Es and not on the entire turnover / sales. We, thus, agree with the contentions of the learned Sr. Counsel that bench marking should be done only on A.E. transactions and not for the entire turnover.

31. Now we have to basically examine whether the adjustment in ALP falls within safe harbour of +/– 5% or not. Section 92C provides that the assessee's ALP along with price in relation to international transactions shall be determined by following any of the methods, being the most appropriate method having regard to the nature of transaction and the most appropriate method should be applied for determining of ALP. The proviso to section 92C(2) provides that where more than one price is determined by the most appropriate method, the ALP shall be taken to be the arithmetical mean of such price or at the option of the assessee a price

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which may vary from arithmetic mean by an amount not exceeding 5% of such arithmetical mean. The basic philosophy and concept behind the *proviso* is that in transfer pricing, there cannot be exact determination of ALP as there are lot of factors and variables in coming to a proper judgment. The use of range of 5% in the results reduces the effect of difference in the controlled and un–controlled transactions. The CBDT, vide Circular no.12/2001 dated 23rd August 2001, laying down the guidelines for applying the newly introduced transfer pricing regime stated as under:–

> *"However, this is a new legislation. In the initial years of its implementation, there may be room for different interpretations leading to uncertainties with regard to determination of arm's length price of an international transaction. While it would be necessary to protect our tax base, there is a need to ensure that the taxpayers are not put to avoidable hardship in the implementation of these regulations."*
>
> In the background, the Board has decided the following:
>
> *"(i) The Assessing Officer shall not make any adjustment to the arm's length price determined by the taxpayer, if such price is up to 5% less or up to 5% more than the price determined by the Assessing Officer. In such cases the price declared by the taxpayer may be accepted."*

This concept was given statutory form in the Finance Act, 2002, by providing the *proviso* to section 92C(2). Thus, the statute itself recognises that if the variation between ALP so determined and the price at which international transaction has been undertaken variation of arithmetic mean should be within tolerable range of +/– 5%.

32. Now, we come to the application of safe harbour range of +/– 5% in this case. The application of +/– 5% to the ALP in this case can be demonstrated by way of the following illustration:–

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Figures in crores

1.	*Operating expenditure attributable to A.E. sales*	*₹ 100*
2.	*Net profit of the assessee from A.E. sales (OC / TC)*	*₹ 14.16*
3.	*Operating profit % of the assessee*	*14.16%*
4.	*A.E. sales*	*₹ 114.16*
5.	*If the profit margin, as determined by the TPO, is taken at 17.48%, then the arm's length sales would come to*	*₹ 117.48*
6.	*Thus, the difference in transactions price and ALP would be ₹ 117.48 (–) ₹ 114.16*	*₹ 3.32*
7.	*Range of A.E. sales considering 5% variation from ALP* *+5% of ₹ 117.48* *–5% of ₹ 117.48*	 *₹ 123.35* *₹ 111.61*

Thus, +/– 5% range falls between ₹ 111.61 crores and ₹ 123.35 crores. Hence, the assessee's profit at 114.16% is within the range. Now, let us examine the assessee's A.E. transactions.

Figures in crores

1.	*Actual transaction with A.E.*	*₹ 689.89*
2.	*Margin of actual @ 14.16% and OP/OC cost taken by the TPO*	*₹ 97.69*
3.	*Total cost of actual*	*₹ 592.20*
4.	*Arm's length margin by the TPO @ 17.48%*	*₹ 105.78*
5.	*ALP of the A.E. transactions as per TPO will work out to*	*₹ 710.96*
6.	*Range @ 95%*	*₹ 675.41*
7.	*Range @ 105%*	*₹ 746.50*

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Thus, the assessee's transactions with A.E. at ₹ 689.89 crores is within the range of ₹ 675.41 crores and ₹ 746.50 crores. Therefore, the transactions of the assessee with the A.Es are at arm's length, even as per the ALP taken by the TPO at ₹ 710.96.

33. In the present case, the TPO has applied mark–up of 17.48% at the entity level after taking into entire transactions. If the mark–up of 17.48% is applied, on the entire transactions, then, following results will emerge:–

Figures in crores

1.	*Cost based as per TPO*	*₹ 10748.64*
2.	*At mark–up of 17.48%*	*₹ 1878.86*
3.	*ALP for the sales [₹ 10748.64 (+) 1878.86]*	*12627.50*
4.	*95% ₹ 12627.50*	*₹ 11996.13*
5.	*Assessee's sales as per the TPO*	*₹ 12271.79*

34. Thus, from this working also, at the entity level, the assessee's transactions falls within the range of +/– 5%. Therefore, in our conclusion, by whatever approach, bench marking is done, the entire adjustment made by the TPO falls within the safe harbour of +/– 5%. Insofar as the calculation furnished by the learned Departmental Representative is concerned, we do not find any merit in the said calculation in view of our analysis given above. Thus, at the very thresh hold level itself, the entire adjustment made by the TPO stands deleted.

35. It has been admitted by both the parties that if bench marking is being done at the entity level either for the A.E. transaction or for the entire transactions, then there is no requirement of any further adjustments as all the adjustments made by the TPO / Assessing Officer including that of Research Innovation and Development Related Services and Undercharging for Common Corporate Audit and Intra Group Services

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will get automatically subsumed including those adjustments also relating to royalty, etc. as done by the TPO.

36. In view of the above findings, the other arguments with regard to the segmental accounts vis–a–vis internal comparables and that the assessee's profit margin on A.E. transactions are far more than the non A.E. transactions and various other adjustments like payment of royalty, receiving of royalty, advertisement and sales promotion and advertisement, adjustment out of R&D cess, payment of service tax, research and innovation development related services and undercharging for central services, have become purely academic and, hence, the same are not adjudicated upon even though both the parties have argued at length. Thus, on this preliminary ground itself, the entire transfer pricing adjustment of ₹ 368,79,26,000 stands deleted and, accordingly, grounds no.1 to 15, technically speaking, stands allowed.

Other Issues:

37. Ground Nos. 16 to 19 are on the issue of claim of deduction under section 80IB & 80IC as claimed by assessee. Assessee claimed deduction of ₹ 336,81,40,961 under section 80-IB and ₹ 748,56,22,895 under section 80-IC. AO was of the view that for the purpose of sections 80-IB & 80-IC, the profits derived from the industrial undertaking are to be worked out by reducing certain common expenses incurred at the head office and the central departments such as audit, legal, secretarial, shares department, selection and training, accounting, treasury which cannot be identified with any of the industrial undertakings of assessee. Accordingly, he identified additional allocation of expenses to the tune of ₹ 107,75,44,354 which were allotted to various units. It was the contention that assessee has already allocated indirect expenses at ₹ 1077,77,45,837 to varius units claimed deduction under section 80-IB &80-IC and also to two units eligible for section 10A and section 10B in addition to direct expenses of ₹ 3070,36,18,599. It was the submission that assessee had

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already considered the direct expenses and indirect expenses relevant for the particular unit to an extent of ₹ 1077.77 crores, therefore, allocation of additional expenses to the extent of ₹ 107.75 crores was not warranted. It was further submitted that the allocation of research expenses to the tune of ₹ 51.59 crores and interest expenses to the tune of ₹ 16.77 crores were not made in earlier years and allocated for the first time in this year.

38. The learned Counsel submitted that assessee has allocated all the expenses including those of common expenses which are relevant to compute the profits derrived from the concerned industrial undertaking such as marketing as well as distribution, purchase, export department etc. With reference to the head office expenses it was submitted that the expenses that were not allocated are those which in any case have to be incurred by assessee irrespective of the existence of new undertaking eligible for deduction. Without prejudice to the above contention, it was also reiterated the contention before AO and the DRP that if the common head office expenses are to be allocated for computing the profits, then on the same basis the common income credited to the Profit & Loss A/c but not allocated by assessee to industrial units be allocated accordingly. With reference to the allocation of research expenses the learned Counsel relied on the judgment of the jurisdictional High Court in the case of Zandu Pharmaceuticals Works Ltd vs. CIT in ITA No.8/Mum/2007 dated 12.9.2012. He also referred to the orders of the Coordinate bench of the ITAT in assessment years 1985-86 and 1986-87,1988-89 wherein in some oredes one of us Accountant Member is a party, to submit that there is no need for allocating the expenses. In reply the learned DR informed the facts of the allocation and relied on the orders of AO. It was his submission that the ITAT in the case of NITCO Tiles vs. DCIT in ITA No.5701/ Mum./2007 dated 9.4.2009 upheld the contention that the expenses of the business, whether direct or indirect, project specific or common expenses have to be considered for computation for the profits and gains of an

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eligible business. Therefore, it was submitted that all the indirect expenses and common expenses have to be considered for the said computation.

39. We have considered the rival arguments and the facts on record and orders of the ITAT in earlier years. The ITAT in ITA Nos 539 & 820/Mum/1992 for the assessment year 1988-89 dated 16.07.2010 has examined similar issue in the context of deduction claimed under section 80HH and 80I in respect of common expenses incurred at the head office. The findings of the ITAT are as under:

> *"12.4 We have heard the rival contentions and also perused the record. We find that there is considerable strength in the submission of the assessee that term 'derived from' used in section 80HH and 80I were not as wide as 'attributable to'. This view is already upheld by the Hon'ble Apex Court vide its decision in CIT vs. Sterling Foods Ltd (237 ITR 579) and there is no debatable point here. Now the question is whether for allocation the expenses of a Head Office the same strict yardstick as applicable for ascertaining the profits derived from an undertaking is to be applied. In our opinion, since the benefits under section 80HH and 80-I are limited to profits derived from an industrial undertaking, then the expenses which are directly attributable to such units alone could be deducted while computing such profit. It will not be fair to apply two different principles one for working out the profit and another for allocation of expenses. Law as laid down by the apex court on this point has to be applied fairly and squarely, so that rational results can follow. Therefore, in our opinion, expenses of the head office which had a direct bearing on the activities of the units from which deduction under section 80HH and 80-I were claimed alone could be considered for allocation. At the same time, we find that for the impugned assessment year as well as for preceding year, learned CIT(A) had given certain directions to the Assessing Officer with regard to the method of allocation of expenses of the head office to such units, where claim for deduction under section 80HH and 80-I were made for the assessee. Learned counsel was unable to pinpoint what was wrong in such direction and how such directions went against the aforesaid principle regarding allocation of expenses. It is for this reason that for the assessment year 1985-86 in Misc. Application filed by the assessee numbered as MA No. 670/Mum/2006 arising out of ITA No. 4997/Bom/1990, this Tribunal in its order dated 15th June 2007 held as under:*
>
> *"As regards the allocation of common expenses incurred by the assessee at head office, the assessee has furnished all the details. Having regard to this, it cannot be said that all common expenses not relating to specific units need such a blanket allocation as is done by the departmental authorities. But at the same time we*

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cannot accept the assessee's contention that all the common expenses at the head office have not contributed to the earning of income of the units, which are entitled for relief u/s.80HH and 80-I of the Act. If such expenses are not allocated in some reasonable manner, it will only distort and result in arriving at higher income of in the hands of eligible units. We, therefore, direct the Assessing Officer not to allocate the expenses of chairman, company secretaries and public relation department, which for A.Y. 1985-86 has been quantified at Rs. 1,26,03,000/- on day to day running of the individual units of the group. On the same reasoning salary, wages and staff welfare expenses relating to financial controller, chief medical officer cannot be allocated. In our opinion, these four operations at the head office are in no way connected to the running of the units. It must be appreciated that each of the units has their own departmental head including financial controller and medical officer. These four operation centres at the head office are more concerned with the managerial issues, they are not connected either with production or sale of these units. The allocation of other common expenses as directed to be done by the CIT(A) is approved. The order of the CIT(A) on this issue is modified to the extent stated herein."

It is clear from the above that the aspect relating to the expenditure which needed to be allocated was considered by this tribunal. Hence, we find no force in the contention of the assessee that the issue regarding which items of expenditure could be considered as allocable in view of the terminology used in section 80HH and 80I of the Act was not considered. As aforesaid, the learned counsel for the assessee was also unable to point out how the directions of the CIT(A) were not in accordance with law on the matter. Therefore, respectfully following the decision of the Tribunal in assessment year 1985-86, we direct that for the impugned year also, the expenses as mentioned in aforementioned para has to be excluded while making the allocation for the purpose of computing the deduction under section 80HH and 80-I of the Act. Except for this, directions of the CIT(A) as in the preceding year has to be followed. Ordered accordingly. Ground No. 9.1 of the assessee is allowed for statistical purposes".

40. Therefore, In the interest of justice we restore the issue to the AO who is directed to workout the common expenses accordingly. We were informed that orders of the ITAT in earlier years are yet to be given effect by AO and the intervening years appeals are pending at various stages including before the ITAT. In assessment year 1989-90 similarly the matter was restored to AO vide the order dated 21/09/2011. In view of the stay granted in this appeal the issues have come up for consideration.

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Keeping in mind the directions in earlier years, AO is directed to reworkout the common expenses accordingly.

41. With reference to the research expenses and the interest expenses which were allocated for the first time, allocation of the research expenses is covered by the decision of the jurisdictional High Court in the case of Zandu Pharmaceuticals Works Limited in Income Tax Appeal No.8 of 2007 dated 12.09.2012 whereinthe Hon'ble High Court has considered the issue as under:

> *"8. There is no dispute that the assessee is entitled to the benefits of the provisions of sections 80-HH, 80-I and 80-IA. Section 80-I provides that where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains an amount equal to twenty per cent thereof. Section 80-IA provides that where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount specified therein. Section 80-HH provides that whether the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, there shall be in accordance with law and subject to the provisions of the section be allowed in computing the total income of the assessee a deduction from such profits and gains of an amount equal to 20% thereof.*
>
> *9. While computing the profits and gains of the concerned undertaking, only expenses relating thereto can be deducted. In other words, the expenses must be incurred, for and on behalf of the concerned undertaking. The expenses attributable to any other unit or the head office expenses which have no relevance to the industrial undertaking, cannot be deducted in respect of the said undertaking while computing the profits and gains of the undertaking.*
>
> *10. In CIT vs. Sterling Foods, (1999) 4 SCC 98 = (1999) 237 ITR 579, the following question was considered by the Supreme Court:-*
>
> > *"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the receipt from the sale of import entitlements could not be included in the income of the assessee for the purpose of computing the relief under Section 80-HH of the Income Tax Act, 1961?"*

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The question therefore, was converse to the one before us. The Supreme Court held as under :-

> *"12. Crude petroleum is refined to produce raw naphtha. Raw naphtha is further refined, or cracked to produce the said products. This is not controverted. It seems to us to make no difference that the appellants buy the raw naphtha from others. The question is to be judged regardless of this, and the question is whether the intervention of the raw naphtha would justify the finding that the said products are not 'derived from refining of crude petroleum'. The refining of crude petroleum produces various products at different stages. Raw naphtha is one such stage. The further refining or cracking, of raw naphtha results in the said products. The source of the said products is be held to have been derived from crude petroleum.*
>
> *13. We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available. There must be, for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. In the instant case the nexus is not direct but only incidental. The industrial undertaking exports processed seafood. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking."*

The Supreme Court held that there must be for the application of the words "derived from" a direct nexus between the profits and gains and an industrial undertaking. Sections 80-I and 80-IA also use the expression "derived from". If there must be a direct nexus between the profits and gains and an industrrial undertaking, it must follow equally that there must be a direct nexus between an industrial undertaking and the expenses which are sought to beapportioned/ attributable to it. Expenses which do not relate to an industrial undertaking/unit under consideration and they relate to other units or to the head office of the assessee, cannot be taken into consideration while computing the deduction under the said provisions".

42. On the argument that the research & development activities carried out by the head office has enduring benefit to the units/industrial

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undertaking, the Hon'ble High Court also considered this argument and held as under:

> *"14. The submissions proceeds on an erroneous basis and does not take into consideration the facts of the case at all. As we noted earlier, in the present case, the said R & D activities were in relation to the new drugs. There is nothing to indicate that in the event of the assessee deciding to commercially exploit the benefits of the R & D work, the products would be manufactured by the said units. The fallacy in the submissions proceeds on the hypothetical basis that the said products would be manufactured by each of the units or any one of them.*
>
> *15. The fallacy also arises on account of an erroneous presumption that the benefit of any R & D activity can only be exploited by an enterprise utilizing the same in its manufacturing activities. That is not so. An enterprise can always assign the benefit thereof to a third party. It can always grant a licence in respect of any patent or design to a third party. In that event, the other units would not derive any benefit in respect thereof. The presumption of a nexus between the R & D activities and the units is not well founded".*

Respectfully following the same, we are of the opinion that the research expenditure cannot be allocated to the units claiming deduction unless it has a nexus. Therefore, AO is directed to exclude the same.

43. With reference to the interest expenses allocated the same also stands on the same footing. Assessee has not claimed any interest expenditure for the investment in the unit as assessee had substantial funds of its own. The interest expenditure claimed in the Profit & Loss A/c pertains to the export activities being export credit facility as submitted by assessee in the details. Therefore, in the absence of any direct nexus of the interest claim to the units, it is very difficult to allocate the expenditure on common expense basis, as the claim of said expenditure has no relevance to the manufacturing activity of the Unit. As rightly held by the Hon'ble jurisdictional High Court in the case of Zandu Pharmaceuticals Works Ltd (Supra), the expenses attributable to any other unit or the head office expenses which have no relevance to the industrial undertaking cannot be deducted in respect of the said undertaking while computing the

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profits and gains of the undertaking. Accordingly, we have no hesitation in directing AO to delete the interest expenses so allocated to the Unit. The grounds are partly allowed to the above extent.

Ground Nos. 20 to 23.

44. These grounds are against the claim of deduction of ₹ 17,09,27,843 under section 10A and ₹ 7,69,86,126 under section 10B on Pune Tea Export Unit and Khandla Unit. The facts are similar to the grounds raised above from Ground Nos. 16 to 19 on section 80-IB and section 80-IC. AO in line with the stand taken for arriving at the unit profits has allocated the same common expenses, research expenditure and interest expenditure on the basis of the turnover to these units. Since the facts are similar and working is similar, the directions given in the above grounds will equally apply to these grounds as well. Accordingly, AO is directed to exclude certain common expenses as directed above and totally exclude the research expenditure and interest expenditure which cannot be directly attributable to the unit claiming deductions under the above sections. These grounds are also considered as partly allowed.

Ground No.24:

45. Ground no.24 relates to allowability of the provision for retirement pension payable to the employees. The learned Counsel fairly mentioned that the issue came up for adjudication before the Tribunal and the same was set aside to the file of the AO. He referred to paras from 43 to 45 of the order of the Tribunal for AY 1991-92 in ITA no 4628/Mum/2003 dt.08.02.12. He fairly mentioned that in the AY 1991-92, there was a claim not only of the current year but also of the liabilities relatable to earlier assessment years, being first year of claim. He relied on various judgments to advance his case.

a) the judgment of the Hon'ble Supreme Court in the case of Bharat Earth Movers Ltd. vs. CIT (245 ITR 428) (SC);

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b) Hon'ble Supreme Court in the case of Metal Box Company of India Ltd. Vs. Their Workmen (73 ITR 53);

c) order of Hyderabad ITAT in the case of DCIT vs. Park Devis India Ltd. in ITA No.652/Hyd/97 and CO No.4/Hyd/97;

d) Orders of Mumbai ITAT in M/s. Siemens India Ltd. vs. ITO in ITA No.1835 (Bom), M/s. Siemens India Ltd vs. ITO in ITA No.1632 (Bom) & CIT vs. Siemens India Ltd in ITA No.1325 (Bom) and

e) the judgment of the Hon'ble Delhi High Court in the case of CIT vs. Ranbaxy Laboratory Ltd. 334 ITR 341.

Further he mentioned that there is no dispute about the mercantile system of accounting followed by the assessee and the actuarial method of estimation of the liabilities. He heavily relied on the decision of the Hon'ble Delhi High Court in the case of Ranbaxy Laboratory Ltd (supra). He also mentioned that while the issue was set aside to the file of the AO for AY 1991-92, and 1992-93 the AO himself allowed the claim of the assessee for AY 1993-94 and 1994-95. Therefore, this issue is no longer a disputed one for the assessment years 1993-94 and 1994-95.

46. We have heard the parties and perused the orders of the Revenue Authorities. It is noticed from paragraphs 43 to 45 of the order of the Tribunal for AY 1991-92 (supra) issue was discussed as under:

"43. Ground No.11 regarding provision for retirement pension payable to the employees.

43.1 The Assessing Officer noted that during the year, the assessee company has made provision of Rs. 7,77,60,972/- which included Rs. 6.77 crores relating to the earlier years, as liability on account of retirement pension plan. The expenditure had been claimed as deduction during the previous year. Therefore, the Assessing Officer was of the view that the liability is towards the discretionary retirement pension payment to its employees as supplementing amount otherwise payable by LIC under the approved Superannuation Fund. Since there is a departure from the pension payable by the LIC, the assessee has found that the amount of

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pension payable by the LIC was to be inadequate and accordingly, the assessee made the payment to its retired employees under this plan by supplementing the amount otherwise payable by the LIC. The Assessing Officer observed that the assessee failed to furnish the original retirement pension plan, the retirement pension was not approved or recognized under the provisions of the I T Act and therefore, the expenditure was not covered under the provisions of sec. 36(1)(iv). According to the Assessing Officer this provision is specifically made and inadmissible u/s 40A(9) and was merely a provision and not an ascertained liability. It was also not admissible under sec. 43B. 43.2 On appeal, the CIT(A) noted that supplementary Retirement Pension Plan was not approved or recognised fund under the provisions of IT Act; therefore, this expenditure was not covered under the specific provisions of sec. 36(i)(iv). The CIT(A) has further observed that it is necessary to refer to an approved Superannuation Fund u/s 2(6) of the Act, which is approved by the Commissioner in accordance with the Rules contained in part B of the 4th Schedule of the act. Accordingly, he has confirmed the action of the Assessing Officer.

44 Before us the ld Sr counsel has narrated the relevant facts as under: "The assessee made a provision for ` 7,77,60,872 for pension payable by it under the Retirement Pension Plan, which provide for supplementary/additional pension based on salary and number of years service by individual employees. This amount was claimed as deductible u/s 37(1). This provision which was based on actuarial valuation of the appellant's liability as on 31.12.90 included Rs. 6.77 crores in respect of earlier years. The amounts payable by the assessee under this supplementary pension scheme were in addition to the pension receivable by the employees from approved superannuation Fund. The supplementary Retirement Pension payments hitherto were at the discretion of the employer. This liability under the pension plant was formally committed by the assessee during previous year as recorded in assessee's Board Resolution dated 22.3.91."

44.1 He has submitted that the claim of the assessee for provision of retirement pension payable to the employees is covered in favour of the assessee by the decision of the Hon'ble Delhi High Court in the case Commissioner of Income- tax v. Ranbaxy Laboratories Ltd. reported in 334 ITR 341. He has also relied upon the decision of the Supreme Court in the case of Bharat Earth Movers v. Commissioner of Income-tax Bharat reported in 245 ITR 428. The ld Sr counsel also filed a copy of the rule of Pension Scheme.

44.2 The ld DR has relied upon the orders of the lower authorities and submitted that the assessee could not furnish the copy of the approved pension scheme before the Assessing Officer.

45. We have considered the rival submission as well the relevant material on record. It is an undisputed fact that the pension scheme of the assessee is not approved as per provision of I T Act. and as

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> *observed by the Assessing Officer and the CIT(A) the pension scheme as formulated by the assessee for meeting the extra payment over and above the amount payable under LIC scheme. The Hon'ble Supreme Court in the case of Bharat Earth Movers (supra) has taken into consideration the principle laid down in the case of <u>Metal Box Company of India Ltd. v. Their Workmen</u> reported in 73 ITR 53 and held that for making liability incurred by the assessee under leave encashment scheme proportionate with the entitlement earned by the employees of the company, was entitled to deduction out of the gross receipts of the accounting year during which the provision is made for the liability. The liability was not a contingent liability. It was observed that what should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible.*
>
> *45.1 Thus, as held by the Hon'ble Supreme Court (supra) that if the liability on account of pension scheme is capital of being estimated with reasonable certainty, then it is allowable. However, in the case in hand, the dispute is regarding the provisions of Pension liability of earlier years and that too with respect to the employees who have already retired. In our opinion, the liability on account of Pension to the employees already retired in the earlier years is a definite liability of the relevant year in which the employees got retired.*
>
> *45.2 Since the Pension Scheme was not produced before the Assessing Officer and the copy of the same has been produced before us with the request to allow the additional evidence vide letter dated 14.11.2011 of the assessee; therefore, it requires examination and verification of the fact as to whether the provision made by the assessee is as per the Pension Scheme and the same is also applicable to the employees already retired. Accordingly, in the interest of justice, we set aside this issue to the record of the Assessing Officer to decide the same afresh after considering the Pension Scheme and as per law."*

47. From the above, we find that provision pertaining to earlier years as well as the provision for current year liabilities was referred to the file of the AO by the Tribunal in AY 1991-92. For uniform approach by the AO, we are of the opinion that this issue should also be remanded with identical directions. Accordingly, ground no 24 is allowed for statistical purpose.

48. In case AO has allowed the actual pension paid during the year while disallowing the provision so made, he is free to withdraw the amount as it may result in double deduction, after reconciling the actual provision made

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and the actual amounts paid and the claim to be allowed. With these directions the ground is considered allowed for statistical purposes.

Ground No.25

49. Ground No.25 pertains to the disallowance of amount under section 14A. Assessee had claimed exempt income of ₹ 63,55,91,552 as exempt on account of tax free bonds, dividends etc. AO applied Rule 8D and worked out the disallowance at ₹ 9,81,98,817. Assessee contended before the DRP that Rule 8D is not applicable for the impugned assessment year as held by the Hon'ble Bombay High Court in the case of Godrej Boyce Mfg.Co Ltd. Vs. DCIT (332 ITR 81 (Bom.). Now DRP while accepting assessee's objection that Rule 8D cannot be applied retrospectively, directed the AO to recalculate the disallowances in a proper and rationale manner. However the direction is such that Rule 8D is applied indirectly. Therefore, AO worked out the disallowances of the same amount of ₹ 9,81,98,817 while completing the assessment in pursuance of the DRP directions. The learned Counsel referred to the submissions made before AO and the DRP placed in the paper book to submit that assessee has not incurred any expenditure in earning the exempt income. After considering the rival arguments, we are of the opinion that large amount of investment could not be made without any secretarial assistance. We are of the opinion that an adhoc amount of 0.5% on the income claimed as exempt would be reasonable to consider as expenditure incurred for earning exempt income under section 14A. Therefore, AO is directed to work out the disallowances at 0.5% of the income claimed exempt. With these directions, the ground 25 is considered partly allowed.

Ground Nos. 26 & 27

50. These two grounds pertain to payment of an amount of ₹ 4.6 crores made to the suppliers for termination of arrangement for supply of Sugar Candies and an amount of ₹ 14.25 crores made to suppliers for

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termination of the arrangement for manufacture of toothpaste and shampoos. Assessee claimed the first amount to the extent of ₹ 4.6 crores out of ₹ 8 crores provided in an earlier year as an expenditure of this year while the balance amount was written back. This written back amount was reduced in the computation as the same was not claimed as expenditure in the earlier year. The amount of ₹ 14.25 crores was made for discontinuation of purchase agreement with reference to two companies for the manufacture of tooth paste and shampoos on contract basis arrangement of which was cancelled by the agreement dated 31.12.2005. AO was of the opinion that the expenditure was capital in nature. Assessee made objections before the DRP which considered this vide Para 12 of the order. Submissions made with reference to the claims are as under:

> *Movement in provision created* at *the time* of *discontinuation* of *Max" sugar candies:*
>
> *The Company's food business included the business* of *marketing of sugar candies under the brand name "Max". During the financial year 2004-05, the Company decided to discontinue the activity of marketing* of *sugar candies under the brand name "Max". The company had incurred significant expenditure in supporting this product. However, given the price sensitive nature of candies whereby the individual candy is required to be priced at certain price points, for e.g.* 50 *paise and due to the increase in input cost, the company incurred losses on the product. Consequently, during the financial year 2004-05, the company had to incur one-time losses aggregating RS.30.44 crs. The particulars* of *the expenditure incurred are enclosed in Annexure* -1. *It may be relevant to note that the Foods business* of *the Company has not been discontinued. Further, had the company continued marketing of sugar candies, it would have made huge losses.*
>
> *Your Honour will notice that out of the total expenditure* of *RS.30.44 crs.* a *sum of RS.22.44 crs. relates to stocks which were written* off *in financial year 2004-05 and the same was allowed to us as* a *genuine business expense. The balance amount i.e. Rs. 8 crores represented* a *provision made by the company in respect of additional expenditure in the form* of *compensation, etc payable to suppliers. However, since the terms of settlement with the suppliers were not finalized, the company had not claimed the provision of* `8 *crs.* as a *tax deductible expenditure in financial year 2004-05.*
>
> *In financial year 2005-06, out* of *the provision* of *Rs.* 8 *crores mentioned above, the company has paid an amount* of *Rs.4.6 crores to Makson Nutrition Food Private Ltd. (MNFPL) towards final settlement to cancel rescind the sourcing arrangement that the company had with them for conversion of sugar confectionary products. A copy of the termination agreement between the company and MNFPL is enclosed in Annexure-2. The remaining provision of Rs.*

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3.4 *crores was written back since the same was no longer required.*

It is submitted that the amount of *RS.4.6 crores paid to Makson Nutrition Food Private Limited(MNFPL) towards final settlement to cancel/rescind the sourcing arrange-ment is* a *genuine business expense justified by commercial expediency and that the same is fully allowable under sec.* 37(1) of *the Act. As regards the write back of RS.3.4 crores the same is not taxable in financial year 2005-06 as the same was not claimed as* a *deductible expense and added back in the statement of total income in the year in which provision was made.*

<u>Actual Expenses incurred against provisions included under exceptional items of earlier years disallowed in the computation of those years.</u>

The Company had made provision of RS.16,51,18,000 in the earlier years based on prudent accounting policy when the claims were received from business associates. These provisions were offered for tax in the respective years. On settlement of the claims, an amount of Rs. *15,26,43,057 has been claimed* as a *deduction in the current year. The details* of *settlement* of *claims* as *under:*

i) *<u>Payment to Prime Healthcare Products - Rs.</u>* <u>9.5</u> *<u>crore</u>* <u>&</u> *<u>MUL Dentpro Pvt. Ltd. - Rs.4. 75 crore</u>*

The Company had been sourcing large quantities of toothpaste and shampoos from Prime Healthcare Products (PHP) and MUL Dentpro Pvt.Ltd.(MDPL) till the time when toothpaste was *reserved for small scale industries in India. PHP and MDPL had setup facilities at the behest* of *the company at Daman for supply* of *toothpaste and shampoos to the company. Post de-reservation of toothpaste by Government of India in 2002, it was decided to set up our own manufacturing facilities in Assam and Uttaranchal. Consequent to the creation of these manufacturing facilities at Assam and Uttaranchal the sourcing of toothpaste and shampoos from PHP and MOPL substantially reduced. Due to reduction in demand from the company PHP and MOPL had to restructure their operations and incurred costs, losses and damages on reduction* of *its surplus workers/employees at the factory. The Company agreed to compensate Rs.9.5 crore to Prime Healthcare Products and Rs.4.75 crore to MUL Dentpro Pvt. Ltd. A copy of the agreement between the company and Prime Healthcare Products for compensation of* RS.9.5 *crore is enclosed* as *Annexure-3 and agreement between the company and MUL Dentpro Pvt.Ltd. for compensation of* Rs. 4.75 *crore is enclosed* as *Annexure-4.*

It is submitted that the amount of RS.9.5 crores paid to Prime Healthcare Products and Rs.4.75 crore to MUL Dentpro Pvt.Ltd. towards restructuring is a *genuine business expense justified by commercial expediency and that the same is fully allowable under sec.* 37(1) *of the Act."*

51. The DRP considered the above issue vide objection Nos. 18 & 19 and decided as under:

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"<u>Objection No.l8 & 19</u>

The assessee has objected to treatment of RsA.60 crores as capital expenditure which was paid by the assessee for termination of arrangements for conversion of sugar candies. The assessee contended that the business of sugar candy was resulting into heavy losses, and hence, the arrangement with M/s. Max Sugar Candies was cancelled and a compensation of RsA.60 crores was paid to M/s. Max Sugar Candies on account of settlement for the loss of business to M/s. Max Sugar and that the same was allowable u] s.30(7)(i) of the Income-tax Act. Similarly, claim is made by the assessee in objection No.19 relating to payment of Rs.14.25 crores for termination of manufacturing of toothpaste and shampoo. The Assessing Officer has discussed the issue in para 12 of the assessment order and has recorded a finding that the payments made by the assessee are in the nature of capital expenditure because the enduring benefit to the assessee would be in the form of avoiding future losses on account of continuation of such arrangements. The DRP has carefully considered the issue and agrees with the assessee that no new assets or any enduring benefit has been created. The Assessing Officer has not doubted the genuineness of the amount settled and the actual payment of expenditure is a capital expenditure as it has been paid in respect of termination of a contract which was otherwise spread over a number of future years. The recipient have forgone their right to produce these products for future years and thus the right has been acquired by the assessee to enforce the same in the Court of law, if so required on the basis of agreement entered into with the recipient. Therefore, a right has been acquired which is of an enduring nature, accordingly, action of Assessing Officer in treating it as a capital expenditure is upheld"

52. The learned Counsel referring to the submissions made before the DRP placed in Page No.1269 onwards and the agreement placed at page Nos. 1273, 1283 and 1290 submitted that after having given a finding that no new asset or any enduring benefit has been created and further noting that AO has not doubted the genuineness of the amount settled and the actual payment of expenditure, the DRP has come to a wrong conclusion that assessee has acquired a right. This finding of the DRP was contradictory to the facts of the case. It was submitted that assessee has not acquired any right but only paid the compensation for termination of the business arrangement for conversion of sugar candies on behalf of assessee for distributing under 'Max' brand and further termination of purchase agreement with the two companies. Therefore, these

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expenditures are business expenditures and relied on the following cases for the principles therein:

1) Empire Jute Co. Ltd. v. Commissioner of Income-tax. 124 ITR 1 (SC)

2) CIT vs. Rajaram Bandekar (1994) *121 CTR 233* (Bom)

3) Commissioner of Income-tax. v. Madras Auto Service (P.) Ltd 233 ITR 468 (SC)

4) Bikaner Gypsums v. CIT [1991] *187 ITR 39*

It was his submission that since no enduring benefit has come to the assessee, the expenditure has to be allowed as Revenue expenditure.

53. We have considered the issue and rival submission and examined the record. As far as the payment to Max Sugar Candies is concerned, assessee had an agreement dated 10.01.2003 and supplementary agreement dated 02.02.2004 for conversion of finished products of candies. The said Makson Nutritional Food (P) Ltd (MNFPL) had carried out conversion of about 5780 tonnes of finished products during the period June 2002 to September, 2004. Assessee on finding that the said activity was incurring losses discontinued the business of Max w.e.f. September, 2004. The said company raised invoices in the next 5 months from October 2004 to Feb 2005 demanding an amount of ₹ 29 crores. Subsequently vide agreement dated 10.05.2005 a termination agreement was made by which assessee agreed to pay ₹ 46 crores for cancellation of all arrangements w.e.f. 10.05.2005. Assessee has provided an amount of ₹ 30.44 crores in the books of account in the assessment year 2005-06 out of which AO allowed an amount of ₹ 22.44 crores in that year. The provision made of ₹ 8 crores was not claimed in that year with a note that the compensation will be claimed in the year of payment. Since the final agreement was entered in this year assessee claimed amount of ₹ 4.6 crores as an expenditure while adding back the balance provision in the books of account. As seen from the above facts, we are of the opinion that

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assessee has claimed the amount of ₹ 4.60 crores as Revenue expenditure as no right has been acquired by terminating the conversion agreement entered with the said company. It is a business decision and since assessee is still in the business of food and beverages the expenditure is rightly claimed as revenue expenditure. The principles laid down by the Hon'ble Supreme Court in the above referred four judgments equally apply to the facts of the case. Therefore, AO is directed to allow the amount of ₹ 4.6 crores claimed.

54. Now coming to the other issue of payment claimed under the same way by way of Ground No.27 this is with reference to the payment made to Prime Healthcare Products of `.9.75 crores and to M/s MUL Dentpro (P) Ltd of ₹ 4.75 crores on termination of purchase agreements. Before AO as well as before the DRP it was submitted that these amounts are also paid for termination of the agreements and on the similar facts to the above issue both AO and the DRP treated them on similar manner as capital expenditure. The agreement placed before us in the paper book at Page No.1283 pertain to the Prime Healthcare Products which indicated that vide clause 1 assessee had to compensate the said company a sum of ₹ 4.50 crores as one time lump sum and includes compensation payment towards sharing the cost burden to be incurred by the said company. This amount is akin to the payment made to M/s MNFPL discussed above and comes in the nature of revenue expenditure. To that extent assessee's claim can be allowed. However, the amount of ₹ 5 crores was further agreed to be paid as compensation to the said company towards covenants of non-competing. The said company has agreed to abide by for a period of two years so that the interest of the company are duly safeguarded during the non- compete covenant period for which both parties accepted as reasonable and fair period. Therefore, an amount of ₹ 5 crores out of ₹ 9.50 crores involved pertain to non-compete fee. This non compete fee cannot be considered as revenue expenditure as it is paid in the same agreement by which the contract was terminated and the

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principles laid down by the Special Bench of ITAT in the case of Tecumseh India Private Limited Vs. Additional CIT in ITA No.3759/Del/2003 will apply. Special Bench of the Tribunal (supra) held that non-compete fees is to be considered as capital in nature. However, since AO and the DRP did not examine the agreement and did not consider the nature of the payment in its correct perspective, we are of the opinion that the claim of ₹ 5 crores has to be reexamined by AO by giving an opportunity to assessee. Even before us, even though the agreements are placed in the paper book, the contention that was made was that the payment was same as that of ₹ 4.6 crores made company MFNL Ltd discussed in the above para. Since, we noticed that there is a non-compete fee involved in the payment, in the interest of justice, we restore this part of the claim to the file of AO.

55. Coming to the next payment of ₹ 4.75 crores paid to M/s MUL Dentpro (P) Ltd, here also clause-1 states that an amount of ₹ 0.25 crores was for compensation towards sharing the cost pertains to the said company. This amount is similar to the payment made to M/s MNFPL discussed above and for the reasons stated therein this has to be allowed as a revenue expenditure. However, vide clause-2 of this agreement placed at page No.1287 of the paper book, the assessee company agreed to compensate a sum of ₹ 4.5 crores to the said company towards covenant of non compete fees for a period of 2 years on the same terms and conditions as specified in the earlier agreement with M/s. Prime Healthcare Products (incidentally both the agreement are signed by the same person Mr. Manek Shah, may be associated companies as the terms of the agreement are same). Since the issue of non-compete fees is restored to the file of AO as it was not examined in the interest of justice, we refer this payment of ₹ 4.5 crores to the file of AO. Assessee is free to make its submissions about the claim before AO and AO is directed to consider in the light of the facts and law on the issue. Accordingly an amount of ₹ 9 crores covered in this ground is restored to the file of AO for

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fresh adjudication, whereas the balance amounts are considered as revenue expenditure. Ground No.26 is fully allowed, while Ground No.27 is partly allowed.

Ground No.28

56. Ground No.28 pertains to the payment towards club services (₹ 4,16,590). In the assessment AO disallowed the entire club membership fees and entrance fees and 50% of the cost of the club services and facilities, being personal in nature. As far as the entrance fees and membership fees are concerned the DRP allowed the claim following the judicial principles laid down by various Courts including the jurisdictional High Court. The DRP however, confirmed the disallowance of 50% cost of the club services.

57. It was the submission that in earlier years the issue was with reference to the disallowance of entrance fees only. For the first time the club services and facilities were also disallowed by AO. This issue is covered by the jurisdictional High Court in the case of Sayaji Iron & Engg. Co. vs. Commissioner of Income-tax, 253 ITR 749. In view of this, AO is directed to allow the expenditure as claimed. Further when assessee is a company, there cannot be any expenditure for personal use. The expenditure can only be disallowed as non business expenditure, if any. On this reason also the disallowance cannot be supported. Ground 28 is considered allowed.

Ground No.29

58. Ground No.29 pertains to the addition of ₹ 2,15,45,233 (wrongly stated as ₹ 24,02,27,143 in ground). AO made this adjustment stated to be under section 145A on the modvat credit available unutilised. It was the submission by assessee that no such adjustment is required under the provisions of Sec.145A. DRP vide objection No.12 decided as under:

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> *"Assessee has objected to the adjustment of closing stock on account of CENVAT. Keeping in view the ratio of decision of various Courts, the DRP directs AO to adjust the opening stock, purchases and the closing stock by considering all taxes/duties and shares and in case there is any difference, the addition should be made under section 145A".*

59. Inspite of clear directions from the DRP, AO on the pretext that assessee has not furnished any details except making general submissions repeated the addition in the assessment order without complying with the directions of DRP. Before us a detailed note was submitted how the adjustment need not be made under the provisions, which is as under:

> *"We give below an illustration explaining why the valuation of closing stock followed by the appellants should not be disturbed:*
>
> *Take a case where there is an opening stock of ten units purchased at Rs. 10/- per unit the excise duty paid on these units was Rs.2/- per unit. During the previous year 100 units of raw materials are purchased for an aggregate price of Rs.12/- per unit which includes a sum of Rs. 2/- per unit representing the excise duty payable by the manufacturer. Seventy units of raw materials are consumed in the manufacturing process and all such finished goods are sold prior to the end of the year. Accordingly, there would be a closing inventory of 40 units of raw materials. On the goods manufactured assessee is liable to pay excise duty at Rs.3/- per unit and ultimately it sells the finished goods for a price of Rs. 20/- per unit. The modvat credit would be available in respect of the Rs. 2/- per unit paid by the assessee at the time of purchase of the goods. In accordance with the "net method" of accounting followed by the assessee the accounting treatment in the profit and loss account would appear thus:*

PROFIT AND LOSS ACCOUNT

	Unit	***Rs.***		***Unit***	***Rs.***
Opening stock	*10*	*100*	*Sales*	*70*	*1400*
Purchase	*100*	*1000*	*Closing stock*	*40*	*400*
Excise duty	*70*	*210*			
Profit		*490*			
		1800			*1800*

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Even if the adjustment as contemplated by section 145A(b) were to be made the profit would actually reduce as illustrated below:

Net Profit		*490*	
LESS: Adjustment to opening stock		*20*	
Adjustment to purchase	*200*	*220*	
		270	
ADD: Adjustment to closing stock		*80*	*350*

However, in order to ascertain the correct profits one would have to pass an entry to make suitable adjustment for. the modvat utilized. According to the Institute of Chartered Accountants 'of India the entry that is to be passed is In a sum of Rs. 1401- which represent the mod vat credit that is utilized on the units which arc consumed. In the aforesaid example 70 units are consumed and as the modvat credit is Rs. 2/- per unit a credit of Rs. 1401- is taken. This would result in the profits being determined at Rs.490 which is the same as per the net method. The case of the revenue that the entry that should be passed is in a sum of Rs. 200/- because according to the revenue the entire 100 units which the assessee purchases are eligible for a modvat credit of Rs.2/- per unit i.e. Rs. 2001- in the aggregate and the assessee's excise duty liability of Rs. 210/- is discharged partly by availing of the credit of Rs. 200/-. It is this entry that represents the area of difference. According to the revenue as the assessee has utilized the modvat credit that is available to it on its purchases in its entirety a credit for the entire amount has to be taken whilst according to the assessee credit can only be taken for the units actually consumed. The correctness of this aspect of the matter is not the subject matter of an adjustment as contemplated under section 145A but is in fact an adjustment which was considered by the Supreme Court in the case of Indo Nippon Chemicals Ltd (261 ITR 275) and the Supreme Court specifically held that merely because the mod vat credit is an irreversible credit available to the manufacturers upon purchase of duty paid raw materials it would not the amount to income which is liable to tax under the Act".

60. Assessee also relied on the decision of the Hon'ble Supreme Court in the case of Indo Nippon Chemicals Ltd (261 ITR 275) to submit that the following the above principles, no adjustment is required. Considering the rival submissions, we are of the opinion that the matter has to be restored to the file of AO to decide the issue in the light of the legal principles and to particularly implement the directions given by the DRP. Assessee is also directed to submit the relevant data to AO. With these directions the ground 29 is allowed for statistical purposes.

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61. **Ground No.30** pertains to the issue of adjustment made on the capital subsidy received of ₹ 5.00 lakhs which AO adjusted in the WDV for the purpose of computation of depreciation. It was fairly admitted that this issue is against assessee. Therefore, the ground is rejected.

Ground No.31

62. Ground No.31 pertains to the short deduction of tax at source and the consequent disallowance made under section 40(a)(ia). AO disallowed the amount of ₹ 60,97,100/- on the reason that assessee has short deducted the tax. It was the submission that the provisions of section 40(a)(ia) does not apply in respect of short deduction but will only apply where the tax has not been deducted and after deducting has not been paid. The learned Counsel relied upon the decision of the Coordinate Bench in the case of Chandabhoy & Jassobhoy vs. DCIT in ITA No.20/Mum/2010 and also in the case of S.K. Tekriwal vs. DCIT in ITA No.1135/Kol/2010. After considering the rival submissions, we are of the opinion that the provisions of section 40(a)(ia) does not apply to short deduction of tax. This issue was considered and decided in the case of Chandabhoy & Jassobhoy (supra) wherein one of us Accountant Member is a party to the decision, as under:

> *3.3. We have heard the rival arguments and examined the record. Assessee has employed about 18 consultants with whom it entered into agreements for a period of two years renewable further at the option of either parties and they were paid fixed amounts without any share in the profit. These consultants are prohibited from taking any private assignments and worked full time with the assessee firm. There is no dispute with reference to the deduction of tax under section 192 and also the fact that in their individual assessments these payments were accepted as salary payments. It is also not disputed that the entire amount paid for 18 consultants is only an amount of `26,75,535, which indicates that they are in employment and not professional consultants. It is also not the case that assessee has not deducted any amount. Assessee has indeed deducted tax under section 192 and so we are of the opinion that provisions of section 40(a)(ia) also do not apply as the said provision can be invoked only in the event of non deduction of tax but not for lesser deduction of tax. In view of this, we are of*

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the opinion that there is no merit in Revenue's contention that the amount paid to the employees should be disallowed as provisions of section 194J would attract. On the facts of the case, there is no merit in Revenue's appeal. Accordingly the order of the CIT(A) is confirmed".

63. In the case of M/s S.K. Tekriwal in ITA No.1135/Kol/2010 the Coordinate Bench at Kolkata has examined this issue and decided as under:

"*6. In the present case before us the assessee has deducted tax u/s. 194C(2) of the Act being payments made to sub-contractors and it is not a case of non-deduction of tax or no deduction of tax as is the import of section 40a(ia) of the Act. But the revenue's contention is that the payments are in the nature of machinery hire charges falling under the head 'rent' and the previous provisions of section 194I of the Act are applicable. According to revenue, the assessee has deducted tax @ 1% under section 194C(2) of the Act as against the actual deduction to be made at 10% under section 194I of the Act, thereby lesser deduction of tax. The revenue has made out a case of lesser deduction of tax and that also under different head and accordingly disallowed the payments proportionately by invoking the provisions of section 40(a)(ia) of the Act. The Ld. CIT, DR also argued that there is no word like failure used in section 40(a)(ia) of the Act and it referred to only non-deduction of tax and disallowance of such payments. According to him, it does not refer to genuineness of the payment or otherwise but addition u/s. 40(a)(ia) can be made even though payments are genuine but tax is not deducted as required u/s. 40(a)(ia) of the Act. We are of the view that the conditions laid down u/s. 40(a)(ia) of the Act for making addition is that tax is deductible at source and such tax has not been deducted. If both the conditions are satisfied then such payment can be disallowed u/s. 40(a)(ia) of the Act but where tax is deducted by the assessee, even under bonafide wrong impression, under wrong provisions of TDS, the provisions of section 40(a)(ia) of the Act cannot be invoked. Here in the present case before us, the assessee has deducted tax u/s. 194C(2) of the Act and not u/s. 194I of the Act and there is no allegation that this TDS is not deposited with the Government account. We are of the view that the provisions of section 40(a)(ia) of the Act has two limbs, one is where, inter alia, assessee has to deduct tax and the second where after deducting tax, inter alia, the assessee has to pay into Government Account. There is nothing in the said section to treat, inter alia, the assessee as defaulter where there is a shortfall in deduction. With regard to the shortfall, it cannot be assumed that there is a default as the deduction is not as required by or under the Act, but the facts is that this expression, 'on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction has not been paid on or before the due date specified in*

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sub-section (1) of section 139'. This section 40(a)(ia) of the Act refers only to the duty to deduct tax and pay to government account. If there is any shortfall due to any difference of opinion as to the taxability of any item or the nature of payments falling under various TDS provisions, the assessee can be declared to be an assessee in default u/s. 201 of the Act and no disallowance can be made by invoking the provisions of section 40(a)(ia) of the Act.

Accordingly, we confirm the order of CIT(A) allowing the claim of assessee and this issue of revenue's appeal is dismissed".

64. In view of the above, respectfully following the same, we direct AO to delete the said addition made, by invoking the provisions of section 40(a)(ia). Ground31 is allowed.

Ground No.32

65. Ground No.32 pertains to taxing of interest granted under section 244A of the Act vide intimation under section 143(1) for the assessment year 2005-06. Ground Nos. 32 to 32.3 is as under:

"32. The learned AO erred in holding that the amount of interest received by assessee under section 244A of the Act vide intimation under section 143(1) for assessment year 2005-06 in April 2006 was liable to be taxed as assessee's income in assessment year 2006-07.

32.1 The learned AO failed to appreciate that the order under section 143(1) for A.Y 2005-06 was received by assessee only in April 2006 and hence the interest received with the order under section 14391) could not be taxed in A.Y 2006-07.

32.2 Without prejudice, the appellant submits that the learned AO failed to appreciate that, along with the receipt of intimation under section 143(1) for A.Y 2005-06 the appellant had also received notice under section 143(2) indicating that the appellant's case was selected for scrutiny which could only be on the basis that the appellant has claimed an exemption, deduction, allowance or relief which was inadmissible.

32.3 The learned AO ought to have held that the interest received by the appellant had not attained finality so as to constitute income in the hands of the appellant".

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66. Briefly stated, AO granted interest on ₹ 589,81,740 under section 244A on processing of return for assessment year 2005-06 on 31.3.2006. As assessee received the amount in April 2006 this amount was taken as income in that year. AO was of the opinion that assessee should have offered the amount for taxation in assessment year 2006-07 as having been granted on 31.03.06. Accordingly, he brought to tax an amount of ₹ 589,81,740 in addition to the interest on Income Tax refunds already offered by assessee of ₹ 6.03 crores. Since the same was confirmed by the DRP, assessee is aggrieved.

67. After considering the rival submissions, we are of the opinion that this issue has crystallized by the Special Bench of the ITAT in the case of Avada Trading Co. (P) Ltd vs. ACIT, 100 ITD 131 (Mum)SB, wherein in was held as under:

> "*According to the charging provisions of sections 4 and 5, the income is chargeable in the year in which it either accrues or is received as the case may be. The issue regarding accrual of income is concluded by the judgment of the Supreme Court rendered in the case of* E.D. Sassoon & Co. Ltd. *v.* CIT *[1954] 26 ITR 27, wherein it has been held that income accrues when right to receive is acquired and such right can be said to have been acquired when an enforceable debt is created in favour of the assessee.*
>
> *A bare look at the provisions of sub-section (1) of section 244A reveals that as soon as any refund becomes due under any provisions of the Act, the assessee becomes entitled to receive the interest in respect of such refund calculated in the manner provided in clauses (*a*) and (*b *) of such provisions. Therefore, the moment the refund is granted, an enforceable debt is created in favour of the assessee in respect of interest due on such refund. Consequently, income can be said to accrue on the date of refund itself. Therefore, when such interest is actually granted along with the refund, then the requirements of sections 4 and 5 are fully satisfied and the same can be taxed in the year of receipt.*
>
> *There was no merit in the contention of the assessee that such right was contingent as the interest so received could be varied or withdrawn after the assessment under section 143(3). According to the dictionary meaning, a right or an obligation can be said to be contingent when such right or obligation is dependent on something not yet certain. According to section 244A, the only condition for grant of interest is that there must be a refund due to the assessee under any provision of the Act. There is no other condition in the*

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said provision affecting such right. Therefore, the moment a refund becomes due to the assessee, an enforceable debt is created in favour of the assessee and the assessee acquires a right to receive the interest. Sub-section (3) of section 244A only affects its quantification under certain circumstances and not the right of interest. The Supreme Court in the case of CIT *v.* Shri Goverdhan Ltd. *[1968] 69 ITR 675 has observed that once a debt is created, then the liability cannot be said to be contingent merely because it is to be quantified at later date. Under section 244A, even the interest is quantified immediately whenever a refund is issued. Hence, the right to grant interest is absolute since existence of such right is not dependent on any event.*

It is well settled from the judgment of the Supreme Court rendered in the case of Kedarnath Jute Mfg. Ltd. *v.* CIT *[1971] 82 ITR 363 that if an enforceable debt is created under a statute, then any subsequent event would not affect the existence of such right/obligation despite the fact that such debt is subject-matter of appeal. The right to interest under section 244A is not dependent upon any assessment inasmuch as there is no compulsion or obligation upon the Assessing Officer to make an assessment under section 143(3). The moment the return is processed under section 143(1)(*a*) and refund is issued on the basis of intimation under section 143(1)(*a*), an enforceable legal right is created in favour of the assessee under section 244A and simultaneously the Assessing Officer is under legal obligation to grant the interest. Merely because quantum of such interest may vary on assessment made under section 143(3), it cannot be said that legal right was not acquired on the date of refund. The effect of assessment under section 143(3) would be that interest on refund under section 244A would get substituted in terms of sub-section (3) of section 244A without affecting right already accrued.*

Further, the judgment of the Supreme Court rendered in the case of CIT *v.* Chunilal V. Mehta & Sons (P.) Ltd. *[1971] 82 ITR 54 clearly shows that once a right accrues under an agreement, then such accrual is not affected by dispute between the parties. Further, in case of dispute, the final outcome would ultimately relate back to the year of accrual.*

It was also contended by the assessee that it would be without remedy if the interest was reduced by virtue of assessment under section 143(3). That apprehension was unfounded. If interest is reduced by virtue of sub-section (3) of section 244A on account of assessment under section 143(3), the interest granted in earlier year gets substituted and it is the reduced amount of interest that would form part of income of that year. Thus, it would amount to mistake rectifiable under section 154. If the basis on which income was assessed is varied or ceases to exist, then such assessment would become erroneous and can be rectified. Similarly, any income assessed may become non-taxable by virtue of retrospective amendment and, consequently, erroneous assess–

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> *ment can be rectified. Therefore, if the interest granted under section 244A(1) is varied under sub-section (3) of such section, then the interest originally granted would be substituted by the reduced/increased amount, as the case may be. Thus, income on account of interest if assessed can be rectified under section 154.*
>
> *Therefore, interest on refund under section 244A(1) granted to the assessee in the proceedings under section 143(1)(*a*) would be assessable in the year in which it is granted and not in the year in which proceedings under section 143(1)(*a*) attain finality.*

68. Therefore, while upholding in principle that the amount is to be taxed in the year of granting the refund, AO is further directed to examine whether assessee was entitled for any interest under the same provisions after an order under section 143(3) was passed and if so modify the order to the extent assessee's quantum of interest to be brought to tax. In case the entire interest granted was withdrawn by any order subsequently, the relief to the extent has to be provided to assessee. With these directions, the ground 32 is partly allowed.

<u>Ground No.33</u>

69. Ground No.33 pertains to the disallowing an amount of ₹ 4,43,057 as unexplained income. In the course of the assessment while considering the write back of the provisions and making disallowance of the claim made for the expenditure during the year out of the provisions so made and after taking reconciliations from assessee, AO has come to the conclusion that an amount of ₹ 15,26,43,057 was sought to be explained towards various provisions out of which an amount of ₹ 15.22 crores i.e. ₹ 9.5 crores + ₹ 4.75 crores + ₹ 0.95 crores was explained. The difference amount of ₹ 4,43,057 remain unexplained. Accordingly the same was added back to the total income of assessee. Assessee's submissions before the DRP that provisions for this amount made earlier was also not accepted. The learned Counsel referring to page No.301 of the documents placed i.e. objections filed before the DRP submitted that assessee made provision of ₹ 14,29,43,057 in earlier years based on prudent accounting

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policy when the claims were received from M/s Prime Healthcare products and M/s MUL Dentpro (P) Ltd. This provision amount was disallowed and not claimed in the respective years. Out of the above provisions, assessee paid ₹ 9.50 crores to Prime Healthcare Products and ₹ 4.75 crores to MUL Dentpro (P) Ltd (discussed in Ground Nos. 26 & 27 above). The balance amount of ₹ 4,43,057 was written back to the Profit & Loss A/c as the said provisions was not required. Since the amount was offered to tax in the respective years when the provisions was made the write back of the same should not be taxed in the year of write back.

70. After considering the rival submissions, we are of the opinion that assessee's contention is correct on facts. Since the provision was not allowed as deduction in the year of creation, the write back of the amount cannot be brought to tax in the year of write back. Even though assessee had explained how this balance provision was written back, we are of the opinion that both AO and the DRP did not examine the facts correctly. We are of the opinion that there is no need to bring to tax this amount. However, since AO did not give proper opportunity to assessee to make submissions on this amount, the objection of which was there before the DRP, we remit the issue to the file of AO to examine the facts and delete the additions so made after satisfying with the reconciliation of amounts involved. Ground is considered allowed for statistical purposes.

Ground No.34

71. Ground No.34 pertains to the issue of brought forward depreciation of amalgamating company being set off. Briefly stated as per the details furnished in schedule 7 of the Tax Audit Report in relation to clause 25 of the report, assessee claimed set off of unabsorbed depreciation of amalgamating company Vashisti Detergents Ltd (VDL) for the assessment year 1996-97 and assessment year 1997-98 of ₹ 5,63,66,551 and ₹ 8,97,30,340 respectively (although the unabsorbed depreciation as per assessment order under section 143(3) dt 29.01.99 for the assessment

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year 1996-97 was mentioned as ₹ 5,33,10,169). The AO was of the opinion that as per provisions of section 32(2) relating to carry forward and set off of unabsorbed depreciation had been amended by Finance (No.2) Act, 1996 w.e.f. assessment year 1997-98 and remained on the statute till assessment year 2001-02 and as per the amended provisions the unabsorbed depreciation was allowed to be carried forward only for a period of eight assessment years immediately succeeding the assessment year for which the aforesaid allowance was first computed. Thus, the unabsorbed depreciation for the assessment year 1996-97 which was deemed to be part of the depreciation allowance for assessment year 1997-98 as per the unamended provision of section 32(2) and the depreciation for assessment year 1997-98 could be carried forward only upto assessment year 2005-06. Assessee vide questionnaire dated 05.10.2009 and during the assessment proceedings was required to justify the claim for set off of brought forward losses/depreciation.

72. It was the claim that the unabsorbed depreciation of Vashisti Detergents Ltd (VDL) was to be set off when the company got amalgamated with the assessee company. AO did not accept on the reason that the depreciation for 1996-97 got merged into depreciation for assessment year 1997-98 and therefore as per the amended provisions of section 32 (2) the set off cannot be allowed by the assessment year 2005-06. Therefore, the claim was not allowed in the assessment year 2006-07 which was beyond the period of succeeding eight assessment years. The same opinion was held by the DRP.

73. Before us the learned Counsel relied on the decision of the Hon'ble Gujarat High Court in the case of General Motors India (P) Ltd vs. DCIT in Special Civil Application No.1773 of 2012 dated 23.08.2012, whereas the learned DR relied on the Special Bench of the ITAT in the case of DCIT vs. Times Guaranty Ltd, 40 SOT 14 (SB) (Mum).

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74. We have considered the issue. It is true that this issue was held against assessee and in favour of the Revenue by the ITAT Special Bench in the case of DCIT vs. Times Guaranty Ltd (Supra) wherein it has considered vide Para 38 as under:

"38. The legal position of current and brought forward unadjusted/unabsorbed depreciation allowance in the three periods, is summarized as under:—

A. In the first period (i.e. up to assessment year 1996-97)
(i)Current depreciation, that is the amount of allowance for the year under section 32(1), can be set off against income under any head within the same year.

(ii)Amount of such current depreciation which cannot be so set off within the same year as per (i) above shall be deemed as depreciation under section 32(1), that is depreciation for the current year in the following year(s) to be set off against income under any head, like current depreciation.

B. In the second period (i.e., assessment years 1997-98 to 2001-02)
(i)Brought forward unadjusted depreciation allowance for and up to assessment year 1996-97 (hereinafter called the 'First unadjusted depreciation allowance'), which could not be set off up to assessment year 1996-97, shall be carried forward for set off against income under any head for a maximum period of eight assessment years starting from assessment year 1997-98.

(ii)Current depreciation for the year under section 32(1) (for each year separately starting from assessment year 1997-98 up to 2001-02) can be set off firstly against business income and then against income under any other head.

(iii)Amount of current depreciation for assessment years 1997-98 to 2001-02 which cannot be so set off as per (ii) above, hereinafter called the 'Second unabsorbed depreciation allowance' shall be carried forward for a maximum period of eight assessment years from the assessment year immediately succeeding the assessment year for which it was first computed, to be set off only against the income under the head 'Profits and gains of business or profession'.

C. In the third period (i.e., assessment year 2002-03 onwards)

(i)'First unadjusted depreciation allowance' can be set off up to assessment year 2004-05, that is, the remaining period out of maximum period of eight assessment years [as per B(i) above] against income under any head.

(ii)'Second unabsorbed depreciation allowance' can be set off only against the income under the head 'Profits and gains of business or

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profession' within a period of eight assessment years succeeding the assessment year for which it was first computed.

(iii)Current depreciation for the year under section 32(1), for each year separately, starting from assessment year 2002-03 can be set off against income under any head. Amount of depreciation allowance not so set off (hereinafter called the 'Third unadjusted depreciation allowance') shall be carried forward to the following year.

(iv)The 'Third unadjusted depreciation allowance' shall be deemed as depreciation under section 32(1), that is depreciation for the current year in the following year(s) to be set off against income under any head, like current depreciation, in perpetuity.

75. However, the same issue was considered by the Hon'ble Gujarat High Court in the case of General Motors India Pvt. Ltd (Supra) Ahmedabad as under:

"37. The CBDT Circular clarifies the intent of the amendment that it is for enabling the industry to conserve sufficient funds to replace plant and machinery and accordingly the amendment dispenses with the restriction of 8 years for carry forward and set off of unabsorbed depreciation. The amendment is applicable from assessment year 2002-03 and subsequent years. This means that any unabsorbed depreciation available to an assessee on 1st day of April, 2002 (A.Y. 2002-03) will be dealt with in accordance with the provisions of section 32(2) as amended by Finance Act, 2001 and not by the provisions of section 32(2) as it stood before the said amendment. Had the intention of the Legislature been to allow the unabsorbed depreciation allowance worked out in A.Y. 1997-98 only for eight subsequent assessment years even after the amendment of section 32(2) by Finance Act, 2001 it would have incorporated a provision to that effect. However, it does not contain any such provision. Hence keeping in view the purpose of amendment of section 32(2) of the Act, a purposive and harmonious interpretation has to be taken. While construing taxing statutes, rule of strict interpretation has to be applied, giving fair and reasonable construction to the language of the section without leaning to the side of assessee or the revenue. But if the legislature fails to express clearly and the assessee becomes entitled for a benefit within the ambit of the section by the clear words used in the section, the benefit accruing to assessee cannot be denied. However, Circular No.14 of 2001 had clarified that under Section 32(2), in computing the profits and gains of business or profession for any previous year, deduction of depreciation under Section 32 shall be mandatory. Therefore, the provisions of section 32(2) as amended by Finance Act, 2001 would allow the unabsorbed depreciation allowance available in the A.Y. 1997-98, 1999-2000, 2000-01 and 2001-02 to be carried forward to the succeeding years, and if any unabsorbed depreciation or part thereof could not be set off till the A.Y. 2002-03 then it would be

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> *carried forward till the time it is set off against the profits and gains of subsequent years.*
>
> *38. Therefore, it can be said that, current depreciation is deductible in the first place from the income of the business to which it relates. If such depreciation amount is larger than the amount of the profits of that business, then such excess comes for absorption from the profits and gains from any other business or business, if any, carried on by the assessee. If a balance is left even thereafter, that becomes deductible from out of income from any source under any of the other heads of income during that year. In case there is a still balance left over, it is to be treated as unabsorbed depreciation and it is taken to the next succeeding year. Where there is current depreciation for such succeeding year the unabsorbed depreciation is added to the current depreciation for such succeeding year and is deemed as part thereof. If, however, there is no current depreciation for such succeeding year, the unabsorbed depreciation becomes the depreciation allowance for such succeeding year. We are of the considered opinion that any unabsorbed depreciation available to an assessee on 1st day of April 2002 (A.Y. 2002-03) will be dealt with in accordance with the provisions of section 32(2) as amended by Finance Act, 2001. And once the Circular No.14 of 2001 clarified that the restriction of 8 years for carry forward and set off of unabsorbed depreciation had been dispensed with, the unabsorbed depreciation from A.Y.1997-98 upto the A.Y.2001-02 got carried forward to the assessment year 2002-03 and became part thereof, it came to be governed by the provisions of section 32(2) as amended by Finance Act, 2001 and were available for carry forward and set off against the profits and gains of subsequent years, without any limit whatsoever".*

76. Since this decision is in favour of assessee and from higher judicial authority, we are bound by the decision of the Gujarat High Court in preference to the Special Bench decision of the ITAT. There is no contrary judgment to the above. Therefore, respectfully following the decision of Hon'ble Gujarat High Court on the issue, we direct AO to allow the set off of unabsorbed depreciation pertaining to assessment year 1996-97 and 1997-98 as per the records. This ground is allowed.

<u>Ground No. 35</u>

77. The issue in Ground No.35 is with reference to disallowance of an amount of ₹ 5,000 paid to Fort Convent Parent Teachers Association, Mumbai on 28.10.2005 by way of Cheque No.041624 dated 24.08.2005

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drawn on Duetsch Bank, HS Marg, Mumbai by assessee. The deduction at 50% was disallowed on the reason that instead of assessee's name the receipt contains name as "Rin Advance". It was the submission of assessee that the said Parent Teachers Association instead of giving receipt in the name of assessee company, however, issued the receipt on the product name as they have given advertisement in the cover page of the souvenir bring brought out, at ₹ 10,000. AO and the DRP did not accept the contentions of assessee.

78. After considering the submissions and examining the details, we are of the opinion that there is no need for disallowing the claim under section 80G made by assessee. There is evidence on record that assessee paid by way of cheque an amount of ₹ 10,000 to the said Parent Teachers Association for cover page in the souvenir and the material for advertisement was given in the name of "Rin Advance" with Mr Amitabh Bachan and child star being the persons representing the products. This advertisement material was given to the Parent Teachers Association and they gave receipt along with the certificate for claim u/s 80G in the name of 'Rin Advance', a product of assessee. This could be a mistake but one cannot deny that the said payment was made by assessee. In fact, the whole amount of ₹ 10,000 could have been claimed as deduction as an advertisement under section 37(1). However, assessee restricted the same to an amount of ₹ 5,000 being the donation under section 80G. We do not see any reason to disallow the amount as the amount has been paid by the assessee company by way of cheque and there is no dispute with reference to the eligibility under section 80G. Accordingly, AO is directed to allow the amount of ₹ 5,000 as claimed.

<u>Ground No.36</u>

79. Ground No.36 pertains to levy of interest under section 234C. There is no discussion by AO in the draft assessment order. Therefore, assessee could not raise any objection before the DRP. However, at the time of

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finalizing the assessment as there is no direction to levy interest, nor the working has been provided to assessee, assessee raised the objection before us in this ground. After considering the rival submissions, we restore the issue to the file of AO to examine the facts as it is a contention that assessee has paid more advance tax and no interest under section 234C is warranted. Moreover though there is direction to levy interest u/s 234B and 234D, there is no such direction in assessment order for levy of interest u/s 234C. Since the facts are not available on record either of the advance tax paid by assessee or how the interest have been worked out, AO is directed to examine and after giving due opportunity to assessee to explain, consider levy of interest u/s 234C, if required under the provisions of the Act. With these directions, the issue in Ground No.36 is also restored to the file of AO for fresh examination and adjudication.

80. परिणामतः निर्धारिती की अपील आंशिक स्वीकृत की जाती है ।

80. In the result, assessee's appeal is partly allowed.

आदेश की धोषणा खुले न्यायालय में दिनांकः 10th December 2012 को की गई ।

Order pronounced in the open Court on 10th December 2012

Sd/- **बी. रामकोटय्य** **लेखा सदस्य** **B. RAMAKOTAIAH** **ACCOUNTANT MEMBER**	**Sd/-** **अमित शुक्ला** **न्यायिक सदस्य** **AMIT SHUKLA** **JUDICIAL MEMBER**

मुंबई MUMBAI, दिनांक DATED: 10th December 2012

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<u>आदेश की प्रतिलिपि अग्रेषित / Copy of the order forwarded to</u>:

(1) निर्धारिती / The Assessee;

(2) राजस्व / The Revenue;

(3) आयकर आयुक्त(अपील)/ The CIT(A);

(4) आयकर आयुक्त / The CIT, Mumbai City concerned;

(5) विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / The DR, ITAT, Mumbai;

(6) गार्ड फाईल / Guard file.

त्यापित प्रति / True Copy

आदेशानुसार / By Order

प्रदीप जे. चौधरी / Pradeep J. Chowdhury

वरिष्ठ निजी सचिव / Sr. Private Secretary

उप / सहायक पंजीकार / (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai