

IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "C", PUNE

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

ITA No.797/PUN/2022

निर्धारण वर्ष / Assessment Year: 2014-15

DCIT, Circle-1(1), Pune	Vs.	M/s. Ampacet Speciality Products Private Limited, D-276, D-277, D-283, Ranjangaon MIDC, Koregaon, Pune 412 220 Maharashtra PAN : AAICA2806P
Appellant		Respondent

C.O. No.10/PUN/2023

(Arising out of ITA No.797/PUN/2022

निर्धारण वर्ष / Assessment Year: 2014-15

M/s. Ampacet Speciality Products Private Limited, D-276, D-277, D-283, Ranjangaon MIDC, Koregaon, Pune 412 220 Maharashtra PAN : AAICA2806P	Vs.	DCIT, Circle-1(1), Pune
Cross Objector		Appellant in the appeal

Assessee by: Shri Rajat Soni
Revenue by: Shri Shashank Deogadkar

Date of hearing: 11-09-2023
Date of pronouncement: 13-09-2023

आदेश / ORDER

PER R.S.SYAL, VP :

These two cross appeals – one by the assessee and other by the Revenue - arise out of the order passed by the CIT(A)-13, Pune on 02-09-2022 in relation to the assessment year 2014-15.

2. The first issue taken by the Revenue in its appeal is against the decision of the Id. CIT(A) directing to allocate various costs between the 'Trading' and 'Manufacturing' segments in the Gross Profit ratio as against the Sales ratio applied by the Transfer Pricing Officer (TPO). The other issues raised by the Revenue against the Trading segment are against the granting of adjustment towards higher amount of custom duty paid by the assessee on the purchases in this segment and changing the computation of the working capital adjustment. The assessee's only issue in the Cross objection is an assail to the finding of the Id. CIT(A) rejecting the allocation of expenses done by it to the Trading and Manufacturing segments.

3. Succinctly, the facts of the case are that the assessee is a domestic company engaged in the manufacturing of colour concentrates and additive masterbatches. In addition, it is also engaged in Trading activities. The return was filed declaring total income at Rs.4.99 crore along with audit report in Form No. 3CEB, detailing certain international transactions. The Assessing Officer (AO) made a reference to the Transfer Pricing Officer (TPO) for determining Arm's Length Price (ALP) of the international transactions. The first issue is against the transfer

pricing adjustment of Rs.1,42,95,079/- in the Trading segment. The assessee declared an international transaction of “Purchase of manufactured finished goods from AE for the purpose of trading” with transacted value at Rs.33,48,84,268/-. The Transactional Net Margin Method (TNMM) was applied as the most appropriate method for its ALP determination. The assessee computed its operating margin from the trading segment at (-) 0.36%. Certain comparables were shown having average Operating Profit (OP) to Operating Ratio (OR) at 3.17% to show that the transaction was at ALP. During the course of the transfer pricing proceedings, the TPO observed that the assessee had not properly allocated the expenses between the manufacturing and trading segments inasmuch as inadequate/no expenditure under the heads Employee benefit, Depreciation, Sales Commission and Other expenses was allocated to the Trading segment. On being called upon, the assessee furnished a revised working of the Trading segment computing Profit Level Indicator (PLI) of OP to OR at (-) 0.88%. The TPO observed that the assessee itself accepted that expenses to the tune of Rs.34,88,446/- were earlier not allocated to the trading segment under the transfer pricing study report. He observed that various expenses were not/improperly allocated to the trading

segment. The TPO also observed that allocation of some expenses between trading and manufacturing segments on the basis of gross profit ratio was not correct. He noted that the assessee allocated salary of only one employee at Rs.6.90 lakh to the trading segment. Considering the FAR analysis, it was opined that the trading was much more than a single person activity. He held that the salaries of Directors and Finance personnel etc. were also required to be allocated to the trading segment on the basis of Sales ratio. He recomputed the Employee cost between manufacturing and trading segments in the Sale ratio. However, while doing so, he took care not to consider certain expenses which were specifically and exclusively allocable to the manufacturing segment. Regarding Depreciation, the TPO observed that the assessee allocated to the trading segment only depreciation on building amounting to Rs.58,337/-. Despite accepting that land, building, warehouse and other facilities were also used for trading activity, the assessee had not allocated any depreciation in respect of such assets to the trading activity. Rejecting the assessee's contention, the TPO allocated depreciation on such assets between the trading and manufacturing segments. However, no depreciation on plant and machinery, exclusively used for the manufacturing segment, was

allocated to trading segment. Similarly, regarding Other expenses, consisting of local travel, lodging, communication expenses, stationary etc., the assessee had not allocated anything to trading segment. A meagre sum of Rs.6.88 lakh out of total Rs.1.12 crore under Legal and Professional fees was apportioned. Rejecting the assessee's contention, the TPO made allocation of Other expenses to the trading segment in the ratio of revenue. Aggrieved thereby, the assessee objected before the ld. first appellate authority, firstly, to the rejection of its allocation of certain expenses and then, to the making of allocation of the expenses by the TPO in the Sales ratio between the two segments as against its claim of allocation on the basis of Gross Profit ratio. The ld. CIT(A) accepted the fact that the assessee did not properly apportion the expenses between the manufacturing and trading segments. He, however, went with the assessee's arguments in respect of allocation of expenses in the ratio of gross profit ratio. Both the sides have come up in appeal before the Tribunal on their respective stands.

4. Having heard the rival submissions and gone through the relevant material on record, it is seen that the assessee's revenue from the trading segment stands at Rs.28.13 crore as against the revenue from the manufacturing segment at Rs.164.35 crore.

Initially, the assessee allocated Operating expenses to trading segment at Rs.28.02 crore. When the TPO confronted the assessee with omission of several expenses in the allocation, the assessee came out with a revised figure of allocation at Rs.28.37 crore, thereby and increasing the allocation of expenses to the trading segment by Rs.34,88,446/-. Despite an opportunity granted by the TPO, the assessee still did not come clean by not properly allocating Employee cost, Depreciation and Other expenses as discussed *supra*. This demonstrates that the assessee failed to properly apportion the expenses between the manufacturing and trading segments, as has been correctly adjudicated by the Id. CIT(A). The assessee's solitary grievance in this regard is, therefore, not jettisoned.

5. Having held that the Id. CIT(A) was justified in rejecting the allocation of expenses by the assessee to the trading segment, the next question is about the proper allocation of expenses to the segment. The first item is 'Employees cost'. The assessee made allocation to the trading segment by considering only one person's salary as employee cost at Rs.6.90 lakh. It goes without saying that the Directors also devoted their time to the trading segment in

the same way as they did for the manufacturing segment. Similar is the position regarding Finance and H.R. personnel also. To contend that the Directors, Finance personnel, Human Resources etc. did not devote any time to the trading segment, in our considered opinion, is totally unacceptable. At the same time, the expenses which are peculiar to manufacturing segment alone cannot be included in the common cost base. The TPO has rightly excluded the salaries of site Directors/Managers etc. from the ambit of common employee cost for allocation.

6. The second item is 'Depreciation'. The assessee allocated depreciation only in respect of building amounting to Rs.58,837/- to the trading segment. It was fairly conceded by the assessee before the TPO that Land, Building, Warehouse and other facilities were also used for the trading activity. In that view of the matter, depreciation on these items also needed to be allocated to the trading segment. However, depreciation on plant and machinery, which is peculiar to the manufacturing segment alone, is required to be excluded from the ambit of common base of depreciation, which has rightly been done by the TPO.

7. The last item is 'Other expenses'. The assessee did not allocate expenses on account of Local travel, Lodging,

Communication expenses, Stationary, Courier charges to the trading segment, having turnover of Rs.28.00 crore. Obviously, some sort of travelling would be required for the trading segment including visiting clients. Similarly, stationary etc. would also be needed for this segment as part of any office expense. In our considered opinion, the TPO was justified in clubbing such expenses in the purview of the common expenses for the allocation. We, therefore, hold that the TPO rightly constituted the base of common expenses for allocation to the trading segment.

8. It is further observed that the assessee did not allocate some of the expenses as discussed *supra* and whatever allocation it did was in the gross profit ratio of trading and manufacturing segments. The TPO rejected such basis and proceeded to apportion the common expenses in the ratio of revenue from the two segments. The Id. CIT(A) accorded his imprimatur to the view point of the assessee for applying the gross profit ratio as a key for bifurcation of common expenses.

9. Gross profit ratio represents the percentage of gross profit to sales. It is only in percentage terms and does not take into account the weight of the higher or lower amounts of the sales or gross profit. In our view, the gross profit ratio cannot be a yardstick to

allocate the expenses *dehors* the actual figures. This can be understood with the help of an example. Suppose out of total sales of Rs.100/- made by an assessee, sale under the manufacturing segment is Rs.10/- and in the trading segment are Rs.90/-. Further, suppose that the rate of gross profit in the manufacturing segment is 20% and in the trading segment is 2%. Though revenue from the trading activity is a major constituent at 90% of the total, but the gross profit ratio will be unevenly poised at 20%:2%. Further suppose that total common expenses are Rs.30/-. If we allocate the common expenses in the ratio of gross profit rates, then expenses only to the tune of Rs.2.72 will be allocated to the trading segment and Rs.27.28 to the manufacturing segment. This is totally illogical because the manufacturing segment will have to bear the allocation of common expenses at Rs.27.28 against its total revenue at only Rs.10/-, which is preposterous. The allocation of common expenses needs to be done involving the figures having some base of volume of the two segments. In the absence of the assessee putting forward any rational basis for allocation, it is held that the allocation done by the TPO on the basis of revenues from the two segments is in order, which does not call for any

interference. The impugned order on this issue, is ergo, overturned and the view point of the TPO is countenanced.

10. The assessee imported masterbatches from its Associated Enterprises and paid import duty thereon. Adjustment to own operating profits was made on the ground that it paid higher amount of custom duty *vis-a-vis* the comparables. The TPO rejected it, but the Id. CIT(A) accepted.

11. The case of the assessee is that it paid more custom duty in comparison with its comparables and hence adjustment on account of higher custom duty should be allowed. In our considered opinion, there is no merit in the contention urged on behalf of the assessee. Under the TNMM, the ALP is determined by considering the operating margin to a common base and while computing the operating margin, all the operating expenses and the corresponding revenue are taken into consideration. Having done so, it is usually not open to again go back to the individual items of the operating costs for claiming that such expenditure was higher in the case of the assessee in quantitative terms *vis-a-vis* the comparables and adjustment should be given. It is but natural that if a costly purchase of high quality product is made, it will yield higher sale price as well. This shows that if the operating cost is

higher, the operating revenue will also be higher and *vice versa*. Once operating margin is considered for benchmarking, it implies that the higher operating costs have equalised the corresponding higher operating revenue as well. In such cases, there can be no question of granting any separate adjustment in respect of costly purchases. However, the adjustment will be warranted only if there is a difference between the rate of custom duty paid by the assessee and comparables. We are confronted with a situation in which the difference is only in respect of amount of custom duty and not the rate of custom duty. In such circumstances, there is no point in allowing any adjustment on account of custom duty. We, therefore, overturn the impugned order on this score.

12. The next issue challenged by the Department is against the grant of working capital adjustment. In this regard, the assessee calculated the working capital adjustment on segmental basis. However, it could not substantiate the figures of Receivables, Payables, Inventories relating to trading segment. The TPO also observed difference in the figures of Inventory of traded goods as per Annual report at Rs.10.76 crore and as taken for working capital adjustment at Rs.8.13 crore. When pointed out, the assessee accepted this mistake. The TPO also noticed certain

defects in the calculation of working capital adjustment of comparables, in which the assessee had also considered advances to and from customers, prepaid expenses, other payables etc. In view of the above facts, the TPO rejected the assessee's computation and recomputed the working capital adjustment. The Id. CIT(A) gave certain directions for the computation of the working capital adjustment, against which the Revenue is aggrieved.

13. At the outset, the Id. AR submitted that the TPO had not given adequate opportunity to the assessee to submit correct figures after noticing certain defects. We observe that the CIT(A), too, has not gone into such details taken note of by the TPO and simply accepted the assessee's contention without any discussion on these relevant points having bearing. In view of the fact that the assessee could not furnish relevant details before the TPO *qua* the working capital adjustment and further the Id. CIT(A) was swayed by the submissions of the assessee and did not consider the objections of the TPO, we are satisfied that it would be just and fair if the impugned order on this score is set-aside and the matter is remitted to the file of the AO/TPO. We order accordingly and direct him to compute the amount of working capital adjustment

afresh after allowing reasonable opportunity of hearing to the assessee.

14. The only other issue which survives in the Revenue's appeal is against the application of the Comparable Uncontrolled Price (CUP) method in the manufacturing segment. The TPO observed that the assessee applied the TNM method in respect of international transaction of 'Sale of finished goods' at the transacted value of Rs.42,11,78,831/-. He opined that the CUP method should have been applied instead of the TNMM. Accordingly, he computed the transfer pricing adjustment amounting to Rs.40,77,800/- on this count. The Id. CIT(A) allowed the relief.

15. Having heard the rival submissions and gone through the relevant material on record, it is noticed that the assessee applied the TNM method for benchmarking the international transaction of 'Sale of finished goods', which was substituted with the CUP method by the TPO. The latter method can be applied more appropriately if all other facts and circumstances of the international transaction and of the comparable transaction are similar. If there is difference in product, geography, timing or quantity sold etc., then the CUP method cannot be applied as the

most appropriate method. Turning to the facts of the extant case, it is observed that there is a huge difference in quantities of products sold by the assessee to its AE and non-AEs. The detail has been provided at page 287, which shows that as against the item COMITE 31R, the assessee sold 15000 units for the month of February, 2014 to its AE as against third party export of 25 units. Similarly for August, 2013, the item sold is COMITE 86. Sale to AEs is of 3000 units and to third parties of 40,000 units. Such difference in the quantity sold to the AEs and non-AEs appears for other months as well. In view of such huge quantitative differences, one cannot say that the price charged for a product sold in huge quantity can be taken as comparable price for the sale of lower units of the same product. Thus the CUP is not the most appropriate method in the facts of the case. If the CUP method is excluded, what remains is the TNMM, as was applied by the assessee. We, therefore, hold that the ld. CIT(A) was justified in accepting the assessee's contention that the TNMM should be applied in respect of international transaction of 'Sale of finished goods'. The grounds relating to this issue in the appeal of the Revenue are, thus, not allowed.

16. In the ultimate analysis, we set aside the impugned order and send the matter to the file of the AO/TPO for a fresh determination of the ALP of the international transactions in the light of above directions. Needless to say, the assessee will be allowed a reasonable opportunity of hearing in such fresh proceedings.

17. In the result, the appeal of the Revenue is partly allowed and the Cross Objection of the assessee is dismissed.

Order pronounced in the Open Court on 13th September, 2023

Sd/-
 (S.S.VISWANETHRA RAVI)
 JUDICIAL MEMBER

Sd/-
 (R.S.SYAL)
 VICE PRESIDENT

पुणे Pune; दिनांक Dated : 13th September, 2023
 Satish

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

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13
4. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "C" / DR 'C', ITAT, Pune
5. गार्ड फाईल / Guard file

आदेशानुसार/ BY ORDER,

// True Copy //

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

		Date	
1.	Draft dictated on	11-09-2023	Sr.PS
2.	Draft placed before author	12-09-2023	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

*