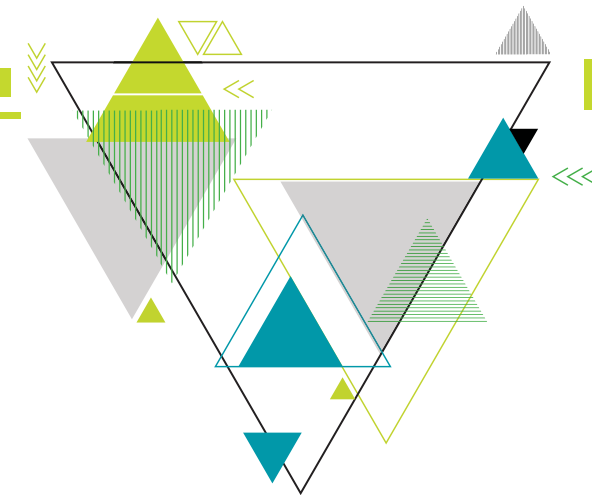


Key cases and highlights

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2016

Some interesting Case Studies



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Mumbai

Short Summary of the case

Re-assessment proceedings - validity thereof

- The assessee is a Government of India Undertaking engaged in the business of rural infrastructure development and institutional development of the Co-operative Bank and Regional Rural Banks (RRB).
- In terms of an Order dated 25 March 2005 passed u/s. 143(3) of the Act, the AO held that the development activities carried on by the assessee do not yield any taxable income and also other receipts viz. donations, gifts, etc. are not in the nature of income. He thus concluded that the funds received by the assessee are in the nature of exempt income, and therefore disallowed expenses in relation thereto by applying the provisions of section 14A of the Act.
- The CIT(A) deleted the said disallowance following the Orders passed for earlier years.
- No further appeal was preferred by the Income-tax Department against the Order passed by the CIT(A).
- In terms of an Order dated 18 February 2009, the AO re-opened the assessment in respect of the same issue.
- The assessee objected to the re-assessment proceedings bringing all the facts to the notice of the AO, however, the AO proceeded with the re-assessment proceedings without disposing off the objections raised by the assessee.
- The CIT(A) after considering the submissions of the assessee, in the light of the judicial precedents cited before him, held the re-opening of assessment and the assessment order passed in consequence thereof to be invalid / not maintainable.
- The Income-tax Department filed an appeal before the ITAT against the Order passed by the CIT(A).

On appeal, the ITAT decided the appeal in assessee's favour held that:

- The Assessing Officer before completing the re-assessment having not disposed off the objections of the assessee, the impugned assessment order is invalid;

- Moreover, this issue of having already merged with the order of the learned Commissioner (Appeals) cannot be a subject matter of re-opening.
- Further, from the office note available in the assessment order it appears that the assessment was re-opened only due to the revenue audit objection. Therefore, there is also lack of application of mind by the Assessing Officer while

Penalty proceedings u/s. 271C – period of limitation

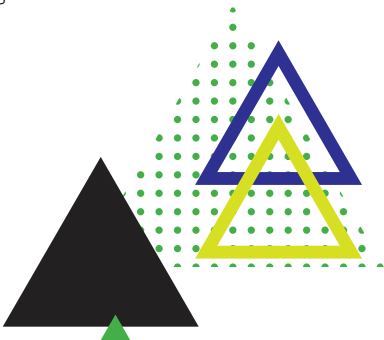
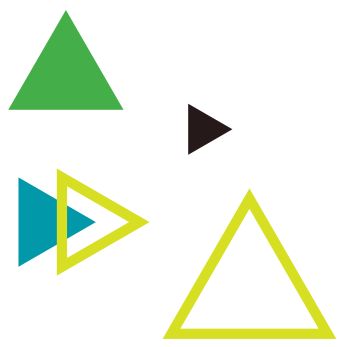
- Penalty proceedings u/s. 271C of the Act were initiated on the assessee not in the course of any proceedings under the Act, but due to non-deduction of tax at source and because of subsequent proceedings u/s. 201(1) and 201(1A) of the Act.
- The proceedings were initiated on 29 September 2010 and concluded vide Order dated 28 March 2012.
- It was contended before the Tribunal, that as per the provisions of Section 275(1)(c) of the Act, no order imposing penalty under the Chapter shall be passed after expiry of the financial year in which the proceedings in the course of which action of imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later.
- Further, in the case in hand the penalty proceedings were not initiated in the course of any proceedings.

recording reasons for re-opening of assessment and on this count also, the re-assessment is invalid.

**DCIT v/s. National Bank for Agriculture and Rural Development
Mumbai ITAT**

- Hence, the later period prescribed under the section providing the limitation period of six months from the end of the month in which the penalty proceedings were initiated will be applicable.
- The assessee also relied on the decision of the Delhi High Court in the case of **CIT (TDS) Vs. IKEA Trading Hong Kong Ltd. 333 ITR 565 (Delhi)**.
- The ITAT held that where initiation of action for imposition of penalty is not in the course of any proceedings, the first period prescribed u/s 275(1) (c) of the Act would have no application and only the period of limitation prescribed in the second part would apply which is six months from the end of the month in which the penalty proceeding was initiated by issuance of show-cause notice.
- Accordingly, the penalty Order being barred by limitation has no legal sanctity and the same was set aside.

**Jotun India Pvt. Ltd. v/s. ADIT
Mumbai ITAT**



Provisions for warranty expenses

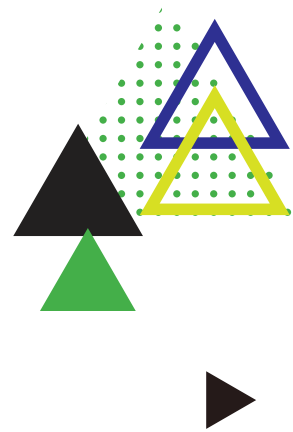
- The assessee company is engaged in business of trading and servicing of medical equipments.
- The Assessing Officer on perusal of tax audit report observed that assessee had debited an amount of INR1,66,07,319/ in P&L account as provisions of warranty.
- The Assessing Officer observed that having made a provision for warranty of INR1,66,07,319/- a sum of INR41,60,325/- had been utilized. Thus, the provision was only a contingent liability. So, Assessing Officer made addition to the extent of INR1,24,46,994/-.
- The matter was carried before the First Appellate Authority, wherein various contentions were raised on behalf of assessee and having considered the same, CIT(A) granted relief to the assessee.

Upon appeal by the Income-tax Department, the ITAT held that:

- As per the accounting system regularly followed by the assessee, provision was made @ 2% of sales and would written back if in excess at the expiry of warranty period.
- In this background, CIT(A) observed that assessee's case is squarely covered by the

- decision of **M/s. Rotork control India Pvt. Ltd. vs. CIT [2009] 314 ITR 62 (SC)**, wherein it was observed that the valve actuators manufactured by the assessee, were sophisticated goods and statistical data indicated that every year some of these were found defective; that valve actuators being a sophisticated items, no customer was prepared to buy a valve actuator without a warranty.
- Therefore the warranty became an integral part of the sale price; in words the warranty was attached to the sale price of the product.
- In this case the warranty provision had to be recognized because the assessee had a present obligation as a result of past event resulting in outflow of resources and reliable estimate could be made of the amount of obligation.
- Therefore the assessee had incurred a liability during the assessment year which was entitled to deduction u/s. 37 of the Act.
- Facts being similar, the CIT(A) was justified in granting relief to assessee.

**DCIT v/s. Maquet Medical India Pvt. Ltd.
Mumbai ITAT**



Computation of arm's length price and selection of comparables - When a concern had functioned in quite dissimilar business model than that of assessee while carrying out activity of an ITES provider and it had high transaction charges and low employee cost ratio, it should be excluded from comparable list

- The assessee was engaged in ITES services and had provided the same to its AEs.
- It had selected TNMM as the most appropriate method for determining the ALP of the transactions. The PLI was determined by adopting OP/OC at 15.43%.
- The TPO, following the directions issued by the DRP, selected 8 comparables whose average PLI after granting working capital adjustment was 25.79%.

Upon appeal, the ITAT held as under:

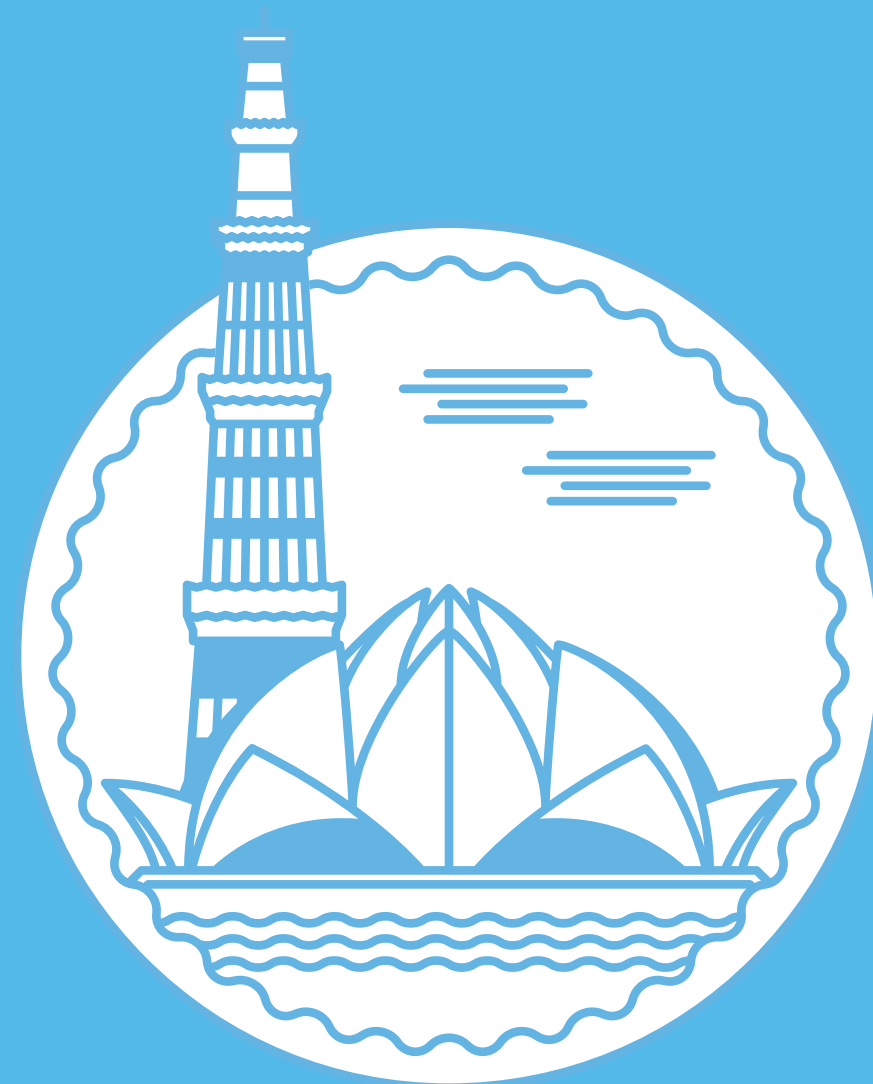
- **Informed Technologies Ltd.:** is rejected as it is following a different business

model as that of the assessee

- **Cosmic Global Ltd.:** is rejected as a comparable due to rejection as per employee cost filter and fluctuating profitability from year to year
- **Accentia Technologies Ltd.:** is rejected following assessee's prior case of AY 2008-09 where it was rejected due to extraordinary events

Aptara Technologies Pvt. Ltd. v/s. ACIT Pune ITAT





Delhi

Short Summary of the case

Selection of comparables and depreciation of peripherals

Facts: The assessee was engaged in providing software development support services to its AE.

ITAT ruling:

01. Inclusion/Exclusion of comparables
 - A. ITAT excluded following companies on the basis of functional differences:
 - Celestial Labs Ltd.
 - Helios & Matheson Information Technology Ltd.
 - Infosys Technologies Ltd.
 - Kals Information Systems Ltd.
 - Persistent Systems Ltd.
 - Tata Elxsi Ltd.
 - Wipro Limited

- B. In respect of Accel Transmatic Ltd., ITAT restored the matter back to TPO for verification on whether this comparable failed software service revenue filter.

02. Depreciation on computer peripherals

ITAT held that UPS would form part of computer peripherals; accessories and depreciation is to be allowed at 60% rate.

AVL Software India Pvt. Ltd. (ITA No. 6454/Del/2012)
Delhi ITAT

Selection of comparables

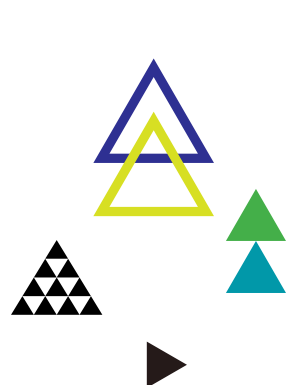
Facts: The assessee was engaged in providing software development support services to its AE.

ITAT ruling:

01. Inclusion/Exclusion of comparables
 - A. ITAT excluded following companies on the basis of functional differences:
 - Kals Information Systems Ltd.
 - Persistent Systems Ltd.
 - Tata Elxsi Ltd.

- B. Issue with regard to one comparable (Softsol India) has been restored to the file of the CIT(A) to consider the assessee's claim of capacity adjustment.

AVL Software India Pvt. Ltd. (ITA No. 279/Del/2013)
Delhi ITAT



Computation of stamp duty and registration expenses - Revenue Expenditure

Facts: This is an appeal filed by department. The assessee provides software development services to its AE.

ITAT ruling:

01. Selection of comparables
The Hon'ble ITAT upheld the decision of CIT(A) in excluding Celestial Biolabs from the list of comparables

02. Disallowance of stamp duty and registration expenses:
The tribunal upheld the decision of CIT(A) in treating the stamp duty and registration expenses as revenue expenditure.

Intuit Technology Services Ltd. (ITA No. 1892/Del/2013)
Delhi ITAT

Taxability of offshore supplies and issue on Permanent Establishment

Facts: Assessee supplied certain equipment to ONGC under a composite contract which involved offshore and onshore training and installation, besides offshore supplies.

AO concluded that it was a 'composite contract' given on turnkey basis by ONGC. AO attributed 25% of the contract value to be taxable in India and raised a demand of INR 32 crores.

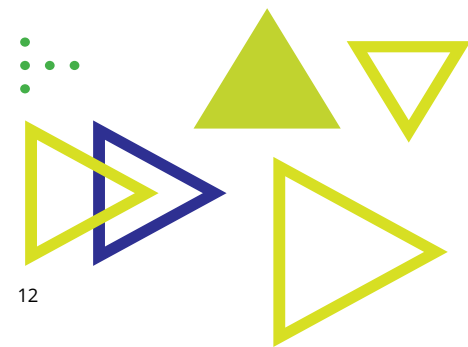
ITAT ruling:

01. Taxability of offshore supplies and Permanent Establishment
Based on documents furnished such as dispatch instructions, packing and insurance, shipping arrangement, it is evident that the 'title in goods' passed offshore and therefore

no part of the consideration could be attributed to the supplies in India.

With regard to PE, revenue's stand of constitution of Installation PE under Article 5(2)(j) and (k) of the India-US DTAA rejected as the Revenue could not establish that employees were present in India for more than 120 days. In absence of a PE, no income from offshore supplies was taxable in India.

Ion Geophysical Corporation (ITA No. 1607/Del/2015)
Delhi ITAT



Selection of comparables and disallowance u/s 14A of the Act

Facts: Assessee is engaged in the business of consulting and support services

ITAT ruling:

01. Selection of comparables
Observing the functional profile of the assessee, ITAT directed to exclude TSR Darashaw Ltd. and HCCA Business Services Pvt. Ltd. from being taken as comparable.

02. Disallowance u/s 14A
ITAT held that in the absence of any exempt income received/receivable section 14A does not apply and accordingly deleted the disallowance made u/s 14A.

LG Chemical India Pvt. Ltd. (ITA NO. 1819/Del/2015)
Delhi ITAT

Allowability of commission paid to AE

Facts: The Assessee has paid commission @10% to its AEs. However, adjustment was made for the reason that the third parties cited by the assessee are from USA. i.e. from a market different from India and hence are not comparable to the assessee.

ITAT ruling:

The Hon'ble ITAT deleted the addition by holding that commission paid by the assessee to AEs is also for services rendered in respect of sales in USA.

Paxar India Pvt. Ltd. (ITA No. 1788/Bang/2013)
Delhi ITAT



Use of segmental financials upheld

Facts: Assessee provides support services to Indian projects of Stanley group. During the year under consideration, assessee performed the function of supervision of project. The AE raised a consolidated bill containing the complete break-up of work done by different parties to the contract.

Assessee had bifurcated its P&L account into two parts, namely, project expenses and non-project expenses. However, adjustment was made for the reason that there are no basis for segregation of expenses

ITAT ruling:

- 01. Rejection of segmentals:
ITAT appreciated the fact that Stanley India

acted as an entrepreneur and had substantial business from non-AEs. Accordingly, the approach of using segmental financials was upheld. ITAT agreed on treating project work as separate cost center and remanded back the matter to the TPO, for determination of ALP.

- 02. Reimbursement of recruitment expenses
ITAT allowed the expense incurred on account of recruitment charges.

**Stanley Consultants Pvt. Ltd. (ITA No. 3336/Del/2012)
Delhi ITAT**

Transfer Pricing adjustment has to be under prescribed method only

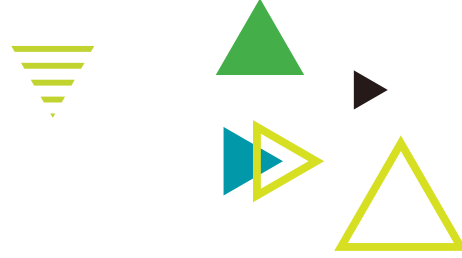
Facts: TPO noted that management fees was unwarranted and determined the ALP as 'Nil'. It was argued that TPO did not adopt any of the prescribed methods to determine ALP of management charges.

ITAT ruling:

The Tribunal held that transfer pricing adjustment

can be made only under any of the prescribed methods as per Rule 10B and remitted the issue back to AO/TPO to determine the ALP by adopting anyone of the prescribed methods.

AB Mauri India Pvt. Ltd. (ITA No. 1970/Mds/2011)





Bengaluru

Selection of comparables

Facts: The assessee is engaged in providing back-office support services to its group companies.

ITAT Ruling:

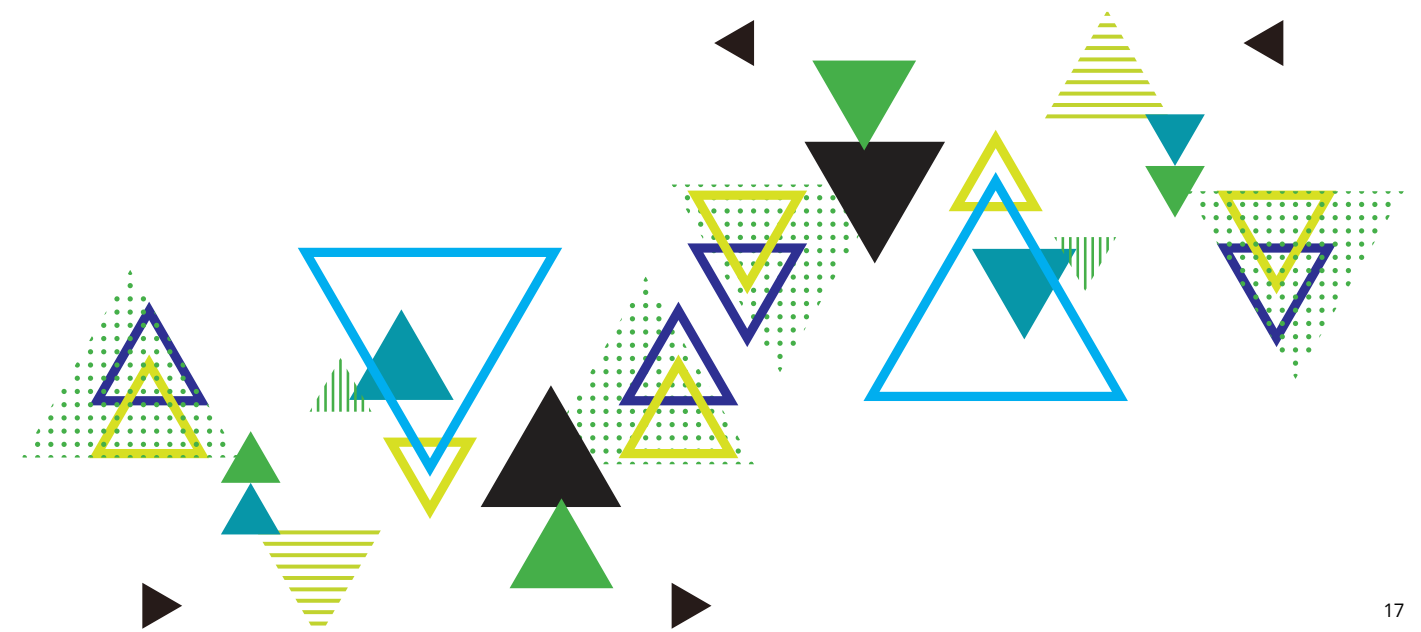
Cost incurred after the seizure of business operations of one of the unit is extra-ordinary in nature and therefore, cannot be included in the margin computation of assessee:
Any expenses incurred after the seizure of operations of one of the unit is extra-ordinary in nature: The ITAT has held that since the one of the unit of the assessee was not functioning during half of the year, the ITAT held that the cost such as personnel cost, rental cost and other expenses is extra-ordinary and therefore, should be excluded

from the margin computation.

Exclusion of companies: The ITAT has held that Accentia Technologies Limited and Fortune Infotec Limited has to be excluded as it is functionally dissimilar to the assessee.

Inclusion of Comparable companies: The ITAT has held that R Systems and Ultramarine are comparable to the assessee and therefore, cannot be excluded.

**Business Process Outsourcing India Private Limited (IT(TP)A No. 238/Bang/2016)
Bangalore ITAT**



Selection of most appropriate method and cost base for computing profitability

Facts: The assessee has contended before the ITAT on following grounds:

- Losses incurred by the assessee was on account of genuine business reasons and not on account of transfer pricing considerations;
- Assessee had availed tax holiday benefits during the year and therefore, there was no reason for the company to shift profits and manipulate the transfer price;
- Assessee had incurred substantial expenditure on account of idle time which had led to under-utilization of capacity during the year under consideration;
- The lower authorities had erred in holding that assessee was an independent service provider.

ITAT Ruling:

The ITAT held that adjustments should be allowed in case of employee cost, depreciation and rental charges. The ITAT observed that there is no dispute on the fact that AY 04-05 was the first year of operations or on the Most of Appropriate Method to be adopted for the benchmarking study. Further, there is no disagreement on the elements of costs that should be considered for computation of gross profit margin. The only contention put forth by the company is that it should be allowed capacity utilization adjustments with respect to depreciation, rental and employee expenses.

Safran Engineering Services India Pvt. Ltd. (ITA No. 750/ Bang/2008)
Bangalore ITAT

Treatment for provisions of warranty and jurisdiction of DRP u/s 154 of the Act

01. Whether DRP can assume jurisdiction u/s 154

The Tribunal held that it is a case of non-consideration of material on record which would constitute a mistake apparent from record. Therefore, the DRP was justified in assuming jurisdiction u/s. 154 of the Act.

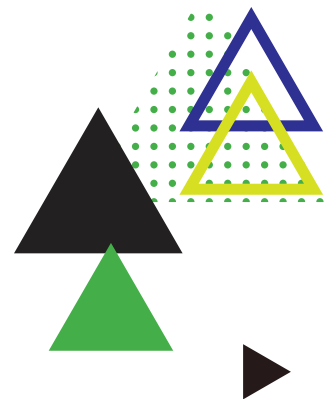
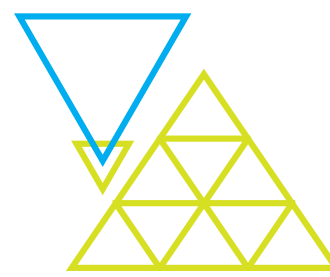
02. Provision of warranty

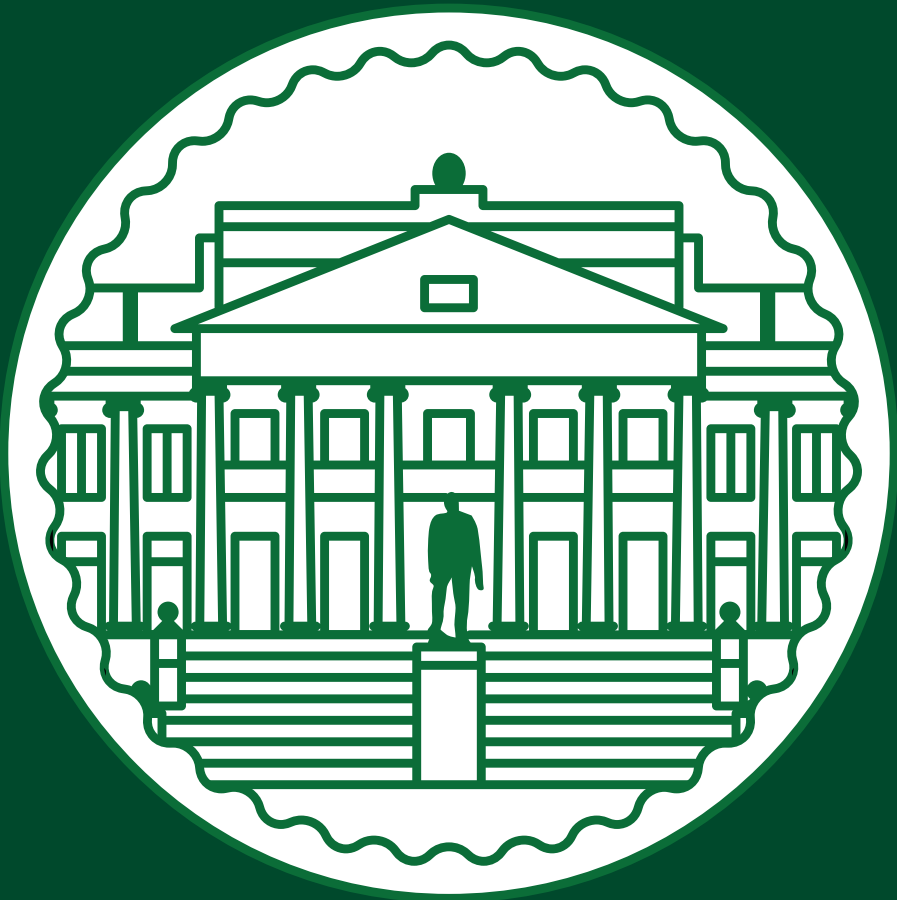
The Tribunal after perusing the chart which depict the provisions created and actual claims made by the Company for the FYs 2008-09 to 2012-13 held that:

A. The provision made is not far in excess of the actual claims made in the succeeding year

- B. It can be presumed that the provision for warranty was created on a reliable estimate basis and based on historical trend.
- C. Further, the ratio of the Hon'ble Supreme Court in the case of Rotork Controls Pvt. Ltd. is squarely applicable.

Stanley Black and Decker India Ltd. (ITA No. 518 & 967/Bang/2015)
Bangalore ITAT





Other Cities

Transfer Pricing adjustment has to be under prescribed methods only

Facts: The assessee purchased raw materials from its AE and paid fees for technical services. The TPO/DRP adopted statistical method to determine the ALP of the international transaction.

ITAT ruling:

ITAT remanded the matter back with the direction to find and adopt the most appropriate method

among the methods prescribed under section 92C of the Act. (adjustment of INR30.29 crores is likely to get deleted in the remand proceedings)

Doowon Automotive Systems India Pvt. Ltd. (ITA No. 1016/Mds/2015)
Chennai ITAT

Selection of comparables and treatment of royalty under TNMM

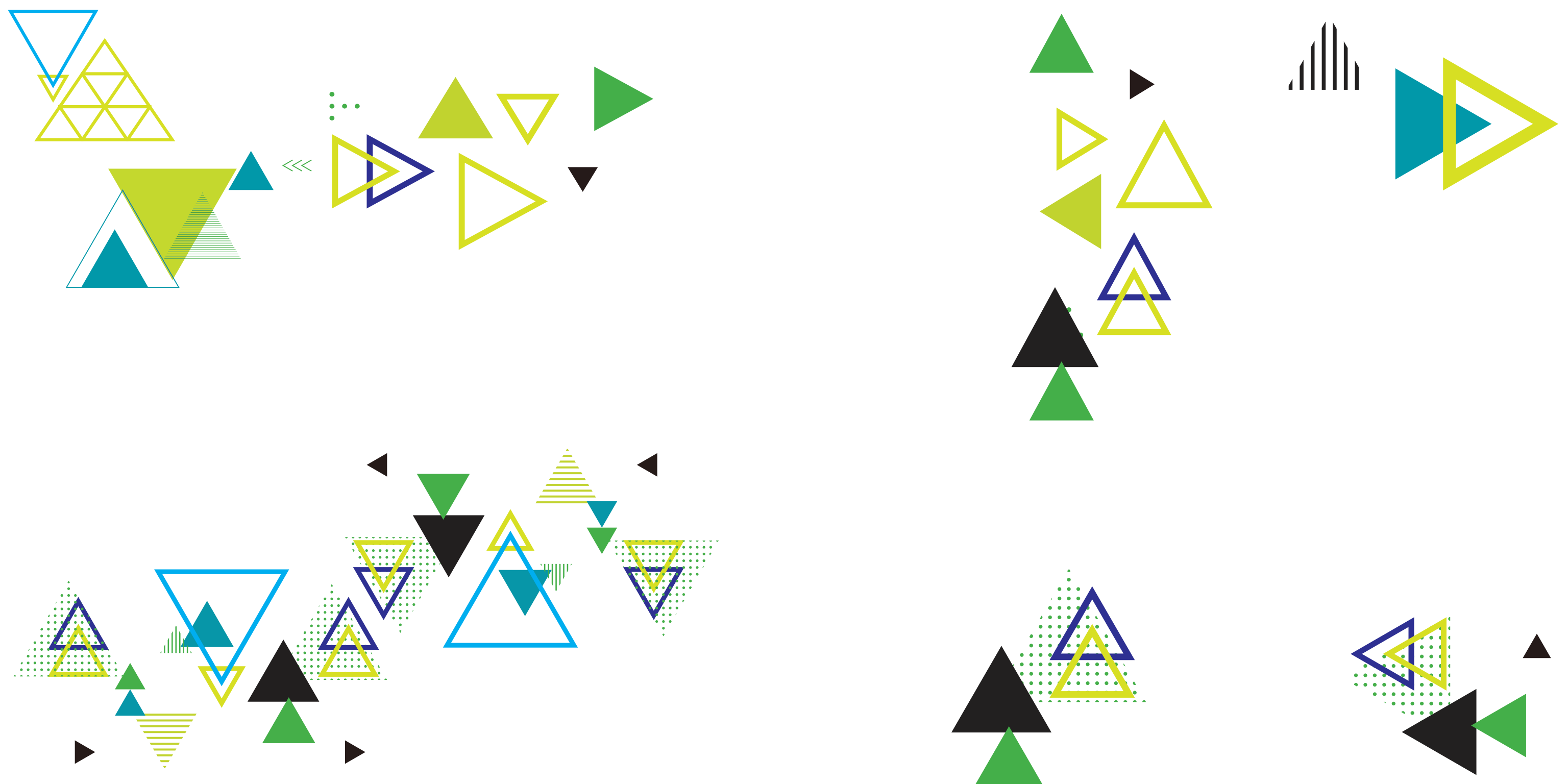
Facts: The assessee is engaged in development and customization of software for its AE. Additionally it sells software licenses to customers for which it pays royalty to its AE.

ITAT ruling:

01. Exclusion/inclusion of comparables
ITAT excluded three comparables based on functional differences and included one comparable namely, Akshay Software Technologies Limited considering it to be functionally comparable.

02. Payment of royalty
ITAT held that payment of royalty was integral to the operations of the assessee and thus it is to be aggregated with the provision of software design and development services under TNMM method.

Labvantage Solution Pvt. Ltd. (ITA No. 617/Kol/2015)
Kolkata ITAT





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