IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 1286 OF 2014

The Commissioner of Income Tax-2 .. Appellant

v/s.

M/s. Welspun Zucchi Textiles Ltd. .. Respondents

Mr. Suresh Kumar for the appellant
Mr. F.V. Irani a/w Mr. Atul Jasani for the respondent

CORAM : M.S. SANKLECHA &
P. R. BORA, J.J.

DATED : 6th JANUARY, 2017

P.C.

1. This Appeal under Section 260-A of the Income Tax Act, 1961 (the Act) challenges the order dated 5th February, 2014 passed by the Income Tax Appellate Tribunal (the Tribunal). The impugned order is in respect of Assessment Year 2008-09.

2. The Revenue urges the following substantial questions of law for our consideration :-

(i) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in directing inclusion of the two

companies in the list of comparables, ignoring the fact that consistently loss making companies and companies having high fluctuations in margins over the years does not reflect comparable conditions?

(ii) Whether on the facts and in the circumstances of the case and despite the prescription of parameters of comparability by Rule 10 B(2) of the Income Tax Rules, 1962, the Tribunal was correct in law, in directing the inclusion of DEPB in turnover and depreciation in net profit for the purpose of profit margin of comparables and assessee?

3. <u>Regarding question (i) : -</u>

(a) The respondent assessee is *inter alia* engaged in the business of exporting bathrobes and towels. During the subject assessment year, the respondent assessee had entered into international transactions and exported bathrobes / towels to its Associated Enterprises (AE). In its transfer pricing study, the respondent assessee determined the Arms Length Price (ALP) of exports to its A.E. by bench marking the price of exports of towels and bathrobes of comparables companies. This included Santogen Exports Ltd. (SEL) and Vanasthali

Textile Industries (VTI) as it was accepted as a comparable for the earlier assessment year. Accordingly, no transfer pricing adjustment was made by the respondent. However, the TPO while arriving at ALP excluded SEL and VTI without assigning any reasons. Consequent to the exclusion of the aforesaid two companies, the TPO enhanced the price of exports made by the respondent assessee to its Associated Enterprise. The Assessing Officer in terms of the order of the TPO enhanced the income on account of International Transactions by Rs.3.96 crores in his order dated 20th December, 2011.

(b) Being aggrieved, the respondent assessee carried the issue to the Commissioner of Income Tax (Appeals) [CIT(A)]. By an order dated 2nd November, 2012, the CIT(A) upheld the exclusion of SEL and VTI done by the TPO in the comparability analysis. This even after holding that no reasons were assigned by the TPO for the exclusion. The CIT(A) upheld the exclusion on the ground that the two companies were not comparables for subject assessment year as they had suffered losses during the year and the respondent had not analysed the reason for the losses. It also stated that FAR (Function, Assets and Risks) analysis of the two companies with that of the appellant had not been done. Therefore, SEL and VTI could not be used as comparables to determine the ALP of the respondent assessee's sales to A.E.

(c) Being aggrieved, the respondent assessee carried the issue in appeal to the Tribunal. The impugned order records the fact that the two companies viz. SEL and VTI which have been excluded from the list of comparables for the subject assessment year were in fact accepted / adopted by the Revenue in the immediately preceding Assessing Year 2007-08. The Tribunal further held that the comparables were not shown to be consistent loss making companies. Further, the impugned order places reliance upon Rule 10B(2) of the Income Tax Rules, 1962 to hold that merely because the comparable has made a loss in one year would not *ipso facto* result in its exclusion from the comparable analysis. Thus, allowed the assessee's appeal.

(d) The grievance of the Revenue before us is that as the two comparables namely SEL and VTI made loss in the subject assessment year, they ceased to be a comparables. On a specific query made by us, Mr. Suresh Kumar for the Revenue does not dispute that the two companies do satisfy the FAR analysis vis-a-vis the respondent. The only reason for their disqualification as comparable is the loss made by them in the subject assessment year.

(e) In the present facts, we find that the Revenue itself had accepted SEL and VTI as comparables for the immediately preceding assessment year i.e. A.Y. 2007-08. Before us also, it is not disputed that the two companies are otherwise comparable as they satisfy the FAR analysis for comparison with the respondent assessee. Further, Rule 10B(2) of the Income Tax Rules itself sets out that for the purposes of determining the ALP, the comparison between an international transaction and an uncontrolled transaction would be judged with reference to the aspects specified therein preceded by the word 'namely'. The Rule 10B(2) of the Rules reads as under :-

> *"2. For the purposes of sub-rule (1), the comparability of an international transaction (or a specified domestic transaction] with an uncontrolled transaction shall be judged with reference to the following, namely:-*
> *(a) the specific characteristics of the property transferred or services provided in either transaction;*
> *(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;*
> *(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;*
> *(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the law and Government orders in force, costs of labour and capital in the markets, overall economics development and level of competition and whether the markets are wholesale or retail."*

(f) From the reading of the above, it would be clear that the bench marks for comparison as specified being preceded by the word 'namely' is exhaustive. Therefore, it is not permissible to include new reference point while making comparison. The aforesaid Rule does not require exclusion of a company from comparability analysis only because it had suffered a loss in a particular year. However, it must be clarified that in the facts of a particular case, a loss could be a symptom to enquire / examine whether it is on account of any of the reference point referred to in Rule 10B(2) of the Rules would get attracted. In any case, the impugned order records a finding that the Revenue has not shown that the two companies are consistent loss making concerns, which would require examination to ascertain, if it is hit by one of the reference points mentioned in Rule 10B(2) of the Rules.

(g) Moreover, one must not loose site of the fact that Revenue has itself accepted SEL and VTI as comparables for the earlier assessment years. Therefore, if the Revenue were of the view that only because of the losses in the subject assessment year the two companies are not comparable, then further examination / enquiry ought to have been done by the Revenue to find out that whether the loss was a symptom of the reference points in Rule 10B(2) of the Rules making it non-comparable. This is more so as the Revenue before us does not dispute that otherwise the two companies are comparable to the respondent assessee even on the parameters laid down in Rule 10B(2) of the Rules. Therefore, if in the present facts, the Revenue seeks to discard the two companies SEL and VTI from the comparables for the subject assessment year, the onus would be upon the Revenue to justify the same.

(h) In the above view, in the present facts, the the view taken by the Tribunal in the impugned order is a possible view. Accordingly, question (i) as proposed does not give rise to any substantial question of law. Thus, not entertained.

4. **<u>Regarding question (ii) : -</u>**

(a) The TPO while arriving at the ALP for the export of bathrobes and towels had excluded the DEPB benefit and depreciation while arriving at the operating profits and total cost respectively of the respondent for the purposes of application of the TNMM method to arrive at ALP. This exclusion of DEPB benefit from profit and depreciation from costs, was done only while arriving at the profits of the respondent assessee and not while arriving at the profit margin of the comparables.

(b) Being aggrieved, the respondent assessee filed an appeal to the CIT(A). In appeal, the CIT(A) by an order dated 2nd November, 2012 held that both the DEPB as well as the depreciation are part of the operating income / expenses respectively. Thus, they have to be taken into account while arriving at the operating profit and total cost before determining the margin on adoption of TNMM method.

(c) Being aggrieved, the Revenue carried the issue in appeal to the Tribunal. By the impugned order, the Tribunal held that so far DEPB benefit is concerned, the issue arose for consideration before it in the case of respondent assessee itself for Assessment Years 2005-06 and 2007-08 and the Tribunal held that the same has to be included for the purposes of arriving at operating profit for the application of the TNMM method. This on the basis that comparison should be made on like to like and similar to similar. So far as the depreciation is concerned, the impugned order of the Tribunal adopted the same reasoning which it had applied while holding that DEPB benefit is includable in arriving at the net profit in its order in the earlier Assessment Years 2005-06 and 2007-08 in the subject assessment year with regard to the claim of depreciation. Therefore, the DEPB was includable in arriving at the operating profit and depreciation was includable while arriving at the total costs of the respondent assessee as the same is not excluded in arriving at the profits of the comparable companies.

(d) We find that so far as exclusion of DEPB benefit in arriving at the operating profit of the respondent assessee is concerned, the order of the Tribunal for the Assessment Years 2005-06 and 2007-08 were appealed by the Revenue to this Court. Mr. Suresh Kumar, learned Counsel appearing for the Revenue very fairly states that this very issue was raised by the Revenue in its appeal before this Court for the earlier assessment years being Income Tax Appeal No.1827 of 2013 relating to A.Y. 2005-06 and Income Tax Appeal No. 171 of 2014 relating to A.Y. 2007-08. However, this Court by orders dated 22nd September, 2015 for A.Y. 2005-06 and 1st July, 2016 for A.Y. 2007-08, dismissed the Revenue's appeal. In the above view, the issue with regard to the exclusion of the DEPB benefit stands concluded by virtue of order of this Court against the Revenue and infavour of the respondent assessee.

(e) So far as depreciation is concerned, we find that the analysis done by the Tribunal to include DEPB benefit to hold it to be an operating revenue to determine operating profit, would be equally applicable in case of depreciation for the purposes of holding it to be an operating expenses to determine operating costs. It must be borne in mind that the depreciation which is incurred by the comparables are not being excluded before arriving at the total cost while applying the TNMM method for the purposes of determining the ALP price of the respondent assessee's export to its Associated Enterprise. The comparison to determine the ALP has to the extent possible has to be done between like to like and similar to similar One sided exclusion would lead to distortion in comparison.

(f) Thus, the question (ii) as proposed does not give rise to any substantial question of law. Thus, not entertained.

5. The appeal is dismissed. No order as to costs.

(P. R. BORA, J.) **(M.S. SANKLECHA, J.)**