IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 01.04.2019

CORAM:

THE HONOURABLE Dr. JUSTICE ANITA SUMANTH

Writ Petition No.1564 of 2017

& WMP No.1512 of 2017

M/s. Madura Coats Private Limited,
New Jail Road, Madurai 625 001
Tamil Nadu,
Represented by its Director, AnilDias ... Petitioner

vs.

1. The Secretary, The Dispute Resolution Panel - 2,
7th Floor, Income Tax Office,
BMTC Building, 80 Feet Road,
Koramangala, Bangalore 560 095

2. The Joint Commissioner of Income Tax,
Transfer Pricing Officer - 2,
Room No.502, 5th Floor, Tower-1,
BSNL Building, No.16 Greams Road,
Chennai 600 006

3. The Deputy Commissioner of Income-Tax,
Corporate Circle 2, Madurai ... Respondents

Prayer:- Petition filed under Article 226 of the Constitution of India praying for the issuance of a Writ of Certiorarified Mandamus to call for the records of the first respondent in F.No.49/DRP-2/BLR/2016-17 dated 16.12.2016, quash the impugned directions and to direct the first respondent to accept the report on the additional evidence of the second respondent and provide opportunity of being heard.

For Petitioner: Mr. Venkataraman, Senior Counsel for Mr. Muthu Venkataraman

For Respondents: Ms. Hema Muralikrishnan, Standing Counsel

O R D E R

Heard Mr.Venkataraman, learned senior counsel, for Mr.Muthu Venkataraman, learned counsel for the petitioner and Ms.Hema Muralikrishnan, learned Senior Standing Counsel for the Revenue.

2. The petitioner challenges an order of Dispute Resolution Panel-2 /the first respondent, dated 16.12.2016.

3. A return of income was filed by the petitioner in terms of the applicable provisions of the Income Tax Act, 1961 ('Act') for the assessment year (AY) 2012-13. The matter was taken up for scrutiny by the Assessing Officer. Since the petitioner had engaged in international transactions with Associated Enterprises (AE) in the previous year, a reference was made to the Transfer Pricing Officer (TPO)/the second respondent, for a proper determination of the Arm's Length Price (ALP) of transactions. The petitioner followed the Transactional Net Margin Method (TNMM) to arrive at the proper ALP on segmental basis. The TPO issued a show cause notice on 04.01.2016 proposing to reject the methodology adopted by the petitioner for the reason that the segmental profit and loss had not been disclosed as part of the financial statements and were also not certified by an external Chartered Accountant.

4. Despite objections filed to the show cause notice, the TPO passed an order dated 27.01.2016 making an adjustment of an amount of Rs.63,47,73,087/- on the reasoning that voluminous documents had been produced by the petitioner in support of its stand and that it was not 'humanly verifiable' with the time available for completion of Transfer Pricing proceedings. He states as much in the order at paragraph 5.11:

> '5.11 The assessee's plea that Rs.56.3 crores consisted of exports to AE cannot be accepted in the absence of a full proof verification with reference to export invoices. It was admitted by the assessee that there are as many as 1193 invoices, accounting for these transactions of export of thread to AEs amounting to Rs.56.30 crores. It is humanly impossible to entertain the said plea in response to the show cause notice and with barely a week to go for completion of proceedings.'

5. Thus the TPO concludes the issue based on circumstantial evidence available, admittedly without proper verification of the export invoices, making an adjustment of a sum of

Rs.63,47,73,086/-. The relevant portion of his order is set out between paragraphs 5.12 and 5.15, extracted below for clarity:-

> '5.12 The assessee's claim has to be considered in the light of the following circumstantial evidences let in by the assessee itself on record:
>
> - There is inconsistency in disclosing the segmental profits. It was claimed to be 17.68% as per Table 7 and as per Appendix C eventually reduced to 9.49% vide submission dated 07.09.2015;
> - Disclosures as per AS 18 in the financials is Rs.286.38 crores and FOB value of aggregate exports disclosed as part of notes 33 to accounts is Rs.259.52 crores.
> - The assessee came up with the explanation only after being enquired into by this office.
>
> 5.13 Taking into account the above set of facts and circumstances, the claim of export turnover to AE reported in the segmental turnover of Rs.342.68 crores is taken to be not representing the export turnover of thread to AEs and has to be substituted by the disclosures reported in Form 3CEB and AS 18.
>
> 5.14 The assessee's claim for benchmarking the AE segment with Non AE segment cannot be entertained for the reasons stated above. In the absence of the same, as proposed in the show cause notice, the segmental results would be benchmarked with reference to external comparables. The assessee did not question the validity of the comparables proposed.
>
> 5.15. This would result in re-computing the profit margin of the AE segment which would call for downward adjustment as under:

Description	Amount (Rs. in crores)
Profit from AE segment	30.69
Less: Revenues overstated	56.30
Revised Loss	(-) 25.61
Profit margin on cost	(-) 7.91%
comparables margin as proposed in the SCN	8.95%

Description	Amount (Rs. in crores)
Downward adjustment	Rs.63,47,73,087

Adjustment template - OP/OC as the PLI

Particulars	Reference	Amount (in INR)
Operating cost	A	3234621949
Arm's Length mark-up	B	8.95%
Arm's length revenue	C=A + (A+B)	3,524,120,613
Revenue as recorded in P & L	D	2863861526
Difference	E = C - D	660,259,
Proportion of AE revenue to total revenue	F	96.14%
Adjustment	G = E * F	634,773,087

6. A draft assessment was made by the AO on 16.03.2016 adopting the Arm's Length Price as determined by the TPO. The adjustment of Rs.63,47,73,087/- was added back to the total income and as against the same, objections were filed before the Dispute Resolution Panel. Along with the objections, a petition was filed for admission of additional evidence. The petitioner explained that the TP adjustment arose from a difference in methodology of accounting followed by the petitioner viz-a-viz that followed by the AE. The petitioner followed the accounting year between 1st of April to the 31st of March of the subsequent year, whereas the AE followed the accounting year 1st January to 31st December of the calendar year.

7. The petitioners' case was that, inadvertently, the sales in the quarter between January to March 2011 had been included in the sales for financial year 2011-12, when for the purpose of computation of Tax, the financial year would only commence from 1st of April 2011. According to the assessee, the amount of Rs.63,47,73,087/- represents the sum total of the transactions occasioned between 01.01.2011 and 31.03.2011 and these invoices were produced before the TPO who, on account of imminent expiry of limitation, did not find time to verify the same.

8. The petition for additional evidence was admitted by the DRP which sought a remand report from the AO on the segmented financials filed. A report was filed on 11.11.2016 and paragraph 4 of report is extracted below:-

'4. Upward adjustment of Rs.63,47,73,087 in AE export segment:-

4.1. Vide para 5.15 in page 9 of his order, the TPO determined this adjustment of Rs.63,48 crores in the AE export segment. As discussed in para 5.9, the main reason for this adjustment was the difference of Rs.56.30 crores between the sales figures as per the financials under AS-18 and Form 3CEB on the one hand (Rs.286.38 crores) and the sales figure as per uncertified segmental statement filed during TP proceedings (Rs.342.68 crores).

4.2. During the hearing on 8-11-2016, it was explained that the sales through 1193 invoices amounting to Rs.56.30 crores relating to the period January-March 2011 was inadvertently considered as sales for the F.Y.2011-12. The invoice-wise break-up for the period January-March 2011 for a total sum of Rs.56.30 crores was furnished by the assessee. Several sample invoices in the three months' period were test-verified and found to match with the summary of sales for Rs.56.30 crores. Thus the assessee could substantiate that Rs.56.30 crore relates to the period January-March 2011 as per the claim made by the assessee in its letter dated 10-11-2016 (copy enclosed).

4.3 The additional evidence filed on 1-9-2016 include segmented financials certified by a cost accountant on 19-8-2016. it is relevant to note that the segmented financials filed during TP assessment proceedings was an uncertified one. But as admitted by the assessee in its letter dated 31st August 2016, the revised segmentation and certification was done after the completion of TP assessment proceedings.

4.4 Vide letter dated 10-11-2016 (copy enclosed) the assessee claimed that corresponding to the mistake in the sales figure for the quarter January-March 2011 being included in the saes for the F.Y. 2011-12, there is also mistake in the cost figures adopted in

> the uncertified segmental financials filed during T.P. assessment proceedings. During the hearing on 8-11-2016 the ARs filed an item-wise break-up for the cost figures adopted by it.
>
> 4.5. The assessee, vide its letter dated 10-11-2016 (copy enclosed) has claimed that "once the audited segment is considered the AE segment of MCPL (10.1%) will be ALP viz-a-viz its non-AE export margins (3.21%) and external comparable margins (8.95%).
>
> 4.6 On facts, the claim of the assessee appears to be correct. Therefore DRP may decide whether the revised segmentation and the certification done after the completion of TP assessment proceedings can be accepted. If accepted then the adjustment of Rs.63,47,73,086 will become NIL.'

9. The conclusion of the AO appears to indicate, on verification of the invoices filed, that the transaction details did tally with the claim of the petitioner. The AO then, in the light of his confirmation of facts, places the matter for consideration before the DRP to decide whether, in principle, the revised segmentation and certification done, post completion of transfer pricing proceedings, can be accepted.

10. The DRP has passed its order on the objections filed by the petitioner on 16.12.2016, rejecting the report of the TPO in full. The DRP states that though the TPO has referred to item-wise break-up for the cost figures, the sales figures as reflected in the segmental accounts will also contain a component of cost, and the report of the TPO does not clarify whether this aspect has been verified and if so what the revised figures would be. In this view of the matter, the TPO's report was recorded as incomplete and the claim of the Assessee rejected. The relevant portion of the order of the DRP is as follows:-

> '2.9 The above report of the TPO has been perused by the panel. In the additional evidence, the assessee claims that the difference amount of Rs.56.30 corres was in fact the domestic sales figures for the quarter January-March of FY 2010-11 which was wrongly considered as sales for the FY 2011-12. A report from the cost accountant dated 19-08-2016 has been submitted by the assessee in its support. It appears, the certification from a cost accountant is intended to

weigh with the TPO as the assessee has claimed that the segmentals submitted during the TP proceedings were not verified by the CA. Further, the TPO has only mentioned in the report that during the hearing on 08-11-2016 the AR filed an item wise break-up for the cost figures adopted by it. It is observed that consequent to the sales figures as submitted in segmentals, corresponding cost figures would also have got included in the same. However, the report of the TPO does not clarify whether this aspect has been verified or not and if verified, what are the revised figures. In view of the cost allocation remaining unverified, the report of the TPO cannot be considered as complete. Therefore, the claim of the assessee that the difference amount of Rs.56.30 crores is the domestic sales of the assessee is not possible to be accepted.'

11. The Dispute Resolution Panel was constituted as an Alternate Dispute Resolution mechanism in 2009 by insertion of section 144C in the Act. The Notes on clauses at the time of insertion of the provision states as follows:

'The subjects of transfer pricing audit and the taxation of foreign company are at nascent stage in India. Often the Assessing Officers and Transfer Pricing Officers tend to take a conservative view. The correction of such view takes very long time with the existing appellate structure.

With a view to provide speedy disposal, it is proposed to amend the Income-tax Act so as to create an alternative dispute resolution mechanism within the income-tax department and accordingly, section 144C has been proposed to be inserted so as to provide inter alia the Dispute Resolution Panel as an alternative dispute resolution mechanism.'

12. The intent and purpose of constituting the DRP, with three high ranking Commissioners that have exclusive jurisdiction for the said purpose, is to provide effective and speedy resolution of transfer pricing disputes. The DRP is thus expected to use every measure possible to resolve a dispute before it. The DRP, in the present case, rejects the petitioners' claim solely on the reasoning that the report of the TPO was incomplete. If at all further information was required, the DRP is expected to have called for the said information to equip itself with the necessary material to come

to a reasoned conclusion. Needless to state, its conclusion will depend upon independent application of mind to all relevant facts and circumstances but such an exercise has to be undertaken in a judicious manner, taking cognizance of all relevant factors.

13. Reference may also be made at this juncture to two relevant notifications/instructions issued by the Central Board of Direct Taxes that throw some light on the role of, and responsibilities expected of the DRP. First is a report of the Committee constituted by the Central Board of Direct Taxes in (OM No.279/Misc./M-26/2016-ITJ (Pt.) dated 05.09.2016 setting out a comprehensive road map to minimise litigations and strengthen ligitation management. The report of this Special Committee in turn refers to another report issued by a Committee set up under the chairmanship of one Ms.Rani Singh Nair (referred to as RSN Committee). The mandate of the latter committee was to study appellate orders and examine the filing of statutory appeals by the Department before various fora.

14. Curiously, though the Committee suggests that departmental resources be devoted and committed to the disposal of pending appeals and the entire system be re-engineered to include global desk practices like Alternate Dispute Resolution (ADR) methodology for the quick and efficacious disposal of litigation, there is no mention of the DRP in this context. How unfortunate! A progressive move has been made to formulate the DRP as a mechanism specifically to address issues of transfer pricing expeditiously and in a balanced and fair manner. The functioning of the DRP is also required to be in tandem with this purpose, addressed at resolving disputes in as non-adversarial a fashion as possible, rather than to confirm an adjustment made, come what may. The latter approach would, in my view, reduce the stature of the DRP to a departmental panel and the purpose of the exercise would be entirely lost.

15. The fact that the DRP has, in the present case, accepted the request to admit additional documents and seek a remand report from the assessing officer can only mean that the panel was of the view that further examination of the issue by the Department was called for. Having done this, the purpose is lost if the exercise is not carried through to its logical conclusion. The remand report of the TPO states that the addition was unwarranted on facts but the DRP reasons that the aspect of ‘cost’ being included in the sales was not examined by the officer. Certainly the DRP is not bound to accept the conclusions of the officer in the report, but the Panel could

well have sought a clarification, or directed the officer to carry out further verification in this regard.

16. In the light of the discussion above, I set-aside the order of the DRP dated 16.12.2016 and direct rehearing of the matter, in regard to the adjustment relating to Rs.634,773,087/-. The DRP will decide the issue de novo, calling for such information as it deems necessary either from the Assessing Officer or the petitioner, and after affording an opportunity of personal hearing to the petitioner. Seeing as the matter pertains to Assessment Year 2011-12, the DRP will conclude the hearing within a period of two months from date of receipt of a copy of this order.

17. The writ petition is allowed in the aforesaid terms. No costs. Consequently, connected WMP is closed.

-Sd/-

Assistant Registrar

// True Copy //

Sub Assistant Registrar

To

1. The Secretary, The Dispute Resolution Panel - 2,
   7th Floor, Income Tax Office,
   BMTC Building, 80 Feet Road,
   Koramangala, Bangalore 560 095
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   Corporate Circle 2, Madurai

+ 1 cc to Mr.S.Muthu Venkataraman, Advocate Sr.No.31237

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PA(CO)

RRI 08/06/2019