M/S Cornell Overseas Private Ltd., New ... vs Dcit, New Delhi on 31 July, 2019

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH : I-1 : NEW DELHI

BEFORE SHRI R.K. PANDA, ACCOUNTANT MEMBER
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No.2395/Del/2011
Assessment Year: 2004-05

DCIT, Circle-3(1), New Delhi,.	Vs Cornell Overseas Private Ltd., B-235, Okhla Industrial Area, Phase-I, New Delhi. PAN: AAACC0034F

CO No.217/Del/2011
(ITA No.2395/Del/2011)
Assessment Year: 2004-05

Cornell Overseas Private Ltd., B-235, Okhla Industrial Area, Phase-I, New Delhi. PAN: AAACC0034F	Vs DCIT, . Circle-3(1), New Delhi.
(Appellant/Cross Objector)	(Respondent)

Assessee by : Ms Vandana Bhandari, Advocate
Revenue by : Shri Sandeep Kumar Mishra, Sr. DR

Date of Hearing : 22.05.2019
Date of Pronouncement : 31.07.2019

ORDER

PER R.K. PANDA, AM:

The appeal filed by the Revenue is directed against the order of the CIT(A)- 20, New Delhi relating to assessment year 2004-05. The assessee has also filed Cross Objections against the appeal filed by the Revenue. For the sake of convenience, these were heard together and are being disposed of by this common order.

2. Facts of the case, in brief, are that the assessee is a company engaged in the business of manufacturing and export of garments. It filed its return of income on 01.11.2004 declaring total income of Rs.1,23,23,444/- after claiming deduction of Rs.35,20,656/- u/s 80HHC. Since the assessee has entered into certain international transactions, the Assessing Officer referred the

matter to the TPO for determination of the arm's length price (ALP). The TPO, during TP assessment proceedings, noted that the assessee has undertaken the following international transactions with its group companies:-

S.No. Description of transaction Method Value (in Rs.)

1. Garments Home Furnishings CPM 37,20,22,974

2. Charge for samples provided for TNMM 13,52,700 various styles

3. Payment of royalty CUP 1,67,07,324

4. Freight Charges recovered CPM 8,28,869

3. After considering the various submissions made by the assessee from time to time, the TPO proposed an upward adjustment of Rs.1,67,07,324/- as the ALP of the international transaction relating to payment of royalty. The Assessing Officer in the body of the assessment order made this addition. Apart from the above, the Assessing Officer also made certain disallowances/additions on account of:

payment of gratuity - Rs.19,44,514/-; depreciation on computer peripherals -

2,17,032/-; income from other sources - Rs.37,82,419, software expenses -

Rs.2,60,500/- and disallowance u/s 14A - Rs.700. He also determined the deduction u/s 80HHC at nil. The Assessing Officer accordingly determined the total income of the assessee at Rs.3,49,93,940/-. The assessee went in appeal and the ld.CIT(A) gave part relief to the assessee wherein he deleted the addition of Rs.1,67,07,324/- on account of ALP. He also directed the Assessing Officer not to exclude the 'sample design and development charges' amounting to Rs.13,52,700/-

while calculating the deduction u/s 80HHC. Further, the ld.CIT(A) directed the Assessing Officer to delete the addition of Rs. 2,17,032/- on account of depreciation on computer peripherals. He, however, upheld the action of the Assessing Officer in making certain disallowances/additions.

4. Aggrieved with such order of the CIT(A), the Revenue is in appeal before the Tribunal by raising the following grounds:-

"1. The Ld. C1T(A) has erred on facts and in law in directing the AO not to exclude the Sample Design and Development charges receipt amounting to Rs. 1352700/- for the calculation of deduction u/s 80HHC ignoring that the assessee failed to file documentary evidence to justify its claim and as per provisions of explanation (baa) of section 80HHC, for computing "profits of business" 90% of sums referred to in

clauses (iiia) to (iiie) of section 28 or any receipt by way of brokerage, commission, interest, rent, charges of any receipt of similar nature included in such profits have to be deducted from the profits and gains of business or profession. Reliance is also placed on the decision of Hon'ble 1TAT in Beekay Engineering & Casting Ltd. vs. JC1T A. No. 4961 (Del) of 2002.

2. In the facts and circumstances of the case, the Ld.CIT(A) has erred in law and on facts in deleting addition of Rs.217032/- on account of disallowance of extra depreciation on computer peripherals/accessories ignoring that as per the IT Rules 60% depreciation is allowable only on computer and computer software and not on computer peripherals and accessories.

3. The Ld. CIT(A) has erred on facts and in law in deleting addition of Rs.

16707324/- on account of Arm's Length Price u/s 90CA(3) ignoring the fact that each International transaction must be benchmarked separately. The approach of amalgamating transactions should be followed only where the transaction are closely interlinked. The TPO has brought out that in the assessee's arrangement with its AE, the rewards of the marketing and fruits of intangible would be enjoyed by the AE. Hence, the assessee need not make a payment for the same. Ld. CIT(A) has erred in ignoring this fact.

4. The appellant craves leave for reserving the right to amend, modify, alter, add or forego any ground(s) of appeal at any time."

5. The assessee has raised the following grounds in the Cross Objection:-

"1. DEPB Credit Ld AO has erred in interpreting the provisions of section 80HHC as amended retrospectively by the Taxation Laws Amendment Act 2005 and hence on non production of evidence required by third proviso to section 80HHC(3) ld AO has wrongly added entire sale receipts of DEPB amounting to Rs.17,308,013/- ; whereas profit realized on transfer of DEPB is only Rs 5,48,411/-, therefore amount subject to add back under third proviso to Section 80HHC(3) is Rs 5,48,411/-.

2. Contribution to Group Gratuity Scheme of LIC Respondent has contributed Rs 19,44,514/- to Group Gratuity Policy of LIC of India; Id AO has disallowed the same u/s 36(l)(v) on the ground that the trust to which contribution is made is not approved by the department.

The expense since incurred wholly and exclusively for the purpose of business should be allowed as deduction u/s 37(l)/36(l)(v) of the Income Tax Act

3. Interest Income Ld AO has erred in treating Interest amounting to Rs 37,82,419/- on Fixed Deposits created for the purposes of securing bank overdraft facility for export business, as Income for other sources in place of business income for the

purposes of computing deduction u/s 80HHC Hence the fixed deposit is inextricably linked with the export business of the appellant, and therefore while working out the deduction under section 80HHC of the IT Act, appellant has considered these amounts as part of business profit and not as income from other sources."

6. The assessee has also raised the following additional grounds in the Cross Objection:-

"1. That the AO & CIT(A) erred on facts and in law in applying sec 80HHC as amended by Taxation Laws Amendment Act, 2005, with retrospective effect, and failed to appreciate that in view of the decision of Hon'ble Supreme Court in CIT v Avani Exports [2005] 232 Taxman 357 (SC) and Delhi HC in the case of Pawan Kumar Jain v Union of India [2014] 224 taxman 169 (Delhi) the amendment is applicable only prospectively, therefore entire disallowance by AO & upheld by the CIT(A) is bad in law and deserves to be deleted.

2. Without prejudice, the assessee should be allowed deduction u/s 37(1) of the gratuity contribution made to LIC group gratuity scheme (Rs.19,44,514/-) or the amount of gratuity actually paid (Rs.6,47,678/-) to employees during the year as the expense is incurred wholly and exclusively for the purpose of business.

3. The CIT-A erred on facts and in law in restricting the rate of depreciation to 25% on UPS and failed to appreciate that depreciation @60% is available on UPS."

7. After hearing both the sides, the additional grounds raised by the assessee in the Cross Objection are admitted since all material facts are available on record and no new facts are required to be investigated.

8. In ground of appeal No.3 the Revenue has challenged the order of the CIT(A) in deleting the addition of Rs.1,67,07,324/- on account of ALP of the international transaction.

9. Facts of the case, in brief, are that the Pike River Corporation (PRC) is a body incorporated under the laws of State of Vermont, United States of America. This is an AE of the assessee company and is engaged in the business of designer's garments which include study of latest fashion trends in the market, developing styling the market and conceptualizing designs. It is the owner of brand in the name of 'Apprel Cornell' The trademark is patented with office of United States. PRC has entered into agreement with Cornell Overseas Pvt. Ltd. (the assessee) for permitting use of trademark and providing technical know-how. The details of royalty payment on various services are as under:-

a) For use of trademark, trade name etc., an amount equal to 2% of all net sales of products made by the Indian company.

b) For services to be rendered by PRC, for preparing designs and drawings and handling them over, an amount equal to 2% of all net sales of products made by the Indian company.

c) For services to be rendered by PRC for sending a team of professional designers to India an amount of US $ 750/- per diem for the services of a senior designer and US $ 500/- per diem for the services of a junior designer.

10. On being confronted by the TPO, it was submitted by the assessee that the assessee has immensely benefited by entering into the agreement with PRC. The TPO noticed that there were two agreements which were entered on 2nd April, 2003 with its AE. In the first agreement, which is in respect of trade mark, the TPO noted that as per Article 3.3 of the said agreement, the AE shall have a right to control how each product of the assessee is to be manufactured, labeled and packaged. No marks are allowed to be applied on any other product which does not have prior approval of the AE. Article 4.1 of the agreement places a further condition that the assessee will supply free of cost samples to the AE which are returnable at the cost of assessee. He noted that the agreement permitting use of mark is very restrictive and it becomes of no use when the substantial sale of the goods manufactured by the assessee are to its other AEs. According to him, exploitation of trade name and similar intangible is not possible when the sales are to the related parties. So far as the second agreement is concerned i.e., regarding technical know-how, he observed that the same is regarding sharing of technical information/data/documentation. Article 2.2 of the said agreement puts an exclusive restriction on the assessee company to the extent that it can manufacture top quality products designed, manufactured, promoted, advertised and sold according to the highest standard of industries so as to maintain, enhance and protect the image and prestige of the AE. This, according to the Assessing Officer, shows that the agreement is restricted about the manufacturing and further activities of the assessee. According to the TPO, in view of Article 3.1.2 of the agreement, the assessee is under obligation to prepare and submit to the associated enterprise designs for prior written approval in the form of products to be manufactured, sold or distributed which shall include approval of workmanship material, fabric and colours. The TPO noted that the design of the product manufactured is provided by the AE, the details of fabric to be used is prescribed by the AE, the technology and the process to be employed is prescribed by the AE, the place at which the logo is to be fixed is conveyed by AE and the mode of delivery is determined by the AE. The AE having common control through Cornell Shareholders exercises full control over the affairs of the assessee company. Therefore, he inferred that the assessee company was a mere contract manufacturer of its overseas related parties. The risk and reward matrix in respect of a contract manufacturer is entirely different from an independent entrepreneur. According to him, an independent entrepreneur may require technical know-how, logo, market access, designs and help of an expert whereas the contract manufacturer requires none out of the above. Rejecting the various explanations given by the assessee and observing that the assessee company is making its total sales to its related parties and the benefit of producing quality garments is reaped by overseas entity, the payment of charges for royalty or technical know-how do not conform to arm's length principle. In view of the above, he proposed an upward adjustment of Rs.1,67,07,324/-.

11. In appeal, the ld.CIT(A) deleted the addition so made by the A.O./TPO by observing as under:-

"I have carefully considered the facts of the case and submissions filed by the appellant. The facts and the issue raised under this ground are similar to issue decided in the favour of appellant during A.Y. 2003-04. Appellant is not a contract

> manufacturer. The royalty payment is at arm's length; as Royalty is included in the sale price of the garments it is automatically benchmarked at arm's length.
>
> The international transaction of Export of garments is benchmarked at arm's length using Cost Plus Method. The royalty expense has been reduced to arrive at gross profit for the purposes of benchmarking international transaction of Export of garments. The gross profit margin earned by the appellant is 15.64% whereas comparables have earned gross margin of

12.73%. This has been acknowledged by the TPO vide para 2.3 of his order dt 21.11.2006 accordingly the TPO has held that the international transaction is at arm's length. Since the international transaction of Royalty and Export of garments has been clubbed to arrive at the gross profits, if the gross profit margins are at arm's length automatically it follows that both the international transactions are at arm's length.

It has been discussed in the case of ACIT v. Sona Okegawa Precision Forging Ltd. [2010-TII-41-ITAT-DEL-TP] that "royalty paid by the taxpayer, computed on the basis of sales made to the associated enterprise, was at arm's length given that the taxpayer was not a contract manufacturer. Further, the amount paid as a royalty was recovered by the taxpayer from the associated enterprise as a part of the sale price; thus, the transaction was revenue neutral."

As a result this ground of appeal of the appellant is allowed."

12. Aggrieved with such order of the CIT(A), the Revenue is in appeal before the Tribunal.

13. The ld. DR strongly objected to the order of the CIT(A) in deleting the addition made by the Assessing Officer. Through his oral arguments as well as detailed written synopsis he submitted that the TPO made TP Adjustment of Rs. 16707324/- on account of payment for different intra group services and use of trade mark to M/s Pike River Corporation (AE) by computing ALP at NIL. The ld. CIT(A) allowed the appeal of the assessee on the ground that the Royalty Payment is included in the sales of garments to AEs and the TPO has not taken any adverse view. Thus it follows that the Royalty transactions are also at arm's length. The above argument is highly erroneous and non-judicious. The Ld. CIT(A) has effectively held that the international transactions can be benchmarked at entity level and there is no requirement of benchmarking each of the international transactions separately which is against the specific provision of the Income Tax Act. It has been held in plethora of decisions that each international transaction is needed to be benchmarked separately unless they are inextricably linked. Reference is made to the judgement of Hon'ble Punjab and Haryana High Court in case of Knorr-Bremse India (P.) Ltd. v. Assistant Commissioner of Income-tax [2015] 63 taxmann.com 186 (Punjab & Haryana). In this case, even the assessee has separately benchmarked the "Sales of Garments" and "Royalty Payments" in its TP Study Report and has even applied different methods - CPM for the "Sales of Garments" and CUP for the "Royalty Payments". The Ld. CIT(A) also relied on the judgement of Sona Okegawa Precision Forgings (ITA No. 4781/Del/2010). The above judgement is clearly not applicable in the present case as in that case it is clearly mentioned in the order itself that bulk of goods are sold to independent parties

unlike the case of the assessee where 100% of the goods are sold to the AEs. Besides the above, it is evident that the assessee is a "Contract Manufacturer"

> and is manufacturing the Garments on the strict instructions and specifications given by the AEs. 100% of the sales are made to the AEs. This is a unique case where the AE is charging Royalty on the sales made to itself. It is pertinent to mention that the assessee is charging a markup @30% on the direct cost on the sales made to the AEs but in that computation Royalty Payments are not included.
>
> In the TP Study the assessee has compared the rate of royalty with the rate of royalty approved by the RBI i.e. 8% and has held that since it is paying only around 5% hence the transaction is at Arm's Length.

14. The ld. counsel for the assessee, on the other hand, while supporting the order of the CIT(A) deleting the addition, submitted that the Tribunal, in assessee's own case for the preceding assessment year, has deleted such addition. He submitted that the royalty payments applicable during assessment year 2004-05 i.e., w.e.f. 1st April, 2003, is same as that of the earlier year except to the extent that during the current year the assessee had split the royalty agreement into two separate agreements i.e., one for technical know-how and assistance agreement and the second for use of trade mark made under the label of corporate agreement. He submitted that the terms and conditions of the agreements are same as that of royalty agreement applicable during assessment year 2002-03 and 2003-04. The agreement effective from 01.04.2001 as applicable during assessment year 2002-03 and 2003-04 was a simple agreement which dealt with both technical know-how assistance and trade mark. He submitted that the TPO treated the assessee as a full-fledged manufacturer in assessment year 2002-03. Royalty payment under the same terms of the agreement has been accepted at ALP by the TPO in assessment year 2002-03. He submitted that the case for assessment year 2002-03 was reopened by the Assessing Officer u/s 147 on the ground that royalty is a capital expenditure. The Assessing Officer had accepted that the assessee had derived benefit under the agreement and the only dispute was whether the expense is a capital expenditure or revenue expenditure. The assessee went to the Tribunal and the Tribunal vide order dated 30th March, 2016, held that royalty expenses is a revenue expenditure. Similarly, for the assessment year 2003-04, the Tribunal, following the principle of consistency, held that the assessee had derived benefit under the royalty agreement and royalty payment during assessment year 2003-04 was at arm's length. Further, royalty paid to PRC, USA has been assessed in its hands in India and tax has been paid by PRC, USA thereon. He submitted that the transaction is revenue neutral as royalty expenses are embedded in the sale price. He submitted that the functions, assets and risk profile of the assessee remain the same in the current year as in the previous year, therefore, treating the assessee as a contract manufacturer in the current year despite same underlying facts amounts to taking inconsistent stand year on year. Relying on various decisions, he submitted that the TPO/A.O. were not justified in making the addition. He further submitted that the TPO referred to certain clauses of the agreement to drive home the point that the assessee is a contract manufacturer. However, these clauses were very much there in the earlier years too and the order of the TPO in 2004-05 is similarly worded as that of in the assessment year 2003-04. Since the Tribunal has already considered the identical issue in the assessment year 2002-03 and has

given relief to the assessee, therefore, this being a covered matter in favour of the assessee the order of the CIT(A) should be upheld and the ground raised by the Revenue should be dismissed.

15. We have considered the rival arguments made by both the sides and perused the orders of the A.O./TPO and the CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before us. We find the assessee, in the instant case, is a manufacturer and exporter of ready-made garments. The TPO disallowed the royalty paid by the assessee to its AE amounting to Rs.1,67,07,324/- on the ground that the assessee is a contract manufacturer of its AE and is not deriving any benefit from payment of royalty and, therefore, he should not have paid any royalty. We find the ld.CIT(A) deleted the addition made by the A.O./TPO, the reasons for which have already been reproduced in the preceding paragraphs. It is the submission of the ld. counsel for the assessee that the terms and conditions of the agreement for the current year are identical to the terms and conditions of the agreement for the preceding two assessment years. The only difference is that during the current year, the assessee has split the royalty agreement into two separate agreements i.e., (i) technical know-how and assistance agreement; and (ii) use of trade mark made under the label of corporate agreements. According to him, the terms and conditions of the agreement are same as that of the royalty agreement applicable during assessment year 2002-03 and 2003-04. It is also his submission that the transaction is revenue neutral as royalty expenses are embedded in the sale price. The functional, assets and risk profile of the assessee also remained the same in the current year. We find merit in the above argument of the ld. counsel. A perusal of the royalty agreement w.e.f. 1st April, 2003 shows that the terms and conditions of the agreement are same as that of royalty agreement applicable during assessment years 2002-03 and 2003-04. The agreement effective as on 01.04.2001 as applicable during assessment years 2002-03 and 2003-04 was a single agreement which dealt with both technical know-how and assistance and trade mark whereas in the current year the assessee had split the royalty agreement into two separate agreements i.e., technical know-how and assistance agreement and use of trade mark made under the label of corporate agreement.

16. We find the Tribunal in assessee's own case for assessment year 2003-04, vide ITA No.2166/Del/2011, order dated 2nd May, 2017 has decided an identical issue and dismissed the appeal filed by the Revenue on this issue by observing as under:-

> "42. We have considered the submissions of both the parties and carefully gone through the material available on the record. In the present case, it is not in dispute that the assessee entered into an agreement with its AE i.e. Pike River Corporation (PRC), USA under "Technical Assistance, Trade-Mark and Royalt y Garments" for use of technical know-how, designs, logos, trade names, and trade-marks. The royalty was paid @ 5% on net sale of products manufactured with the technical assistance of PRC, USA. The royalty agreement was effective from 02.04.2001 and for the assessment year 2002-03, the royalty payment was accepted by the TPO at arm's length. However, the AO considered that the royalty was a capital expenditure and not the revenue expenditure. Being aggrieved the assessee carried the matter to the ITAT in ITA No.4739/Del/2010 wherein vide order dated 30.03.2016 it has been held as under:

"8. Ground No.2: The assessee has debited sum of Rs.1,26,58,195/- on account of royalty payment, which has been disallowed by the Assessing Officer on the ground that the said amount is capital in nature as the assessee in its reply has himself used the words "product from the design and know-how". Ld. A.R. contended that the royalty payment has been made only for the purpose of running the business being an integral part of the profits earning process and not for acquiring an asset / enduring advantage.

8.1 To decide the controversy at hand, relevant provisions of agreement dated 02.04.2010 made between the assessee company with Pike River Corporation holding all the rights to licencee in name of 'April Cornell Label' and several other trade names. Undisputedly, the assessee company is engaged in manufacturing and sales of clothing, apparels, house hold products and related merchandise and entertainment agreement with Pike River Corporation to the following effect:-

"2. 1 The LICENSOR hereby grants to the LICENSEE a non-transferable, right and license within the TERRITORY:

a. To manufacture and/or cause to be manufactured and to distribute and/or sell products reproduced from designs created by LICENSOR or prepared by LICENSEE and approved by LICENSOR under the terms and conditions hereinafter set forth (the "Products"); The LICENCEE shall not at any time, have the right to manufacture the Products reproduced from the designs created by the LICENSOR outside the territory either directly or indirectly, without the prior, written consent of the LICENSOR.

b. To use LICENSOR's know-how and designs, in connection with the manufacture and sale of the Products;

2.2 The License herein granted shall only extend to the top quality products, designed, manufactured, promoted, advertised and sold according to the highest standards of the industry and in full compliance with the terms and conditions Hereof, so as to maintain, enhance and protect the image and prestige associated with the Name.

3.1 LICENSEE shall only use the Name, the Label and the Marks as authorized and, provided herein and in full compliance with the terms and conditions hereof and only for the duration of this Agreement. The license herein granted shall confer unto LICENSEE no proprietary rights whatsoever in the name or "APRIL CORNELL", the Marks or the goodwill now attached or hereafter to become attached thereto.

> 4.6 (LICENSEE, its agents and its employees shall keep any and all elements of LICENSOR's know-how strictly confidential and w111 refrain from using such (know-how for any purpose other than the purpose of this Agreement. Upon termination thereof for any reason whatsoever, LICENSEE will return to LICENSOR any and all elements of LICENSOR's know-how fixed in a tangible medium of expression."

8.2 A perusal of the provisions of Agreement (supra) goes to prove that the assessee company has made the royalty payment to manufacture/sell products designed by licensor and also used its name, the label and the mark and has also availed technical assistance having limited right during subsistence of agreement for the aforesaid technical knowhow / use of name label and mark and technical assistance of the licensor. Assessee paid 5% of the net sales of the product during each year of the agreement.

Now, the question arises for determination is, "as to whether payment of Rs.1,26,58,195/- on account of royalty payment is to be capitalized or is revenue expenditure?"

> 8.3 A perusal of the terms and conditions of agreement (supra) goes to prove inter alia; that the same was made for a specific period of seven years i.e. w.e.f. 01.04.2001 to 31.03.2008; that the assessee was made to pay 5% of the net sales of the product during such term and year of agreement for the use of knowhow, label and mark and to avail of consequent technical assistance; that only non-

transferable and limited rights to use the aforesaid know how etc have been granted to the assessee; that as per terms of agreement, assessee was made to return to the licensor any and all the elements of licensor's know how fixed in tangible medium of expression; that this payment of royalty was to be made on the basis of net sales, meaning thereby, while sales is directly linked with day to day running of business and as such expenditure on account of royalty payment cannot be considered as capital expenditure.

> 8.4 Ld. A.R. in order to support the impugned order, relied upon the judgement cited as CIT Vs Goodyear India Ltd. (2010) 110 Taxman 59 (Del.). Hon'ble

Jurisdictional High Court in the judgement in case of Goodyear India Ltd. (supra) held as under:

> "Section 37(1) of the Income-tax Act, 1961 - Business expenditure - Allowability of - Assessment year 1984-85 - Assessee-company manufacturing and selling automotive tyres and tubes paid certain amount to foreign company as consideration for agreeing to provide technical know-how for manufacture of extra large OTR tyres - Whether findings recorded by Tribunal that agreement was not made for manufacturing of an entirely new product, that consideration was paid for betterment of product and that assessee had only enlarged range of its existing products were pure findings of fact, and those facts having attained finality, expenditure incurred by assessee was

revenue in nature - Held, yes 8.5 Ld. A.R. also relied upon the judgements cited as CIT Vs IAEC (Pumps) Ltd. 232 ITR 316 (S.C.), CIT Vs IAEC (Pumps) Ltd. 110 ITR 353 (Mad.), CIT Vs Steel Plant (P) Ltd. 17 Taxman 301 (Bom.) and CIT Vs Southern Pressings (P) Ltd. 125 Taxman 714 (Mad.). By applying the ratio of judgements cited above relied upon by the Ld. A.R., to the facts and circumstances of the present case, we are of the considered view that when the expenditure on account of payment of royalty have been paid by the assessee for having access to the technical knowhow, that too for a limited period, the payment was made as a licensee @ 5% of net sales of the product for making use of the knowhow, label and mark and technical assistance and it has not a right to retain the knowhow, mark or label as absolute owner, such an expenditure cannot be capitalized and the same are revenue expenditure. Consequently, ground No.2 is determined against the revenue."

43. In the present case, it is not brought on record that the aforesaid decision of the ITAT has been reversed by the higher form, therefore, by keeping in view the principle of consistency, we are of the confirmed view that the ld. CIT(A) was fully justified in deleting the addition of Rs.1,57,35,495/- made by the AO, particularly, when the benefit derived under the agreement dated 02.04.2001 was not doubted by the TPO and the assessee b y using the technical know-how assistance and designs received under the said agreement was manufacturing the finished products which were sold to the AE as well as to the other parties.

Therefore, the assessee derived benefit under the royalty agreement and it was accepted by the AO for the assessment year 2002-03. However, the only dispute raised by the AO in the said assessment year was as to whether the royalty payment was a capital expenditure or revenue expenditure. The said dispute has been settled by the ITAT vide aforesaid referred to order dated 30.03.2016 and it was held that the royalty payment was revenue expenditure and not the capital expenditure. In the present case, the royalty expenditure by the assessee was fully and exclusivel y incurred in the regular course of business and after incurring this expenditure the assessee declared profit @19% which was better than the GP rate of 12 & 16% declared by the comparables.

Therefore, it was at arm's length and the addition made by the AO was not justified which has rightly been deleted by the ld. CIT(A). We, therefore, considering the totality of the facts, do not see any valid ground to interfere with the findings given by the ld. CIT(A).

44. In the result, appeal of the department is dismissed."

17. We further find some force in the argument of the ld. counsel for the assessee that the transaction is revenue neutral as the royalty expenses are embedded in the sale price from the AEs to whom goods are sold and pays to other AE i.e., PRC, USA. The price to be charged to buyer is determined on the basis of cost plus mark up. Further, the assessee is consciously recovering royalty from AEs by including it in the price quoted to the buyer and royalty is also part of cost of production and, therefore, arm's length nature of expenses is established while benchmarking the international transaction of export of sales. We also find force in the argument of the ld. counsel for the assessee that the agreements with PRC, USA are for providing technical know-how and allowing

use of trade names and trade marks by PRC, USA to the assessee and not a contract manufacturing agreement and, therefore, the action of the TPO in re-writing the agreement is not permissible in law. Further, for the purpose of computing the ALP on export garments, the assessee has compared itself with companies which are full-fledged risk bearing manufacturers, a comparison which has been accepted by the TPO. Hence, the TPO has himself acknowledged that for the purpose of manufacture and export of garments, the assessee is a full-fledged manufacturer and not a contract manufacturer. The TPO has also accepted the functional, assets and risk profile of the assessee given in the TP documentation which is that of full-fledged risk bearing manufacturer. We find from para 3.5 of the order that the TPO has mentioned that 'the contract manufacturer does not carry the risk of marketing and, therefore, is not worried about the latest trends in the market, this risk is borne by the entity providing work to the contract manufacturer.' However, the assessee in its TP report has clearly mentioned that the assessee is undertaking market risk as it trades in open market condition and bears risk of excessive supply, presence of competitors, risk of advent of new business in markets, etc., which is evident from the TP study report and at page 119 of the paper book. The same reads under:-

> "c. Market Risk Since Cornell Trading buys from unrelated parties in India as well, all risks associated with market e.g. excessive supply, presence of competitors, new products etc., and low prices by unrelated enterprises are to be borne by COPL."

18. We further find the assessee during the impugned assessment year has exported to non-AEs as well as AEs and, therefore, it is factually incorrect on the part of the TPO that the sale of the entire finished product is to the AE. From the various submissions made by the assessee, we find that:

> a) The assesse purchases raw material and semi-finished goods from third parties on its own behalf and not on behalf of AEs.
>
> b) The assessee transacts with AEs on principal to principal basis in open market conditions.
>
> c) The assessee is free to manufacture and sell to outside world as there is no restriction, if assessee would get better price from unrelated parties, then assessee would sell to unrelated parties. The assessee has in fact sold to third parties during the year, which has increased substantially in subsequent years.
>
> d) There is no guarantee/assurance from AEs that they will purchase entire production from assessee.
>
> e) Further, the assessee is not guaranteed any remuneration which is the hall mark of the relationship between contract manufacturer and the principal.
>
> f) The assessee is free to market its products and develop its own designs.

g) The buyer AEs have no say or control of any nature on decision of volume of production, terms of sale and inventory etc.

h) The contract manufacturer does not take Bad Debt risk, whereas assessee has taken Bad Debt risk. In future years, the appellant has had bad debts and same have been accounted for in its books.

19. In view of the above discussion and considering the fact that the Tribunal in assessee's own case in the immediately preceding assessment year has deleted the adjustment made by the A.O./TPO on account of payment of royalty, therefore, we uphold the order of the CIT(A) on this issue and the ground raised by the Revenue on this issue is dismissed.

20. Now, we take up ground of appeal No.2 by the Revenue and the additional ground No.3 in the Cross Objections which are correlated.

21. Facts of the case, in brief, are that the Assessing Officer noted that the assessee has claimed depreciation @ 60% on computer accessories and peripherals, namely, UPS and printers. According to the Assessing Officer as per the depreciation rate mentioned in Appendix I (Rule 5 of IT Rules) only computers and computer software were entitled to depreciation @ 60%. He, therefore, recomputed the depreciation and restricted the same to 25% on computer accessories and peripherals as against 60% claimed by the assessee.

22. In appeal, the ld.CIT(A) allowed depreciation @ 60% on printers. However, she restricted the same to 25% on the UPS.

23. Aggrieved with such order of the CIT(A), the Revenue is in appeal before the Tribunal and the assessee has raised the ground in the Cross Objection.

24. After hearing both the sides, we find the issue relating to depreciation on computer peripherals, namely, printers and UPS at 60% stands decided in favour of the assessee by the coordinate Benches of the Tribunal where it is being consistently held that printers and UPSs are integral part of the computer system and are entitled to depreciation @ 60%. We, therefore, uphold the order of the CIT(A) in allowing depreciation @ 60% on computer peripherals and reverse the order of the CIT(A) in allowing 25% depreciation on UPSs as against 60% claimed by the assessee. Thus, the ground raised by the Revenue on this issue is dismissed and the additional ground raised by the assessee in Cross Objections is allowed.

25. Ground of appeal No.1 by the Revenue and Ground No.1 of CO by the assessee as well as the additional Ground No.1by the assessee relate to the order of the CIT(A) in modifying the order of the Assessing Officer in allowing deduction u/s 80HHC of the IT Act.

26. Facts of the case, in brief, are that the Assessing Officer, during the course of assessment proceedings, noted that the assessee has shown total export sale of Rs.38.45 crores and claimed deduction u/s 80HHC of the Act amounting to Rs.35,20,656/-. He noted that the export incentives

included Duty Drawback of Rs.2,05,68,726/- and DEPB of Rs.1,73,08,013/-. Further, the assessee has also shown to have received interest, dividend, sample design and development charges, scrap sale etc., totaling to Rs.60,54,861/-. He noted that the sample design and development charges received by the assessee during the year was Rs.13,52,700/- which was included in the profits and loss of business derived from export activity for deduction u/s 80HHC of the Act. Similarly, scrap sale and sample design and development charges and licence fee amounting to Rs.22,65,442/- was not considered for computation of total turnover. Since the export turnover of the assessee exceeded Rs.10 crore, he held that the amendment brought by the Taxation Laws (Amendment) Act, 2005 which is effective from 01.04.1998 is applicable to the assessee. He, therefore, confronted the same to the assessee as to why the interest income amounting to Rs.37,82,419/- be not treated as 'Income from other sources' and as a result be taken out from the computation of deduction u/s 80HHC of the Act; the sample design and development charges received be not excluded from the export turnover; and why the DEPB be not excluded while computing the deduction u/s 80HHC. Rejecting the various explanation given by the assessee and following various decisions, the Assessing Officer held that the interest income earned by the assessee is assessable under the head 'Income from other sources' and does not form part of the 'Profit and gains of business or profession' and even 10% of such interest cannot be considered for 80HHC deduction. So far as the DEPB is concerned, he held that since the assessee had the option to choose DEPB and Duty Drawback and since the rate of DEPB is more than that of Duty Drawback, therefore, the benefit of DEPB cannot be granted to the assessee while computing deduction u/s 80HHC. So far as sample design and development charges received amounting to Rs.13,52,700/- is concerned, the Assessing Officer, following the order for assessment year 2001-02, held that the same is receipts of similar nature including any 'such profits' referred to in Explanation (baa) and, therefore, such income in principle is excludible to the extent of 90% out of profits of the business in terms of Explanation (baa).

27. In appeal, the ld.CIT(A) directed the Assessing Officer not to exclude the sample design and development charges receipts amounting to Rs.13,52,700/- while calculating deduction u/s 80HHC. She further directed the Assessing Officer to exclude DEPB receipts amounting to Rs.1,73,08,013/- for the calculation of deduction u/s 80HHC. She, however, upheld the action of the Assessing Officer in treating the interest income of Rs.37,82,419/- earned on fixed deposits as 'Income from other sources' for the purpose of computation of deduction u/s 80HHC.

28. We have heard the rival arguments made by both the sides and perused the orders of the authorities below. So far as calculation of deduction u/s 80HHC on account of sample design and development charges of Rs.13,52,700/- is concerned, we find an identical issue had come up before the Tribunal in the assessee's own case in the preceding assessment year. We find the Tribunal, in assessee's own case, vide ITA No.2166/Del/2011, order dated 2nd May, 2011 for assessment year 2003-04, following the order of the Tribunal in assessee's own case for assessment year 2001-02 in ITA No.1260/Del/2005 has held that the receipts on account of sample design and development charges are export turnover and represents the business income of the assessee and, thus, cannot be excluded from the receipt under Explanation (baa) of section 80HHC of the Act. In view of the consistent decision of the Tribunal, we hold that receipts on account of sample design and development charges are export turnover and represents the business income of the assessee and this cannot be excluded from the receipts under Explanation (baa) of section 80HHC. The ground

raised by the Revenue on this issue is accordingly dismissed. So far as the issue relating to DEPB is concerned, we find the Assessing Officer held that since the assessee failed to furnish any evidence that the rate of Duty Drawback was higher than the rate of DEPB as per the amended provision, hence, the amount of DEPB of Rs.1,73,08,013/- shall not be included in 90% of the amount to be added to 'profits of business.' We find the assessee before the CIT(A) submitted that the only profit component on the sale of DEPB licence was needed to be included on account of computation of deduction u/s 80HHC and not the face value and since, in this case, there was a loss, therefore, the entire amount needed to be excluded. We find the ld.CIT(A) directed the Assessing Officer to exclude the DEPB receipts amounting to Rs.1,73,08,013/- for the calculation of deduction u/s 80HHC by accepting the contention of the assessee and without examining the actual profit component or loss. Since the computation along with evidence was not submitted by the assessee either before the Assessing Officer or before the CIT(A) and since no such details are available in the audited accounts of the assessee as in the P&L Account, there is only one entry i.e., receipt of Rs.1,73,08,013/- on account of DEPB, therefore, we agree with the argument of the ld. DR that this matter should be restored to the file of the Assessing Officer with a direction to examine the profit element in the sale of DEPB licence and to recompute the deduction u/s 80HHC in the light of the decision of the Hon'ble Supreme Court in the case of Topman Exports reported in 342 ITR 49. The Assessing Officer shall decide the issue as per fact and law, after giving due opportunity of being heard to the assessee. We hold and direct accordingly. The issue relating to DEPB as per the first additional ground of the Cross Objections is allowed for statistical purposes.

29. So far as the issue relating to interest income of Rs.37,82,419/- on fixed deposits for the computation of deduction u/s 80HHC is concerned, the ld. counsel for the assessee fairly conceded that this issue has been decided against the assessee by the Hon'ble High Court in the case of Ram Honda Power Equipment reported in 158 Taxman 474 (Del). In view of the above submission of the ld. counsel for the assessee, this issue is decided against the assessee.

30. Ground No.2 of the Cross Objections as well as additional grounds relate to the denial of deduction of Rs.19,44,514/- being contribution to Group Gratuity Policy of LIC of India.

31. Facts of the case, in brief, are that the Assessing Officer, during the course of assessment proceedings, noted that the assessee has debited a sum of Rs.19,44,514/- to the P&L Account on account of gratuity. It was submitted that the assessee has subscribed to a group gratuity policy with LIC of India and, accordingly, a sum of Rs.19,44,514/- was contributed towards this policy. The Assessing Officer, noted that the trust to which the contribution has been made has not been approved by the Department. Therefore, invoking the provisions of section 36(v) which says that any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the benefit of its employees under an irrecoverable trust is allowable as deduction and since the trust has not been approved by the Department, the Assessing Officer disallowed the contribution of Rs.19,44,514/-. No ground was taken before the CIT(A) on this issue for which there was no adjudication. However, the assessee, in the additional ground, has raised this issue.

32. After hearing both the sides, we find an identical issue had come up before the Visakhapatnam Bench of the Tribunal in the case of District Cooperative Central Bank vs. ITO in a batch of appeals vide common order dated 25th January, 2018. We find the Tribunal relying on various decisions held that the assessee is entitled for deduction for payment of group gratuity to LIC of India towards group gratuity scheme. The relevant observations of the Tribunal from para 8 onwards reads as under:-

> "8. We have heard both the parties, perused the materials available on record and gone through the orders of the authorities below. The assessee is a cooperative bank and created the group gratuity fund/trust of the District Co-operative Central Bank Employees but the same was not yet approved by the CIT. Pending receipt of approval, the assessee had made application to LIC of India under pension and group schemes, and taken policy under Master proposal for group for payment of gratuity on 1.7.2003, and is contributing the sums to the LIC of India towards the group gratuity on actuarial basis. The assessee has not made any provision and made the payment before filing the return of income. On happening the event, the assessee bank is receiving the gratuity payment from the LIC which is being paid to the employee concerned and no further deduction is being claimed by the assessee as expenditure. Thus no double deduction is claimed. The expenditure claimed by the assessee under group gratuity scheme to LIC of India was allowed in the earlier years prior to the previous year relevant to the assessment year 2007-08, the A.O. disallowed the same since the payment made to LIC of India towards group gratuity scheme is not covered by section 36(1)(v), 40A(7)(b) & 40A(9) of the Act because the assessee has not satisfied the conditions. The argument of the assessee is that since the payments were made to LIC of India in Master policy scheme, the premiums contributed to the LIC of India is allowable deduction and relied on the decisions of coordinate bench of Hyderabad in the case of Capital IQ Information Systems (India) Pvt. Limited (supra). The Hon'ble ITAT Hyderabad Bench while deciding the issue on similar facts held as under:
>
> 8. We have heard the arguments of the parties, perused the material on record and have gone through the orders of the authorities below. We find that the issue is squarely covered by the decision of the ITAT, Hyderabad in the case of M/s. Sri Krishna Drugs Ltd. Vs. Department of Income-tax in ITA No.2126/Hyd/2011 for AY 2007.08 dated 11.4.2012, where the JM was one of the party. The Tribunal in the said case held as follows:
>
> 3. The second ground raised by the Revenue is as under:
>
> "The learned CIT(A) erred in holding that unrecognised gratuity fund is allowable u/s. 37(1),when the case is hit by the provisions of section 40A(9) and especially when the assessee failed to comply with the provisions of section 36(1)(v)."

4. After hearing both the sides, we find this issue is covered in favour of the assessee and against the Revenue in I.T.A. No. 198/Hyd/2011 in assessee's own case for A.Y. 2006-07 order dated 16.12.2011 wherein this Tribunal held as follows:

> "3. After hearing both the parties, we are of the opinion that similar issue came up for consideration in assessee's own case for assessment year 2002-03 in I.T.A. No. 349/Hyd/2006. The Tribunal decided the issue in favour of the assessee vide its order dated :15.2.2008 by holding as follows:
>
> "4. We have considered rival submissions on either side and also perused the material available on record. Admittedly, the Group Gratuity Scheme was not recognised by the Commissioner of Income-tax. This fact is not in dispute. We have carefully gone through the provisions of sec. 36(1)(v) of the Income-tax Ac. Sec. 36(1)(v) reads as follows:
>
> "36. (1) The deductions provided for in the following clauses shall be allow d in respect of the matters dealt with therein, in computing the income referred to in section 28 -
>
> (v) any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust".

We have also carefully gone through the provisions of sec. 37 of the Income-tax Act. Sec. 37 provides for deduction of expenditure not being in the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenditure of the assessee, but laid out and expended wholly and exclusively for the purposes of the business or profession, while computing income chargeable to tax. The main contention of the Revenue is that under sec. 36(1)(v), the payment made by the assessee as employer could be allowed only in respect of approved gratuity fund. Since the Group Gratuity Scheme is not approved by the CIT, according to the Revenue, it cannot be allowed. However, the contention of the assessee is that in view of the judgement of the Madras High Court in the case of Premier Spinning Mills Ltd. (supra) and the judgement of the jurisdictional High Court in the case of Warner Hindustan Ltd. (supra), it has to be allowed.

5. We have carefully gone through the judgement of the jurisdictional High Court in the case of Warner Hindustan Ltd. (supra). In the case before the jurisdictional High Court, the Provident Fund was not approved by the CIT. The Andhra Pradesh High Court after referring to the judgement of the Bombay High Court in Tata Iron & Steel Co. Ltd. v. D. V. Bapat, ITO (1975) 101 ITR 292, and the judgement of the Supreme Court in Metal Box Company of India Ltd. vs. The Workmen (1969) 73 ITR 53, held that the amount paid towards an unapproved gratuity fund can be deducted under sec. 37 of the I.T. Act, though not under sec. 36(1)(v). In view of this judgment of the jurisdictional High Court, in our opinion, even if any payment is made to an unapproved gratuity fund, it has to be allowed under sec. 37. By respectfully following the binding judgement of Andhra Pradesh High Court in the case of warner Hindustan Ltd. (supra), we uphold the order of the CIT(A).

In view of the above discussion, we dismiss the ground taken by the Revenue."

5. In view of the above decision of this Tribunal, the ground raised by the Revenue is dismissed."

9. Since the issue under consideration is materially identical to the one decided by the ITAT in the case of M/s. Sri Krishna Drugs Ltd. (supra), respectfully following the same, we set aside the order of the CIT(A) and allow the ground of appeal of the assessee."

9. Similarly, ITAT Ahmedabad Bench in the case of Baroda Gujarat Grameen Bank cited (supra) held that the payment made to LIC of India is not a provision but it is actual expenditure claimed under the gratuity contribution. Hon'ble ITAT Ahmedabad Bench held that since assessee has not claimed the provision and claimed on actual basis, the expenditure is allowable deduction. For ready reference, we reproduce para Nos.4 & 5 of the order of the Hon'ble ITAT Ahmedabad Bench which reads as under:

> "4. We have considered the rival submissions and material available on record. Section 40A (7) of the IT Act provides that subject to provision of clause (b), no deduction shall be allowed in respect of any provision made by the assessee for payment of gratuity to his employer on their retirement or on termination of their employment for any reason. It is clear from the above provision that section 40A (7) of the IT Act would apply in respect of the provision only. However, in the case of the assessee, the assessee claimed deduction of the expenditure on account of actual expenses claimed under the head gratuity contribution. ITAT Ahmedabad Bench in the case of New Bharat Engineering Works (Jam) Ltd. (supra) held "Disallowance under s. 40A(7) - Gratuity -

Actual payment of funds to LIC and not mere provision - Not hit by s. 40A(7) - CIT vs Gujarat Machine Tools (ITA 666/Ahd/1985) followed". Hon'ble Punjab & Haryana High Court in the case of CIT Vs Bitoni Lamps Ltd. 144 Taxman 33 held that "Section 40A(7) of the Income-tax Act, 1961 - Business disallowance - Gratuity - Assessment year 1979-80 - Assessee-company claimed deduction under section 40A(7) (b) (i) on account of gratuity actually deposited in fund created by it - Whether such a claim could only have been disallowed if it had been proved that gratuity, in respect of which said payment had been made, had not become payable during previous year - Held, yes -

Whether in absence of such a case made out by revenue, Tribunal was right in holding that grant of approval of gratuity fund was not relevant for purpose of instant case as said deduction was not being claimed on account of any provision and amount of gratuity was an allowable deduction - Held, yes".

5. Considering the above aspects, we do not find any infirmity in the order of the learned CIT(A) in deleting the addition. There is no merit in the departmental appeal. Same is accordingly dismissed."

10. In the case of Verizon Data Services India Pvt. Ltd. (supra) the coordinate bench of Madras held that payment made to gratuity fund maintained with LIC has no control over the irrevocable trust

created exclusively for the benefit of employees and deduction shall be allowed. The coordinate bench of Madras while deciding the appeal relied on the decision of Hon'ble Madras High court in the case of Textool India Pvt. Limited (supra) (civil appeal No.447 of 2003). In the instant case the assessee has made the payments to the LIC towards group gratuity scheme directly in approved schemes. The assessee has also obtained the policy in favour of the bank. The assessee has no control over the funds contributed to LIC towards the gratuity. The assessee is receiving the gratuity payment directly from the LIC of India as per the scheme which is paid to the employee on happening of the event i.e. retirement or death or resignation. Therefore, the facts of the assessee's case are squarely covered by the decisions cited supra. The coordinate bench of Hyderabad while delivering the ruling relied on the decision of jurisdictional High Court in the case of Warner Hindustan Ltd. Since the facts are identical, respectfully following the view taken by the coordinate benches, we hold that the assessee is entitled for the deduction for payment of gratuity to LIC and accordingly, we set aside the order of the lower authorities and allow the appeal of the assessee.

11. This issue is involved for the assessment year 2007-08, 2008-09, 2009- 10, 2010-11 & 2011-12 on identical facts. The appeal of the assessee on this ground for all the said assessment years stands allowed."

33. Respectfully following the decision cited (supra), we hold the assessee is entitled to the deduction for contribution to Group Gratuity Policy of LIC of India. The grounds raised by the assessee are accordingly allowed.

34. In the result, the appeal filed by the Revenue is dismissed and the CO filed by the assessee is partly allowed for statistical purposes.

The decision was pronounced in the open court on 31.07.2019.

Sd/-	Sd/-
(SUCHITRA KAMBLE)	(R.K. PANDA)
JUDICIAL MEMBER	ACCOUNTANT MEMFBER

Dated: 31st July, 2019

dk

Copy forwarded to

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asstt. Registrar, ITAT, New Delhi