Lenovo (India) Private Limited, ... vs Income Tax Officer Ward-4(1)(1), ... on 24 March, 2023

IN THE INCOME TAX APPELLATE TRIBUNAL
"A''BENCH: BANGALORE

BEFORE SMT. BEENA PILLAI, JUDICIAL MEMBER
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

IT(TP)A No.281/Bang/2021
Assessment Year: 2016-17

M/s Lenovo (India) Pvt. Ltd., Ferns Icon, Level 2, Doddanakundi Village, Marathalli Outer Ring Road,	The Income-tax Officer, Ward-4(1)(1), Bangalore.
Vs.	
Marathahalli Post, K.R Puram, Hobli, Bangalore - 560 037.	
PAN: AABCI 3372 H APPELLANT	RESPONDENT

Appellant by : Shri Padam Chand Kincha, C.A
Respondent by : Shri Sankar K Ganeshan, CIT (D.R)

Date of Hearing : 05.01.2023
Date of Pronouncement : .03.2023

ORDER

PERLAXMI PRASAD SAHU, ACCOUNTANT MEMBER:

This is an appeal filed by the assessee against the order passed by the NFC dated 28-04-2021 DIN ITBA/AST/S/143(3)/2021-22/1032713409(1) with the following grounds of appeal :-

I. General Ground:

1. The final assessment order dated 28 April 2021, passed by the learned AO under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 ("the Act"), the directions issued by the IT(TP)A No.281/Bang/2021 Honourable Dispute Resolution Panel ("DRP") under section 144C(5) and the order passed by the learned Transfer Pricing Officer ("TPO") under section 92CA(3) of the Act, to the extent prejudicial to the Appellant, are not in accordance with the law and made in violation of the principles of equity and natural justice and are contrary to the facts and circumstances of the present case.

II. TP adjustment of INR 4,27,47,621 in relation to manufacturing segment:

2. The Honourable DRP and the learned AO / TPO have erred in law and on facts in making transfer pricing ("TP") adjustment of INR 4,27,47,621 to the returned income of the Appellant and in holding that the international transactions undertaken by the Appellant with its associated enterprises ("AEs") in the manufacturing segment were not at arm's length.

Rejection of Internal Comparable Uncontrolled Price Method adopted as the most appropriate method by the Appellant:

3. The Honourable DRP and the learned AO / TPO have erred in law by rejecting the application of Internal Comparable Uncontrolled Price ("Internal CUP") method selected as the most appropriate method ("MAM") by the Appellant for benchmarking the international transaction of import of raw materials in relation to manufacturing segment, without giving any cogent and valid reasons for such rejection.

4. The Honourable DRP and the learned AO / TPO have erred in rejecting the Internal CUP method as MAM when the same has been upheld in Appellant's own case in preceding years as below:

a. Upheld by the jurisdictional bench of Honourable Income-tax Appellate Tribunal ("ITAT") for AY 2006-07 (1st and 2nd round), AY 2009-10, AY 2010-11 and AY 2015-16;

b. Upheld by the Honourable DRP for AY 2006-07 (2nd round) and AY 2010-11; and
c. Accepted by the learned TPO for AY 2007-08 and AY 2008-09.

5. The Honourable DRP and the learned AO / TPO have erred in not following the settled principle based on the rulings of the Honourable Supreme Court ("SC") that where a fundamental fact permeates through more than one year and is accepted by the Revenue authorities, it should not be arbitrarily rejected.

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6. The Honourable DRP and the learned AO / TPO have erred in rejecting Internal CUP as MAM by providing following reasons which are incorrect and contrary to facts of the present case:

a. This method is applied by using weighted average billing rate; and b. There is no publicly available information on prices charged in independent transactions of similar or identical nature, so External CUP cannot be applied.

Notwithstanding and without prejudice to the above grounds that the Internal CUP is the MAM,

7. The Honourable DRP and the learned AO / TPO have erred in law and on facts by adopting the Transactional Net Margin Method ("TNMM") as the MAM for benchmarking the international transaction of import of raw materials in relation to manufacturing segment.

8. The Honourable DRP and the learned AO / TPO have erred in law in rejecting the TP documentation maintained by the Appellant:

a. Rejecting the TP documentation without providing cogent reasons, which has been prepared by the Appellant in the manner contemplated under the relevant provisions of the Act and the Income-tax Rules, 1962 ("the Rules").

b. Rejecting the TP documentation of the Appellant as "not reliable or correct", under Section 92C(3) of the Act, merely because the learned TPO did not agree with the method adopted by the Appellant in its the TP documentation.

9. The Honourable DRP and the learned AO / TPO have erred in law in adopting the below filter for conducting TP analysis:

a. Rejection of comparable companies having different financial year ending (other than March 31, 2016) b. Rejection of companies having persistent losses

10. The Honourable DRP and the learned AO / TPO have erred in law and on facts in not rejecting the following companies which are not comparable to the Appellant due to reasons including functional dissimilarity, presence of significant R&D etc.:

a. Bhagwati Products Limited b. Exicom Tele-Systems Limited

11. The learned AO / TPO has erred in law and on facts in not accepting the following companies which are comparable to the Appellant and thereby not considering the detailed submissions of IT(TP)A No.281/Bang/2021 the Appellant. Further, the learned TPO has not provided any reasons for the same in the TP Order:

a. Hitachi Hi-Rel Power Electronics Pvt. Ltd b. Powersonic Electric Solution India Pvt. Ltd c. V X L Instruments Ltd d. CCS Infotech Limited e. TVS Electronics Limited

12. The Honourable DRP and the learned AO / TPO have committed arithmetical errors in computing the margin of the following company:

a. Exicom Tele-Systems Limited

13. The Honourable DRP and the learned AO / TPO have erred in law by not granting appropriate favourable economic adjustments (including the working capital adjustment) while calculating the arm's length margin for final set of comparable companies under the TNMM for the manufacturing segment.

III. TP adjustment of INR 125,54,51,517 on account of alleged excess AMP expenditure pertaining to trading segment:

14. The Honourable DRP and the learned AO / TPO have erred in law and on facts, in making TP adjustment of INR 125,54,51,517 to the returned income of the Appellant by assuming the existence of an alleged international transaction of brand promotion services to AE and alleging the same to be not at arm's length in terms of the provisions of sections 92C(1) and 92C(2) of the Act read with Rule 10D of the Income tax Rules, 1962 ("the Rules").

AMP expenditure not an international transaction

15. The Honourable DRP and the learned AO / TPO have erred in law and on facts by alleging that the unilateral Advertising, Marketing and Promotion ("AMP") expenditure, being payments made to third parties, is an "international transaction" as per the provisions of section 92B of the Act, without appreciating that they had not incurred any expenditure on the directions of the AE.

16. The learned TPO erred in suo-moto benchmarking the alleged international transaction related to the AMP expenses without there being any order or reference from the AO in relation thereto.

17. The Honourable DRP and the learned AO / TPO have erred in unilaterally re-characterizing the AMP expenses being payments IT(TP)A No.281/Bang/2021 made by the Appellant to independent third parties as an 'international transaction' under chapter X of the Act, and particularly when the jurisdiction of the TPO is only to compute arm's length margin of the international transaction.

18. The Honourable DRP and the learned AO / TPO have erred in law and on facts by not appreciating that no such TP adjustment can be made in respect of AMP expenses (being legitimate, bona fide and deductible business expenditure) incurred by the Appellant towards payments to independent parties, the benefit of which accrues to the Appellant alone.

19. In this regard, the Honourable DRP and the learned AO / TPO have failed to consider that the alleged AMP expenses were incurred exclusively in relation to the Appellant's business, which is also evident from the fact that the expenditure has been accepted by the AO under section 37 of the Act.

20. The Honourable DRP and the learned AO / TPO have erred in law and on facts in concluding that the "conduct of the Appellant clearly shows the presence of an arrangement for promotion of marketing intangibles".

21. The Honourable DRP and the learned AO / TPO have erred in law and on facts by not appreciating that the Appellant is a distributor of products imported from its AEs on a principal-to-

principal basis, and hence has incurred the AMP expenses solely for improving its business market and increasing the sales of its products in India.

22. The Honourable DRP and the learned AO / TPO have failed to appreciate that the Appellant has been uninterruptedly using the said brand for the last several years and till date, thus, all benefits endured to the Appellant, for which the Appellant has not even been paying any royalty to its AE. Consequently, for all purposes the Appellant is the sole beneficiary of all the benefits of AMP expenditure incurred during financial year ending 31 March 2016.

23. The Honourable DRP and the learned AO / TPO have erred in law and on facts, byholding that the Appellant by incurring excessive AMP expenditure has resulted in creation of marketing intangible in favor of the AE, for which it should be compensated by the AE.

24. The Honourable DRP and the learned AO / TPO have erred in law and on facts by disregarding judicial pronouncements in undertaking TP adjustments in relation to AMP.

IT(TP)A No.281/Bang/2021 Notwithstanding and without prejudice to the above grounds that the AMP expenditure incurred by the Appellant does not constitute an international transaction under Chapter X of the Act, the Appellant craves to raise following grounds of objections on merits.

25. The Honourable DRP and the learned AO / TPO have erred in disregarding the Appellant's submission that the Appellant would operate at arm's length under following scenarios using RPM and TNMM for trading segment and hence no adjustment is warranted in this regard:

> a. Scenario 1 - Adjusted gross margin approach: The adjusted gross profit margin of the Appellant after considering AMP expenditure is compared with the adjusted gross profit margin of the comparable companies.
>
> b. Scenario 2 - Adjusted marked-up gross margin approach: The adjusted gross profit margin of the Appellant after considering AMP expenditure along with mark-up is compared with the adjusted gross profit margin of the comparable companies. c. Scenario 3 - Net profit margin approach: The net profit margin of the Appellant is compared with the net profit margin of the comparable companies.
>
> d. Scenario 4 - Adjusted marked-up net margin approach: The net profit margin of the Appellant after considering AMP expenditure along with mark-up is compared with the net profit margin of the comparable companies.

26. The Honourable DRP and the learned AO / TPO have erred in not considering scenario 3 approach as depicted in Ground 25 above, when the said approach has been upheld in Appellant's own case by the jurisdictional bench of Honourable ITAT for AY 2015-

16.

27. The Honourable DRP and learned AO / TPO have erred in law in not considering the detailed submissions of the Appellant that even after performing an AMP expense intensity adjustment to the comparable companies, the adjusted net margin earned from the trading activity by the Appellant is at arm's length.

28. The Honourable DRP and learned AO / TPO have erred in not appreciating that if for the comparable trading companies selected by the Appellant and accepted by the learned TPO, an additional revenue (AMP expenditure incurred plus a mark-up as determined by the learned TPO) is imputed to the respective revenues of comparable companies on account of the alleged brand building activity, the net margin earned by Appellant will IT(TP)A No.281/Bang/2021 still be within the tolerance band of the adjusted net margin of the comparable companies.

29. The Honourable DRP and learned AO/TPO have erred in applying the Bright Line Test as a methodology to quantify the brand promotion service alleged to have been rendered by the Appellant to its AE. Further, the Honourable DRP and learned AO / TPO have erred in selecting companies that are not comparable to the intensity of AMP functions of the Appellant for computing the AMP/Sales ratio and thereby considered companies that have very low AMP/Sales ratio.

29. The Honourable DRP and the learned AO / TPO have erred in law and on facts in concluding that the distribution and AMP are two distinctive functions and requires to be remunerated separately.

30. The Honourable DRP and the learned AO / TPO have erred in law and on facts by characterizing the incurrence of AMP expense as a provision of brand promotion services by the Appellant to its AE requiring a mark-up.

31. Without prejudice to the other grounds, the Honourable DRP and the learned AO / TPO have erred in law and on facts in not appreciating that the Appellant has not provided any value added / brand building services to its AE by incurring AMP expenses, and therefore, no mark-up could have been charged / levied on such expenses, even if the same was to be characterized as an 'international transaction'.

32. Without prejudice to the other grounds, the Honourable DRP and the learned AO / TPO have erred in not appreciating that in view of the Appellant being contractually assured of a margin after cost recovery, the entire AMP expenditure has in fact been recovered from the AE and hence adjustment could only be restricted to markup, that too if the operating margin of the company was not at arm's length.

Benchmarking analysis undertaken in determining the mark-up to be charged on the alleged brand promotion services

33. The Honourable DRP and the learned AO / TPO have erred in carrying out a search for comparable companies in order to determine the mark-up that the Appellant should have recovered from the AE in relation to the alleged AMP expenses considered to be in the nature of brand

promotion service.

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34. The Honourable DRP and the learned AO / TPO have erred in determining the mark-up for the alleged international transaction of brand promotion services by selecting following companies which are not comparable to the Appellant due to reasons including functional dissimilarity, failing quantitative filters, etc. Further, the learned TPO has not provided any reasons for the same in the TP Order:

a. Killick Agencies & Marketing Limited b. Scarecrow Communications Limited

35. The Honourable DRP and the learned AO / TPO have erred in law and on facts in not accepting the following companies which are comparable and thereby not considering the detailed submissions of the Appellant. Further, the learned TPO has not provided any reasons for the same in the TP Order:

a. Showhouse Event Management Private Ltd b. MCI Management India Private Limited c. Quadrant Communication Limited d. Esha Media Research Limited e. Nielsen (India) Private Limited IV. Other TP related grounds

36. The Honourable DRP and the learned AO / TPO have erred by not carrying out the determination of arm's length price as required under section 92C of the Act read with Rule 10D of the Rules.

37. The Honourable DRP and the learned AO / TPO have failed to appreciate the Appellant's commercial judgment about the application of arm's length principle which is tied to the business realities.

38. The Honourable DRP and the learned AO / TPO have erred in law and on facts, in making several observations and findings, which are based on incorrect interpretation of law and contrary to facts of the case.

V. Disallowance of provision for warranty

39. The Honourable DRP and the learned AO have erred in law in arbitrarily disallowing the provision for warranty amounting to INR 185,94,26,047 claimed as a deduction by the Appellant, holding the same to be contingent and unascertainable in nature.

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40. The Honourable DRP and the learned AO have erred in law by not following the order of the Honourable Karnataka High Court ("HC") in the Appellant's own case for AY 2007-08 and AY 2011-12 and Honourable ITAT in the Appellant's own case for the AY 2006-07, AY 2007-08, AY

2010-11, AY 2011-12 and AY 2015-16, wherein it was held that the provision for warranty has been created on a scientific basis and that the same should be allowed as a deduction.

41. The Honourable DRP and the learned AO have not appreciated the fact that the Appellant maintains its books on a mercantile basis of accounting and that the said warranty provision has been created on a scientific manner followed consistently over the years, having due regard to the nature of activity, its global warranty accrual processes and the industry requirement in which the Appellant operates.

42. The Honourable DRP and the learned AO have erred on facts in failing to consider that the Appellant has provided for warranty on a scientific and consistent manner every year applying the principles laid out by the Honourable SC in the case of Rotork Controls India Private Limited1 and therefore such expenditure is an allowable deduction under section 37 of the Act.

43. The Honourable DRP and the learned AO have erred in appreciating that the Appellant provides warranty for a period from one year to three years on its products and accordingly, the entire provision could not be utilized in one year and has to be spread over multiple years.

VI. Addition of provision for warranty to the book profits

44. The Honourable DRP and learned AO have erred in adding back the warranty provision created during the relevant AY amounting to INR 185,94,26,047 to the book profit of the Appellant.

45. The Honourable DRP and the learned AO have erred in law and on facts in holding that the warranty provision of INR 185,94,26,047 is an unascertained liability and therefore, not appreciating that the warranty provision is created on a scientific basis after considering technical estimates which is consistently followed by the Appellant year on year.

46. The Honourable DRP and the learned AO have erred in law by not following the order of the Honourable Karnataka HC in the IT(TP)A No.281/Bang/2021 Appellant's own case for AY 2007-08 and AY 2011-12 and Honourable ITAT in the Appellant's own case for the AY 2006-07, AY 2007-08, AY 2010-11, AY 2011-12andAY 2015-16, wherein it was held that the provision for warranty has been created by the Appellant on a scientific basis and that the same should not be treated as an unascertained liability and therefore, provision for warranty should not be added back while re-computing book profits under section 115JB of the Act.

VII. Disallowance of unrealized foreign exchange loss

47. The Honourable DRP and learned AO have erred in disallowing the unrealized foreign exchange loss amounting to INR 17,55,00,000 claimed as a deduction under section 37 of the Act while computing the taxable income.

48. The Honourable DRP and learned AO have erred in law and on facts by treating the unrealized foreign exchange loss as marked-to-market loss, arising to the Appellant on account of restatement

of financial instruments, i.e., forex derivatives/ forward contracts and thereby, categorizing the same to be 'speculative' under section 43(5) of the Act, disregarding the fact that the unrealized foreign exchange loss is on account of restatement of debtors, creditors and other trade advances, which does not fall under the purview of section 43(5) of the Act.

49. The Honourable DRP and learned AO have erred in not appreciating that the unrealized foreign exchange gain at the time of realization, if any, would be duly offered to tax.

50. The Honourable DRP and learned AO have not appreciated the fact that the treatment of unrealized foreign exchange loss is in line with Accounting Standard ("AS")-11 and also, the principles of 'prudence' provided in AS-1, which is required to be complied by the Appellant under section 145(2) of the Act.

51. The Honourable DRP and learned AO have erred in not appreciating the fact that the foreign exchange loss incurred in the course of Lenovo India's business operations and is in the nature of revenue expenditure deductible under section 37 of the Act in the year of fluctuation in the rate of exchange and not in the year of settlement of such amount.

52. The Honourable DRP and learned AO have erred in disregarding the decisions of the SC and various other courts relied on by the Appellant in support of its arguments during the course of assessment proceedings.

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53. The Honourable DRP and learned AO have erred in law and on facts by placing reliance on the decision of the SC in the case of Sanjeev Woolen mills2 which dealt with valuation of closing stock and also, the decision of Allahabad HC in the case of Oriental Motors Car Co P. Ltd.3which dealt with allowability of infringement commission and therefore, the said cases could be distinguished from the facts of the Appellant.

54. The Honourable DRP and learned AO have erred in law and on facts by relying on the Instruction No 17/2008issued by the Central Board of Direct Taxes ("CBDT") which provides for guidelines for conducting assessment of banks and hence, not relevant to the present case. Further, the Honourable DRP and learned AO have erroneously concluded that unrealized foreign exchange loss is a contingent liability without appreciating that the same is computed as per the principles laid down in AS-11.

55. The Honourable DRP and learned AO have erred in law and on facts by relying on the Instruction No 3/2010issued by CBDT which provides for allowability of losses on account of forex derivatives and hence, not relevant for the facts of the Apellant's case.

VIII. Addition of unrealized foreign exchange loss under section 115JB of the Act

56. The Honourable DRP and learned AO have erred in law and on facts by adding back the unrealized foreign exchange loss amounting to INR 17,55,00,000 to the book profit of the Appellant.

57. The Honourable DRP and learned AO have erred in concluding that unrealized foreign exchange loss is an unascertained liability without appreciating the fact that the treatment of unrealized foreign exchange loss is in line with AS-11 issued by ICAI and also, the principles of 'prudence' prescribed in AS-1, which is required to be complied by the Appellant under section 145(2) of the Act.

58. The Honourable DRP and learned AO have erred in not appreciating the fact that the foreign exchange loss has been incurred by Lenovo India in the course of its business on account of restatement of debtors, creditors and other trade advances which is not an unascertained liability and therefore, should not be added back while computing book profits under section 115JB of the Act.

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59. The Honourable DRP and learned AO have erred in disregarding the decisions of the SC and various other courts relied by the Appellant in support of its arguments during the course of assessment proceedings.

60. Without prejudice to the above, the learned AO has erred in law and on facts in not providing the Assessee an opportunity of being heard before making an addition to the book profits under section 115JB of the Act for the subject AY, thereby violating the principles of equity and natural justice.

IX. Other grounds

61. The learned AO has erred in law and on facts by not granting appropriate credit of the Tax Deduction at Source ("TDS"), as claimed by the Appellant in the return of income.

62. The learned AO has erred in law and on facts in levying interest under section 234A of the Act even though the Return of Income was filed within the due date, and has also erred in re- computing interest under section 234C of the Act.

63. The learned AO has erred in law and on facts in initiating penalty proceedings under section 271(1)(c) of the Act without concluding that the Appellant has furnished inaccurate particulars of income or has not acted in good faith and has not exercised due diligence."

2. The brief facts of the case are that the assessee filed revised return of income electronically for the assessment year 2016-17 on 29/03/2018 declaring Nil income. The case was selected for scrutiny through CASS for complete scrutiny. Accordingly, statutory notices were issued to the assessee and various details were called for. In response to notice issued, the assessee company submitted details from time to time which were examined from documents submitted. It was noted that the company

had international transactions exceeding Rs.10 crores, therefore, the case was referred to the TPO u/s 92CA of IT(TP)A No.281/Bang/2021 the Act for determination of arms length price after obtaining prior approval from the competent authority. The ld. TPO after receipt of reference, called the documents maintained u/s 92D(3) of the Act. From the documents submitted, the ld. TPO noticed that the assessee company is engaged in the business of trading, manufacture and sale of desktops, lap tops, servers and smart phones. The company has its manufacturing unit at Pondicherry, India. The business operations of Lenovo India are primarily divided into following categories:-

> "Manufacture/Assembly Under this segment, Lenovo India imports parts for the manufacture/ assembly of PCs and notebooks (Lenovo ldeapad range) from the group companies as well as thirdparty vendors. The manufactured! assembled PCs and notebooks are sold to third party customers in India.
>
> Trading Under this segment. Lenovo India imports finished products from Lenovo Group such as desktops, notebooks, mobile phones. computer peripherals and servers from its AEs and resells the same to local customers in India through its distribution network.
>
> Further. Lenovo India has the following business verticals:
>
> Commercial - Caters to private institutional customers and government orders through standard tendering process.
>
> Home and small business - Caters to retail customers. The distribution is carried out through channel partners (Tier 1). They sell onward to Tier 2 and Tier 3 distributors.
>
> Enterprise business - Consists of the server business, currently Model X86. Very large business - Caters to corporate customers such as Infosys. TCS etc. Smart phone business Lenovo India currently has a workforce of about 700 people. About 350 are housed at headquarters i.e. Bangalore and balance are spread across locations in India.

Budgets and forecasts Lenovo India does not prepare economic and market analyses in the form of forecasts which have bearing on the pricing of the international transactions entered into during the year under review."

2.1 During the impugned assessment year, the following international transactions were undertaken by the assessee:-

> IT(TP)A No.281/Bang/2021 2.2 The following financial segmental analysis prepared by the TPO is as under:-

IT(TP)A No.281/Bang/2021 2.3 The ld.TPO from tax payers study report noticed that the assessee had adopted CUP method as the most appropriate method for import of parts of manufacture of personal computers for determination of PLI. The ld.TPO after considering the written submissions, computed the adjustment of ALP after applying TNMM as the most appropriate method and determined the adjustment for Manufacturing segment. The DRP also accepted the reasons given by the TPO for applying the TNMM as most appropriate method for computation of Arms Length Price. The assessee contested as per grounds of appeal for TP adjustment of Rs. . 4,27,47,621/- for the manufacturing segment after passing the final assessment order.

2.4 The ld.AR reiterated the submissions made before the lower authorities and he further submitted that the CUP method is the most appropriate method and the assessee has himself determined ALP at Rs.192,64,51,800/- and suo moto adjustment of Rs.1,38,18,647/- has been made in its return of income. The value of import of part and components for manufacture of PCs as per books of accounts were of Rs.

1,91,26,33,153/-. He filed written synopsis which is as under:-

1. Aggrieved by the order of the DRP, the Appellant has raised Ground No. II before the Tribunal.

Ground No. II relate to the contention of the Appellant that CUP should have been accepted as the MAM. It is submitted that as far as the issue of MAM in the case of the Appellant, the objections of the Appellant to each of the reasons put forth by learned TPO / DRP for the rejection of CUP as the MAM are as under:

Reasons for rejection of CUP as the Sl. No. Lenovo India's contention MAM

1. Non-availability of reliable data in • Assessee imported components from order to compare the degree of both AEs as well as unrelated vendors.

comparability between the • These components have a unique international transaction and identity and bear serial numbers or IT(TP)A No.281/Bang/2021 Reasons for rejection of CUP as the Sl. No. Lenovo India's contention MAM uncontrolled transactions. codes by which they are identified.

		• Assessee has documented comparability analysis in respect comparison of the prices for all components that have been importe from its AEs.
2.	Weighted average rate is not an uncontrolled transaction that can be compared with the purchases made from AEs / Non-AEs since the level of	• Assessee has procured components throughout the year which indicat the components are not obsolete a actively used in the production p

	obsolesce in the computer hardware industry is very high	• Where transactions are large in numb it would not be practically possi compare each and every import transaction. • Components used in the manufacture o PCs are dependent on the quantity imported and therefore it would b more prudent to compare the avera prices rather than the transactio • Assessee had compared the average price of each product purchased f the AEs throughout the year with average price of products purchas from unrelated parties.
3.	Industry average billing rate cannot be considered in this method by relying on the decision of the Bangalore ITAT in the case of Aztec Software & Technology Services vs ACIT	Facts in case of Aztec Software and Technology Services Vs ACIT are comple different from Assessee's case: • Case law pertains to a taxpayer i software services industry which materially different from Assesse business, i.e., the har manufacturing segment • In case law, the rates were depen on the expertise and technical le the person performing the functio measurement of such qualitative service can be subjective. Howeve the instant case, components have distinctive codes by which they a known in the industry and the measurement of the prices is not subjective. • Case law was based on the fact th taxpayer had received income from services rendered to its AE and Assessee's transactions in the pr case pertains to expenses that ha been incurred. • Lastly, in the case law relied up the TPO, the taxpayer relied upon external CUP whereas Assessee has relied upon internal CUP

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Sl. No.	Reasons for rejection of CUP as the MAM	Lenovo India's content
		benchmarking its inter transaction.
4.	There is no publicly available	• In the instant case, Assess

information on prices charged in independent transactions of similar or identical nature, so external CUP cannot be applied.	considered internal CUP and external CUP.

2. It is respectfully submitted before your Honor'sthat in the AYs (i.e., AY 2006-07 to 2015-16), the Appellant had adopted CUP as MAM to benchmark its international transaction of Import of parts and components for manufacture of PCs pertaining to its manufacturing segment. The Appellantfurthersubmitsthat the functions performed for undertaking its manufacturing activity for allthe years i.e., AY 2006-07 to AY 2015-16 have remained the same andaccordingly, CUP was considered as the MAM for the subject AY as well.

It isalso submitted that the Hon'ble ITAT of Bangalore in Appellant'sown case has upheld the application of CUP Method adopted by the Appellant for benchmarking the subject transaction in following Assessment Years:

AY	ITAT
2006-07	ITAT directed TPO to give effect to DRP directions holding CUP a ITAT order dated May 30, 2016) [refer page 139 ofCase Law Compilation]
2009-10	Upheld CUP method as MAM.

(Refer page 19 to 22 of ITAT order dated July 06, 2018) [refer page 126 of Case Law Compilation] 2010-11 Upheld CUP method as MAM and directed the AO/TPO to give effect to the DRP directions having carried merit.

(Refer page 16 to 23 of ITAT order dated March 31, 2017) [refer page 189 of Case Law Compilation] 2012-13 Held CUP to be the MAM for the manufacturing segment (Refer page 3 of ITAT order dated 05 May 2022) [refer page 3 of Case Law Compilation] 2013-14 Held CUP to be the MAM for the manufacturing segment (Refer page 19 of ITAT order dated 21 March 2022) [refer page 29 of Case Law Compilation] 2014-15 Held CUP to be the MAM for the manufacturing segment (Refer page 08 of ITAT order dated 13 June 2022) IT(TP)A No.281/Bang/2021 AY ITAT [refer page 55 of Case Law Compilation] 2015-16 Held CUP to be the MAM for the manufacturing segment (Refer page 18 of ITAT order dated 06 March 2020) [refer page 86 of Case Law Compilation]

3. Further, it is respectfully submitted before your Honor's that the contentions of the TPO has been duly dealt by the Hon'ble Tribunal and Hon'ble DRP in Appellant's own case for AY 2010-11. The Hon'ble DRP has independently considered the matter and concluded that CUP is the MAM. Following is the relevant extract from the DRP Direction:

"4.6 The taxpayer's objections as above have been considered and are found to carry merit. When the product category imported is identifiable, the adoption of internal CUP would appear to be the

most reasonable method of TP analysis. The TPO's contention that CUP has been applied only to 91% of the total purchase made from AE's is not borne out from facts and the TPO appears to have been confused with the transaction involving import by the taxpayer made adjustment for the remaining 21 products. The Hon'ble Tribunal Bangalore's view inAppellant's own case are alsofound to be squarely applicable for FY 2009-10. In view of these reasons, the replacement of CUP byTNMM by the TPO is found to be unjustified. The TPO is directed to adopt the CUP method as thebasis for TP analysis this year. The objections raised are, therefore accepted."

(emphasis supplied) Below is the extract from the Hon'ble DRP Directions:

> IT(TP)A No.281/Bang/2021 IT(TP)A No.281/Bang/2021 IT(TP)A No.281/Bang/2021
>
> 4. The Honorable DRP for AY 2010-11 and Honorable ITAT for AY 2006-2007 & AY 2009-

2010 to AY 2015-2016 (except AY 2011-2012) have upheld the CUP method as MAM rejecting the above-mentioned reasons of learned TPO.The nature of the transaction and other facts remainingsame, internal CUP is the MAM for transaction in question as was held in previous Assessment Years by variousappellate authorities.

5. Following the above said decisions and argument of Appellant, it is humbly prayed before the Hon'ble Tribunal that CUP should be accepted as the MAM for the manufacturing segment of the Appellant and the TP adjustment carried out by the Ld. TPO/DRP by using TNMM as MAM should be deleted.

3. The ld.DR relied on the orders of the lower authorities.

4. After considering the rival submissions and perusing the entire materials available on record and facts narrated above, we noticed that the import of part and components for manufacturing of PCs valued at Rs.191,26,33,153/- and the assessee suo moto made adjustment of Rs.1,38,18,647/-. During the financial year, IT(TP)A No.281/Bang/2021 the assessee has imported different parts of products from its AEs and it can be identified on the basis of distinctive code. Out of 387 products 254 products were purchased from its AEs exclusively while the rest of 133 were purchased from AEs as well as from unrelated 3rd parties.

4.1 We noticed from the documents submitted by the assessee that this issue has been continuously held in favour of the assessee that the CUP is the most appropriate method for determining the ALP of the assessee for the importing of goods for manufacturing segment. In the assessee's own case for the assessment year (AY) 2015-16 in IT(TP)A No. 2444/Bang/2019 order dated 06.03.2020 at para No. 06 to 11 in which it has been held that the CUP is the most appropriate method for computing the ALP. The relevant part of the order is as under:-

6. The Transfer Pricing Officer (TPO) to whom the question of determination of ALP was referred to by the Assessing Officer (AO) u/s.92CA of the Act, did not accept the aforesaid TP analysis for the reasons given in his show cause notice(SCN) to the AO dated 26.9.2018. In the said SCN, the TPO firstly, expressed his opinion that for applying CUP method, reliable data is required for comparing controlled transaction with an uncontrolled transaction and such reliable data was not available. The reply of the Assessee in this regard was that each of the component/parts were identified with a unique identification number and the details were captured in the TP Analysis. The second objection of the TPO was that the Assessee used weighted average of price of components/parts imported throughout the year and therefore it cannot be said that the method adopted by the Assessee was CUP as weighted average price is not the actual price in the controlled and uncontrolled transaction. The Assessee's reply in this regard was that the components/parts were imported throughout the year and were large in number. It was practically impossible to compare each and every import transaction. It was the plea of the Assessee that the price would depend on quantity imported and used in the manufacture of computers and hence weighted average would be the most appropriate price that should be chosen for comparison. In support of its contention that weighted average price is more appropriate the Assessee relied on decision of ITAT Mumbai Bench in the case of Gharda Chemicals Ltd. 2009 TIOL 790 (MumbaiITAT) and Audco India Ltd. 47 SOT 420. The third reason given by the TPO was that industry average billing will not be reflected in CUP method. The TPO placed reliance on decision of Special Bench ITAT Bangalore in the case of Aztec Software & Technology Vs. ACIT. The Assessee's reply to this objection was that the said case related to a Software Industry which was different from import of components/parts and that the IT(TP)A No.281/Bang/2021 method used in that case of external CUP and not internal CUP as in Assessee's case.

The last objection of the TPO was that there was no publicly available information on prices charged in independent transactions of similar or identical nature, so external CUP cannot be applied. The reply of the Assessee on this objection was that when internal CUP is used there is no need to look at publicly available information and doing so will be against the basic feature of CUP method of determination of ALP.

7. The Assessee also submitted that for the prior AYs (i.e. AY 2006-07 to 2015-16), the Assessee had adopted CUP as MAM to benchmark its international transaction of Import of parts and components for manufacture of PCs pertaining to its manufacturing segment. The Assessee submitted that the functions performed for undertaking its manufacturing activity for all the years i.e. AY 2006-07 to AY 2015-16 have remained the same and accordingly, CUP was considered as the MAM for the subject AY as well. It was also submitted that the Hon'ble ITAT of Bangalore in Assessee's own case has upheld the application of CUP Method adopted by the Assessee for benchmarking the subject transaction in AY 2006-07 to AY 2009-10 and AY 2010-11. Copies of ITAT Orders with clear findings for these years was also filed before the TPO.

8. The TPO however applied the Transaction Net Margin Method (TNMM) as the MAM and determined ALP which resulted in an addition of Rs.67,09,25,862 to the total income of the Assessee in the draft assessment of the AO. The Assessee filed objection to the proposed addition before the Dispute Resolution Panel (DRP) but the DRP upheld the order of the TPO. The DRP upheld the order of the TPO by observing that in CUP method strict comparability is required and such comparability is not possible in the case of the Assessee. The DRP also upheld application of TNMM as MAM and methodology adopted to determine ALP under the TNMM by the TPO.

9. Aggrieved by the order of the DRP, the Assessee has raised Grd.No.II before the Tribunal. We shall first take up Gr.No. II sub grounds 2 to 6 which grounds relate to the contention of the Assessee that CUP should have been accepted as the MAM. We have heard the rival submissions. As far as the issue of MAM in the case of the Assessee in the transaction of import of components is concerned, we have already extracted the reasons assigned by the TPO for rejecting CUP as MAM and the reasons given by the Assessee as to why the reasons assigned by the TPO are unsustainable.

10. In AY 2006-07, the Tribunal has in its order dated 30.5.2016 in IT (TP) A.No.582/Bang/2015 upheld the DRP's direction that CUP is the MAM to be applied in the case of the Assessee. In AY 2007-08, the DRP upheld CUP as the MAM and the department did not file any appeal against that order of DRP before the Tribunal. In AY 2008-09 the TPO vide his order dated 31.10.2011 accept Assessee's adoption of CUP as MAM and also accepted that price paid in the international transaction to the AE is at Arm's Length. In AY 2009-10 in ITA(TP)A.No.74/Bang/2014 order dated 6.7.2018 the Tribunal upheld order of the DRP accepting CUP as MAM. In AY 2010-11 the Tribunal in IT(TP)A No.580/Bang/2015 order dated 31.3.2017 upheld the order of the DRP upholding CUP as MAM. There are no changes in the facts and circumstances in the present AY and hence the decision of the Tribunal rendered in the past will apply to the present AY 2015-16 also.

11. We are therefore the view that CUP should be adopted as the MAM. We direct the TPO to apply CUP as the MAM and determine ALP after due opportunity of being afforded to the Assessee. Ground II sub-grounds 2 to 6 are allowed. In view of the above conclusions the other sub-grounds 7 to 11 raised in Ground No.II does not require any adjudication.

4.2 Respectfully following the above judgment of the coordinate bench of the Tribunal in assessee's own case, we allow the grounds IT(TP)A No.281/Bang/2021 raised by the assessee that the CUP is MAM for the determination of international transactions for the computation of PLI in above terms. Accordingly ground No. 2 to 6 are allowed. In view of our above conclusions, the ground No.7 to 13 raised by the assessee does not require any adjudication.

AMP Expenditure pertaining to trading segment - Ground

5. Ground No. III relates to the adjustment of alleged excess AMP expenditure pertaining to trading segment as an international transaction and determining the ALP and making the consequent addition to the total income of the Appellant. The Appellant is engaged in the business of manufacturing and distribution of desktop, laptop, servers, and smartphones. During the relevant previous year, the Appellant incurred expenditure in connection with advertisement marketing ,

sales promotion campaigning, depicting features of new products, providing information to the public about details of product, its specification etc. The aforesaid advertisement and business promotion activities undertaken by the Appellant are specific to the products sold in India. As per the TPO the assesse should be compensated for additional AMP functions performed in the form of above noted functions. But the assessee's contention is that the selling of the products in India is the function of the Appellant therefore, there are no approvals sought by the Appellant in connection with the incurrence of said expenses which influences the volume of sales of the Appellant. Also to clarify further, the advertisement contents are decided by IT(TP)A No.281/Bang/2021 the Appellant and the said expenses does not require any approval from its AEs. The aforesaid activities are primarily to promote the business of Appellant and the same is done to influence the volume of sales of the Appellant in India. The ld. TPO issued show cause notice and observed that the appellant has not confined itself to distribution of trading goods but has performed additional functions in the form of AMP. Therefore, the Company needs to be adequately compensated for such additional functions. (Refer Page 270 of Appeal Set) , RPM analysis carried out by the Appellant in the TP Doc is flawed as AMP is not captured while calculating gross margin. (Refer Page 271 of Appeal Set) , Ratio of AMP to sales incurred by 9 comparable companies selected by the Appellant for benchmarking trading segment is much lower than the ratio of AMP to sales as incurred by Lenovo India thereby TPO is of the view that Appellant has incurred much higher AMP expenditure than the industry average. (Refer Page 272 of Appeal Set), The excessive AMP expense constitutes an international transaction. This additional function of building marketing intangible for the AE should have been reimbursed by AE to the Appellant with a markup. (Refer Page 272 of Appeal Set). The ld. DRP also upheld the observations of the ld. TPO., 5.1 The appellant reiterated the submissions made before the lower authorities and filed written submission which is as under:-

The Appellant's arguments before ITAT

15. It is submitted before your Honor's that incurring of AMP expenses does not constitute an international transaction and in this regard, the Appellant has summarized its arguments as below:

IT(TP)A No.281/Bang/2021 • AMP expenditure is not an international transaction under purview of Section 92 of the Act (Refer page 1497 of PB Vol 3) • Reliance on various case laws that have directed deletion of transfer pricing adjustments determined by the lower authorities by alleging the excess AMP expenditure as a separate international transaction. (Refer page 1497 of PB Vol 3) • AMP expenses are paid to third parties and not to AEs. AMP expenses do not also fall within the definition of international transactions.

• AMP expenditure is essential to boost sales and the direct benefit is received by Appellant and not by its AEs (Refer page 1528 of PB Vol 3) • The Appellant is solely responsible for improving its market share (Refer page 1532 of PB Vol

3) • Principal-to-principal relationship (Refer page 1533 of PB Vol 3) o The Appellant acts as a limited-risk distributor of Lenovo products imported from its AEs and these

transactions are carried out on a principal-to-principal basis.

o The essence of the transaction is appointment of the Appellant as a non-exclusive distributor of Lenovo products imported from its AEs, such transaction being on principal-to-principal basis.

o The Appellant's intention to buy products from AEs and sell the same in India on principal-to-principal basis.

o Thus, the Appellant only acts as a distributor of the products imported from AEs and at no point of time acts as their agent.

6. Without prejudice to the above argument that the AMP expenditure incurred by the Appellant does not constitute an international transaction under Chapter X of the Act, the Appellant would like to bring to your Honor's notice the principles coming out of the Delhi HC ruling in the case of Sony Ericsson Mobile Communications India P. Ltd. v. CIT, 374 ITR 118 (Del). The relevant extract of the ruling of the Delhi High Court is as under:

> "101. However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the interlinked transaction. This would be also in consonance with Rule 10B(1), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible."

(Emphasis supplied) The Delhi HC has also held, where the learned AO / TPO accepts comparables as a bundled transaction, AMP expenditure cannot be treated as a separate international transaction. The relevant extract of the ruling is as follows:

> "...(v) Where the Assessing Officer/TPO accepts the comparables adopted by the assessed, with or without making adjustments, as a bundled transaction, it would be illogical and improper to treat AMP expenses as a separate international transaction, for the simple reason that if the functions performed by the tested parties and the comparables match, with or without adjustments, AMP expenses are duly accounted for. It would be incongruous to accept the comparables and determine or accept the transfer price and still segregate AMP expenses as an international transaction..."

(Emphasis supplied) IT(TP)A No.281/Bang/2021

17. In the case of Maruti Suzuki (ITA 110/2014 & ITA 710/2015), it was held that the AMP expenditure cannot be considered as an international transaction. Below is the relevant paragraph from the order:

> 44. However, in the present appeals, the very existence of an international transaction is in issue.

The specific case of MSIL is that the Revenue has failed to show the existence of any agreement, understanding or arrangement between MSIL and SMC regarding the AMP spend of MSIL. .....

51. The result of the above discussion is that in the considered view of the Court the Revenue has failed to demonstrate the existence of an international transaction only on account of the quantum of AMP expenditure by MSIL. Secondly, the Court is of the view that the decision in Sony Ericsson holding that there is an international transaction as a result of the AMP expenses cannot be held to have answered the issue as far as the present Assessee MSIL is concerned since finding in Sony Ericsson to the above effect is in the context of those Assessees whose cases have been disposed of by that judgment and who did not dispute the existence of an international transaction regarding AMP expenses."

86. ..... As far as MSIL is concerned, its operating profit margin is 11.19% which is higher than that of the comparable companies whose profit margin is 4.04%. Therefore, applying the TNMM method it must be stated that there is no question of TP adjustment on account of AMP expenditure.

(Emphasis supplied)

18. In a recent case of Hon'ble Bangalore Tribunal in the case of HP India Sales Private Limited [IT(TP)A No.524/Bang/2017] it was held that merely because the AE has a financial interest, it cannot be presumed that AMP expenses incurred by the Assessee are at the instance or on behalf of the associated enterprise. It was held that in absence of any international transaction relating to AMP expenses, the impugned TP adjustment cannot be sustained. Further, the Hon'ble bench also held that The Hon'ble Delhi High Court in Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT [2015] 374 ITR 118 held that once the revenue accepts the entity level margins as per the most appropriate method, it would be inappropriate to treat a particular expenditure as a separate international transaction. It was held that such an exercise would lead to unusual and absurd results.

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19. Inthe Appellant's own case for AY 2015-2016, AY 2014-2015, AY 2013-2014 & AY 2012-2013, the Hon'ble Tribunal has deleted the Transfer Pricing adjustment with regard to the above AMP expense. Below are the relevant extracts from the orders of the Hon'ble Tribunal:

Ruling	Findings
Lenovo India Private Limited Bangalore Tribunal	Relevant Para:
Order Date: 06.03.2020	would be just and appropriate to set aside

determination of net margin of the assessee and in the trading AY: 2015-2016 segment, as claimed by the assessee in Scenario-3 before the TPO. If the margins are accepted as at arm's length and then applying the principles laid down by the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India P. Ltd. (supra), incurring of AMP expenses cannot be treated as international transaction and consequently determination of ALP would not arise for consideration at all. We therefore set aside the order of the AO and remand the issue to the TPO for consideration of ALP of the trading segment applying the net profit margin method and if by such method the price received in the international transaction is considered as at arm's length, then no separate addition needs to be made. In view of the above conclusion, we are of the view that sub- grounds (23) to (34) in ground III does not require adjudication at this stage.

	[refer page 89 of Case Law Compilation]
Lenovo India Private Limited Bangalore Tribunal	Relevant Para:
Order Date: 13-06-2022	ordinate Bench in assessee's own case for A

2015-16 and remit the issue to the TPO for consideration of ALP of AY: 2014-2015 the trading segment applying the net profit margin method, and if as a result, the price received is found to be at arm's length, no separate addition needs to be made.

	[refer page 59 of Case Law Compilation]
Lenovo India Private Limited Bangalore Tribunal	Relevant Para:
Order Date: 21-03-2022	computing the ALP of the trading segment. F

categorical observation by the Ld.TPO regarding the trading AY: 2013-2014 segment to be at arm's length, we direct the Ld.AO/TPO to delete the adjustment proposed, in respect of the AMP expenses as it cannot be treated as international transactions in the present facts of the case. [Page 25 of the ITAT order] [refer page 35 of Case Law Compilation] IT(TP)A No.281/Bang/2021 Lenovo India Private Limited Relevant Para:

> Bangalore Tribunal Order Date: 05.05.2022 expenses, in the facts and circumstances of the case, cannot be considered as an international transaction. In support of this AY: 2012-2013 contention, he brought out certain facts and also placed reliance on the decision rendered by Hon'ble Delhi High court in the case of Maruti Suzuki Ltd

(supra). We notice that the facts surrounding the AMP expenses have to be examined by AO/TPO vis-a-vis the decision rendered by Hon'ble Delhi High court in the above said case. Further, we notice that the co-ordinate bench has restored an identical issue to the file of AO/TPO in AY 2015-16, we prefer to restore this issue to the file of AO/TPO in this year also. We also direct AO/TPO to first examine the applicability of decision rendered by Hon'ble Delhi High court in the case of Maruti Suzuki India Ltd. (supra) to the facts of the present case and accordingly first determine the question as to whether the AMP expenses would fall under the category of international transaction. If it is held to be not an international transaction, then the question of making any transfer pricing adjustment will not arise. After hearing the assessee and examining the facts afresh, the AO/TPO may take appropriate decision in accordance with law.

[refer page 5 of Case Law Compilation]

20. From the above order of the Hon'ble Tribunal clearly indicates thatif the net profit margin meets the Arm's length price, then no separate addition needs to be made. It is pertinent to note that the net level margin of the Lenovo India for trading segment is 0.97%, which is within the arm's length range of the comparable companies(please refer page 1084 of PB Vol II). In the present Assessment year, the Ld. TPO has not made any adjustment in the trading segment adopting the TNMM method.

21. Further, it is respectfully submitted that the Hon'ble Tribunal in AY 2013-2014 at page 25 of the orderclearly stated that the issue of AMP should not be remanded back.Further, considering Ld. TPO has accepted the ALP of Appellant in trading segment to be at arm's length, Hon'ble Tribunal directed Ld. TPO to delete the adjustment proposed, in respect of the AMP expenses as it cannot be treated as international transactions in the present facts of the case.

22. Therefore, the said issue should not be sent back to the Ld. TPO for further verification and applying the principles laid down by the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India P. Ltd. (supra) and following the Hon'ble Tribunals ruling in Appellant's own case for AY 2015-16,AY 2014-2015, AY 2013-2014 & AY 2012-2013 it should be concluded that no separate TP adjustment for alleged AMP expenses is warranted.

23. In light ofthe above para, we request the Hon'ble Tribunal to providea clear direction to the TPO to delete the AMP adjustment.

In view of such finding, the argument whether AMP is an international transaction in the present case becomes academic.

6. The ld. DR relied on the order of the lower authorities and submitted that the huge expenses incurred by the asseseee compared to the previous year which is 2.71% of the turnover. The assesse had not carried out any exercise to determine the ALP of IT(TP)A No.281/Bang/2021 such expenses although these were leading to rise of marketing intengibles in the form of brand value for AEs of

the assessee. The TPO concluded that the benefit arising out of AMP expenses over and above average marketing expenses towards sales is a benefit arising to AEs and not to the assessee and so the AEs should reimburse the assesse with a mark-up for the marketing support given by the assesse for promoting the Brands. The AMP function is an international transactions which was confronted to the assesse by show-cause notice. It is undisputed fact the AE is the legal owner for brands marketed by the assesse and located outside India. The expenses incurred by the assesee enhances the value of the marketing intangibles of the AE, therefore the assesse needs to be compensated for such additional functions undertaken by it, since the assesse is only distributor. It is also evident from the agreement between the parties that the assesse has to undertake advertisement. The assesse has incurred huge expenses towards AMP which is dictated by the AE which is over and above the level of AMP spent by a routine distributer needs to be identified and compensated by the AE. The TPO has rightly benchmarked the AMP expenses.

7. Considering the rival submissions, we are of the view that this issue is covered from the order of the co-ordinate bench of Tribunal in favour of the assessee in the assessee's own case for assessment year 2015-16 in ITA No. 2444/Bang/2019, the relevant part of the order is reproduced as under:-

> IT(TP)A No.281/Bang/2021
>
> 13. As we have already seen the assessee company is engaged in the business of manufacturing and distribution of desktop, laptop, servers and smartphones. During the relevant previous year, the assessee incurred expenditure in connection with campaigning, depicting features of new products, providing information to the public about details of product, its specification etc. According to assessee, the aforesaid advertisement and business promotion activities undertaken by the assessee are specific to the products sold in India. It was the contention of assessee that in the trading segment of desktop, laptops etc., it decides on advertisement, training etc. According to the Assessee the expenditure so incurred was to improve its sale and it cannot be said that by incurring such expenses, the assessee promoted the brand of its foreign AE. It was the case of revenue that assessee did not confine itself to distribution of trading goods, but has performed additional functions in the form of advertisement and marketing promotion to promote the brand of foreign AE and therefore the assessee needs to be adequately compensated for such additional function. The TPO adopted Resale Price Method (RPM) as the most appropriate method. The TPO chose 9 comparable companies and arrived at the AMP to sales of those companies and compared the same with that of the assessee. By such comparison, the TPO came to the conclusion that assessee was incurring much higher AMP expenditure than the industry average and incurring of excessive AMP expenses constitutes an international transaction of promotion of AE's brand. The TPO concluded that assessee performed additional functions which promoted the marketing intangibles of the AE and that the assessee should have been reimbursed by the AE the additional expenses along with mark-up. In other words, the TPO adopted the Brightline Test in making the aforesaid addition. The DRP upheld the order of the TPO.

14. The ld. counsel for the assessee submitted before us that incurring of AMP expenses does not constitute an international transaction and in this regard filed before us a copy of the decision of the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India P. Ltd. v.

CIT, 374 ITR 118 (Del). Our attention was drawn to para 101 of the aforesaid decision in which the Hon'ble Delhi High Court held that once the TPO accepts and adopts TNM Method and then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation and segregation, it would lead to an unusual and incongruous results as AMP is the cost or expense and is not diverse. It is factored in the net profit of the interlinked transaction. This would be also in consonance with Rule 10B(1)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make IT(TP)A No.281/Bang/2021 a comparison of a horizontal item without segregation would be impermissible.

15. The ld. counsel for the assessee pointed out that in the present case, the TPO accepted the international transaction of trading of AE's product as at arm's length and in this regard drew our attention to para 6 of the TPO's letter dated 26.9.2018, a copy of which is at pages 934 to 972 of assessee's PB. The relevant para 6 is at page 946 in which the TPO accepted that the PLI of 9 comparables chosen by the assessee was 4.23% and that taxpayer's PLI was 13.08%. In the TP order, the TPO did not make any adjustment in the trading segment and therefore it is presumed that he has accepted the transaction of trading with the AE as at arm's length. The ld. counsel for the assessee submitted that following the decision of the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India P. Ltd. (supra), incurring of AMP expenses cannot be regarded as an international transaction at all.

16. The Bench queried that in the case decided by the Hon'ble Delhi High Court, TNM Method was adopted whereas in the case of assessee in the trading segment RPM has been adopted and that would make a difference. The ld. counsel for the assessee firstly pointed out that the AMP addition on account of determination of AMP expenses has been made only in the trading segment and in this regard drew our attention to an order dated 14.11.2018 passed by the TPO u/s. 154 of the Act wherein the fact that AMP expenditure is in relation to trading segment only has been accepted by the TPO. His next submission was that the assessee has also demonstrated in its TP study with regard to the trading segment that the net margins earned by it were at arm's length. In this regard, the ld. counsel for the assessee brought to our notice that even before the TPO, the assessee had given the net margins by way of alternative submission and those details are at pages 1392 and the computation is at page 1540. Our attention was drawn to the fact that Scenario-3 was projected by the assessee in which the net margin of the comparable companies was arrived at 2.62% and the assessee's net profit margin was 1.45% which was within the +/- range permitted under proviso to

section 92CA(2) of the Act.

17. We have considered his submission and are of the view that it would be just and appropriate to set aside the issue of determination of net margin of the assessee and in the trading segment, as claimed by the assessee in Scenario-3 before the TPO. If the margins are accepted as at arm's length and then applying the principles laid down by the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications India P. Ltd. (supra), incurring of AMP expenses cannot be treated as international transaction and consequently determination of ALP would not arise for consideration at all. We therefore set aside the order of the AO and remand the issue to the TPO for consideration of ALP of the trading segment applying the net profit margin method and if by such method the price received in the international transaction is considered as at arm's length, then no separate addition needs to be made. In view of the above IT(TP)A No.281/Bang/2021 conclusion, we are of the view that sub-grounds (23) to (34) in ground III does not require adjudication at this stage.

7.1 Respectfully following the above judgment of the coordinate bench of the Tribunal in assessee's own case, we are of the view that ground No.14 to 24 is allowed in above terms and ground No.25 to 36 does not require any adjudication at this stage.

8. Ground No.37 to 39 are general in nature, hence does not require any adjudication.

Disallowance of Provision for Warranty Ground No.40 to 44 The AR submitted written synopsis which is as under:-

> Ground NO. V - DISALLOWANCE OF PROVISION FOR WARRANTY

9. During the course of the assessment proceedings, the AO enquired regarding the process of creation of warranty. In response, the assessee made submission dated December 19, 2019 and December 24, 2019, & he submitted that the provision for warranty (after deduction of actual expenditure incurred during the year) was created based on the total number of warranty obligations outstanding as of 31 March 2016. Further, the methodology of computation of provision for warranty along with the worksheet demonstrating the same was submitted. .The appellant submitted as under:-

> > The Appellant is engaged in manufacturing and trading of computer system and components thereof. In line with the practice followed by companies in this industry, the cost of providing warranty services is factored into the selling price of the product. Therefore, at the time of sale, Lenovo India commits to repair the product in case it fails in the future and in order to pay such commitment, Lenovo India sets aside funds when the products are sold. There are a number of factors affecting the determination of warranty provision to be set aside by the company at the time of sale, which also includes fixed or standing charges for which payments are accrued and payments have been made during the year. As already submitted to the IT(TP)A No.281/Bang/2021 learned AO, the amount that is set-aside for meeting the warranty

obligations of Lenovo India is computed based on a scientific and technical estimate of the costs to be incurred in meeting these obligations over the period of the warranty. The formula used by the Appellant is provided below:

Machine months X Repair rate X Cost per claim Where:

- Machine months is the factor of the unexpired warranty period in months and the number of desktops/ laptops/ smartphones which are under warranty at the end of the year;

- Repair rate is the percentage of claims out of the total sales made on the historical data for the region; and

- Cost per claim is the average expected repair cost per desktops/ laptops/ smartphones based on historical data for the region Therefore, the Appellant submits that the method followed for creation of warranty is scientific and the same has not been created on an ad- hoc basis.

As per the provisions laid down in AS 29 a provision is a liability which can be measured only by using substantial degree of estimation. Further, provision can be recognized on fulfillment of the following conditions:

• There is a present obligation as a result of past event;

• It is probable that an outflow of resources embodying economic benefit will be required to settle the obligation; and • A reliable estimate can be made of the amount of obligation.

In light of the aforementioned conditions, it can be said the Company had a present obligation to make good the claims under warranty, which is arising out of the past sales . Since the Company has no other realistic alternative in settling the warranty obligation arising due to sale, it is an obligating event for the Company and thus, the Company satisfies the first condition stipulated in AS 29 for the recognition of provision.

Further, in case of warranty claims made by the customers, the Company is obligated to make good the claim by virtue of warranty agreement and this essentially results in outflow of resources embodying economic benefit to the Company and thus, the same satisfies the second condition stipulated in AS 29 for the recognition of provision.

On the third condition, it would be relevant to note that the Company, after having considered the present obligation arising from the past event, the outflow of resource and the past experience has a scientific methodology which is followed consistently year on year for the creation for provision for warranty.

IT(TP)A No.281/Bang/2021 The scientific methodology followed by the Company year on year for creation of provision for warranty is dependent on the sales, the repair rate, cost of servicing the warranty claims and the utilisation of warranty provision for each year.

The details of provision for warranty created over years is enclosed as Appendix-1.The Appellant submits that it provides warranty ranging from 1 to 3 years on sale of desktops, laptops and smartphones made to customers in India. Theutilization of a particular year cannot be compared with the provision of the same year but should be compared to provision of the preceding year against which such utilization is made. Accordingly, the learned AO has erred in comparing the utilization over provision of the same year to arrive at the conclusion that the provision for warranty is an unascertained liability. In this regard, a specific reference is made to the ruling of Hon'ble ITAT in Appellant's own case for AY 2006-07 and AY 2015-16, wherein the Hon'ble ITAT has held as under:

Further in this context, we submit that the Honourable ITAT in the Company's own case for AY 2006-07, AY 2007-08, AY 2010-11, AY 2011-12, AY 2012-13, AY 2013-14 and AY 2015-16 has upheld that provision for warranty has been created on a scientific basis and hence allowable as expenditure under section 37 under the Act. The relevant extract of the orders passed by Honourable ITAT in the Company's case for AY 2006-07, AY 2007-08, AY 2010-11 and AY 2011- 12, AY 2012-13, AY 2013-14, 2014-15 and AY 2015-16 has been mentioned below:

AY 2006-07 "Para 16- We are of the opinion that the three conditions set out by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd have been satisfied by the assessee, viz., establishing that there is a present obligation on account of a past event, working out the probable estimate of the outflow of the resources required and substantiating the reliability of such estimate. Especially so since the assessee was mandatorily required to follow AS-I and principles of prudence stipulated in such AS-I required provisioning for all known liabilities even if it could not be determined with certainty, but was made based on available data. We therefore delete the addition made by the AO disallowing the provision for warranty." (Refer page 3108- 3111 of PB Vol IV) AY 2007-08 Placing the reliance on the Appellant's own case for the AY 2011-12 the Hon'ble ITAT has concluded:

"Para 5- Thus the Tribunal has taken a consistent view on this issue. The Id. Senior Counsel has also relied upon the decision dt. 10.4.2013 of Hon'ble jurisdictional High court in the case of CIT Vs. IBM India Limited for the Assessment Year 1998-99 wherein the Hon'ble Supreme Court has held that the conditions as stipulated by the Hon'ble Supreme Court in the decision in the case of Rotork Controls India Pvt. Ltd. Vs. CIT (supra) were found to be fulfilled and no case of interference with the finding of the Tribunal is made out. It is pertinent to note that in this case the assessee has acquired this business from IBM and for the Assessment Year 2006-07, the claim of

the assessee for the provision of warranty was based on historical data of IBM. Thus in IT(TP)A No.281/Bang/2021 view of the above facts and circumstances of the case as well as by following the decision of Tribunal in assessee's own case, we decide the issue in the favour of the assessee and allow the claim of the assessee on the account of provision for warranty which was found to be based on scientific basis and method." (Refer page 3115- 3119 of PB Vol IV) AY 2010-11 "We have heard the Id Senior Counsel as well as Id. CIT,DR and considered relevant material on record. This issue is identical as involved in the assessee's own case for the Assessment Year 2007-08, in view of our finding on the this issue for the Assessment Year 2007-08, this ground stands allowed.

AY 2011-12 "Para 10- It is worth mentioning that the co-ordinate bench has considered the historical data pertaining to financial year 2005-06 to 2010-11 and came to conclusion that the provision was made based on historical data and following scientific method. Therefore, we do not find any reason to interfere with the conclusion reached by the co-ordinate bench. Accordingly, we hold that provision for warranty expenditure is allowable".(Refer page 3149- 3152 of PB Vol IV) The Honourable ITAT had relied on the decision of the Honorable Supreme Court ("SC") in the case of Rotork Controls India Private Limited (supra), while upholding Lenovo India's claim for deduction of provision for warranty as an allowable expenditure AY 2012-13 "Para 5.3- We also notice that an identical disallowance made by the AO in assessment year 2011-12 has since been allowed by Hon'ble High Court of Karnataka in the assessee's own case following the decision rendered by Hon'ble Supreme Court in the case of Bharat Earth Movers Vs. CIT 245 ITR 278 by holding that no substantial question of law has arisen on this issue. Accordingly, following the decision rendered by the coordinate bench as well as Hon'ble jurisdictional High Court, we direct the A.O. to delete the disallowance of Rs.3,49,28,600/- relating to provision for warranty"

AY 2013-14 Placing the reliance on Appellant's own case for AY 2006-07, AY 2007-08, AY 2010-11 and AY 2011-12 the Hon'ble ITAT has concluded:

"Based on the consistent view taken by coordinate bench of this Tribunal in assessee's own case for preceding and subsequent assessment years relying of the decision of the Hon'ble Supreme Court in the case of Rotork Controls India Pvt.Ltd (supra), we hold that provision for warranty expenditure is allowable".

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AY 2014-15

Para 24- We notice that the Tribunal has been consistently taking the similar view in assessee's own case for Assessment Year 2006-07, 2007-08, 2010-11 to 2015-16 also. Therefore, we respectfully follow the decisions of the Co-ordinate Bench and hold that the provision for warranty is an allowable expenditure.

AY 2015-16 (supra) "Para 34- The hypothetical computation by the revenue authorities of percentage of actual claim for the year and provision made for the very same year, cannot be sustained because the basis of providing warranty is Machine months x repair rate x cost per claim. The tribunal has already pointed out the flaw in the approach of the revenue authorities in its order for AY 2006-07 that the basis should be the actual expenditure incurred on discharge of warranty claims in future which is much more than the provision made in an earlier year. The warranty obligation is not just for one year and it spreads over a period of more than 1 year and therefore the comparison as done by the revenue authorities is unsustainable. The method followed by the Assessee for creating provision for warranty has been held to be scientific and based on historical data of sales and repair ratio in every region in which the products are sold. The method has been accepted by the Tribunal in its order for several AYs. The method followed has not been shown to be not scientific by the revenue authorities. In such circumstances, we are of the view that the method followed by the Assessee should be accepted as proper and the deduction allowed as per the provision created by the Assessee. We hold and direct accordingly".

9.1 The AO noticed During the current year that the assesse has debited an expenditure of Rs.4,07,24,39,923/- and utilized during the year is Rs.2,21,30,13,876/-. The movement of the warranty is as under:-

IT(TP)A No.281/Bang/2021 9.2 In this regard, the assessee was asked to file details and assessee submitted that the warranty outstanding as on 31/03/2016 are number of desk tops, laptops and smart phone that carried valid warranty. He further submitted that the warranty has been created as per Accounting Standard 29 and is based on the work formula, which as under:-

IT(TP)A No.281/Bang/2021 IT(TP)A No.281/Bang/2021 IT(TP)A No.281/Bang/2021 9.3 The movement in the provision for warranty on the earlier years and on account year is as under:-

9.4 The AO did not accept the contentions of the assessee and he relied on the judgment of the Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd., Vs. CIT (2009) reported in 314 ITR

62. Further the AO from the above tables noted as under:-

"5.13 From the above, it can be noted that the sales turnover has increased from Rs.1044.24 crores in FY.2005-06 to Rs.1805.40 crores in FY.2007-08.

Subsequently. there is drop in turnover to Rs 1286.92 crores in FY.2008-09 with a marginal increase to Rs.1329.58 crores in FY.2009-10. Here, it is noted that there is drastic increase in Warranty provision created from Rs.61.21 crores in FY.2007-08 to as high as Rs.108.79 crores in FY.2008- 09, though there is fall in turnover from Rs. 1805.40 crores in FY.2007-08 to Rs.1286.92 crores in FY2008-09. Thus, provision created has increased from 3.34% of turnover to 8.40% of turnover in FY.2008-09. There is no IT(TP)A No.281/Bang/2021 reason as to why there is such a huge jump in provision created even though there is reduction in sales turnover.

5.14 Further, it is seen that the provision created has fallen from Rs.108.79 crores in FY.2008-09 to Rs-97.20 crores in FY.2009-10, inspite of increase in turnover from Rs. 1286.92 crores in FY.2008-09 to Rs. 1329.58 crores in FY.2009-10. Here, provision created has fallen from 8.40% to 7.31% in FY.2009-10. Even if it is presumed that the reason for increase in provision created was due to increase in service cost including labor, travelling expenses. etc., the same does not justify the fall in provision created in the very next year though there is increase in turnover.

> " 5.15 The Warranty provision utilized over the years has always been less than the provision created. Never ever the provision utilized has crossed the water mark of provision created. Consequently. the closing balance of the provision created has increased over the years. which has reached as high as Rs. 407.24 crores in FY 2015-16 when compared to Rs.27.27 crores in FY.2005-06. This shows that such a huge amount of Rs.407.24 crores has been claimed as expense over the years without actually incurring the same and the claim of the provision for warranty though increasing year after year has not been charged to tax.
>
> 5.16 During the current financial year 2015-16, the provisionade is Rs. 407,24,39923/-. But the total expenditure incurred during the year on warranty is Rs. 221,39,13,876/-, which works out to as low as 54.36% of the total provision created. The provision utilized is nowhere near provision created when compared to FYs.2006-07 to 2008-09. Thus the assessee is making excessive provisions which do not have a correlation with the actual expenditure and thus reducing its tax liability.
>
> 5.17 From the above discussion and in view of above mentioned discrepancies, it is concluded that the assessee does not have a reasonable, scientific and reliable basis for the calculation of the provision for warranty. Accordingly. provision for warranty of Rs.407,24,39,923/- created by the assessee is contingent and unascertainable in nature and hence not allowed as a revenue expense u/s.37 of the I.T. Act. However, in the interest of natural justice, it would be fair to allow the actual expenditure incurred of 221,39,13,876/-. Hence, an amount of Rs.185,94,26,047/- being difference of provisional warranty created and actual expenditure incurred (Rs. 407,24.39.923 - 221.39,13,876) is disallowed and added to the income.

9.5 The assesse filed objection before the ld. DRP, the ld. DRP, upheld the Draft order of the AO, accordingly the AO passed final assessment order.

IT(TP)A No.281/Bang/2021 9.6 In regard to the disallowance of excess provision for warranty the assesse challenged before the ITAT against the final assessment order. The ld.AR reiterated the submissions made before the lower authorities and filed written synopsis and he submitted the assessee has maintained scientific method for calculation of provision for warranty. Further, in case of warranty claims made by the customers, the Company is obligated to make good the claim by virtue of warranty agreement and this essentially results in outflow of resources embodying economic benefit to the Company and thus, the same satisfies the second condition stipulated in AS 29 for the recognition of provision. On the third condition, it would be relevant to note that the Company, after having considered the present obligation arising from the past event, the outflow of resource and the past experience has a scientific methodology which is followed consistently year on year for the creation for provision for warranty. The scientific methodology followed by the Company year on year for creation of provision for warranty is dependent on the sales, the repair rate, cost of servicing the warranty claims and the utilisation of warranty provision for each year. The details of provision for warranty created over years is enclosed in the paper book.The Appellant submits that it provides warranty ranging from 1 to 3 years on sale of desktops, laptops and smartphones made to customers in India. The utilization of a particular year cannot be compared with the provision of the same year but should be compared to provision of the preceding year against which such utilization is made. Accordingly, the learned AO has erred in IT(TP)A No.281/Bang/2021 comparing the utilization over provision of the same year to arrive at the conclusion that the provision for warranty is an unascertained liability. In this regard, a specific reference is made to the ruling of Hon'ble ITAT in Appellant's own case for AY 2006- 07 to AY 2015-16, wherein the Hon'ble ITAT has held the issue in favour of the assesee. The detailed written synopsis filed by the ld. AR. Of the assesse are as under

> The Appellant is engaged in manufacturing and trading of computer system and components thereof. In line with the practice followed by companies in this industry, the cost of providing warranty services is factored into the selling price of the product. Therefore, at the time of sale, Lenovo India commits to repair the product in case it fails in the future and in order to pay such commitment, Lenovo India sets aside funds when the products are sold. There are a number of factors affecting the determination of warranty provision to be set aside by the company at the time of sale, which also includes fixed or standing charges for which payments are accrued and payments have been made during the year. As already submitted to the learned AO, the amount that is set-aside for meeting the warranty obligations of Lenovo India is computed based on a scientific and technical estimate of the costs to be incurred in meeting these obligations over the period of the warranty. The formula used by the Appellant is provided below:
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> Machine months X Repair rate X Cost per claim Where:
>
> - Machine months is the factor of the unexpired warranty period in months and the number of desktops/ laptops/ smartphones which are under warranty at the end of the year;

- Repair rate is the percentage of claims out of the total sales made on the historical data for the region; and

- Cost per claim is the average expected repair cost per desktops/ laptops/ smartphones based on historical data for the region Therefore, the Appellant submits that the method followed for creation of warranty is scientific and the same has not been created on an ad- hoc basis.

As per the provisions laid down in AS 29 a provision is a liability which can be measured only by using substantial degree of estimation. Further, provision can be recognized on fulfillment of the following conditions:

• There is a present obligation as a result of past event;

• It is probable that an outflow of resources embodying economic benefit will be required to settle the obligation; and • A reliable estimate can be made of the amount of obligation.

IT(TP)A No.281/Bang/2021 In light of the aforementioned conditions, it can be said the Company had a present obligation to make good the claims under warranty, which is arising out of the past sales . Since the Company has no other realistic alternative in settling the warranty obligation arising due to sale, it is an obligating event for the Company and thus, the Company satisfies the first condition stipulated in AS 29 for the recognition of provision.

Further, in case of warranty claims made by the customers, the Company is obligated to make good the claim by virtue of warranty agreement and this essentially results in outflow of resources embodying economic benefit to the Company and thus, the same satisfies the second condition stipulated in AS 29 for the recognition of provision.

On the third condition, it would be relevant to note that the Company, after having considered the present obligation arising from the past event, the outflow of resource and the past experience has a scientific methodology which is followed consistently year on year for the creation for provision for warranty.

The scientific methodology followed by the Company year on year for creation of provision for warranty is dependent on the sales, the repair rate, cost of servicing the warranty claims and the utilisation of warranty provision for each year.

The details of provision for warranty created over years is enclosed as Appendix-1. The Appellant submits that it provides warranty ranging from 1 to 3 years on sale of desktops, laptops and smartphones made to customers in India. The utilization of a particular year cannot be compared with the provision of the same year but should be compared to provision of the preceding year against which such utilization is made.

Accordingly, the learned AO has erred in comparing the utilization over provision of the same year to arrive at the conclusion that the provision for warranty is an unascertained liability. In this regard, a specific reference is made to the ruling of Hon'ble ITAT in Appellant's own case for AY 2006-07 and AY 2015-16, wherein the Hon'ble ITAT has held as under:

AY 2006-07 "Para 16- We have perused the materials and heard the rival contentions. Question before us is whether assessee had made the provisioning for warranty in a scientific manner. It is not disputed that in the impugned assessment year it had started doing the business of sale of laptops and desktops. Obviously assessee had no historical data with it. It is also not disputed that assessee had taken over this business from IBM, who had substantial experience in such business. Hence, if the assessee relied on the methodology followed by IBM for working out the warranty provision we cannot say that it was incorrect. There is no case for the Revenue that any provisioning made by IBM in respect of such business in any earlier years were disallowed for a reason that it was unscientific. It is true that assessee had adopted two factors namely, repair action rate and cost per claim from IBM data available at Asia Pacific Level. It might also be true that assessee had not produced records relating to IBM to show that these rates were correctly worked out by IBM.....

There is -much strength in the argument of the Ld. AR that provision done for a year should be compared with the actual spending in the succeeding year. This is for the simple reason that IT(TP)A No.281/Bang/2021 expenditure incurred against warranty given on sales made in any given year would be reflected in the succeeding year, when the provisioning is done on the basis of machine months. Assessee had done the provisioning based on machine months. If by application of the formula of multiplying machine months with repair action rate and cost per claim, an excessive warranty provisioning had resulted, then definitely in the succeeding year the expenditure incurred on warranty would be much less. The table above would show that expenditure on warranty was higher in almost all succeeding years except financial year 2009-09. In such circumstances we cannot say that assessee had followed a method which was not scientific. We are of the opinion that the three conditions set out by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd have been satisfied by the assessee, viz., establishing that there is a present obligation on account of a past event, working out the probable estimate of the outflow of the resources required and substantiating the reliability of such estimate. Especially so since the assessee was mandatorily required to follow AS-I and principles of prudence stipulated in such AS-I required provisioning for all known liabilities even if it could not be determined with certainty, but was made based on available data. We therefore delete the addition made by the AO disallowing the provision for warranty. Ground 7 of the assessee stands allowed.

AY 2015-16 "Para 34- The hypothetical computation by the revenue authorities of percentage of actual claim for the year and provision made for the very same year, cannot be sustained because the basis of providing warranty is Machine months x repair rate x cost per claim. The tribunal has already pointed out the flaw in the approach of the revenue authorities in its order for AY 2006-07 that the basis should be the actual expenditure incurred on discharge of warranty claims in future which is much more than the provision made in an earlier year. The warranty obligation is not just for one year and it spreads over a period of more than 1 year and therefore the comparison as done by the revenue authorities is unsustainable. The method followed by the Assessee for creating provision for warranty has been held to be scientific and based on historical data of sales and repair ratio in every region in which the products are sold. The method has been accepted by the Tribunal in its order for several AYs. The method followed has not been shown to be not scientific by the revenue authorities. In such circumstances, we are of the view that the method followed by the Assessee should be accepted as proper and the deduction allowed as per the provision created by the Assessee. We hold and direct accordingly".

Without prejudice to the above, the Appellant wishes to draw the attention to the ratio of utilization to provision of immediate preceding year tabulated in Appendix-1, the Appellant has consistently incurred atleast 75% of the immediately preceding year's provision. This goes on to show that the Appellant is incurring warranty cost against its provision and the same is being tracked in a robust manner.

The Appellant submits that the Hon'ble HC in the case of Lenovo India for the year AY 2007-08 and AY 2011-12 has held ruled against the revenue and in favour of the Appellant. The relevant extract of the orders passed by Honourable HC in the Company's case for AY 2007-08 and AY 2011-12, are mentioned below:

AY 2007-08 and AY 2011-12

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"The Tribunal has rightly relied on the decision rendered by the Supreme Court in ROTORK CONTROLS INDIA PVT.LTD. supra. Similar view has been taken by a division bench of this court in IBM LTD. Supra. Therefore, the first and second substantial questions of law are answered against the revenue and in favour of the assessee." (Refer page 3183-3201 of PB Vol IV).

Further in this context, we submit that the Honourable ITAT in the Company's own case for AY 2006-07, AY 2007-08, AY 2010-11, AY 2011-12, AY 2012-13, AY 2013-14 and AY 2015-16 has upheld that provision for warranty has been created on a scientific basis and hence allowable as expenditure under section 37 under the Act. The relevant extract of the orders passed by Honourable ITAT in the Company's case for AY 2006-07, AY 2007-08, AY 2010-11 and AY 2011-12, AY 2012-13, AY 2013-14, 2014-15 and AY 2015-16 has been mentioned below:

AY 2006-07 "Para 16- We are of the opinion that the three conditions set out by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd have been satisfied by the assessee, viz., establishing that there is a present obligation on account of a past event, working out the probable estimate of the outflow of the resources required and substantiating the reliability of such estimate. Especially so since the assessee was mandatorily required to follow AS-I and principles of prudence stipulated in such AS-I required provisioning for all known liabilities even if it could not be determined with certainty, but was made based on available data. We therefore delete the addition made by the AO disallowing the provision for warranty." (Refer page 3108- 3111 of PB Vol IV) AY 2007-08 Placing the reliance on the Appellant's own case for the AY 2011-12 the Hon'ble ITAT has concluded:

> "Para 5- Thus the Tribunal has taken a consistent view on this issue. The Id. Senior Counsel has also relied upon the decision dt. 10.4.2013 of Hon'ble jurisdictional High court in the case of CIT Vs. IBM India Limited for the Assessment Year 1998-99 wherein the Hon'ble Supreme Court has held that the conditions as stipulated by the Hon'ble Supreme Court in the decision in the case of Rotork Controls India Pvt. Ltd. Vs. CIT (supra) were found to be fulfilled and no case of interference with the finding of the Tribunal is made out. It is pertinent to note that in this case the assessee has acquired this business from IBM and for the Assessment Year 2006-07, the claim of the assessee for the provision of warranty was based on historical data of IBM. Thus in view of the above facts and circumstances of the case as well as by following the decision of Tribunal in assessee's own case, we decide the issue in the favour of the assessee and allow the claim of the assessee on the account of provision for warranty which was found to be based on scientific basis and method." (Refer page 3115- 3119 of PB Vol IV) IT(TP)A No.281/Bang/2021 AY 2010-11 "We have heard the Id Senior Counsel as well as Id. CIT,DR and considered relevant material on record. This issue is identical as involved in the assessee's own case for the Assessment Year 2007-08, in view of our finding on the this issue for the Assessment Year 2007-08, this ground stands allowed.
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> AY 2011-12 "Para 10- It is worth mentioning that the co-ordinate bench has considered the historical data pertaining to financial year 2005-06 to 2010-11 and came to conclusion that the provision was made based on historical data and following scientific method. Therefore, we do not find any reason to interfere with the conclusion reached by the co-ordinate bench. Accordingly, we hold that provision for warranty expenditure is allowable".(Refer page 3149- 3152 of PB Vol IV) The Honourable ITAT had relied on the decision of the Honorable Supreme Court ("SC") in the case of Rotork Controls India Private Limited (supra), while upholding Lenovo India's claim for deduction of provision for warranty as an allowable expenditure AY 2012-13 "Para 5.3- We also notice that an identical disallowance made by the AO in assessment year 2011-12 has since been allowed by Hon'ble High Court of Karnataka in the assessee's own case following the decision rendered by Hon'ble Supreme Court in the case of Bharat Earth Movers Vs. CIT 245 ITR 278 by holding that no substantial question of law has arisen on this issue. Accordingly, following the

> decision rendered by the coordinate bench as well as Hon'ble jurisdictional High Court, we direct the A.O. to delete the disallowance of Rs.3,49,28,600/- relating to provision for warranty"

AY 2013-14 Placing the reliance on Appellant's own case for AY 2006-07, AY 2007-08, AY 2010-11 and AY 2011-12 the Hon'ble ITAT has concluded:

> "Based on the consistent view taken by coordinate bench of this Tribunal in assessee's own case for preceding and subsequent assessment years relying of the decision of the Hon'ble Supreme Court in the case of Rotork Controls India Pvt.Ltd (supra), we hold that provision for warranty expenditure is allowable".

AY 2014-15 Para 24- We notice that the Tribunal has been consistently taking the similar view in assessee's own case for Assessment Year 2006-07, 2007-08, 2010-11 to 2015-16 also. Therefore, we IT(TP)A No.281/Bang/2021 respectfully follow the decisions of the Co-ordinate Bench and hold that the provision for warranty is an allowable expenditure.

AY 2015-16 (supra) "Para 34- The hypothetical computation by the revenue authorities of percentage of actual claim for the year and provision made for the very same year, cannot be sustained because the basis of providing warranty is Machine months x repair rate x cost per claim. The tribunal has already pointed out the flaw in the approach of the revenue authorities in its order for AY 2006-07 that the basis should be the actual expenditure incurred on discharge of warranty claims in future which is much more than the provision made in an earlier year. The warranty obligation is not just for one year and it spreads over a period of more than 1 year and therefore the comparison as done by the revenue authorities is unsustainable. The method followed by the Assessee for creating provision for warranty has been held to be scientific and based on historical data of sales and repair ratio in every region in which the products are sold. The method has been accepted by the Tribunal in its order for several AYs. The method followed has not been shown to be not scientific by the revenue authorities. In such circumstances, we are of the view that the method followed by the Assessee should be accepted as proper and the deduction allowed as per the provision created by the Assessee. We hold and direct accordingly".

10. The ld. DR relied on the order of the lower authorities and he further submitted that the assesse has not demonstrated that there is any scientific method adopted by the assesse . The AO has examined the issue in detail and found that there is provisions is also excessive and unreasonable and has not followed the AS 29. The warranty provision utilized over the years has always been less than the provision created. Never ever the provision utilized has crossed the water mark of provision created. Consequently, the closing balance of the provision created has increased over the years, which has reached as high as Rs. 407.24 crores in F.Y. 2015- 16 when compared to 27.27 crores in F.Y. 2005-06. This shows that such a huge amount of Rs. 407.24 crores has been claimed as expenses over the years without actually incurring the same and IT(TP)A No.281/Bang/2021 claim of the provision for warranty though increasing year after year has not been charged to tax.

11. Considering the rival submissions, we are of the view that this has been considered by the co-ordinate bench in the assessee's own case for assessment year 2015-16, the relevant part is reproduced as under:-

> 31. We have heard the rival submissions. The learned counsel for the Assessee submitted before us that the approach of the AO and the DRP is flawed because they have compared the provision made in AY 2015-16 with the actual liability incurred on account of performance of warranty claims of the same AY 2015-16.

The proper approach should be to compare the current year provision with the actual of the succeeding year because the discharge of the warranty obligation will have only in the subsequent years and not in the year in which the products are sold. Our attention was drawn to the decision of the Hon'ble ITAT in AY 2006-07 in IT(TP) A.No.582/Bang/2015 dated 30.5.2016 wherein the Tribunal pointed out and explained how a similar approach of the revenue authorities are not correct. The following were the relevant observations of the Tribunal:-

> "16. We have perused the materials and heard the rival contentions. Question before us is whether assessee had made the provisioning for warranty in a scientific manner. It is not disputed that in the impugned assessment year it had started doing the business of sale of laptops and desktops. Obviously assessee had no historical data with it. It is also not disputed that assessee had taken over this business from IBM, who had substantial experience in such business. Hence if the assessee relied on the methodology followed by IBM for working out the warranty provision we cannot say that it was incorrect. There is no case for the Revenue that any provisioning made by IBM in respect of such business in any earlier years were disallowed for a reason that it was unscientific. It is true that assessee had adopted two factors namely, repair action rate and cost per claim from IBM data available at Asia Pacific Level. It might also be true that assessee had not produced records relating to IBM to show that these rates were correctly worked out by IBM. Nevertheless a look at the warranty provisioning table of the assessee for the succeeding assessment years reveals the following :
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> IT(TP)A No.281/Bang/2021 There is much strength in the argument of the Ld. AR that provision done for a year should be compared with the actual spending in the succeeding year. This is for the simple reason that expenditure incurred against warranty given on sales made in any given year would be reflected in the succeeding year, when the provisioning is done on the basis of machine months. Assessee had done the provisioning based on machine months. If by application of the formula of multiplying machine months with repair action rate and cost per claim, an excessive warranty provisioning had resulted, then definitely in the succeeding year the expenditure incurred on warranty would be much less. The table above would show that expenditure on warranty was higher in almost all succeeding years except financial year 2009-09. In such circumstances we cannot say that assessee had followed a method which was not scientific. We are of the opinion that the three

conditions set out by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd have been satisfied by the assessee, viz., establishing that there is a present obligation on account of a past event, working out the probable estimate of the outflow of the resources required and substantiating the reliability of such estimate. Especially so since the assessee was mandatorily required to follow AS-I and principles of prudence stipulated in such AS-I required IT(TP)A No.281/Bang/2021 provisioning for all known liabilities even if it could not be determined with certainty, but was made based on available data. We therefore delete the addition made by the AO disallowing the provision for warranty. Ground 7 of the assessee stands allowed."

32. The learned DR relied on the order of the AO/DRP.

33. We have carefully considered the rival submissions. The basis for creating provision adopted by the Assessee is Machine months x repair rate x cost per claim Where: Machine Months = Factor of the unexpired warrant period in months and the number of PCs which are under warranty at the end of the year Repair Rate = Percentage of claims out of the total sales made on the historical data for the region.

Cost per claim =Average expected repair cost per PC on historical data for the region.

34. The hypothetical computation by the revenue authorities of percentage of actual claim for the year and provision made for the very same year, cannot be sustained because the basis of providing warranty is Machine months x repair rate x cost per claim. The tribunal has already pointed out the flaw in the approach of the revenue authorities in its order for AY 2006-07 that the basis should be the actual expenditure incurred on discharge of warranty claims in future which is much more than the provision made in an earlier year. The warranty obligation is not just for one year and it spreads over a period of more than 1 year and therefore the comparison as done by the revenue authorities is unsustainable. The method followed by the Assessee for creating provision for warranty has been held to be scientific and based on historical data of sales and repair ratio in every region in which the products are sold. The method has been accepted by the Tribunal in its order for several AYs. The method followed has not been shown to be not scientific by the revenue authorities. In such circumstances, we are of the view that the method followed by the Assessee should be accepted as proper and the deduction allowed as per the provision created by the Assessee. We hold and direct accordingly.

11.1 In the case on hand the method followed has not been shown to be not scientific by the revenue authorities. In such circumstances, we are of the view that the method followed by the Assessee should be accepted as proper and the deduction should be allowed as per the provision created by the Assessee following the above judgement in assessee's own case cited supra. However the assessing officer has observed that there is huge amount of balance of the provisions are carry forwarding over the years but no details submitted year wise IT(TP)A No.281/Bang/2021 balance of provision for warranty before the AO, therefore, we direct to the asseesee for giving the details of provisions for warranty is outstanding year wise remained unutilized. The assesee has submitted that the period of warranty is maximum for one to three years, if the provision for warranty is

unutilized for more than three years from the date of commencement of warranty of the products, it should be reversed and offered for taxation in the year of expiry of warranty. We noted from the order for the AY 2015-16 there is only opening balance plus provisions created and utilized is mentioned but there is no any entry for unutilized warranty amount found. Considering the entire facts the AO is directed to follow the direction in above terms.

Ground No.45 to 47 related to addition of provision for warranty loss to the book profit u/s 115JB

12. The AO observed as per clause (i) of explanation 1 to sec. 115JB that the profit from the profit and loss account shall be reduced by the amount withdrawn from any provision for said amount is credited to the profit and loss account. But as per the assessee neither any such provision is withdrawn from the profit and loss account and he further observed that even otherwise the utilization during the year is utilization from the provision credited during the earlier previous years to which the utilization pertains and hence the above provisions are not allowable. The assessee failed to increase book profit by the addition towards provisions for warranty of Rs.185.94 crores on account of provision for warranty and Rs.17.55 lakhs on account unrealized foreign exchange loss while computing the income u/s 115JB of the Act.

IT(TP)A No.281/Bang/2021 The AR of the assessee has relied on his written submission which are as under:-

> The learned AO has erred in law and on facts in not appreciating that the warranty provision has been created on a scientific basis after considering technical estimates which is consistently followed by the Appellant year on year and in line with the principles laid out in the case of Rotork Controls India Private Limited (supra).
>
> As per the provisions laid down in AS 29 a provision is a liability which can be measured only by using substantial degree of estimation. Further, provision can be recognized on fulfillment of the following conditions:
>
> • There is a present obligation as a result of past event;
>
> • It is probable that an outflow of resources embodying economic benefit will be required to settle the obligation; and • A reliable estimate can be made of the amount of obligation.
>
> In light of the aforementioned conditions, it can be said the Company had a present obligation to make good the claims under warranty, which is arising out of the past sales . Since the Company has no other realistic alternative in settling the warranty obligation arising due to sale, it is an obligating event for the Company and thus, the Company satisfies the first condition stipulated in AS 29 for the recognition of provision.

Further, in case of warranty claims made by the customers, the Company is obligated to make good the claim by virtue of warranty agreement and this essentially results in outflow of resources embodying economic benefit to the Company and thus, the same satisfies the second condition stipulated in AS 29 for the recognition of provision.

On the third condition, it would be relevant to note that the Company, after having considered the present obligation arising from the past event, the outflow of resource and the past experience has a scientific methodology which is followed consistently year on year for the creation for provision for warranty.

The scientific methodology followed by the Company year on year for creation of provision for warranty is dependent on the sales, the repair rate, cost of servicing the warranty claims and the utilisation of warranty provision for each year.

Given the above, in a scenario where all the conditions stipulated under AS 29 are satisfied for a provision to attain recognition, the same cannot be construed to be unascertained. Therefore, it is amply clear that the provision for warranty created by the Company is ascertainable and therefore cannot be added back to the book profits under section 115JB of the Act on the basis that the same is unascertainable.

IT(TP)A No.281/Bang/2021 We wish to submit that the "Hon'ble HC in the case of Lenovo India for the year AY 2007-08 and AY 2011-12 has held ruled against the revenue and in favor of the Appellant.

Hon'ble HC in the case of Lenovo India for the year AY 2011-12 has held ruled against the revenue and in favour of the Appellant. The relevant extract of the orders passed by Hon'ble HC in the Company's case for the AY 2011-12, has been mentioned below:

"Learned Senior counsel for the assessee submitted that the second substantial question of law has been answered against the revenue in decision of the Supreme Court in Bharath Earth Movers vs. Commissioner of Income Tax', 245 ITR 278, the aforesaid submission could not be disputed by learned counsel for the revenue. (Refer page 3200- 3201 of PB Vol IV) For the reason assigned in the aforesaid decision, the second substantial question of law is answered against the revenue."

In this context, we also wish to submit that the Honourable ITAT in the Appellant's own case for AY 2006-07, AY 2007-08, AY 2010-11, AY 2011-12, AY 2012-13, AY 2013-14 and AY 2015-16 has upheld that the provision for warranty has been computed on a scientific basis and accordingly, is not an unascertained liability and therefore, should not be added back to the book profits. The relevant extract of the orders passed by Honourable ITAT in the Company's case for AY 2006-07, AY 2007-08, AY 2010-11, AY 2011-12, AY 2012-13, AY 2013-14, AY 2014-15 and AY 2015-16 has been mentioned below:

AY 2006-07 "Para 16- We are of the opinion that the three conditions set out by the Hon'ble Apex Court in the case of Rotork Controls India (Pvt) Ltd have been satisfied by the assessee, viz., establishing that there is a present obligation on account of a past event, working out the probable estimate of the outflow of the resources required and substantiating the reliability of such estimate. Especially so since the assessee was mandatorily required to follow AS-I and principles of prudence stipulated in such AS-I required provisioning for all known liabilities even if it could not be determined with certainty, but was made based on available data. We therefore delete the addition made by the AO disallowing the provision for warranty." (Refer page 3108- 3111 of PB Vol IV) AY 2007-08 and AY 2010-11 Placing the reliance on assessee's own case for the AY 2011-12 the Hon'ble ITAT has concluded:

"Following the earlier order of this Tribunal in assessee's own case, we decide this ground of favour of the assessee and delete the addition made by Assessing Officer on account of these two amounts while computing the book profit."

IT(TP)A No.281/Bang/2021 AY 2011-12 "It is worth mentioning that the co-ordinate bench has considered the historical data pertaining to financial year 2005-06 to 2010-11 and came to conclusion that the provision was made based on historical data and following scientific method. Therefore, we do not find any reason to interfere with the conclusion reached by the co-ordinate bench. Accordingly, we hold that provision for warranty expenditure is allowable."

AY 2012-13 Placing the reliance on assessee's own case for the AY 2015-16 the Hon'ble ITAT has concluded:

"Para 6.1- Following the same, we hold that there is no requirement of making addition of provision for warranty to the net profit for computing book profit u/s 115JB of the Act. Accordingly, the AO is directed to delete the same. The order passed by Ld CIT(A) on this issue stands set aside".

AY 2013-14 "In the preceding paras, following the ration laid down by Hon'ble Supreme Court in case of Rotork Control(supra) we have held that the provision for warranty cannot be treated as unascertained liability.

Under such circumstances we do not find any merit in the manner in which the book profits for purposes of section 115JB has been computed. Accordingly, we direct the Ld.AO to exclude the two items from the book profits for purpose of computing tax liability under section 115JB of the Act".

AY 2014-15 Para 25- Ground Nos. (43) to (45) on the issue of addition of provision for warranty to the book profits under section 115JB is incidental. In view of the decision on the allowability of provision for warranty, this ground which is incidental, does not warrant any separate adjudication and hence dismissed.

> AY 2015-16 "Para 35- As far Gr.No.VII raised by the Assessee is concerned, the same relates to addition made to the book profits u/s.115JB of the Act on account of provision for warranty liability treating the same to be a liability of a contingent nature and hence liable to be added to the profit as per profit and loss account prepared in accordance with companies act to arrive at the book profit of the Assessee for the purpose of levy of tax on book profit under Sec.115JB of the Act. We have already held that the provision for warrant expenses is not contingent and has to be allowed as deduction while computing income under the head "Income from Business & IT(TP)A No.281/Bang/2021 Profession". As a consequence of such finding, the addition made to the book profits is to be deleted because the liability cannot be said to be contingent. We hold and direct accordingly". Accordingly, the same ought not to be added for computing book profit.

13. The ld. DR relied on the order of the lower authorities.

14. In the judgement cited by the assessee for the AY 2015-16 in which it has been held that the provision for warrant expenses is not contingent and has to be allowed as deduction while computing income under the head "Income from Business & Profession". As a consequence of such finding, the addition made to the book profits is to be deleted because the liability cannot be said to be contingent, accordingly, the same ought not to be added for computing book profit. Considering the facts of the case this issue is also covered in favour of the assessee, accordingly we allow the ground No.45 to 47 .

Ground No.48 to 56 disallowance of unrealized foreign exchange loss

15. The ld.AR submitted that during the course of the assessment proceedings, the Assessee was asked to furnish the details of foreign exchange loss debited to the Profit & Loss Account ("P/L A/c") along with an explanation why the unrealized foreign exchange loss amounting to INR 17.,55 crores should not be brought to tax. The Assessee furnished the required details vide submission dated 19 December 2019 and 24 December 2019. Before us, the ld. AR of the assesse has also furnished written synopsis which is as under:-

> IT(TP)A No.281/Bang/2021 During the FY 2015-16 (relevant to AY 2016-17), an amount of INR 100,33,14,795 representing foreign exchange loss (net) was claimed as a deduction in arriving at the taxable income. Such loss was computed after considering the unrealized foreign exchange loss of INR 17,55,62,222 due to restatement of debtors, creditors and other advances, using the exchange rates as on the date of drawing up the financial statements (viz 31 March 2016) as against the date on which the transactions were entered into with the concerned debtor, creditors and other parties. The break- up of of unrealized foreign exchange losses amounting to INR 17,55,62,222 is enclosed as Appendix- 2.
>
> The Appellant, being incorporated under the Companies Act, 1956, is required to prepare its books of accounts on an accrual system of accounting. Further, as per

> section 211(3A) of the Companies Act, 1956, it is mandatory for each company to follow and apply all the accounting standards issued by the ICAI. Accordingly, the Appellant has accounted for the foreign exchange loss in accordance with 'AS 11 - Effects of changes in foreign exchange rates' issued by the ICAI. As per section 145(1) of the Act, income chargeable under the head "Profits and gains of business or profession" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Sub-section (2) to section 145 states that the Central Government may notify in the Official Gazette from time-

to-time accounting standards to be followed by any class of assesses or in respect of any class of income.

The Central Government has notified two Accounting Standards till date viz.

☐Accounting Standard 1 relating to disclosure of accounting policies; and ☐Accounting Standard 2 relating to disclosure of prior period extraordinary items and changes in accounting policies.

The notification is effective from assessment years 1997-98 and subsequent years. AS -1 - Disclosure of Accounting Policies is one of the Accounting Standards notified by the CBDT in terms of section 145 of the Act. Vide this Standard; the CBDT has recognized accrual as one of the fundamental accounting assumptions. In terms thereof, revenues and costs have to be accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the period to which they relate. The aforementioned AS - 1 as notified by the CBDT also states that prudence should be one of the major considerations governing the selection and application of accounting policies. In other words, as per the Standard, provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Since prudence has been similarly defined in both the CBDT as well as ICAI Accounting Standards, it follows that accounting for MTM losses would be required even in terms of the CBDT's own Standards mandated for accounting under section 145 of the Act. The Courts have acknowledged the view that liabilities, which have been incurred during the year, have to be allowed as a deduction, irrespective of whether the same may have to be quantified and discharged at a future date.

The fundamental principle of accrual rests on the basic premise of recognition of expenses incurred during the year, even though the same may be discharged at a future date. If the same were to be disregarded and allowed only at the time of settlement, it would tantamount to rejecting the method of accounting adopted by the assessee and substituting the same, in part, by the cash method.

Further, it is submitted that the concept of recognizing the foreign exchange losses has been well recognized in judicial precedents in a number of cases. Various courts and benches of the ITAT have held that foreign exchange losses including unrealized loss on account of reinstatement of foreign exchange with respect to current assets and liabilities, is allowable as a deduction in the

computation of income of the assessee, if such loss was in respect of a trading asset or in respect of circulating capital.

The issue is squarely covered in the Appellant's case by the ruling of the Hon'ble Supreme Court in the case of Woodward Governor P Ltd (179 Taxman 326). The question before the Court was whether the increase in liability due to foreign exchange fluctuation as per the exchange rate prevailing on the last day of the financial year cannot be considered as notional and can be allowed as a deduction or not. The Hon'ble Supreme Court held as follows:

> "The accounts and the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till the AO comes to the conclusion for reasons to be given that the system does not reflect true and correct profits.
>
> IT(TP)A No.281/Bang/2021 The fact that the department taxed the gains on fluctuation on the basis of accrual while disallowing the loss is important and indicates the double standards adopted by the Department;
>
> The increase in liability on account of the fluctuation in the rate of foreign exchange remaining on the last day of the financial year is not notional or contingent and, therefore, can be allowed as a deduction."

The Appellant further wishes to place reliance on the following rulings to substantiate its claim:

> i. Sutlej Cotton Mills Ltd. [1979] 116 ITR 1 (SC) ii. Oil & Natural Gas Corpn. Ltd. [2010] 189 Taxman 292 (SC) iii. International Combustion (I) (P.) Ltd. [1982] 11 Taxman 128 (Cal HC) iv. Acer India Private Limited (ITA 473/ Bang/ 2016) (Bang-ITAT) v. Amrit Steels Ltd. [2001] 79 ITD 498 (Delhi ITAT) vi. Dow Agrosciences India (P.) Ltd. [2017] 88 taxmann.com 676 (Mumbai ITAT) vii. Oil & Natural Gas Corpn. Ltd. [2002] 83 ITD 151 (Delhi ITAT) The issue no more res integra and is held in favour of the Appellant. The entire premise of the learned AO to frame the addition i.e. notionalmarked-to-market loss on account of fair value of forex derivatives/forward contract is applicability of section 43(5) of the Act. In this regard, the Appellant wishes to bring your Honor's attention to note no. 43 of the Financial statement (Refer Pg 27 of PB Vol I) which states that the Appellant has not entered into any foreign currency forward contracts to hedge its risk associated with foreign currency fluctuations. The entire edifice of the lower authorities that the loss is due to forward contracts is contrary to the facts. The reliance placed by the learned AO can be distinguished as under:
>
> - Instruction no. 3 of 2010: This was issued in the context of forex derivatives. Since, the Appellant does not have any forex derivatives as evident from note no. 43 of the Financial Statement, the said instruction is not applicable.

- Instruction no. 17 of 2008: This instruction was issued to provide certain guidelines for assessment of banks and hence, not applicable to the Appellant.

The Company submits that the foreign exchange transactions related to restatement of debtors, creditors and other trade advances are related to trading activities and not to speculation activities or transactions on capital account Thus, the addition framed by the learned AO is contrary to facts of the Appellant and liable to deleted.

16. The ld. DR relied on the order of the lower authorities.

16. Considering the rival submissions we noted that the this issue is also covered in favour of the assessee vide Hon'ble High Court of Delhi judgment in the case of Pr.CIT Vs. Simon India Ltd., reported in [2022] 145 taxmann.com 389 (Del). The relevant paras are as under:-

26. The Revenue's contention is unmerited. There is no dispute that the Forward Contracts were entered into by the Assessee to hedge against foreign exchange fluctuations resulting from inflows/outflows in respect of the underlying contracts for provisions of consultancy and project management. Concededly, the Assessee is not dealing in foreign exchange. Clearly, the said transactions were to hedge against the risk of foreign exchange fluctuations and thus, fall within the exceptions of proviso (a) to section 43(5) of the Act. The Forward Contracts were to guard against any loss on account of future exchange fluctuations in respect of IT(TP)A No.281/Bang/2021 inflows and outflows relating to contracts for execution of the works entered into by the Assessee.

27. It is material to note that there is no allegation that the Assessee has not been following the system of accounting consistently. In Woodward Governor India (P.) Ltd. (supra), the Supreme Court had referred to AS-11. In terms of AS-11, the exchange difference arising on foreign currency transactions are necessary to be recognized as income or expense in the period in which they arise, except in cases of exchange differences arising on repayment of liabilities for acquiring fixed assets.

28. In the present case, the Assessee had stated that it was reinstating its debtors and creditors in connection with execution of contracts entered into with foreign entities on the basis of the value of the foreign exchange. Thus, clearly the loss on account of Forward Contracts would require to be recognized as well.

29. It is also relevant to refer to the findings of the learned CIT(A) in this regard.

Paragraph no. 13 of the appellate order reads as under:

"13. It may be noted that the valuation-loss is reflected on the debit side of the P&L account whereas the corresponding valuation Gains resulting on the valuation of the debtors is reflected on the credit side included as part of sales/exchange Gains and in

> respect of imports as reduction in the import price on the debit of the Profit & Loss account. In other words, the entire transaction of either realization of debtors in foreign exchange/payment for imports in foreign exchange which are designated in foreign currency and the entering into Forward cover contract are integral part of the same transaction i.e. two sides of the same coin. By considering both sides of the P&L the correct net profit is worked out. Therefore, in order to ascertain the correct taxable profits of the appellant the loss has to be allowed as a business loss because it is due to the business exigency the forward contracts are entered into to protect against any loss that might result due to foreign exchange currency fluctuation foreign currency fluctuation."

30. Undisputedly, the Forward Contracts, in the present case, are hedging transactions. The Assessee has reinstated its debits and credits from the underlying transactions on the value of the foreign exchange on the due date. The corresponding losses/gains under the Forward Contracts, thus, were also required to be accounted for to arrive at the real profits. It would be anomalous if, on the one hand, debtors and creditors, in respect of current assets, are stated at the current value of foreign exchange and the corresponding loss on the hedging transaction is not accounted for. In essence, the Assessee has stated his income by taking into account the foreign exchange value as it stands on the due date. It is well settled that the CBDT Instructions and circulars which are contrary to law are not binding.

31. This Court finds no fault with the order of the learned CIT(A) as well as the learned Tribunal in finding that the loss, on account of Forward Contracts, cannot be considered as speculative and the AO had erred in disallowing the same. The questions raised (Questions I and II) are thus, covered by the decision of the Supreme Court in Woodward Governor India (P.) Ltd. (supra).

IT(TP)A No.281/Bang/2021

32. No substantial question of law arises from the ITA 976/Del/2013.

16.1 In that above judgement it has been held that loss on account of Forward Contracts, cannot be considered as speculative loss. The assessee has reinstated its debtors and creditors from the underlying transactions on the value of the foreign exchange at the year end. Respectfully following the above judgment of the Hon'ble High Court of Delhi in the case of Simon India Ltd., cited supra, the loss is allowed u/s 37 of the I.T. Act. 1961, accordingly the ground Nos.48 to 56 are allowed.

Unrealized Foreign Exchange Loss under section 115JB

17. The AO noted that the unrealized Foreign exchange loss is as unascertained liability and it should be added while computing Book Profit u/s 115JB. In this regard the ld. AR of the assesse submitted as under:-

> During the FY 2015-16 (relevant to AY 2016-17), an amount of INR 100,33,14,795 representing foreign exchange loss (net) was claimed as a deduction in arriving at the

> taxable income. Such loss was computed after considering the unrealized foreign exchange loss of INR 17,55,62,222 due to restatement of debtors, creditors and other advances, using the exchange rates as on the date of drawing up the financial statements (viz 31 March 2016) as against the date on which the transactions were entered into with the concerned debtor, creditors and other parties. Further, we wish to submit that foreign exchange loss (net) was claimed as a deduction in computing the book profits, since the same represents genuine business expenditure.

The Appellant, being incorporated under the Companies Act, 1956, is required to prepare its books of accounts on an accrual system of accounting. Further, as per section 211(3A) of the Companies Act, 1956, it is mandatory for each company to follow and apply all the accounting standards issued by the ICAI. Accordingly, the Appellant has accounted for IT(TP)A No.281/Bang/2021 the foreign exchange loss in accordance with 'AS 11 - Effects of changes in foreign exchange rates' issued by the ICAI.

The Appellant has followed the relevant accounting standard to compute the unrealized foreign exchange loss and hence, the same cannot be treated as an unascertained liability.

Accordingly, the same ought not to be added for computing book profit.

18. Since we have uphold that the unrealized foreign exchange loss is ascertained liabilities and it is covered u/s 37 of the Act. therefore, the addition can not be made while calculating book profit u/s 115JBof the Act. for the year under consideration. Considering the rival submissions we allow these grounds.

19. In the result, the appeal of the assessee is partly allowed for above terms.

Order pronounced in the court on 24th March, 2023.

Sd/-	Sd/-
(Beena Pillai)	(Laxmi Prasad Sahu)
Judicial Member	Accountant Member

Bangalore,
Dated 24th March,2023
Vms

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.

1. Date of Dictation .....

2. Date on which the typed draft is placed before the dictating Member .....

3. Date on which the approved draft comes to Sr.P.S .....

4. Date on which the fair order is placed before the dictating Member .....

5. Date on which the fair order comes back to the Sr. P.S. .....

6. Date of uploading the order on website.....

7. If not uploaded, furnish the reason for doing so .....

8. Date on which the file goes to the Bench Clerk .....

9. Date on which order goes for Xerox & endorsement.....

10. Date on which the file goes to the Head Clerk .....

11. The date on which the file goes to the Assistant Registrar for signature on the order .....

12. The date on which the file goes to dispatch section for dispatch of the Tribunal Order .....

13. Date of Despatch of Order. .....

14. Dictation note enclosed.....