

Tetra Pak India Pvt. Ltd., Pune vs Joint Commissioner Of Income-Tax,, on 20 September, 2017

" "

IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "B", PUNE

BEFORE MS. SUSHMA CHOWLA, JM AND SHRI ANIL CHATURVEDI, AM

. / ITA No.359/PUN/2014
/ Assessment Year : 2009-10

The Dy. Commissioner of Income Tax,
Circle - 7, Pune

....

/Appellant

Vs.

Tetra Pak India Pvt. Ltd.,
Mayfair Towers, Ground Floor,
Mumbai Pune Road,
Shivaji Nagar,
Pune - 411005

....

/ Respondent

PAN: AAAC3467B

. / ITA No.537/PUN/2014
/ Assessment Year : 2009-10

Tetra Pak India Pvt. Ltd.,
B-53, MIDC Phase II,
Chakan Industrial Area,
Village Vasuli, Taluka-Khed,
Pune

....

/Appellant

PAN: AAAC3467B

Vs.

The Jt. Commissioner of Income Tax,
Range - 7, Pune

....

/ Respondent

./CO No.05/PUN/2015
/ Assessment Year : 2009-10
(out of ITA No.359/PUN/2014)

Tetra Pak India Pvt. Ltd.,
B-53, MIDC Phase II,
Chakan Industrial Area,
Village Vasuli, Taluka-Khed,
Pune

...

/ Cross objector

PAN: AAAC3467B

Vs.

The Jt. Commissioner of Income Tax,
Range - 7, Pune

....

/ Respondent

Assessee by : Shri Nikhil Pathak
Revenue by : Shri M.K. Gautham

/
Date of Hearing : 29.06.2017

i /
Date of Pronouncement: 20.09.2017

/ ORDER

PER SUSHMA CHOWLA, JM:

The cross appeals filed by the Revenue and the assessee are against order of JCIT, Range-7, Pune, dated 20.01.2014 relating to assessment year 2009-10 passed under section 144C(13) r.w.s. 143(3) of the Income-tax Act, 1961 (in short 'the Act'). The assessee also filed Cross Objections against the appeal of Revenue.

2. The cross appeals filed by the Revenue and the assessee and Cross Objections filed by the assessee were heard together and are being disposed of by this consolidated order for the sake of convenience.

3. The Revenue in ITA No.359/PUN/2014 has raised the following grounds of appeal:-

1. Hon'ble DRP has erred while directing that all International transactions of Tetra

Pak India Pvt. Ltd. be aggregated/ whereas as per section 92(1) and Rule 10C(1), 'Income arising from an International Transaction' has to be calculated with regards to Arm's Length Pricing, when clear segments were identified from the financial information by revenue and aggregation of such international transaction is allowed only as an exception as per Rule 10A(d).

2. Hon'ble DRP erred in holding that International transactions of Imports of Machines and Import of straws were functionally different segments, when Function Asset and Risk profile of Tetra Pak was compared to that of uncontrolled comparables after carefully choosing them through a structured search carried out by assessee itself within meaning of Rule 10B(2) and 10C(2).

3. Hon'ble DRP erred in holding that margins of 5.87% used as Arm's Length Price is not correct when Tetra Pak India Private Limited suffered a gross loss in International transactions of Imports of Capital Equipments and Import of straws, as in a pure ' trading junction' net margins will always be positive.

4. The assessee in ITA No.537/PUN/2014 has raised the following grounds of appeal:-

1.1 On the facts of the case and in law, the learned Assessing Officer / DRP erred in disallowing prior period expenses of Rs.1,02,19,142/- while computing the total income of the assessee company.

1.2 The learned A.O./ Dispute Resolution Panel erred in confirming the disallowance of the prior period expenses of Rs.1,02,19,142/- without appreciating that the liability in respect of above expenditure of Rs.1,02,19,142/- had crystallized during the year under assessment and hence, the same should have been allowed as a deduction while computing the income of the assessee company.

2.1 The learned Assessing Officer / DRP erred in disallowing the incremental provision for warranty of Rs.1,27,01,521/-.

2.3 The learned A.O. / Dispute Resolution Panel, Pune erred in not appreciating that the provision for warranty was properly ascertained and was not in the nature of Contingent Liability.

3.1 The learned Assessing Officer / DRP erred in disallowing deposits written off of Rs.16,57,856/-.

3.2 The learned A.O. / Dispute Resolution Panel, Pune erred in confirming the disallowance of the deposits written off of Rs.16,57,856/- during the year without appreciating that the said deposits were given in the course of the business and thus, the amount of deposits written off was allowable as a deduction u/s. 29 or 37(1) of the

Income Tax Act, 1961.

5. The assessee in CO No.05/PUN/2015 has raised the following grounds of objections:-

1. Inappropriately objecting the aggregation approach applied by the Respondent and accepted by the Hon'ble DRP Erred on the facts and in law by objecting the aggregation approach for benchmarking the international transactions as applied by the Respondent and accepted by the Hon'ble DRP in its order for AY 2009- 10 without appreciating the fact that the international transactions relating to import of packaging machinery and import of straws are interlinked to the manufacturing activity of the Respondent and has always been accepted as such by the department in earlier years.

2. Inappropriately applying same comparable set in relation to functionally different segments (without prejudice) Without prejudice to the aggregation approach upheld by the Hon'ble DRP, the learned AO and Transfer Pricing Officer ('TPO') grossly erred in computing the Transfer Pricing ('TP') adjustment by inappropriately comparing the packaging machinery and straw business segment with the comparable companies which are engaged in manufacturing of packaging material with an operating margin of 5.87%.

3. Not considering income from technical services and leasing income as part of packaging machinery segment of the Respondent (without prejudice) Without prejudice to the above objections, erred in computing the margins of the packaging segment ignoring the income from lease of packaging machinery and related technical services which is closely linked to the supply of packaging machinery.

4. Erred in computing the segmental profitability of the Respondent (without prejudice) Without prejudice to the above contentions, erred in ignoring the contentions of the Respondent and prepared a revised profitability statement by considering certain heads of income (like commission income, scrap sale, finance charge on lease agreement etc.), considered as operating by the respondent, as non-operating in nature.

5. Ground of Objection 5 - Transfer pricing adjustment without giving benefit of +/- 5% per cent as available under erstwhile proviso to section 92C(2) of the Act.

Erred in making the transfer pricing adjustment from the arm's length price without giving benefit of the option available to the Respondent under erstwhile proviso to section 92C(2) of the Act of adopting as arm's length price, a price which varies by not more than 5 per cent from the arm's length price (ie without appreciating the facts that the amended proviso is prospective in nature).

6. The learned Authorized Representative for the assessee at the outset pointed out that grounds of appeal No.1.1, 1.2, 3.1 and 3.2 are not pressed. The learned Authorized Representative for the assessee pointed out that only the issue which remains to be adjudicated in assessee's appeal is in relation to allowance of incremental provision for warranty of Rs.1,27,01,521/-. The learned Authorized Representative for the assessee further pointed out that the issue raised in assessee's appeal is squarely covered by the order of Tribunal in assessment year 2008-09.

7. The Revenue is in appeal against directions of Dispute Resolution Panel (DRP) in allowing aggregation of transactions even though clear segments were identified from the financial information by the Revenue. The Revenue has raised the issue that international transactions of import of machines and import of straws were functionally different segments and the same could not be aggregated.

8. The learned Authorized Representative for the assessee also pointed out that the Cross Objections raised by the assessee would become academic in case the appeal of Revenue is dismissed.

9. Briefly, in the facts of the case, the assessee for the year under consideration had furnished the return of income which was revised and the assessee declared total income of Rs.40,52,07,100/-. The Assessing Officer noted that the assessee had entered into international transactions with its associated enterprises which were more than Rs.15 crores during the year under consideration, hence, reference was made under section 92CA(1) of the Act to the Transfer Pricing Officer (TPO). The assessee had entered into various transactions with its associated enterprises and the case of assessee was that the said transactions were closely interlinked and were to be considered as part of assessee's manufacturing activity. Accordingly, the assessee aggregated the said transactions for transfer pricing analysis and evaluated by adopting combined transaction approach. The assessee had identified TNMM method as most appropriate method to benchmark its international transactions. The assessee had selected few companies as functionally comparable and had applied multiple year data to benchmark its international transactions to determine arm's length price of its transactions. The PLI of assessee i.e. OP/sales was 12.09%. The average margin of comparables identified by the assessee of multiple year data works out to 6.13% and hence, it was claimed that international transactions of assessee were at arm's length. During the course of transfer pricing proceedings, the TPO at the first instance asked the assessee to update the margins of comparable companies using the data for the instant assessment year in which on the basis of single year's data, the mean margins of comparables worked out to 5.87%. The TPO thereafter, asked the assessee to split the profitability showing the breakup of revenue under carton packaging segment and processing equipment segment. The TPO provided segmental profitability statements to the assessee and show caused why the same should not be considered for benchmarking the purpose. As per the TPO, there was net level loss in straws, filling machines and processing equipment segment. The assessee pleaded that all the transactions undertaken by it were closely linked to its manufacturing of packaging material and activity-wise analysis was not appropriate. The assessee also pointed out certain computational error in the split profitability statement prepared by the TPO. On without prejudice basis, the TPO rejecting combined transactions approach adopted by the assessee, accepted the transactional value of international transactions carried out in the processing equipment segment but under the carton packaging division, the TPO revised the segmental

profitability statement and separated income from leasing machines and income from technical services from the segment of trading of packaging machinery. Certain items of income forming part of other income were considered as non-operating in nature. The TPO also revised the sales ratio for the allocation of personnel expenses, operating and other expenses. The TPO thus, worked out the operating margins of segment of trading of packaging machinery at (-) 1.55% and trading of straws at (-) 59.62%. The TPO thus, proposed an upward adjustment in both segments of packaging machinery and straws i.e. of Rs.2,96,48,720/- in sale of packaging machinery and equipment, and Rs.4,50,60,280/- in sale of straws. Hence, total transfer pricing adjustment was worked out at Rs.7,47,09,000/-.

10. The Assessing Officer in the draft assessment order proposed the said adjustment on account of transfer pricing provisions. In addition, the Assessing Officer also proposed the disallowance of prior period expenses of Rs.1,02,19,142/-. Another item of expenditure which was noted by the Assessing Officer was provision for warranty expenses (net) at Rs.1,27,01,521/-. The assessee was asked to justify the claim of deduction on account of provision for warranty expenses in the Profit and Loss Account. The assessee explained that in respect of its sale and supply of processing equipment and filling machines, the assessee offered warranty for 12 months from the date of commissioning or 18 months from the date of delivery, whichever was earlier and the assessee made provision for warranty @ 2% of equipment sale price except sale of processing components and this was based on generally acceptable practice worldwide. The assessee furnished the working of its claim of deduction of Rs.1.27 crores. The Assessing Officer noted from the past records of assessee that similar claim of assessee had been disallowed in earlier years also and the DRP in its directions for earlier years had upheld the disallowance. In view thereof, the Assessing Officer was of the view that expenditure was in the nature of contingent liability and hence, sum of Rs.1.27 crores was proposed to be disallowed.

11. The assessee filed objections before the DRP in this regard. The first issue which was considered by the DRP was rejection of aggregation approach by the TPO. The assessee pointed out that it was a full system supplier offering customers packaging solutions, processing solutions and technical services. The assessee claimed that as part of its activities, it was supplying packaging machines, packaging material and straws. The assessee pointed out that as per its business plan, machines supplied to the customers would result in sale of packaging material as only the packaging material manufactured by the assessee, could be used in packaging machines supplied by it. Similarly, straws were also supplied as part of packaging material. The assessee also claimed that its main activity of supply of packaging material was dependent on sale / leasing of packaging machines and machines were connected to the processing equipment. Further, supply of processing equipment and packaging machines gives rise to supply of spares, technical services and commission income, since the customers requires such support. Further, supply of straws was incidental to sales of packaging material. Since the transactions were interlinked to the activity relating to manufacture and sale of packaging material, the assessee claimed that it was not appropriate to separately benchmark such transactions, considering the business strategy of assessee and interlinking nature of international transactions. The assessee claimed that common economic analysis for all the transactions would be most appropriate approach. The assessee pointed out that according to Accounting Standards 17, it reported only two segments i.e. carton packaging segment and processing equipment segment. The

assessee also relied on Guidance Note issued by ICAI on report of international transactions under section 92E of the Act and para 13.8 of ICAI Guidance Notes and also US Transfer Pricing Regulations and further pointed out that definition of transaction as prescribed in Rule 10A(d) of the Income Tax Rules, 1962 (in short 'the Rules') states that transactions include number of closely linked transactions.

12. The DRP noted the business strategy adopted by the assessee, wherein the assessee was the manufacturer of unique packaging material which was chosen to carry on the business by way of creating demand for its packaging material. The assessee was selling its machines at lower price and thereby creating demand for the packaging material during the entire life of use of machinery. The DRP also noted that though the assessee had sold packaging machineries at loss, however, it had recorded net profit margin of 28%. Similarly, it had also chosen to sell straws along with packaging material at reduced price so as to keep cost of total packaging low, so as to provide incentives to purchasers for using its packaging material. The approach adopted by the TPO was not accepted by the DRP on the premise that the manner of conducting business could not be decided by anyone else but only by the assessee. The portfolio approach adopted by the assessee to carry on its business was accepted as business strategy and consequently, the sale of packaging material and straws were held to be closely linked. The DRP further held that it was not possible to determine separate transfer pricing of either straws or machines, packaging material, etc. as the assessee had decided to sell everything as package. The approach of TPO in segregating closely interlinked business activities into two segments was held to be not correct. Another plea raised by the assessee before the DRP that where the TPO had considered segment of sale of packaging machinery and equipment and sale of straws functionally separate, then he could not have applied same margin of 5.87% of comparable companies for both the functionally different segments. The DRP held that after having treated two segments functionally different from each other, it was not possible to compare them with the margins of same comparable companies for both the segments. Thus, the assessee's aggregation approach was accepted and transfer pricing analysis was directed to be based on the said aggregation approach adopted by the assessee. The DRP upheld the order of Assessing Officer with regard to disallowance of prior period expenses of Rs.1.02 crores and the provision for warranty expenses at Rs.1.27 crores.

13. The Revenue is in appeal against the aggregation approach adopted by the DRP. The learned Departmental Representative for the Revenue before us relied on the order of Assessing Officer / TPO. On the other hand, the learned Authorized Representative for the assessee relied on the order of DRP.

14. We have heard the rival contentions and perused the record. The assessee is part of Tetra Pack Group. The assessee is engaged in development of packaging material based on aseptic technology which helps keeping perishable liquid foods fresh, tasty and nutritious for months without refrigeration or added preservatives. The assessee also designs, manufactures and supplies modular equipment for continuous processing and packaging of liquid food in the dairy, cheese making and prepared food industries. The assessee had strategy business specialization in providing the complete solutions for processing, packaging and distribution of food products. The main business of assessee is selling the said packaging material, wherein the assessee claims for the year under

consideration the total turnover declared by it was Rs.62.56 crores and the profit before taxes was Rs.75.08 crores. As part of its packaging solutions, specific filling machines are required for filling the packaging material. The filling machines and add-on machines are not manufactured by the assessee in India but are imported from its associated enterprises and sale in the Indian market. The assessee claims it to be a pioneer in packaging industries in India and as part of its business strategy, it identifies its customers and market its products by selling the same. The assessee first sells the machinery and then packaging material. The assessee also gave services through its engineers which help the customers in printing of packaging material. Further, straws were also sold to the customers and as a business strategy, the assessee imports straws from its associated enterprises for sale to the customers. This division is called Carton Division. The assessee is also engaged in another line of manufacturing processing equipment, wherein some items have been manufactured in India and some are imported from its associated enterprises and both are sold to the customers. The assessee thus, claims that in addition to import of packaging material, it imported certain spare parts, straws and also exported packaging material (some part) to its associated enterprises. The assessee thus, had entered into the following international transactions with its associated enterprises:-

Sr. No.	International transactions	Value (Rs.)
1	Import of raw materials, spares and components, processing/distribution equipment and filling machines	1,214,571,819
2	Import of filling machines, processing equipments, spare parts, etc for resale	974,860,030
3	Import of capital goods	15,333,150
4	Export of finished goods and processing equipment	1,501,039,323
5	Sale of fixed assets	1,509,964
6	Technical services, design services and services in the nature of education and training, etc received by Tetra Pak India	49,723,236
7	Technical services, design services rendered by Tetra Pak India	16,272,887
8	Commission received	13,203,849
9	Reimbursement of expenses to the associated enterprises	65,432,947
10	Reimbursement of expenses from the associated enterprises	61,457,460

15. As part of its transfer pricing report, since the international transactions were closely linked, they were considered as part of assessee's manufacturing activity and were aggregated for transfer pricing analysis. The assessee applied TNMM method as most appropriate method and declared operating margins at 12.09% by adopting OP/sales. The assessee selected functionally similar comparables and by applying multiple years data worked out the average mean of said comparables at 6.13%. Since the operating margins earned by the assessee were higher than the arithmetic mean of operating margins earned by the comparables held the international transactions to be at arm's

length price. The TPO however, did not accept the working of margins of comparables by taking multiple year date. At the instance of TPO, the assessee applied the margins of comparables for the instant assessment year and the average mean worked out to 5.37%. The said comparables which were selected by the assessee have been accepted by the TPO. However, the TPO did not accept the aggregation approach adopted by the assessee since as per the TPO, the revenue under Carton Packaging Segment and Processing Equipment Segment need to be separately benchmarked and accordingly, he worked out the margins of trading of packing machinery and equipment and sale of straws as separate transactions and had proposed total transfer pricing adjustment of Rs.7.47 crores. The reason for the said proposal was losses in two segments. The assessee on the other hand, claims that as part of its business strategy of carrying on the business of packaging material, it was providing complete solutions by way of selling / leasing packaging machines. The supply of processing equipment gave rise to the sale of packaging machines which in turn, were used for filling packaging material; in turn, assessee supplied processing equipment and packaging machines and also supplied spares, technical services and commissioning as part of its bundle of activities in the line of business undertaken by the assessee. In addition to this, the assessee was also imports straws and supplied the same as part of sale of packaging materials. The activities of planning, purchasing, logistics, selling and administrative activities were claimed to be associated with overall business of assessee and the same needs to be aggregated for benchmarking the international transactions. The assessee also claimed that it was a business strategy to charge price to its customers on sale of straws at lower than the total price cost of straws i.e. purchase price + import duty. However, the sale price was higher than the purchase price of straws. Therefore, for comparability purposes, the price of straws should be considered excluding the effect of import duty. The assessee claimed that it was providing support to its customers in the form of subsidizing the cost of packaging machines which in turn, would result increase in sale of its packaging material to the said customers as only the packaging material which was manufactured by the assessee could be used in the filling machines supplied by it. The aforesaid commercial transactions were undertaken by the assessee as business strategy and the same was to create demand for its packaging material which was manufactured by it. Looking at the totality of the facts and circumstances, though the assessee had sold the packaging machinery at loss, but on overall, it has shown net profit margin of 28%. The assessee had also sold the straws along with packaging material at reduced price to keep the cost of total packaging low in order to provide incentives to purchasers for buying its packaging material. Such a strategy adopted by the assessee in order to create a demand for the consumables manufactured by it, is recognized in para 3.10 of OECD Transfer Pricing Guidelines, 2010; such business strategy is named portfolio strategy. Once the business strategy adopted by the assessee is an accepted manner of conducting its business, then the same should be accepted and should not be segregated. There is no merit in the approach of the TPO in segregating the import of straws from the division of packaging material and benchmarking it separately by considering loss in the said division. The reason for loss on sale of straws is the business strategy adopted by the assessee to sell its packaging material and the loss, if any, suffered by the assessee gets absorbed in the sale of manufactured packaging material on overall basis. Accordingly, we hold that sale of machines, packaging material and the straws are closely interlinked and the same cannot be evaluated separately because of business strategy adopted by the assessee.

16. Here, we may refer to the definition of transaction as prescribed in Rule 10A(d) of the Rules, which clearly states that the transaction includes number of closely linked transactions. Hence, the provisions of the Act also recognizes person to undertake its international transactions by including any number of closely interlinked transactions.

17. Even under US Transfer Pricing Regulations, the aggregation of transactions is approved, which is as under:-

"Aggregation of transactions - (A) In general. The combined effect of two or more separate transactions (whether before, during, or after the taxable year under review) may be considered, if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the arm's length consideration for the controlled transactions. Generally, transactions will be aggregated only when that involve related products or services, as defined in §1.603A-3(c)(7)(vii.)."

18. Further, even the Guidance Note issued by ICAI on report of international transactions under section 92E of the Act clearly provides as under:-

"13.5 The conditions referred to above are cumulative. The reference therein to the terms „best suited“ and „most reliable measure“ indicates that the most appropriate method will have to be selected after a meticulous appraisal of the facts and circumstances of the international transaction. Further, the selection of the most appropriate method shall be for each particular transaction. The term „transaction“ itself is defined in rule 10A(d) to include a number of closely linked transactions. Therefore, though the reference is to apply the most appropriate method to each particular transaction, keeping in view, the definition of the term „transaction“, the most appropriate method may be chosen for a group of similar transactions."

19. Further, para 13.8 of ICAI Guidance Note states as under:-

"It may be noted that in order to closely linked transactions, it is not necessary that these transactions need be identical or even similar. For example, a collaboration agreement may provide for import of raw materials, sale of finished goods, and provision of technical services and payment of royalty. Different methods may be chosen as the most appropriate methods for each of the above transactions when considered on a standalone basis. However, under particular circumstances, one single method may be chosen as the most appropriate method covering all the above transactions as the same are closely linked."

20. The approach of pricing a range of closely linked products where it is impractical to determine pricing of each individual product or transaction is an accepted norm by the OECD Transfer Pricing Guidelines, which read as under:-

"Ideally, in order to arrive at the most precise approximation of fair market value, the arm's length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous those they cannot be evaluated adequately on a separate basis.... Such transactions should be evaluated together using the most appropriate arm's length method or methods... Examples may include 1. Some long-term contracts for the supply of commodities or services, 2. Rights to use intangible property, and 3. pricing a range of close-linked products (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction. Another example would be the licensing of manufacturing know-how and the supply of vital components to an associated manufacturer; it may be more reasonable to access the arm's length terms for the two items together rather than individually. Such transactions should be evaluated together using the most appropriate arm's length method. A further example would be the routing of a transaction through another associated enterprise; it may be more appropriate to consider the transaction of which the routing is a part in its entirety, rather than consider the individual transactions on a separate basis."

21. In view thereof, we uphold the business strategy adopted by the assessee which would follow that sale of machinery, packaging material and straws, etc. were closely interlinked and the same could not be evaluated separately. The aggregation approach adopted by the assessee in benchmarking its international transactions of closely interlinked transactions is thus, accepted.

22. We further find that similar issue of aggregation has been accepted by the Pune Bench of Tribunal in Demag Cranes & Components (India) (P.) Ltd. Vs. DCIT (2013) 30 taxmann.com 364 (Pune - Trib.).

23. Further, the Tribunal in Cummins India Ltd. Vs. Addl.CIT (2015) 53 taxmann.com 53 (Pune - Trib.) in turn, relying on OECD Guidelines, Indian Transfer Pricing Provisions and the ratio laid down in Demag Cranes & Components (India) (P.) Ltd. Vs. DCIT (supra), accepted aggregation of transactions holding as under:-

"24. The first issue arising in the present appeal is whether in view of the OECD guidelines and the Indian Transfer Pricing provisions, aggregation of transactions could be made or not. We find that Pune Bench of the Tribunal in Demag Cranes & Components (India) Pvt. Ltd. Vs. DCIT (supra) had elaborately considered the OECD guidelines under Chapter - III and also the guidance Notes issued by the Institute of Chartered Accountants of India on transfer pricing in para 13.7 and had held as under:-

"30. We have carefully considered the rival submissions. Section 92B of the Act provides the meaning of expression "international transaction" as a transaction between two or more associated enterprises. Rule 10A(d) of the Rules explains the meaning of the expression "transaction" for the purposes of computation of ALP as to include a number of closely linked transactions. Rule 10B of the Rules prescribes the manner in which the ALP in relation to an international transaction is to be

determined by following any of the methods prescribed. Shorn of other details, it would suffice to observe that on a combined reading of Rule 10A(d) and 10B of the Rules, a number of transactions can be aggregated and construed as a single „transaction“ for the purposes of determining the ALP, provided of course that such transactions are „closely linked“. Ostensibly the rationale of aggregating „closely linked“ transactions to facilitate determination of ALP envisaged a situation where it would be inappropriate to analyse the transactions individually. The proposition that a number of individual transactions can be aggregated and construed as a composite transaction in order to compute ALP also finds an echo in the OECD guidelines under Chapter III wherein the following extract is relevant:-

"Ideally, in order to arrive at the most precise approximation of arm's length conditions, the arm's length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Examples may include 1. Some long term contracts for the supply of commodities or services; 2. Rights to use intangible property; and 3. Pricing a range of closely linked products (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction. Another example would be the licensing of manufacturing know-how and the supply of vital components to an associated manufacturer; it may be more reasonable to access the arm's length terms for the two items together rather than individually. Such transactions should be evaluated together using the most appropriate arm's length method. A further example would be the routing of a transaction through another associated enterprise; it may be more appropriate to consider the transaction of which the routing is a part in its entirety, rather than consider the individual transactions on a separate basis."

31. In this background, considering the legislative intent manifested by way of Rule 10A(d) read with Rule 10B of the Rules, it clearly emerges that in appropriate circumstances where closely linked transactions exist, the same should be treated as one composite transaction and a common transfer pricing analysis be performed for such transactions by adopting the most appropriate method. In other words, in a given case where a number of closely linked transactions are sought to be aggregated for the purposes of bench marking with comparable uncontrolled transactions, such an approach can be said to be well established in the transfer pricing regulation having regard to Rule 10A(d) of the Rules. Though it is not feasible to define the parameters in a water tight compartment as to what transactions can be considered as „closely linked“, since the same would depend on facts and circumstances of each case. So however, as per an example noted by the Institute of Chartered Accountants of India (in short the „ICAI“) in its Guidance Notes on transfer pricing in para 13.7, it is stated that two or more transactions can be said to be „closely linked“, if they emanate from a common source, being an order or contract or an agreement or an arrangement, and the nature, characteristic and terms of such transactions substantially flow from the said common source. The following extract from the said Guidance Notes is worthy of notice:-

"13.7 The factors referred to above are to be applied cumulatively in selecting the most appropriate method. The reference therein to the terms „best suited“ and „most reliable measure“ indicates that the most appropriate method will have to be selected after a meticulous appraisal of the facts and circumstances of the international transaction. Further, the selection of the most appropriate method shall be for each particular international transaction. The term „transaction“ itself is defined in rule 10A(d) to include a number of closely linked transactions. Therefore, though the reference is to apply the most appropriate method to each particular transaction, keeping in view, the definition of the term „transaction“, the most appropriate method may be chosen for a group of closely linked transactions. Two or more transactions can be said to be linked when these transactions emanate from a common source being an order or a contract or an agreement or an arrangement and the nature, characteristics and terms of these transactions are substantially flowing from the said common source. For example, a master purchase order is issued stating the various terms and conditions and subsequently individual orders are released for specific quantities. The various purchase transactions are closely linked transactions.

13.8 It may be noted that in order to be closely linked transactions, it is not necessary that the transactions need be identical or even similar. For example, a collaboration agreement may provide for import of raw materials, sale of finished goods, provision of technical services and payment of royalty. Different methods may be chosen as the most appropriate methods for each of the above transactions when considered on a standalone basis. However, under particular circumstances, one single method may be chosen as the most appropriate method covering all the above transactions as the same are closely linked."

(Underlined for emphasis by us).

32. In this background, we may now examine the facts of the present case. The primary activity of the assessee is to manufacture material handling equipments viz. cranes and hoists. It is seen from the documents placed in the Paper Book that the assessee enters into a single negotiation with the customers, which, inter-alia, includes manufacturing and supply of the material handling equipment, provision of commissioning and installation services, etc. Though the assessee raises different invoices for supply of equipments and separately for erection and commissioning charges, however, it is evident that the negotiations for the same are carried on at one go. In fact, at the time of hearing, it was specifically queried from the learned counsel as to whether the assessee is undertaking installation/commissioning activities independent of its own-supplied material handling equipments. It was clarified that the servicing and commissioning charges are earned only in relation to services performed for own-supplied manufacture/assembled material handling equipments. The aforesaid factual assertion is not disputed. Factually, it is the activity of manufacturing/assembly of cranes etc. done by the assessee and sales thereof, which brings into play the activities of installation and commissioning of such products. Therefore, it is quite evident that such services are not independent but in-effect are as a result of manufacturing of material

handling equipment undertaken by the assessee and as they arise from a single negotiation with the customers, the source of all such transactions is also to be understood as common.

33. The TPO in this regard has observed that assessee has invoiced separately for such activities and therefore, they have to be understood as different transactions. The TPO has also observed in his order that in a case where profits of each individual transaction can be segregated then the aggregation of transaction is not intended by the transfer pricing regulations. The learned TPO has also referred to the segmental profitability in this regard computed by the assessee during the course of transfer pricing proceedings before him. In our considered opinion, the point made out by the learned TPO is not justified, inasmuch as, separate invoicing of an activity, flowing from a singular contract/ negotiation, would not ipso facto lead to an inference that they are individual/independent transactions. In-fact, it is the nature and characteristic of the activities which would be required to be analyzed having regard to the facts and circumstances of each case as to whether they can be considered as individual/independent transactions or a single transaction for the purpose of transfer pricing regulation. In the present case, as we have noted earlier, it is only on account of the manufacturing activity that the activity of commissioning and installation of the equipment arises and pertinently all the aforesaid activities are negotiated and contracted for at one instance. With regard to the segmental profitability referred by the Assessing Officer, the position has been clarified by the assessee. According to the assessee, in the financial statements affirmed by the Auditors, the activities have been clubbed together in accordance with the Accounting Standards prescribed by the ICAI. It was clarified that the segmental profits were worked out by the assessee only at the asking of the TPO during the proceedings before him. The learned counsel pointed out with reference to the chart in this regard placed in the Paper Book and submitted that the segmental profitability was not computed on the basis of any separately maintained records viz. books of account or vouchers but was computed by undertaking a statistical exercise. The costs were allocated as a proportion of sales/revenues and not an actual basis. In view of the aforesaid fact situation, we do not find that the availability of separate segmental profits in the present case can be a justifiable ground for the TPO to say that the transactions are not „closely linked“ within the meaning of Rule 10A(d) of the Rules. Thus, the activity of installation and commissioning/engineering services is „closely linked“ with the manufacturing activity and deserves to be aggregated and construed as a single transaction for the purposes of determining the ALP as per the method adopted.

34. In view of the aforesaid discussion, in our opinion, the approach of the TPO, in out-rightly rejecting the aggregation of all the transactions itemized at 1 to 7 in para 7 is flawed having regard to the facts and circumstances of the case. Further, it is noticed from the tabulation in para 7 of this order, that the assessee is also rendering marketing services, technical know-how and professional services, etc., which have also been aggregated. For such activities no specific point has been made out by the assessee as to why they can be classified as „closely linked“ transactions for the purposes of Rule 10A(d) of the Rules. Considering the entirety of the facts and circumstances, we are of the opinion that the issue be revisited by the AO/TPO in the light of our aforesaid discussion. The AO/TPO shall take into consideration the pleas and the material sought to be placed by the assessee in the light of the aforesaid discussion and thereafter adopt a combined transaction approach after considering each of the transaction itemized at 1 to 7 as to whether the same are to be bench marked

after aggregation or not. Needless to say, the Assessing Officer shall allow the assessee a reasonable opportunity to put forth material and submissions in support of its stand and only thereafter the Assessing Officer shall pass an order afresh on the above aspect in accordance with law. Thus, on this Ground, assessee succeeds for statistical purposes."

25. Similar principle has been laid down by the Delhi Bench of the Tribunal in M/s. Panasonic India Pvt. Ltd. Vs. ITO (supra) and M/s. Intimate Fashions (India) Pvt. Ltd. Vs. ACIT (supra).

26. In view of the ratio laid down by Pune Bench of the Tribunal in Demag Cranes & Components (India) Pvt. Ltd. Vs. DCIT (supra), it is held that where number of transactions are closely linked transactions, then the same can be aggregated and construed as a single transaction for the purpose of determining the arm's length price. In case, there is close link exists between the different transactions, the same should be treated as composite transaction and appropriate method should be applied to work out the transfer pricing analysis. Where two or more transactions emanate from common source being an order or contract or an agreement or an arrangement, then such transactions could be said to be closely linked as the nature, characteristic and terms of such transaction substantially flow from the said common source.

27. In the above said background, we analyse the different international transactions entered into by the assessee as pointed out by us in the paras hereinabove. The business of the assessee company was to provide aftermarket support to IC engines sold, in the form of sale of spare parts and rendering of after sales service including warranty administration. The assessee is thus, providing after sales support for engines sold by Cummins India Ltd., Cummins INC, etc. which were under warranty period and also post warranty period. The servicing, repair and annual maintenance contract, warranty period and for post warranty period were the services provided by the assessee for carrying out most of the above said activities. The sale of spare parts was claimed to be the principal activity of the assessee. The repair & maintenance and the warranty administration including services of the IC engines requires the support of the spare parts which were sold by the assessee. Where the assessee was engaged in aftermarket support of engines manufactured and sold by Cummins entities, the question arises whether the sale of spare parts could be categorized separately as a trading activity engaged in by the assessee, which in turn is separate from the activity of doing servicing of the IC engines, their repair and maintenance and also warranty administration i.e. support during the warranty period and also annual maintenance contracts and services during post warranty periods. Another activity engaged in by the assessee was payment for customized parts catalogue, which was also aggregated by the assessee company as part of its international transactions, which were claimed to be linked to the sale of spare parts carried on by the assessee.

28. The assessee during the year under consideration had made exports to its associated enterprises on account of the said spare parts totaling Rs.87,48,479/-. The assessee had also made exports to third parties during the financial year totaling Rs.4,16,326/-. The break-up of the exports to associated enterprises and third parties are enlisted at pages 200 to 204 of the Paper Book. Admittedly, there was significant difference in the value of exports made to associated enterprises and the exports made to third parties. The explanation of the assessee in this regard was that the exports made to the associated enterprises were on regular basis and were being made to its

associated enterprises, which in turn were supplying to the dealers and through them, to the customers. However, the exports to third parties were directly made to the consumers who could select the spares through the catalogue and order the same to the assessee, who was engaged in providing aftermarket support to the IC engines sold worldwide. Further, the claim of the assessee was that the export to third parties was made on urgent basis and hence, the premium was charged and further, the frequency of such transactions was low and consequently, higher margins of profits. The first major activity carried on by the assessee was of import of spare parts to Rs.29.45 crores as against which, the export of spare parts was only Rs.0.87 crores. The payment for IT support received from associated enterprises was Rs.1.09 crores and the payment for access to customized part catalogues was Rs.0.02 crores. Further, the assessee had received Rs.0.76 crores against warranty administration. All these international transactions are linked to the main business being carried on by the assessee and such closely linked transactions are to be analysed in aggregate to determine the arm's length price. The aggregation of the import of spare parts, export of spare parts, IT support services, access to customized parts catalogue and amount received for warranty consideration are inter-related transactions, which were the sourcing activities of the assessee company and have to be aggregated in order to benchmark the international transactions. The assessee had benchmarked the arm's length price of all the transactions by comparing results of the comparable companies which were found to be at arm's length price. The assessee had also furnished the segmental Profit & Loss Account for the exports to associated enterprises and as compared to the export to third parties and percentage of services over total sales in respect of export to associated enterprises works out to 0.2069% and in respect of exports to third parties works out to 0.0098%.

29. The plea of the assessee in this regard was that besides difference in the value of exports to third parties and to associated enterprises, the spare parts exported to third parties and to associated enterprises were different in nature. Further, the export value was less and these parties were one of customers and therefore, the risk involved was high. Further, the frequency of such transactions was very low. In view of the above facts and circumstances, the comparison between the export to associated enterprises and export to third parties would not provide accurate results as economic value of the transactions, risk involved were different. We find merit in the plea of the assessee in this regard. We uphold the aggregation of transactions in the TP study carried on by the assessee where the said transactions after benchmark were at arm's length price, no adjustment was to be made. In view thereof, we find no merit in the analysis carried out by the TPO by benchmarking the transactions of exports to third parties with exports to associated enterprises resulting in addition of Rs.22.49 lakhs. In view of our discussion herein above, we delete the addition of Rs.22.49 lakhs. The grounds of appeal raised by the assessee are thus, allowed."

24. Before parting, we may also point out that the TPO while benchmarking two segments of sale of packaging machinery and equipment and sale of straws as functionally separate, had applied same margin of 5.87% of comparable companies for both the functionally different segments. Where the two segments are treated as functionally different from each other, then the same could not be compared with the margins of same comparable companies for both the segments. Accordingly, we accept the aggregation approach applied by the DRP and dismiss the grounds of appeal raised by the Revenue.

25. Now, coming to the issue raised by the assessee in its appeal i.e. provision of warranty. The assessee claims that as part of its sale and supply of processing equipment and filling machines, it was offering warranty for 12 months from the date of commissioning or 18 months from the date of delivery, whichever was earlier. The assessee thus, was making a provision for warranty @ 2% of equipment sale price, except sale of processing components. The assessee was making the said provision from year to year by following a system of accounting and during the year under consideration, had claimed expenditure of Rs.1.27 crores. Both the Assessing Officer and the DRP did not allow the claim of assessee, in view of similar claim being rejected in earlier years.

26. We find that the Tribunal in assessee's own case relating to assessment year 2008-09 in ITA No.786/PN/2014, order dated 23.12.2016, had allowed the claim of assessee holding as under:-

"9. We have heard the rival contentions and perused the record. The issue arising in the present appeal is against the claim of deduction on account of provision made for warranty. The assessee was engaged in the manufacture and sale of processing equipments and filling machines for both dairy and bread processing industries. The machineries which were being manufactured by the assessee were heavy packaging machineries and for the supply of same, the assessee was entering into agreement with the prospective buyers. The copy of one such agreement is placed on record by the assessee at pages 70 to 79 of the Paper Book. As per warranty clause 7 of the agreement, it is provided that the equipment is sold subject to express warranty, wherein the seller warrants that the equipments shall be free from material defects in workmanship, materials and design for period of 12 months from the date of commencement of use or period or 18 months from the delivery, whichever is shorter. It was undertaken by the assessee to repair or replace free of charge to the purchaser any part of equipment which contains a defect or actual refund to the purchaser the portion of price attributable to the defective part. The replacement or repair price were also subject to some warranty for the remainder of original warranty period or six months from the date of repair or installation of replacement part, whichever is shorter. It was agreed that the purchaser had to bear the cost and risk of transport of defective part to the seller, who in turn, had to repair or replace the same on the same terms as the equipment was supplied. As per clause 7.4, the seller i.e. the assessee had no liability for any defect in the equipment because of ordinary wear and tear, misuse or abuse and other conditions. In view of undertaking given by the assessee by way of warranty on the equipment sold by it to the prospective purchasers, the assessee was maintaining a systematic method, wherein the provision was made on account of warranty. In case any part of the warranty was utilized, then the same was so debited or / and the balance on expiry of period of warranty was written back. This method was regularly and systematically followed by the assessee. The CIT(A) has referred to the factual aspects of the case and pointed out that the machinery sold by the assessee was in the range of Rs.4-6 crores and there were limited buyers of said machinery. In view of said facts and circumstances, where the assessee was engaged in the manufacture of specialized machinery for packaging and the assessee had warranty clause against supply of the said machinery,

then the recognition of application of warranty by way of making the provision in the books of account is accepted accounting practice and such a liability recognized by the assessee is Contingent Liability. Following the ratio laid down by the Hon'ble Supreme Court in Rotork Controls India P. Ltd. Vs. CIT (supra), we hold that the value of Contingent Liability by way of recognizing the warranty liabilities, by making a provision and also following systematic method of its write back and / or utilization is an accepted accounting method adopted by the assessee and the provision made by the assessee is to be allowed as deduction in the hands of assessee. It may be clarified herein that the CIT(A) had rejected the claim of assessee in assessment year 2008-09 observing that the assessee had made provision to the extent of Rs.32.74 crores, whereas none of the provisions made in the earlier years were much utilized. The learned Authorized Representative for the assessee in this regard has clarified that inadvertently, the same was created at Rs.32.74 crores but Rs.31.07 crores was written back and the deduction by way of provision of warranty was claimed only at Rs.1.67 crores. The Assessing Officer had also disallowed sum of Rs.1.67 crores only. In view thereof, we find no merit in the observations of CIT(A) in denying the claim of assessee. Applying the ratio laid down by the Hon'ble Supreme Court in Rotork Controls India P. Ltd. Vs. CIT (supra), the assessee having fulfilled the conditions laid down by the Apex Court, we find merit in the claim of assessee and accordingly, we direct the Assessing Officer to allow the deduction on account of provision for warranty made at Rs.1.67 crores. The grounds of appeal raised by the assessee are thus, allowed."

27. The issue arising in the present appeal is squarely covered by the similar issue as in earlier year and even the DRP and the Assessing Officer had disallowed the claim of assessee, since similar claim was not allowed in earlier years. Following the same parity of reasoning, we direct the Assessing Officer to allow the claim of provision for warranty at Rs.1,27,01,521/-. The grounds of appeal No.2.1 and 2.3 are thus, allowed and the balance grounds of appeal raised by the assessee being not pressed, are dismissed.

28. The Cross Objections filed by the assessee are dismissed being academic since the appeal of Revenue has been dismissed.

29. In the result, appeal of assessee is partly allowed and the appeal of Revenue and Cross Objections of assessee are dismissed.

Order pronounced on this 20th day of September, 2017.

Sd/-
(ANIL CHATURVEDI)
/ ACCOUNTANT MEMBER

Sd/-
(SUSHMA CHOWLA)
/ JUDICIAL MEMBER

/ Pune;

Dated : 20th September, 2017.

GCVSR

¥ *f* /Copy of the Order is forwarded to :

1. The Appellant;
2. The Respondent;
3. The DRP, Pune;
4. The DIT (TP/IT), Pune;
5. The DR 'B', ITAT, Pune;
6. Guard file.

/ BY ORDER, //True Copy// § / Sr. Private
Secretary, / ITAT, Pune