

**IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**

IT(TP)A No.2750/Bang/2017
Assessment Year : 2013-14

M/s. Flint Group India Pvt. Ltd., Plot#2, Shiv Indl. Infrastructure Park, Nirma Canal Road, Lamdapura – 391 775 TA Savil, District – Vododara, Gujarat. PAN : AAACI 5639 L	Vs.	The Deputy Commissioner of Income Tax, Circle -3(1)(1), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. Tanmayee, Advocate
Respondent by	:	Shri. Pradeep Kumar, CIT(DR-III)(ITAT), Bengaluru

Date of hearing	:	02.09.2021
Date of Pronouncement	:	06.09.2021

ORDER

Per N. V. Vasudevan, Vice President:

This is an appeal by the assessee against the final Order of the Assessment dated 27.10.2017 passed by the DCIT, Circle 3(1)(1), Bengaluru, u/s.143(3) read with Sec.144C (13) of the Income Tax Act, 1961 (Act).

2. Ground No.1 was not pressed for adjudication as it is general in nature. Ground No.2 was also not pressed being general in nature. Ground No.3 raised by the assessee is with regard to the grievances of the assessee in the action of the Dispute Resolution Panel (DRP) in upholding the stand of the AO in not providing unabsorbed cost adjustment to the assessee on account of utilized capacity.

3. The assessee is a wholly owned subsidiary of Flint Group (Mauritius) Ltd. The assessee is engaged in the business of manufacturing and trading of printing ink in India. The assessee entered into a technical know-how agreement with Flint Group whereby Flint Group provides the assessee with technical information and processes for manufacturing printing inks. The assessee functions as a licenced manufacturer manufacturing ink products based on the technical know-how information provided by the Flint Group. The Assessee had the following international transactions with the Flint group:

S.No.	Description of the Transactions	Amount (Rs.)
1.	Purchase of Raw Materials	11,63,67,584
2.	Purchase of Traded Goods	1,21,53,520
3.	Purchase of Capital Assets	2,87,13,977
4.	Payment of Management Fees	1,43,00,423
5.	Interest on term loan	67,40,696
6.	Reimbursement of Expenses Paid	7,08,321
7.	Reimbursement of Expenses received	55,16,941

3. In terms of Sec.92(1) of the Act which provides that any income arising from an international transaction shall be computed having regard to the arm's length price the Assessee filed Transfer pricing analysis justifying the payments made to the Associated Enterprises (AE) adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) for determination of Arm's Length Price (ALP) of the international transaction in terms of Sec.92 of the Act. The transactions relating to purchase of raw material, purchase of traded goods, purchase of capital assets, reimbursement of expenses paid and management services were treated as inextricably linked the to activity of licensed manufacturing activity and hence closely linked and considered to be included in the

manufacturing activity by adopting a combined transaction approach. The approach of the Assessee was accepted by 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.

4. The Profit Level Indicator (PLI) chosen for the purpose of comparison of Assessee's profit margin with that of the comparable companies was Operating profit on Operating Revenue i.e., OP/OR

The OP/OR as **per the TP study was as follows:**

Operating Income	Rs. 2,05,65,88,838/-
Operating Cost	Rs.1,93,84,70,013/-
Operating Profit (Op. Income – Op. Cost)	Rs. 1,18,118,825/-
Net mark-up (OP/Sales)	5.74%

The TPO computed OP/OR as follows:

Operating Income (OR)	Rs. 2,05,65,88,838/-
Operating Cost(OC)	Rs.2,08,92,67,136/-
Operating loss (OC-OR)	Rs.-3,26,78,298/-
Net mark-up (OP/OR)	-1.59%

5. The difference in profit margins as arrived at by the TPO and the assessee is due to the assessee adopting operating cost of Rs.193,84,70,013/- (second row of the first table). whereas the TPO adopted the Operating Cost of Rs.208,92,67,136/- (Second row of the second table). One of the reason for the difference between the operating costs as adopted by the assessee and as adopted by the TPO due to the assessee considering the following items as not part of operating expenses:

- (i) Net loss on Foreign currency Transaction and Translation: Rs.81,43,524 on the ground that the expenditure is contingent in nature.
- (ii) Manufacturing and other expenses of Rs.13,57,91,598 and Depreciation of Rs.1,56,25,859. These two items of expenses were excluded by the assessee for the reason that due to under utilization of its capacity these expenses had to be regarded as not operating expenses.

The dispute in Gr.No.3 is with regard to excluding the expenses due to under utilization of capacity as not operating expenses by the assessee, which is item No.(ii) given above and the dispute in Gr.No.4 is with regard to action of the assessee in treating net loss on foreign currency transactions and translation as non- operating expenditure which is item No.(i) given above.

6. The TPO rejected the contention of the assessee on the adjustment to assessee's margin for underutilization of capacity by reducing certain expenses and depreciation which were unabsorbed, from the operating costs and he recomputed the operating cost by disallowing the adjustment made towards underutilized capacity. According to the TPO, the assessee did not furnish any evidence in support of its contentions. The TPO also considered the loss arising from fluctuation of foreign currency as being operating in nature and included the same in the operating cost base and this is subject matter of Gr.no.4 in this appeal, which will be dealt with in the later part of this order.

7. Against the draft order of assessment, the assessee filed objections before the Dispute Resolution Panel (DR) which rejected the same on the basis that Appellant had not furnished any evidence in support of its contentions. It also rejected the contention of the assessee that gains/losses arising from fluctuation of foreign currency ought to be considered as non-operating in nature. Pursuant to the directions of the DRP, the AO passed the final assessment order dated 27.10.2017 against which the assessee is in appeal before the Tribunal.

8. As far as Gr.No.3 raised by the assessee is concerned, the learned counsel for the assessee submitted that the assessee shifted its manufacturing facility from Bangalore (Hosur) to Vadodara in the financial year 2012-13 relevant to the assessment year in question. It was the contention of the assessee that Vadodara was a new market for the assessee and it was in the process of gaining market in the new place. Moreover, as result of this relocation, the assessee was not able to operate at its optimum capacity and could not recoup its fixed costs from out of the production during the year under consideration. This resulted in significant underutilization of the production capacity in the factory, resulting in low utilization of the available capacity to manufacture the products, which in turn resulted in non-absorption of various costs. It was submitted that during the year, the manufacturing facility of the Appellant had a production capacity of 20,700 units. As against the same, during the year under consideration, the assessee was able to manufacture only 11,769 units. A summary of the production capacity vis-à-vis the actual production was given as under:

Particulars	Per month capacity	Period of operation	Installed capacity	Sales
Liquid Packing				
Bangalore	600	6	3600	
Lamdapura	1050	10	10500	
Hosur	60	10	600	
			14700	6862
News Ink				
Savli			6000	4907
Total			20700	11769
Utilized capacity				57%

9. It was submitted that from the above, it would be evident that the assessee has underutilized capacity to the extent of 43% and cost to that extent has not been absorbed. This underutilization of capacity resulting in non-absorption of costs has a material impact on the margin of the company which requires granting of reasonably accurate adjustment to eliminate the material effects thereof. In this background the assessee had reduced, of the cost, the manufacturing and other expenses and depreciation by Rs. 15.14 crores being 43% of manufacturing and other expenses and depreciation on account of the significant under-utilisation of capacity. The TPO/DRP rejected the claim of the assessee primarily on the ground that (i) an adjustment for underutilization of capacity is to be made to the margins of the comparable companies and not the tested party and (ii) the Appellant had not furnished details with regard to the capacity utilization of the comparable companies and that comparable companies were working at 100% capacity. It was submitted that the revenue authorities did not dispute that there was under-utilisation of the capacity of the assessee. It was brought to our notice that the **Tribunal in the assessee's own case for AY 2014-15** (order dated 31.10.2019 in IT(TP)A No. 3285/Bang/2018) remanded identical issue to the TPO with a direction to grant an adjustment on account of capacity utilisation by calling for

relevant information on capacity utilisation in the case of comparable companies by exercising his powers in law. The Tribunal also held that if challenges on the lack of information / data are accepted then the adjustment should be made to the tested party.

10. The learned DR while placing reliance on the directions of the DRP submitted that an adjustment for underutilization of capacity is to be made to the margins of the comparable companies and not the tested party and that the assessee had not furnished details with regard to the capacity utilization of the comparable companies and that comparable companies were working at 100% capacity

11. We have considered the rival submissions and we notice that this Tribunal has in **assessee's own case for AY 2014-15** (order dated 31.10.2019 in IT(TP)A No. 3285/Bang/2018) set aside the issue to the TPO for consideration afresh and directed the TPO to grant an adjustment on account of capacity utilisation by calling for relevant information on capacity utilisation in the case of comparable company by exercising his power under Section 133(6) of the Act to collate the information on capacity details of the comparable companies such as actual capacity in units, installed capacity, break up of fixed and variable cost, product wise segmental profitability (if any) and provide the assessee an opportunity by sharing the details so obtained on the comparable companies, and accordingly grant the adjustment for capacity under-utilized. The Tribunal also held that if challenges on the lack of information / data are accepted than the adjustment should be made to the tested party. Facts and circumstances of the case being identical to AY 2014-15, we respectfully follow the decision of the Tribunal for AY 2013-14 and set the order of the AO on this issue remand the same to the AO/TPO for consideration afresh

as directed by the Tribunal in AY 2013-14 after affording assessee opportunity of being heard. We hold and direct accordingly.

12. As far as Ground No. 4 raised by the assessee is concerned, the same relates to Loss/gains arising from fluctuation and restatement of foreign currency ought to be treated as non-operating in nature. On this issue, the learned counsel for the assessee submitted that during the year under consideration, the TPO has considered forex fluctuation as being operating in nature while computing the margin of the assessee as well as the comparable companies. In this regard, it was submitted that the assessee bears the risk arising from forex fluctuations. The assessee would not be insulated or compensated by its AEs for the forex loss incurred during a given period. Further, it was submitted that at the time of determination of arm's length price, it is not possible for the assessee to anticipate the variation in the forex fluctuations. In such situations, forex variation can never be taken into account by the assessee while determining the arm's length price. Therefore, the loss or gains arising from forex fluctuations is not in the control of the assessee or the comparable companies.

13. It was submitted that the assessee is not a captive service provider but a licensed manufacturer, i.e., revenue is earned from third parties and majority of its transactions are with third parties. Therefore, in such a scenario, it is even more imperative to not consider the foreign exchange fluctuations as operating in nature. On the above argument, the learned counsel admitted that the assessee is not in a position to bifurcate transactions with AE and third parties and quantify the loss/gain in foreign currency fluctuation/restatement. The learned counsel placed reliance on the decision of the Hon'ble Tribunal in the case ***DHL Express (India) Private Limited v. ACIT*** (order dated 27.04.2011 in ITA No. 7360/Mum/2010) wherein the Tribunal agreed with the assessee that

interest income, rent receipts, dividend receipts, penalty collected, rent deposits returned back, foreign exchange fluctuations and profit on sale of assets do not form part of the operational income because these items have nothing to do with the main operations of the assessee. This decision is distinguishable as the finding is that the foreign exchange fluctuation did not arise out of the international transaction of the assessee for which ALP was being determined.

14. Reliance was placed on Rule 10TA(j) of the Safe Harbour Rules as notified by the Central Board of Direct Taxes ("CBDT") which defines 'operating expenses' which excludes loss arising on account of foreign currency fluctuations:

"operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including [costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and] depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—

- (i) interest expense;*
- (ii) provision for unascertained liabilities;*
- (iii) pre-operating expenses;*
- (iv) loss arising on account of foreign currency fluctuations;*
- (v) extraordinary expenses;*
- (vi) loss on transfer of assets or investments;*
- (vii) expense on account of income-tax; and*

(viii) other expenses not relating to normal operations of the assessee:

Reference was made to Rule 10TA(k) which also excludes gains from foreign exchange fluctuations from the definition of 'operating revenues' the relevant extract of which is provided below for:

"operating revenue" means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations [including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee] but not including the following, namely:—

- (i) interest income;*
- (ii) income arising on account of foreign currency fluctuations;*
- (iii) income on transfer of assets or investments;*
- (iv) refunds relating to income-tax;*
- (v) provisions written back;*
- (vi) extraordinary incomes; and*
- (vii) other incomes not relating to normal operations of the assessee.*

It was argued that when the CBDT itself has recognised the fact that gains/losses arising on account of foreign exchange fluctuations should not form part of operating incomes/expenses even in case of risk mitigated tested parties.

15. The learned DR reiterated the stand of the revenue that the net loss/gain on account of fluctuation/restatement foreign exchange currency has to be treated as part of the operating expenses/gain respectively.

16. We have carefully considered the rival submissions. In the context of transfer pricing, the Bangalore Bench of the Tribunal in SAP Labs India Pvt. Ltd. Vs ACIT (2011) 44 SOT 156 (Bangalore) has held that foreign exchange fluctuation gain is part of operating profit of the company and should be included in the operating revenue. In the light of above

judgement, which is being followed consistently by the various Benches of ITAT, we hold that the amount of foreign exchange gain/loss arising out of revenue transactions is required to be considered as an item of operating revenue/cost, both of the assessee as well as comparables. Hence, the AO was justified in considering forex loss as operating cost.

17. The AO/TPO will compute the ALP of the international transaction in question in accordance with the directions given above after affording assessee opportunity of being heard.

Corporate Tax Issues:

18. In Ground No. 5 the assessee has projected its grievance in the action of the revenue authorities disallowing deduction of a sum of Rs.12,40,195/-. We have already seen that during the previous year, the assessee had shifted its operations from Bangalore to Vadodara. In the process of relocation, some of the original invoices depicting the amount of duties paid, for which credit was yet to be claimed, were lost. Since for the purpose of claiming countervailing and excise duty, original invoices/bills are required and as the same were lost in the process of relocation, the credit of the same could not be claimed by the assessee and therefore, was written off in the books of accounts. The AO disallowed the amount written off by holding that the same can be claimed only on payment basis as per the provisions of Section 43B of the Act and since the duty was not paid in AY 2013-14, the same would not be allowable. Further, the AO held that it was only the government department which could disallow the credit and that the assessee cannot *suo moto* write off the claim. The DRP accepted the contention of the assessee that duty credits are in the nature of receivables and hence the provisions of Section 43B would not be attracted. The DRP however held that duty credits were not in the nature

of receivables, it would not take the characteristics of expenses for the purpose of deduction under Section 37 of the Act. It directed the AO to examine whether the said credits were actually written off and if so, allowability of the same as bad debts was to be examined. In the final assessment order, no relief was granted to the assessee for the reason that details were not furnished by the assessee to show that the amount of expenditure crystallized during AY 2013-14 as irrecoverable.

19. We have heard the rival submissions. It is not in dispute that the assessee wrote off the countervailing and excise duty by debiting its profit and loss account to the extent it was ineligible to claim the duty credit and consequently claimed the same as a deduction under Section 37(1) of the Act. Since the credit cannot be claimed by the assessee and the said amount was written off, the same ought to be allowable as business expenditure under Section 37(1) of the Act more so, when the conditions specified for claim for expenditure under Section 37 of the Act are satisfied. In terms of Rule 9 of the Cenvat Credit Rules 2004, the assessee would not be able to claim credit on the basis of photocopies of invoices. The Chandigarh Bench of ITAT in the case of **Mohan Spinning Mill v. ACIT** (order dated 25.04.2012 in ITA No. 1212/Chd/2011) allowed CENVAT credit written off by the assessee as a business expenditure under the provision of Section 37 of the Act. The DRP held that cases cited by the learned counsel for the assessee were cases where either the registration certificate was surrendered or the business itself was closed. The DRP directed the AO to examine whether the credits were actually written off and if so allow the claim as bad debt. In our view, the sum in question can be regarded as loss incidental to business. It is no doubt true that in the event of loss, the year in which the loss crystallized is important. The assessee's claim that the original invoices were lost and hence the

assessee could not claim credit for duty paid is not disputed. In such circumstances, to allow the claim as loss incidental to the business in year of write off ought to have been accepted. We therefore direct that the claim of the assessee should be allowed as deduction.

20. In Ground No. 6, the assessee has challenged the order of the revenue authorities in disallowing a sum of Rs.20,000 being admission fees paid to employee of the assessee for securing admission for the employees child in a school. A sum of Rs. 20,000/- was paid to an employee as reimbursement which was incurred due to the transfer of his employment from Bangalore to Vadodara. The AO has held the expenses to be personal in nature and at best can be considered as perquisite in the hands of the employee and taxed in the hands of the employee. Since the evidence to show that the amount was treated as perquisite in the hand of the employee was not filed, the AO disallowed the same. The DRP upheld the order of the citing that the business expediency of the same was not demonstrated.

21. The learned counsel for the assessee submitted that the expenditure in question ought to be considered as having been incurred owing to business expediency. It was submitted that the expenditure was incurred as a necessity for the furtherance of business interest of the assessee company for the purpose of employee welfare to ensure continue employment in the new place of business and thus not an expense of personal nature. Had the expense not been incurred, the assessee would have had to incur expenses on hiring and training fresh employees for newly set up office at Vadodara, which would have resulted in same, or maybe more cost. Also, the hindrance of the business operations would have taken place which cannot be quantified in monetary terms for the purpose of the present cost benefit analysis. It was submitted that the expenditure incurred by the

assessee was (i) wise (ii) prudent, (iii) pragmatic, (iv) ethical, man of the world of business would conscientiously incur with an eye on promoting his business prospects subject to the expenditure being genuine and with reasonable limits. It was submitted that the purpose of the expenditure supersedes the nomenclature given to it, while determining its deductibility. It was argued that the expenses have been incurred in the interest of the business and should be allowed as a deduction under Section 37 of the Act. The learned DR relied on the order of the DRP.

22. We have carefully considered the rival submissions and are of the view that the sum in question is personal expenditure of the employee. The employer having met those expenses, the employer should regard it as a perquisite in the hands of the employee. Admittedly, the sum in question has not been regarded as perquisite in the hands of the employee and therefore the sum in question was rightly disallowed by the AO. We find no grounds to interfere with the order of the DRP. Reliance placed by the learned counsel for the assessee on the decision of the ITAT Kolkata Bench in the case of **Gopalpur Tea Company Limited v. ITO** reported in 12 ITD 259 (Calcutta) is on payment of bonus over and above the statutory limit and that ratio cannot be applied to the facts of the present case. Hence, we dismiss Gr.No. 6 raised by the assessee.

23. In Ground No. 7, the assessee has challenged the action of the DRP in upholding disallowance of irrecoverable insurance claim. As a policy, the assessee accounts for transit damage losses in the account "Claim Recoverable – Insurance" and inventory is adjusted accordingly. Thereafter, claims are filed with the insurance company. Based on the approval letters received from the insurance company, any amount of claim rejected is charged off to "Insurance irrecoverable" account. According to the assessee a sum of Rs.1,77,872/- which was irrecoverable insurance

claims was therefore claimed as deduction, since the amount of claim rejected by the insurance amounts to expenditure incurred by the assessee for the purpose of its business, and therefore the amount is allowable as a deduction under Section 37 of the Act. However, the AO rejected the claim of the assessee on the ground that the necessary evidence was not filed to show that the assessee's insurance claim was rejected. The DRP upheld the action of the AO.

24. At the time of hearing it was brought to our notice that in AY 2014-15, **this Tribunal in assessee's own case for AY 2014-15** (order dated 31.10.2019 in IT(TP)A No. 3285/Bang/2018) remanded the issue to the AO with direction to the assessee to furnish the required details to show that claim made for recovery from the insurance company was rejected to the extent of sum claimed as deduction by the assessee and directed the AO to examine the claim of the assessee in the light of the details that may be filed. We are of the view identical order would meet the ends of justice in the present AY also. We hold and direct accordingly.

25. In the result, appeal by the Assessee is partly allowed for statistical purpose.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Sd/-
(N. V. VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated : 06.09.2021.
/NS/*

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.