(2011) 07 P&H CK 0236

In the Punjab And Haryana At Chandigarh

Case No : Income Tax A. No. 169 of 2011

Commissioner of Income Tax — APPELLANT

Vs

Rakhra Technologies P. Ltd. — RESPONDENT

Date of Decision : 07-07-2011

Acts Referred:

Income Tax Act, 1961 — Section 143(1), 143(3), 260A

Citation : (2011) 243 CTR 505 : (2012) 347 ITR 484 : (2011) 203 TAXMAN 154

Hon'ble Judges : A.K. Goel, Acting C.J.;Ajay Kumar Mittal, J

Bench : Division Bench

Advocate : Tejinder K. Joshi, for the Appellant;

Final Decision : Dismissed

Judgement

Ajay Kumar Mittal, J.—This is the Revenue''s appeal filed u/s 260A of the income tax Act, 1961 (for short "the Act"), against the order dated August 27, 2010, passed by the income tax Appellate Tribunal Chandigarh Bench "A", Chandigarh (in short "the Tribunal") in I.T.A. No. 171/Chandi/2010, relating to the assessment year 2005-06. The following substantial questions of law have been claimed for determination of this court :

(i) Whether, in the facts and in the circumstances of the case, the Tribunal was legally correct in directing the Assessing Officer (AO) to recompute arm''s length price (ALP) at 21.97 per cent, even when the Transfer Pricing Officer (TPO) had arrived at 35.26 per cent, after due consideration of all the relevant factors ?

(ii) Whether, in the facts and circumstances of the case, the income tax Appellate Tribunal was justified in issuing direction to the Assessing Officer to recompute the ALP after adopting the total cost at Rs. 1,70,84,964 instead of Rs. 2,02,67,550 and whether the adjustment for the depreciation on administrative assets, as directed by the income tax Appellate Tribunal, is sustainable in the eyes of law ?

(iii) Whether, in the facts and circumstances of the case, the Tribunal was legally correct in deleting the addition of Rs. 1 lakh on account of disallowance of advertisement expenses, even when the same were inadmissible, being capital in nature ?

2. The facts, in brief, necessary for adjudication as narrated in the appeal, are that the assessee is engaged in the business of research and development of software/IT enabled services. For the assessment year 2005-06, the assessee filed its return on October 31, 2005, declaring loss of Rs. 25,28,901. The return was processed u/s 143(1) of the Act. Assessment u/s 143(3) was completed, vide order dated December 26, 2008, at an income of Rs. 61,29,390 whereby the Assessing Officer made certain additions, i.e., Rs. 79,84,438 on account of difference in the arm''s length price; Rs. 1 lakh on account of disallowance of advertisement and three more amounts of Rs. 4,80,000, Rs. 52,416, and Rs. 41,434 on account of disallowance of diwali expenses, refreshment expenses and printing and stationery expenses, respectively.

3. The assessee filed an appeal before the Commissioner of income tax (Appeals) (for short "the CIT(A)"). The Commissioner of income tax (Appeals) partly accepted the appeal, vide order dated December 8, 2009, deleting the addition of Rs. 41,06,206 out of the total amount of Rs. 79,84,438 on account of the difference in the arm''s length price and all other remaining additions noticed above but sustaining the addition on account of disallowance of advertisement expenses amounting to Rs. 1 lakh.

4. Both the sides felt aggrieved by the order of the Commissioner of income tax (Appeals) and preferred their separate appeals before the Tribunal. The Tribunal, by order dated August 27, 2010, dismissed the appeal of the Revenue and partly allowed the appeal of the assessee in respect of the addition of Rs. 1 lakh on account of disallowance of advertisement expenses holding that expending of money on signboard enables conduct of the assessee''s business more profitably and facilitated the assessee''s trading operations even if the advantage was of enduring nature.

5. The Tribunal further set aside the order of the Commissioner of income tax (Appeals) on the issue of addition made on account of the arm''s length price and while doing so, a direction was given to the Assessing Officer to recompute the same by taking the operating profit/total cost at the rate of 21.97 per cent, as against 35.26 per cent, and further, adopting the total cost at Rs. 1,70,84,964 as against Rs. 2,02,67,550, after making adjustment for the depreciation on administrative assets of Rs. 31,82,586.

6. It is how the Revenue is in appeal before us.

7. Adverting to the first question regarding the arm''s length price to be applied by the Transfer Pricing Officer for determination of correct profits of the assessee, the Revenue had relied upon the instances of the following three companies. The data of the said companies is reproduced here-in-below :

8. By relying upon the above, the Revenue had tried to convince the Tribunal that average of 35.26 per cent, should have been adopted. On the other hand, the assessee had placed reliance on the same kind of data of different companies to persuade the authorities for applying the average of 16.83 per cent, by drawing inference therefrom. The said data is noticed hereunder :

9. The Tribunal, however, on appreciation of the material on record concluded that 21.97 per cent. was the appropriate percentage to be applied for adopting the arm''s length price. For doing so, the Tribunal took into consideration the data of the following comparable companies :

10. The findings recorded by the Tribunal in that behalf are as under :

We have examined the aforesaid aspect carefully. The selection of three comparables made by the assessee, in our view, is also skewed because it leaves out the case of Asian Cerc Technologies Ltd. wherein the turnover is almost near-about the turnover of the asses-see-company. Of course, the three cases selected by the assessee do merit consideration as comparable cases. Apart from the three cases adopted by the assessee and the case of Asian Cerc Technologies Ltd., the other seven cases enumerated in paragraph 7.4.2 of the Transfer Pricing Officer''s order are not strictly comparable having regard to their level of operation and turnover. Therefore, we are not inclined to accept the plea of the learned Departmental representative that all the eleven cases be considered for the purposes of comparability analysis. At this point, we may also notice that though the assessee assailed the selection of comparable cases before the Commissioner of income tax (Appeals) but there is no specific finding on this aspect, and instead he has adopted an ad hoc operating cost/total cost ratio of 15 per cent, for the purposes of computing the ultimate ALP. We find no justification to approve the action of the Commissioner of income tax (Appeals) in this regard. Considering the entirety of circumstances, in our considered opinion, the following four companies out of the list searched by the Transfer Pricing Officer and contained in paragraph 7.4.2 of his order, deserve to be selected for the purpose of comparability analysis :

11. The Tribunal found the four comparable companies for adopting the arm''s length price. No perversity could be pointed out by the learned counsel for the appellant that may warrant interference in the finding recorded by the Tribunal in the above context.

12. Adverting to question No. 2, the Tribunal held that the claim for depreciation on administrative assets amounting to Rs. 31,82,586 was liable to be accepted for determining the profits of the assessee. The findings recorded by the Tribunal in this regard are noticed here :

Having identified the comparables companies, we may now proceed to determine the ALP. The arithmetic mean of the operating profit/total cost ratios work out to 21.97 per cent. At this stage, we may now adjudicate the second objection raised by the assessee. The assessee had explained before the lower authorities that for the comparability analysis two adjustments are required to be made to the profit disclosed by the assessee. Such adjustments were on account of two expenses of extraordinary nature, namely, charity and donation, amounting to Rs. 1,09,49,785 and depreciation on administrative assets amounting to Rs. 31,82,586. It has been explained that such expenses are generally not found incurred in other similarly placed concerns. The Transfer Pricing Officer has accepted the plea of the assessee regarding charity and donation as is evident from the working done in paragraph 9 of his order, and accordingly there is no dispute on this aspect. The dispute surviving before us pertains to the plea of the assessee for adjustment of depreciation amounting to Rs. 31,82,586 which has been denied while computing the ALP as per paragraph 9 of the Transfer Pricing Officer''s order. In this connection the Transfer Pricing Officer has observed as under in paragraph 8.2 of the order :

8.2 As may be observed from the above, depreciation/cost ratio in the case of the assessee is 26.16 per cent, and is far higher as compared to all the comparables listed in the table below paragraph 7.4.2. Considering the submission of the assessee on extraordinary expenditure on administrative assets (cars purchased), wages/total cost and depreciation/total cost ratios are taken at 40 per cent, and 12 per cent. respectively (as submitted by the assessee, vide its letter dated October 14, 2008)

(underlined Here printed in italic. for emphasis by us)

18. Ostensibly, the Transfer Pricing Officer accepted the depreciation/total cost ratio computed at 12 per cent, by the assessee which working is placed at page 95 of the paperbook filed by the assessee. Pertinently, the depreciation/total cost ratio computed and accepted by the Transfer Pricing Officer at 12 per cent, was calculated after making adjustment for the said extraordinary item of depreciation amounting to Rs. 31,82,586. Having accepted the working, the Transfer Pricing Officer in paragraph 9 of the order while determining the ALP has failed to make adjustment for the extraordinary items of depreciation amounting to Rs. 31,82,586. Perhaps, non-adjustment of such depreciation in the course of determination of the ALP in paragraph 9 of the order of the Transfer Pricing Officer is a case of an oversight. Because, in principle the Transfer Pricing Officer accepted the plea of the assessee as reflected by the discussion in paragraph 8.2 of his order but inexplicably he has not considered it while determining the ALP in paragraph 9 of the order. Notwithstanding the aforesaid, on the merits also, we find enough merit in the plea of the assessee for adjustment of such depreciation in order to compare the profit disclosed by the assessee. The assessee has to succeed on this plea.

13. No illegality could be pointed out by the learned counsel for the appellant in the above findings of the Tribunal so as to persuade this court to warrant inference therewith. Thus, no substantial question of law, as claimed on this issue, arises for consideration by this court.

14. The last question is, whether the advertisement expenses would form part of capital expenses. The assessee had debited a sum of Rs. 1 lakh on account of advertisement expenses which it had spent on purchase of signboards and had, thus, treated the same as revenue expenses. The case of the Revenue on this point, however, was that it was capital in nature. The Tribunal recorded the following findings on this issue, which are :

We have considered the rival submissions carefully. In our considered opinion, cost of a signboard cannot be contemplated as a capital expenditure because the benefit accruing to the assessee cannot be said to be in the capital field. Quite clearly, expending of money on signboard may result in a benefit of an enduring nature, yet such benefit is in the revenue field inasmuch as it merely facilitates the assessee''s trading operations. In commercial sense, it enables conduct of the assessee''s business more profitably even if the advantage by way of the usage more profitably even if the advantage by way of the usage of signboard, endures over a longer period. Following the ratio of the decision of the hon''ble Supreme Court in the case of Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1 (SC), the impugned expenditure is held to be a revenue expenditure and accordingly the addition sustained by the Commissioner of income tax (Appeals) is hereby ordered to be deleted.

15. The aforesaid finding being a finding of fact which has not been shown to be erroneous in any manner and being based on appreciation of material on record, the same calls for no interference by this court. No substantial question of law, thus, arises in this appeal for consideration of this court. In view of the above, the appeal is dismissed.