IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI D BENCH, MUMBAI

Before Shri Pramod Kumar (Accountant Member)
and Shri Vijay Pal Rao (Judicial Member)

ITA No. 8753/Mum/2010
Assessment year: 2006-07

Dresser- Rand India Pvt Ltd …………………. ***Appellant***
Lotus Business Park, 11th floor,
Veera Desai Road,
Andheri West, Mumbai 400053
[PAN : AAACD9867P]

Vs.

Additional Commissioner of Income Tax
Range 6(2), Mumbai …………… ***Respondent***

Appearances:
Sunil M Lala,
alongwith Shabbir Motorwala and Divnag Shah, *for the appellant*
Kusum Ingle, *for the respondent*

Date of hearing : June 14, 2011
Date of pronouncement : September 7, 2011

O R D E R

Per Pramod Kumar :

1. By way of this appeal, the assessee appellant has challenged correctness of order dated 28th October 2010, passed by the Assessing Officer under section

143(3) r.w.s. 144C(5) of the Income Tax Act, 1961, for the assessment year 2006-07.

2. Ground Nos. 2 and 3, which are main issues requiring our adjudication in this appeal, are as follows:

Ground No.2-additions under section 92CA(3) of the Act in respect of payments to Parent Company: Dresser Rand, US aggregating to Rs.10,59,70,009(Rs.10,55,00,000 towards cost contributions and Rs.4,70,009 towards field supervision).

2.1 On the facts and in the circumstances of the case and in law, the Transfer Pricing Officer 9TOP) and the AO erred, and the DRP further erred in confirming the additions on cost contribution (Rs.10,55,00,000) and field supervision charges (Rs.4,70,009) under section 92CA(3) of the Act by disregarding the documentation maintained under section 92D of the Act read with Rule 10D of the Income tax Rules, 1962(the rules) and not appreciating the factual details, submissions and various documentary evidences demonstrating benefits to the appellant under the cost contribution agreement.

2.2 The appellant submits that the TOP, the AO and the DRP failed to appreciate the computation of arm's length price in accordance with the Transactional Net Margin Method prescribed under section 92C(1) of the Act read with Rule 10B(1)(e) of the Rules.

2.3 The appellants prays that the Transfer Pricing adjustments made under section 92CA (3) of the Act are erroneous, unwarranted and be deleted.

Ground No.3 –Alternative disallowance on account of allocation of cost contribution charges paid to Dresser Rand US of Rs.10,55,00,000 under section 37(1), section 40A(2)(b) and Section 40(a)(i) of the Act.

3.1 On the facts and in the circumstances of the case and in law, the AO erred and the DRP further erred in confirming the additions on cost contribution (Rs.10,55,00,000) to Dresser Rand US under section 37(1), Section 40(2)(b) and Section 40(a)(i) of the Act without any show cause notice and disregarding the factual details, submissions and various documentary evidences filed with respect of the Cost Contribution Agreement.

3.2 The appellants submits that the AO and DRP failed to appreciate the fact that services have been availed and that the expense towards cost contribution charges have been incurred wholly and exclusively for the purpose of business and is fully deductible under section 37 of the Act.

3.3 The appellant submits that the AO and DRP failed to appreciate that the payment of cost contribution to Dresser Rand US does not fall within the ambit of section 40A(2)(b) of the Act in view of specific coverable under sections 92 to 92F of the Act.

3.4 The appellants submits that the AO and DRP failed to appreciate that no tax was required to be deducted at source on the cost contribution payment to Dresser Rand US as the same are not in the nature of income taxable in India under the Act and/or under the India-USA Tax Treaty and thereby the disallowance under section 40(a)(ia) of the Act is unwarranted.

3.5 The appellants prays that the disallowance on account of cost contribution payment of Rs.10,55,00,000 is erroneous, unwarranted and be deleted.

3. Briefly stated, the material facts, as culled out from material before us, are like this. The assessee is a wholly owned subsidiary of Dresser Rand Co –USA. Until the time the assessee company was incorporated as a separate entity in the year 2000 as a result of demerger, the assessee was said to be a part of Ingersoll Rand India Limited. Upon being incorporated as a separate company, the assessee was initially a wholly owned subsidiary of Ingersoll Rand, but effective 1st November 2004, Dresser Rand US acquired this company from Ingersoll Rand, and Dresser Rand US continues to be owner of the assessee company. The assessee is engaged in the business of manufacturing various types of process gas compressors, including horsepower reciprocating compressors and its accessories, as also of providing field services in connection with the same. During the relevant previous year, the assessee had, *inter alia*, incurred expenditure of Rs 10,54,98,908 towards cost contribution allocation by Dresser Rand USA. As all the international transactions entered into by the assessee were referred to the Transfer Pricing Officer for determination of arm's length price, this cost contribution allocation also came up for examination by the Transfer Pricing Officer. In the course of proceedings before the Transfer Pricing Officer, it was noticed that the assessee had entered into a 'cost contribution agreement' with its parent company, and in terms of the said

agreement, (a) the assessee should compensate on an equitable basis for the expenses incurred by the holding company on its resources which are being shared with the assessee and other affiliates(article-1); (b) the allocation of the cost contribution to various affiliates of the Group (including the assessee) depends on two allocation keys, i.e. based on number of headcount, and based on sales proportion (article 4.2); (c) all the direct and indirect costs, including overheads and termination costs incurred by Dresser Rand Group Inc with respect to the resources shall be computed as cost contribution –(article 4.1); and (d) the resources include strategy, administration, finance and treasury, tax and legal services –(article -3). It was also noted that the said agreement was valid for 1.6.2005 to 31.12.2005 and, renewable thereafter by two-year periods. In response to the Transfer Pricing Officer to explain the services rendered by Dresser Rand, for which assessee was to contribute costs, it was explained by the assessee that the services so rendered by Dresser Rand included (i) human Resources services, (ii) legal services ; (iii) treasury services (iv) technical support services; (v) marketing services; (vi) global business oversight services; (vii) internal audit and controls and (viii) other services such as provision for value added services, sharing for best practices for optimization of services, and safety procedures etc. It was also explained by the assesse that it has no facilities or manpower in order to handle the above fields, except for a three member team in the field of human resource services, and it was for this reason that the company had to avail the services of the holding/parent company and the 'cost contribution' allocated by the Dresser Rand Group to the assessee, is justified. None of these submissions impressed the Transfer Pricing Officer. The reasons for TPO's rejecting the submissions made by the assessee and for his holding that the arm's length price of services rendered in the cost contribution arrangement was nil, were stated to be as follows :-

A. **It was incorrect on the part of the assessee that the assessee did not have an audit department, and that the assessee needed to avail audit services from Dresser Rand USA. The TPO came to this** conclusion on the basis of his finding that (i) the assessee had two managers and executives in the field of accounts; (ii) the salaries of these managers and executives in the field of accounts, amounting to Rs 11.65 lakhs, were included in the staff costs; and (iii) the assessee had also paid Rs 21.86 towards audit fees, as evident from the profit and loss account.

B. While the assessee had incurred cost contribution allocation of US $ 5,03,660 towards treasury services, which include negotiations with banking institutions, corporate guarantees and foreign currency management etc, the assessee is infact a cash rich company which did not need any loans or guarantees. The treasury services were thus not related to assessee's requirements.

C. While the assessee had claimed cost contribution allocation of US $ 6,37,070 towards 'global business oversight', which were said to be towards 'guidance provided by the global leadership team for efficient management for India operations', the assessee has not furnished any precise details or evidence of the exact services received by the assessee. It was also noted that the assessee's staff members also include several experts in the field of business management, production and marketing operations, and, as such, the assessee did not really need any services for global business oversight.

D. The assessee did not incur any such costs in the preceding period, and the agreement was entered into on 15.12.2005, but with retrospective effect from 1st June 2005. The assessee's relationship with the AE remained the same before the cost sharing agreement was entered into. All these facts indicate that the cost sharing agreement was an afterthought for the purpose of shifting profits.

E. An analysis of sales, expenses and profitability of the assessee, for last three years, indicates that the cost sharing agreement is not a genuine business arrangement. This conclusion was based on the observations (a) that normally as turnover increases, the ratio of overheads to sales should reduce, but this year, as a result of cost sharing arrangement, the ratio has gone up even as the turnover has gone up; (b) that operating costs in percentage terms, which should come down as a result of turnover increase, has increased this year; (c) the turnover of the assessee should have grown at an accelerated rate as a result of availing these services, but the growth rate has come down this year vis-à-vis the growth rate last year – 21.29% as against 33.07% last year; (d) overall profitability of the assessee should have increased with increase of turnover, but it has reduced from 13.72% to 13.31%.

4. The Transfer Pricing Officer thus held that there are no real services availed by the assessee from Dresser Rand US, under the cost contribution arrangement, and hence the payment of Rs. 10.055 crores, under the said arrangement, was not a genuine expenditure incurred for the purposes of business of the assessee. It was also held that the arm's length price of services availed by the assessee under the cost contribution arrangement is 'NIL'. The TPO further observed that even if some services were actually availed by the assessee, the cost sharing on the basis of head count was a wholly unacceptable proposition and that cost sharing should be on the basis of actual services availed by the assessee. He went on to observe that "if the assessee wants to get such services in India, the expenses will be in terms of India employee cost" and, therefore, "allocation of the parent company's expenses incurred in USA to an Indian company on head count basis gives a totally distorted picture and results in excess allocation of such expenses to Indian company". The next international

transaction which was picked up for examination by the Transfer Pricing Officer was with respect to field services rendered to (i) Dresser Rand, USA – Rs 1,02,250; (ii) Dresser Rand, France – Rs 74,65,517; and Dresser Rand, Asia Pacific – Rs 20,63,009. The Transfer Pricing Officer noted that these services are rendered to the domestic customers as also the associated enterprises abroad, but the assessee grants a discount of 10% to the AEs. He noted the assessee's contention that this discount of 10% is given to the AEs as a part of the global policy, and on reciprocal basis. However, the TPO held that the since assessee has allowed discount to the AEs, to that extent, the price of services rendered is not an arm's length price. Accordingly, an upward adjustment in ALP was recommended to the extent of discount allowed, which worked out to Rs 10,70,089.

5. In the course of proceedings before the Assessing Officer, the assessee once again submitted that the conclusions arrived at by the TPO are incorrect, that the TPO has ignored factual details submitted explaining the nature of services and benefits received under CCA, that the TPO has ignored evidence submitted to demonstrate that the services were actually received, that the TPO ignored the fact that similar services were availed in the earlier years also, but were not specifically paid for in those years, that the TPO has incorrectly assumed and interpreted details relating to employees of the assessee and that the TPO has incorrectly and inappropriately analyzed past financial results of the assessee. None of these submissions found favour with the Assessing Officer either. The Assessing Officer was of the view that the TPO had given enough opportunities to the assessee, and had determined the ALP after taking into account all the relevant factors, and that there is no room for interference in the matter. The Assessing Officer further observed that even if the ALP of allocation of cost contribution to the assessee is held to be at an arm's length, the amounts so paid can still not be allowed as deduction in computation of business

income, as (i) there is no evidence of assessee having availed any services ; (ii) entire amount paid under CCA is held to be excessive and unreasonable and thus disallowable under section 40A(2)(b); and (iii) the deduction cannot be allowed in view of the fact that the assessee has not deducted any tax at source from such payments and in view of provisions of Section 40(a)(i) of the Income Tax Act. The Assessing Officer thus held ALP of the services received under CCA as 'nil' and also held that the amounts so paid are also not allowable as deduction in computation of business income in view of the provisions of Sections 37(1), 40A(2)(b) and 40(a)(i) of the Act. Upon his proposing to make the arm's length price adjustment in the draft order and hold the expenses as not constituting admissible deduction anyway, the assessee raised objections before the Dispute Resolution Panel as well. In a very brief order, passed by the Dispute Resolution Panel, these objections were disposed of by observing as follows:

> **……..The DRP has perused the submissions of the assessee and the documents. In view of the DRP, such documents do not prove the receipt of services by the assessee ascertained *(asserted ?)* to be provided by its AE, and, accordingly, the action of the AO in treating the cost of such services at zero is confirmed. The TP adjustment made by the AO is accordingly upheld.**
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> **…….The assessee has contended that allowance of discounts and rebates is a normal feature of the business activity and there was nothing unusual, while the TPO has held that there was no justification for allowing discounts to the associated concerns, and accordingly made a disallowance of 10% of commission/ discount. In the alternative, the assessee contended that disallowance made is higher than10% of actual rebates and discounts which amounted to**

Rs 4,70,000. The DRP considers it proper to direct the AO to verify the actual quantum of discounts allowed by the assessee and restrict the disallowance to that extent.

……Since the assessee could not prove to the have received the services from its AE, the action of the AO in invoking provisions of Section 40A (2)(b) is as per law, and, accordingly, confirmed,

…….It is claimed by the assessee that no tax was required to be deducted under section 195 of the Income Tax Act, from the cost sharing paid to its AEs, and relied upon Article 12 and 7 of India-USA Treaty. Since the payment has been made within India, the assessee was liable to deduct tax. Hence, the action of the AO in invoking the provisions of Section 40(a)(ia) are justified.

6. Pursuant to these directions of the DRP, the Assessing Officer made ALP adjustment of Rs 10,55,00,000 in the arm's length price of services received under the cost contribution arrangement, and of Rs 4,70,009 in respect of field services rendered to three associated enterprises abroad. The assessee is aggrieved and is in appeal before us.

7. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

8. We find that the basic reason of the Transfer Pricing Officer's determination of ALP of the services received under cost contribution

arrangement as 'NIL' is his perception that the assessee did not need these services at all, as the assessee had sufficient experts of his own who were competent enough to do this work. For example, the Transfer Pricing Officer had pointed out that the assessee has qualified accounting staff which could have handled the audit work and in any case the assessee has paid audit fees to external firm. Similarly, the Transfer Pricing Officer was of the view that the assessee had management experts on its rolls, and, therefore, global business oversight services were not needed. It is difficult to understand, much less approve, this line of reasoning. It is only elementary that how an assessee conducts his business is entirely his prerogative and it is not for the revenue authorities to decide what is necessary for an assessee and what is not. An assessee may have any number of qualified accountants and management experts on his rolls, and yet he may decide to engage services of outside experts for auditing and management consultancy; it is not for the revenue officers to question assessee's wisdom in doing so. The Transfer Pricing Officer was not only going much beyond his powers in questioning commercial wisdom of assessee's decision to take benefit of expertise of Dresser Rand US, but also beyond the powers of the Assessing Officer. We do not approve this approach of the revenue authorities. We have further noticed that the Transfer Pricing Officer has made several observations to the effect that, as evident from the analysis of financial performance, the assessee did not benefit, in terms of financial results, from these services. This analysis is also completely irrelevant, because whether a particular expense on services received actually benefits an assessee in monetary terms or not even a consideration for its being allowed as a deduction in computation of income, and, by no stretch of logic, it can have any role in determining arm's length price of that service. When evaluating the arm's length price of a service, it is wholly irrelevant as to whether the assessee benefits from it or not; the real question which is to be determined in such cases is whether the price of this service is what an independent enterprise would have paid for the same. Similarly, whether the AE gave the same services to the assessee in the preceding years without any consideration or not is also irrelevant. The AE may have given the same service on gratuitous basis in the earlier period, but that does not mean that arm's length price of these services is 'nil'. The authorities below have been swayed by the considerations which are not at all relevant in the context of determining the arm's length price of the costs incurred by the assessee in cost contribution arrangement. We have also noted that the stand of the revenue authorities in this case is that no services were rendered by the AE at all, and that since there is no evidence of services having been rendered at all, the arm's length price of these services is 'nil'. The Dispute Resolution Panel has also confirmed these findings of the Transfer P-ricing Officer and the Assessing Officer. However, we have noted that vide letter dated 25th January 2010 (acknowledged to have been received in DRP office on 28th January 2010), the assessee has filed a huge compilation of papers, running into almost three hundred pages, including copies of reports, emails and other documents evidencing the rendering of services. Yet, the DRP simply brushed aside these documents by simply observing that "**The DRP has perused the submissions of the assessee and the documents. In view of the DRP, such documents do not prove the receipt of services by the assessee ascertained *(asserted ?)* to be provided by its AE, and, accordingly, the action of the AO in treating the cost of such services at zero is confirmed**". All these evidences were before the DRP, but there is not even a whisper about what was the nature of these documents, why does the DRP find these documents to be not satisfactory, what is the kind of evidence that was necessary to prove the factum of services having been availed, and what precisely is the reason that these documents cannot be relied upon. The soul of an order is in its reasoning, and unless the reasons for coming to a conclusion in the order are not set out, it is not possible to do a meaningful scrutiny of the order, but we find no reasoning at all in the order passed by the DRP. We may in this regard refer to the observations made by Hon'ble Supreme Court in the case of Union of India Vs M L Kapoor AIR 1974 SC 87, wherein Their Lordships have, inter alia, observed as follows:

> **"If the statute requires recording of reasons, then it is the statutory requirement and, therefore, there is no scope for further inquiry. But even when the statute does not impose such an obligation it is necessary for the quasi-judicial authorities to record reason as it is only visible safeguard against possible injustice and arbitrariness and affords protection to the person adversely affected. Reasons are the links between the material on which certain conclusions are based and the actual conclusions. They disclose how the mind is applied to the subject-matter for a decision, whether it is purely administrative or quasi-judicial. They should reveal rational nexus between the facts considered and the conclusion reached. Only in this way can opinions or decisions recorded be shown to be manifestly just and reasonable."**

9. In our considered view, it is not open to Dispute Resolution Panel to reject the objections of the assessee in a summary manner without properly analyzing the objections of the assessee and dealing with evidences filed by the assessee. Under section 144 C (6), the Dispute Resolution Panel can issue directions after, inter alia, considering objections of the assessee and evidences filed by the assessee. That exercise is clearly not done. In the case of Vodafone Essar Limited Vs Dispute Resolution Panel (240 CTR 263), Hon'ble Delhi High Court has observed that, **"When a quasi judicial authority *(like the DRP)* deals with a *lis*, it is obligatory on its part to ascribe cogent and germane reasons as the same is the heart and soul of the matter. And further, the same also facilitates appreciation when the order is called in question by the superior forum".** Yet, more often than not, the orders passed by the Dispute Resolution Panels, like one before us, are not only wanting in terms of their analysis of facts and law and lacking in reasons for arriving at conclusions,

these orders also offer us no assistance in any manner at all. In this view of the matter, we deem it fit and proper to remit the matter to the file of the Assessing Officer for fresh adjudication on the question, of services having been actually rendered, in the light of evidences filed by the assessee.

10. In case the Assessing Officer comes to the conclusion that the assessee has indeed received the services from the AE the next question which we have to decide is as to what is the arm's length price of these services received under cost contribution agreement. It hardly needs to be emphasized that even cost contribution arrangement should be consistent with arm's length principle, which, in plain words, requires that assessee's share of overall contribution to the costs is consistent with benefits expected to be received, as an independent enterprise would have assigned to the contribution in hypothetically similar situation. In the case before us, as evident from the cost contribution agreement, the costs have been shared at average of percentage of (i) head count to the total count and (ii) sales revenue to total revenue. The assessee's share of head count is 3.90% and of total revenue is 3.30%, and, accordingly, 3.50%, being average of these two parameters, is taken as the cost contribution ratio. We see no infirmity in this contribution being taken as an arm's length contribution to the costs. The TPO's objection to this arrangement was two fold – first, that the cost should be shared in the ratio of actual use of services; and – second, that the costs should be charged to the assessee as per Indian employee costs. None of these objections has any legally sustainable merits. There is no objective way in which use of services can be measured and as is the commercial practice even in market factors driven situation, the costs are shared in accordance with some objective criterion, including sales revenues and number of employees. The question of charging as per domestic employee costs cannot be a basis of allocation the costs because such an allocation will deal with some hypothetical pricing whereas the allocations are to be done for the actual costs incurred. As it is an allocation of costs on the basis of actual costs and the fact of expenditure is

not even in dispute, the dispute is confined to the basis on which cost allocations must take place, and since we find the basis of allocation of costs as reasonable, no interference is really called for. In any case, we have noted that the assessee has adopted TNMM as most appropriate method, and the revenue authorities have neither made an effort to show as to how this method is not appropriate to the facts of this case, nor shown as to which other prescribed method of ascertaining arm's length price of services received under CCA will be more appropriate to these facts.

11. The next adjustment of Rs 4,70,000, on the ground that the assessee ought not to have allowed discount of 10% to AEs, is also equally devoid of any merits. We have noted that the assessee has followed the TNMM for determination of ALP and the Assessing Officer has not even disputed TNMM being most appropriate method on the facts of this case. The question of applying CUP, even if that be so, can only arise when TNMM is rejected. Even under CUP method, it is not necessary that all sales must take at the same price. There can always be variations of prices for the same product or services on valid grounds, such as quantum of business, risk factors, marketing efforts needed etc. When assessee is dealing with an AE, at least there are no commercial risks, no marketing costs and there could be several other factors as well justifying a normal discount as the assessee could indeed go to many important customers. It hardly needs to be emphasized that even in independent business situations granting discount is a normal occurrence, and unless the Assessing Officer demonstrates that the discount so allowed would not have been allowed in an arm's length situation, ALP adjustment cannot be made in respect of the same. We are alive to the fact that the discount is allowed by the virtue of status as associated enterprise, but that is not a material factor; in our considered view, the material factor is whether such a discount of 10% is an arm's length discount i.e. a discount which is given even in a situation in which an enterprise is dealing with independent enterprise. There is nothing on record

to even suggest that such a discount is not an arm's length discount, or that discounts have not been allowed under any other situations. In view of these discussions, and bearing in mind entirety of the case, we delete the impugned disallowance of Rs 4,70,000 as well.

12. Let us now deal with the stand of the Assessing Officer that even otherwise payments under CCA are non-deductible in computation of business income.

13. As far as disallowance under section 40 A (2) (b), and inadmissibility of deduction under section 37(1), are concerned, the action of the Assessing Officer was confirmed by the DRP only on the ground that the rendering of services is not proved. The question of services having been actually rendered is now before the Assessing Officer, and the Assessing Officer has to give his findings on the same. However, the payment has been made to the AE under a cost contribution agreement without involving any marks ups, which is held to be at an arm's length price and, the costs having been actually incurred is not even in dispute. . As long as the services have been availed by the assessee is legitimate furtherance of its business interests and are, thus, wholly exclusively for the purposes of business, the costs of these shared services, as allocated to the assessee, are required to be treated to have been computed in a fair and transparent manner.

14. The next issue requiring our adjudication is whether the Assessing Officer was justified in holding that even otherwise the payment under CCA could not be allowed due to the fact that the assessee has not deducted at tax source from these payments, and, accordingly, disallowance under section 40(a)(i) comes into play. This objection proceeds on the assumption that the taxes were deductible at source from the payments made to AEs under the CCA. While at one place, the DRP notes the assessee's argument that "**it is claimed by**

the assessee that no tax was required to be deducted under section 195 of the Income Tax Act, from the cost sharing paid to its AEs, and relied upon Article 12 and 7 of India-USA Treaty" but the it proceeds to summarily reject the same in the immediately following sentences by observing that **"Since the payment has been made within India, the assessee was liable to deduct tax. Hence, the action of the AO in invoking the provisions of Section 40(a)(ia) are justified".** Clearly, this is a case of non application of mind by the Assessing Officer as also by the Dispute Resolution Panel. The issue before the DRP was that since the recipient does not have the primary liabilities to pay tax on these receipts, tax withholding requirements do come into play at all. However, it appears that not only the DRP completely missed the argument, it made some irrelevant observations about tax withholding requirements from payments made within India. That is not the issue here. The issue is whether any tax was deductible from these payments to non residents. Just because a payment is made to non resident, tax withholding requirements under section 195 donot come into play. We find that, as held by Hon'ble Supreme Court in the case of GE India Technology Centre Pvt Ltd Vs CIT (327 ITR 456), tax deduction at source obligations under section 195(1) arise only if the payment is chargeable to tax in the hands of non-resident recipient. Therefore, merely because a person has not deducted tax at source from a remittance abroad, it cannot be inferred that the person making the remittance has committed a failure in discharging his tax withholding obligations because such obligations come into existence only when recipient has a tax liability in India. The underlying principle is this. Tax withholding liability of the payee is inherently a vicarious liability, on behalf of the recipient, and, therefore, when recipient does not have the primary liability to be taxable in respect of income embedded in the receipt, the vicarious liability of the payer cannot but be ineffectual. This vicarious tax withholding liability cannot be invoked unless primary tax liability of the recipient is established. Just because the payer has not obtained a specific declaration from the revenue authorities to the effect that the recipient is not liable to be taxed in India in respect of income embedded in particular payment, howsoever desirable be that practice, the Assessing Officer can not proceed on the basis that the payer had an obligation to deduct tax at source. He still has to demonstrate and establish that the payee has a tax liability in respect of the income embedded in the impugned payment. That exercise was not carried out by the Assessing Officer on the facts of this case. The Assessing Officer was thus clearly in error in proceeding to invoke disallowance under section 40(a)(i) on the short ground that the assessee did not deduct tax at source from the foreign remittance. We have also noted the assessee's claim that payments made to the US based AE, under a cost contribution agreement, do not warrant any tax withholding as neither the AE has any permanent establishment in India, nor the services so rendered are covered by the scope of 'fees for included services'. We see merits in this submission. In view of the provisions of Article 5 read with Article 7 of India US Double Taxation Avoidance Agreement, unless the US based AE can be said to have a PE in India, and unless income embedded in such payments can be said to be attributable to that PE, the US based AE cannot have any tax liability in India in respect of the business profits so earned, even if any. The only other situation in which these payments can be taxed in India is when these payments are treated as 'fees for included services' under Article 12 of India US Double Taxation Avoidance Agreement, but then since these services *prima facie* are not covered by the 'make available' clause of Article 12(4)(b), the payment so made cannot be taxed as 'fees for included services' either. In any event, the Assessing Officer has not even made out the case for taxability of the impugned payments in India. Accordingly, we see no substance in Assessing Officer's invoking the disallowance under section 40(a)(i) either.

15 In view of the above discussions, as also bearing in mind entirety of the case, we partly uphold the grievance of the assessee so far as ALP adjustments in respect of payments under cost contribution arrangements, and in respect of service charges from AEs are concerned, to the extent indicated above.

16. Ground Nos. 2 and 3 are thus partly allowed for statistical purposes in the terms indicated above.

17. In the first ground of appeal, the assessee has raised the following grievance :

> **1. Denial of deduction of Rs 21,67,679 under section 80IB of the Income Tax Act, 1961, on other income in the nature of recovery of freight**
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> 1.1 On the facts and in the circumstances of the case and in law, the Assessing Officer erred, and Dispute Resolution Panel further erred, in denying deduction under section 80IB of the Income Tax Act, 1961, on other income being in the nature of recovery of freight, by concluding that it is not an income derived from industrial undertaking.
>
> 1.2 The appellant submits that the AO and the DRP failed to appreciate that such income is an income derived in the ordinary course of operations of industrial undertaking and thereby is eligible for deduction under section 80 IB of the Act.

18. Learned counsel for the assessee did not make any specific submissions beyond placing reliance on the submissions made before the authorities below and reiterating the same. Having regard to this approach of the learned counsel,

we treat this grievance as practically not pressed and dismiss it as such. Ground No. 1 is thus dismissed.

19. In ground no. 4, the assessee has raised the following grievance:

Ground No.4- Additions under section 145A of the Act on account of unutilized CENVAT credit to closing stock of Rs.98,85,175.

4.1 On the facts and in the circumstances of the case and in law, the AO erred and the DRP further erred in confirming the action of the AO in making addition under section 145A of the Act on account of unutilized CENVAT credit to the closing stock (net of opening stock) on the context that the appellant follows the exclusive method of accounting which does not depict true and fair profits of the business.

4.2 The appellants submits that the AO and the DRP failed to appreciate that the exclusive method of accounting does not impact the profit and loss account thereby the adjustment under section 145A on account of unutilized CENVAT credit to the closing stock is unwarranted and be deleted.

20. The short issue in this ground of appeal is as to how adjustment for unutilized CENVAT credit is to be made to the closing stock. While the Assessing Officer held that the adjustment is to be allowed in respect of the closing stock, the DRP directed the Assessing Officer to grant the same in respect of both closing stock. Learned counsel submits that the directions of the DRP were not properly worded and the issue stands concluded by a coordinate

bench's decision dated 7th February 2008 in assessee's own case for the assessment year 2001-02. Learned Departmental Representative also does not dispute the fact that the issue is covered by the said order. In this view of the matter, we remit the matter to the file of the Assessing Officer for redoing the computation in accordance the said order which will apply *mutatis mutandi* to this assessment year as well. Ground No. 4 is thus allowed for statistical purposes in the terms indicated above.

21. In the result, the appeal is partly allowed in the terms indicated above. Pronounced in the open court today on 7th day of September, 2011.

Sd/-	sd/-
(Vijay Pal Rao)	**(Pramod Kumar)**
Judicial Member	Accountant Member

Mumbai; 7th day of ***September 2011****.*

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1. *The appellant*
2. *The respondent*
3. *Commissioner , Mumbai*
4. *Commissioner (Appeals) , Mumbai*
5. *Departmental Representative, D bench, Mumbai*
6. *Guard File*

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By Order etc.

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai