

Interest on FD was includible in operating profit as FD was made from advances received from buyers

Summary – The Mumbai ITAT in a recent case of Bunge India (P.) Ltd., (the Assessee) held that where advances given by buyers were deposited in fixed deposits interest received for credit period was result of assessee's participation in trading activity; action of TPO excluding same from operating income of merchant trading business was not justified

Where TPO made adjustment for entire segment of manufacturing activity instead of making adjustment for only international transactions, action of TPO was not justified

Facts - I

- The assessee was engaged in merchanting trade activities (MTA). As per the business structure of the assessee, it used to receive advance for a credit period of 180 days which was utilised in maintaining said amount in form of fixed deposit receipts (FDRs) with the banks. These FDRs were used for opening letter of credit in favour of the overseas seller. The assessee included interest on such FDRs in its total income for calculation of operating profit.
- The TPO observed there was no business compulsion to create FDRs, such investment was made to enjoy interest income. Consequently, he excluded interest on FDRs from total income and, thus, proposed an adjustment.
- The First Appellate Authority (FAA) negated order of the TPO by holding that interest income emanated from MTA.
- On appeal before the Tribunal :

Held - I

- *Vide* show cause notices, the TPO had computed the operating margin after considering the interest as operating income. Both the notices prove that the TPO was convinced about the claim made by the assessee in the earlier years. But, the final order passed by the TPO ran converse to the show cause notices.
- From the adjustment calculation made by the TPO about international transactions, it is clear that the interest portion was not considered for determining ALP. The TPO cannot make an adjustment without informing the assessee about exclusion of an item-especially when the same was not excluded in the show cause notice. No assessee can be taxed unwarned. Principles of natural justice demand that the assessee should be given a fair chance of hearing before due taxes are collected. The TPO, being a representative of the State, cannot behave like a mere tax gatherer. Collection of due taxes presupposes fair play and adhering to principles of affording a reasonable opportunity of hearing to the members of subject of the State *i.e.* to the tax-payer. In the instant case, no justification has been given by the TPO as to why he opted for not including the interest portion

while passing the final adjustment order. It appears that once he found the transaction falls within the safe limit (margin of +/- 5 per cent), he decided to exclude the interest portion so that adjustment could be made. If that was the reason, it cannot be endorsed. Definitely adjustments can be made while invoking the provisions of chapter X, but, not in this manner. Such a trend will result in making adjustments at any cost. TP provisions were not introduced for achieving such objects. In other words, the sections governing the TP adjustments were included in the Act to make a meaningful comparison between the controlled and uncontrolled transactions to determine if the international transactions were at arm's length. Therefore, if the comparison process is vitiated, the determination of ALP would also be vitiated. If there were any other reasons for deviating from the show cause notice by the TPO, they are not coming out of the final adjustment order. Therefore, only on this count the order of the TPO has to be reversed.

- On merits, interest income was considered as part of operating income in the earlier years by the TPO and that so long there was no change in the facts and circumstances interest income should have been continued to be considered as part of the operating income. In its reply to the show cause notice, the assessee had argued that the operating margin of MTA should be compared with trading comparables and not with support service comparables. Besides, the assessee had given a detailed working of operating margins of trading comparable companies and the operating margin of trading comparables was at 0.95 per cent on cost and at the rate of 0.92 per cent on sales. The TPO had failed to recognise the difference between the comparables. It is held that he committed a mistake by comparing assessee's margin with support service comparables. The benchmarking process adapted by the assessee was consistent with the process followed and accepted by the TPO in the earlier years. MTA existed during earlier years and the assessee had carried out the similar activities in the year under consideration. The nexus of interest on MTA was explained to the TPO in the submissions made by the assessee. The TPO had not considered the above replies filed by the assessee while framing the final order or while forwarding the remand report. He continued to benchmark the operating margin of the MTA with that of support service comparables.
- Classification of income under the heads like business income/income from other sources had no bearing on the TP analysis. For TP purposes he had to consider the functional profiling of the assessee and had to evaluate income attributable to the international transactions, while invoking the provisions of chapter X. There was link of interest income with the functional analysis, the assets were deployed in the business of the assessee, same were not dependent on the chargeability under the different sets of income.
- It was not the case of the TPO that surplus funds of the company were parked with the bank. The advance received against the exports were immediately placed in FDR with the bank for the purpose of taking letter of credit in favour of the overseas sellers. A perusal of the balance sheet of the assessee reveals that the reserve and surplus of the assessee for the year under consideration was at Rs. 63.06 crores. Therefore, it could not be said that the surplus funds were parked in the FDRs to earn interest income. It is a fact that import/export of the goods did not take place from or to India

and the assessee came into picture to participate in the trading of international trade documents only. The participation by the assessee at a particular juncture resulted in earning of interest income which would not have been earned if the trade would have taken place completely and directly outside India. It is concluded that the interest income was an inherent an integral part of the assessee's business activity and same was rightly considered as an operating income for the purpose of calculation of operating margin by the FAA. Therefore, the views of the FAA are endorsed that the interest income emanated from MTA and that same could not be excluded from calculating the operating margin of such activities for the purpose of section 92.