Business model of co. importing 99% raw material couldn't be compared with co. having only 29% import content

Summary – The Chennai ITAT in a recent case of Gates Unitta India Company (P.) Ltd., (the Assessee) held that Business model of an automotive belt manufacturer, having 99 per cent import content in raw material, normally could not be same as that of comparable companies which were having import content of 29 per cent

Both forex fluctuations loss and forex gains are to be excluded from operating expenses and operating income respectively

Where raw material used by assessee was re-cycled from worn out tyres and tread peelings, product of comparable being inferior to assessee's product, was incomparable

Facts

- The relevant years were initial years of manufacturing operations of the assessee. The assessee's import content of raw materials was as high at 99 per cent. It was procuring a product which underwent a very key process of Calendaring. Local vendors in India did not have the capability of undergoing this process as it required huge investments, plant and machineries. It had to use the best technology since these products were consumed by auto manufacturers. These business factors constrained the assessee and, by the end of the year, it had to import all of its raw material. This was materially different from the import content of the raw material in the case of comparables selected. The average import content of raw material of all the comparable companies was 29 per cent. This variation was particularly important since, the business model of an automotive belt manufacturer having import content of 99 per cent normally could not be the same as that of the comparable companies having import content of 29 per cent. Further, the assessee claimed that suitable custom duty adjustments had to be provided in determining OP/sales.
- The contention of the assessee-company was that in initial year of its operations, customs duty adjustment was provided to it. However, it had to be noted that the assessee had not excluded the customs duty in the comparables. To bring in uniformity, the customs duty was eliminated in the comparable also. The import percentage in the comparables came to 30 per cent and this 30 per cent was excluded from the assessee's customs duty to weed out the difference between the assessee-company and the comparables.
- The TPO disallowed customs duty payment. He included 30 per cent of the customs duty as part of the operating cost of the assessee to determine the ratio of operating profit to sales.
- The DRP observed that the assessee in the computation of the ratio of operating profit to sales to arrive at the profit level indicator excluded the customs duty of Rs. 4.31 crores as this was a variation with materially different facts and, hence excluded.

- On appeal:

Held

- In principle the customs duty adjustments is allowed in view of the Co-ordinate Bench decision in the case of *Motonic India Automotive (P.) Ltd.* v. *Asstt. CIT* [2016] 73 taxmann.com 235 (Chennai - Trib.) wherein finding of the Pune Bench in the case of *Demag Crones & Components (India) Pvt. Ltd.* v. *Dy. CIT* [ITA No. 120/PN/2011, dated 4-1-2012] were considered wherein it was held that no doubt, a higher import content of raw material by itself does not warrant an adjustment in operating margins, as was held in *Sony India (P.) Ltd.'s* case (*supra*), but what is to be really seen is whether this high import content was necessitated by the extraordinary circumstances beyond assessee's control. As was observed by a Co-ordinate Bench of this Tribunal in the case of *E-Gain Communication (P.) Ltd*. (*supra*) the 'differences which are likely to materially affect the price, cost charged or paid in, or the profit in the open market are to be taken into consideration with the idea to make reasonable and accurate adjustment to eliminate the differences having material effect'. The Assessing Officer is not agreed with that every time the assessee pays the higher import duty, it must be passed on to the customers or it must be adjusted for in negotiating the purchasing price. All these things could be relevant only when higher import content is a part of the business model which the assessee has consciously chosen but then if it is a business model to import the SKD kits of the cars, assemble it and sell it in the market, that is certainly not the business models of the comparables that the TPO has adopted in this case. The adjustments then are required to be made for functionally differences. The other way of looking at the present situation is to accept that business model of the assessee company and the comparable companies are the same and it is on account of initial stages of business that the unusually high costs are incurred. The adjustments are thus, required either way. It is, therefore, permissible in principle to make adjustments in the costs and profits in fit cases. The authorities below are also not agreed with that the onus is on the assessee to get all such details of the comparable concerns so as to make this comparison possible. The assessee cannot be expected to get the details and particulars which are not in public domain. In such a situation, *i.e.* when information available in public domain is not sufficient to make these comparisons possible, it is inevitable that some approximations are to be made and reasonable assumptions are to be made. The argument was that it was first year of assessee's operations and complete facilities ensuring a reasonable indigenous raw material content was not in place. The assessee's claim is that it was in these circumstances that the assessee had to sell the cars with such high import contents, and essentially high costs, while the normal selling price of the car was computed in the light of the costs as would apply when the complete facilities of regular production are in place. None of these arguments were before any of the authorities below. What was argued before the AO was mere fact of higher costs on account of higher import duty but then this argument proceeded on the fallacy that an operating profit margin for higher import duty is permissible merely because the higher costs are incurred for the inputs. That argument has been rejected by a Co-ordinate Bench and same is agreed with.

- Hence to bring uniformity, the customs duty was to be eliminated from the comparable price also to arrive at correct PLI.