IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI J. SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A Nos.219/Bang/2018 & 688/Bang/2016
Assessment years : 2013-14 & 2011-12

CISCO Systems Capital (India) Pvt. Ltd., Brigade South Parade, # 10, M.G. Road, Bangalore – 560 001. **PAN: AACCC 4552A**	Vs.	The Deputy Commissioner of Income Tax, Circle 2(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Rajan Vora, CA
Respondent by	:	Shri C.H. Sundar Rao, CIT(DR-I), ITAT, Bengaluru.

Date of hearing	:	04.06.2019
Date of Pronouncement	:	07.06.2019

O R D E R

Per J. Sudhakar Reddy, Accountant Member

Both these appeals are filed by the assessee and are directed against the separate orders of the AO passed u/s. 143(3) r.w.s. 144C(13) of the Income-Tax Act, 1961 ["the Act"] for the AYs 2011-12 & 2013-14 respectively.

2. The assessee is a registered Non Banking Financial Company (NBFC) with RBI and is a subsidiary of CSI Mauritius, Inc., which in turn is a subsidiary of CISCO Systems Inc. The assessee is engaged in the

business of providing end to end financial solutions to the customers of CISCO, in India.

3. The common issue that arises for adjudication for both the assessment year 2011-12 and 2012-13 is the allowability of the claim for depreciation on assets given on financial lease. For the AY 2011-12, the only other issue that arises for adjudication is TP adjustment on the issue of "Provision of management services". For the AY 2013-14, the only other issue that arises is determination of arm's length price (ALP) and validity of the consequent TP adjustment made for the international transaction of "Purchase of equipment for financial lease from Associate Enterprise (AE)".

4. We have heard Mr. Rajan Vora, the ld. counsel for the assessee and Shri C.H. Sundar Rao, the ld. CIT(DR) on behalf of the revenue at length.

5. On a careful consideration of the facts and circumstances of the case and on a perusal of papers on record and orders of the authorities below as well as case laws cited, we hold as follows.

<u>Disallowance of claim of depreciation on equipment leased by the assessee under financial lease arrangement</u>

6. The AO in this case has not followed the binding judgment of Hon'ble Supreme Court in the case of *ICDS Ltd. V CIT [Civil Appeal No.3282 of 2008)*. He has from page 6 onwards in his order recorded views contrary to the ratio laid down by the Hon'ble Supreme Court. This cannot be approved. He relied on the judgment of Hon'ble Supreme Court in the case of *M/s. Asea Brown Boveri Ltd. v. Industrial Finance Corporation of India & Ors. in CA 3574 of 1998 dated October 27, ,2004.* This judgment is not on the issue of claim of depreciation of assets given

on financial lease under the Income-Tax Act, 1961 ["the Act"]. This judgment was rendered in an appeal under section 10 of the Special Courts (Trials of Offences relating to Transactions in Securities) Act, 1992. In fact, the judgment of Hon'ble Supreme Court in the case of *ICDS Ltd. (supra)* has been delivered much after the judgment in the case of *Asea Brown Boveri Ltd (supra)*. Hence, these findings of the ld. AO, which were approved by the DRP are hereby reversed as these are not in accordance with law.

7. Be it as it may, as at page 18 of the final assessment order for the AY 2011-12, the AO records that the assessee was asked to produce copies of agreements and that the assessee had only produced a few of them. We agree with the argument of the ld. DR that at least some more agreements have to be produced for examination before the AO, so that the submissions of the assessee that, the terms of the agreement in these financial leases are similar to the terms of the agreement considered by the Hon'ble Supreme Court in the case of *ICDS Ltd. (supra)* is correct or not.

8. In view of the above discussion, we set aside the issue to the file of the AO for fresh adjudication in accordance with law. The assessee is directed to produce copies of those agreements which the AO may call for. The AO shall examine these agreements and if the terms & conditions mentioned in these agreements are similar to the terms and conditions mentioned in the agreements considered by the Hon'ble Supreme Court in the case of *ICDS Ltd. (supra)* and if there are no material variations in the contracts, then depreciation has to be granted to the assessee as claimed. With these observations, we set aside this issue to the file of AO for fresh adjudication in accordance with the law.

9. In the result, this ground is allowed for statistical purposes.

10. We now take up the grounds against the TP adjustment made for the AY 2011-12 which are on account of payments made for "administrative support services". Admittedly, this issue is covered in favour of the assessee by an order of the Tribunal in the assessee's own case for the AY 2008-09, AY 2009-10 and AY 2010-11 vide IT(TP)A No.1558/Bang/2012 order dated 19.09.2014, where this very same issue was examined. The Tribunal has set aside the matter to the file of the TPO with certain directions. Consistent with the view taken therein, we restore the matter to the file of the TPO for fresh adjudication in accordance with the law. The TPO shall dispose of the matter in accordance with the directions given by the Tribunal on the very same issue in the earlier assessment years in AY 2008-09, AY 2009-10 and AY 2010-11.

11. In the result, appeal for AY 2011-12 is allowed for statistical purposes.

AY 2013-14

12. The first issue that arises for adjudication for AY 2013-14 is grant of depreciation on assets given on financial lease. Consistent with the view taken by us on this issue in the earlier AY 2011-12, we set aside the matter to the file of AO with a direction to apply the decision of the Hon'ble Supreme Court in the case of *ICDS Ltd. (supra)* and grant depreciation, wherever the terms & conditions of the financial lease agreements entered into by the assessee is similar to the terms & conditions of the financial lease agreements considered by the Hon'ble Supreme Court. The assessee is directed to produce the copies of agreements as desired by

the AO for verification. In the result, this ground is allowed for statistical purposes.

13. The second issue that arises before us is determination of arm's length price (ALP) of international transactions for "Purchase of equipment for financial lease from AE". The assessee determined the ALP by adopting the Transactional Net Margin Method (TNMM) on the ground that the same is the Most Appropriate Method (MAM). The "Return of Capital Employed" (ROCE) was taken as Profit Level Indicator (PLI) in the TNMM analysis. As the "ROCE" earned by the assessee was held as more than that which was earned by the comparable companies, it was concluded by the assessee that the "lease service transaction" undertaken by the assessee are at "ALP".

14. The TPO rejected the same by observing as follows:-

> "6. REJECTION OF THE TAXPAYER'S TP STUDY
>
> As per the provisions of Sec. 92C(3)(c) read with Sec. 92CA, on the basis of material or information or documents in his possession, if t e TPO is of the opinion that the information or data used in compu ation of the arm's length price is not reliable or correct, the TPO may proceed to determine the arm's length price in relation to the international transactions in accordance with Sec. 92C(1) and 92C(2) on the basis of such material or information or document available with him.
>
> The following pertinent defects have been found in the TP analysis carried out by the tax payer.
>
> a. As per Rule 10B(4), it is mandatory to the use the current financial year data i.e. the financial year in which the international transactions took place (FY 2012-13) but the taxpayer has computed the 3 year average of the data for the last three years.

The taxpayer has selected cases even where no current year data is available and has based its analysis on earlier year's data.

b. The taxpayer has used the earlier year data pertaining to the FYs 2010-11,2011-12 besides the current year ending 2013 wherever available but no reasons are given as to how the earlier year data has influence over the price either of the taxpayer or of the comparable so to attract the proviso to Rule 10B(4).

c. Out of the taxpayer's total revenue of Rs. 8373 lakhs, Rs. 4949 Lakhs arise out of financial lease and Rs. 906 Lakhs arise out of operating lease. However, it is seen that the comparables chosen by the taxpayer are not engaged in the business of leasing. This is because of the reasons that the taxpayer has not used a filter of "minimum threshold Lease income out of the otal income". This has resulted in the comparables chosen by the taxpayer predominantly engaged in businesses other than leasing.

d. The assessee has treated its financial lease transactions as pure loan transactions and accordingly, has not claimed depreciation on the leased assets in its books of accounts. However, for computing the taxable income under the Indian Income Tax Law, it has treated the finance lease transaction as pure lease transaction and claimed depreciation on the leased assets. It is not clear whether the comparables chosen by the assessee have adopted the same method of accounting in respect of their lease transactions. Such being the case, comparing the profits after depreciation for ALP analysis would be inappropriate. When there are differences in the claims of depreciation of the tested party itself (the claim in the books of accounts and claim under the Indian Income Tax Law are different), comparing the profits before depreciation would not lead to correct results. Therefore, the PLI chosen by the taxpayer (PBIT/Capital employed) cannot be accepted.

Therefore, in view of section 92C(3)(c), it is relevant to hold that the data used in computation of the arm's length price is not reliable or correct. The TP analysis done by the taxpayer is rejected and the TPO proceeds to determine arm's length price by

conducting an independent search for comparables considering the functions of the taxpayer, the assets employed and the risks taken and the results of the search is given in the following paras.:"

15. The DRP upheld the findings of the TPO.

16. The ld. counsel for the assessee, Mr. Rajan Vora, submitted that 'return on capital employed'(ROCE) earned by comparable companies were considered by the assessee for comparability by adopting TNMM as the MAM and as the ROCE earned by the assessee was higher than that earned by the comparable companies, it concluded that the easing service transactions undertaken by the assessee is at arm s length. Mr. Vora disputes the adoption of TNMM as the MAM and PLI of ROCE and submits that this method cannot be used to determine the ALP of the equipment purchased by the assessee from its AE

17. Describing the transaction, he submitted that the assessee provides financial assistance to third party customers, who are unrelated parties and to facilitate this, it imports equipment from its Associate Enterprise (AE), [CSI BV], which is in turn leased to the customers. It was submitted that this unrelated third parties directly negotiate the purchase of the equipment and its price with the AE and the assessee purchases this equipment only at such negotiated price and then leases out the same to the unrelated third party. It was submitted that the equipment in question is shipped directly to the lessee by the AE. The ld. counsel submitted that under OECD guidelines, CUP method is the MAM to determine the ALP for transfer of commodities between AEs. He relied on certain case laws in support of the proposition that CUP is the MAM.

18. He further argued that the transaction in question is made for purchase of equipment and hence is a capital transaction and therefore the adjustment, if any, can be made only on account of "any income arising therefrom", which in the case of assessee, would be leased rentals on the income aspect and depreciation on the expenditure aspect. He justifies the lease rentals on the income side as at ALP as it is a percentage of the purchase price that is charged i.e. 10% of the purchase price and argues that no further adjustment can be made on the income side and that the adjustment required, if any, should be restricted only to depreciation and that too, only on depreciation on operating lease arrangements, as the assessee has not claimed depreciation in its books of account on financial lease transaction, though depreciation had been claimed while computing the taxable income.

19. He further submitted that the adjustment proposed would result in reduction of income u/s. 92(3) of the Act and pleaded that such adjustment reducing the income is not permissible. He filed a computation to demonstrate his claim o reduction of income. He pointed out that the purchases from rela ed party is only 16.51% of total transactions and hence adjustment in question should be restricted to such transaction only as they are relatable to international transactions with AE.

20. On merits of the adjustment made, by following the TNMM as a MAM and for arriving at the ROCE, he submits that :-

(a) provision in NPA should be considered as non-operating item as it is not allowable as a deduction claimed u/s. 36(1)(vii) of the Act;

(b) the double disallowance of the same expenditure is bad in law for the reason that, provision made for NPA by the assessee had

been disallowed *suo motu* while computing taxable income and hence considering the same as an operating item would result in double disallowance;

(c) adjustment in question should be granted on the assessee's margin i.e., assessee's PLI vis-à-vis comparable arithmetic mean;

(d) while computing the capital employed, items such as deferred tax assets, long term provisions, etc. have to be excluded as they do not form part of the capital employed in the business; and

(e) while computing return on capital employed, it is claimed that items of non-operating nature have o be excluded. A list of the same includes provision for depreciation in investment, preliminary expenditure written off, tax expense of prior years, etc.

21. It was argued that if the contentions are considered and computation of ALP made, then there would be no TP adjustment that remains to be made. It was submitted that the issue may be restored to the file of AO for fresh adjudication in accordance with the law, after considering all the claims made by the assessee, which were not adjudicated either by the TPO or by the DRP, despite the assessee raising the same before them.

22. The ld. DR submitted that the methodology adopted by the assessee in its TP study year after year was considered by the AO and only certain comparables were changed for the reasons given in his order. He strongly contended that the assessee cannot go back on its TP study and plead that the method adopted by the company year after year is not the MAM and that the results given provide the ALP. He took this Bench through the order of the ld. TPO as well as the ld. DRP and suggested the same. The

ld. DR though not leaving his ground, ultimately submitted that the matter may be set aside to the file of the TPO for fresh adjudication.

23. The ld. counsel, on the other hand, relied on a number of case laws for the proposition that the assessee can, at the first available opportunity, bring to the notice of the authorities that the TP study was wrongly made. He submitted that the TP study is not sacrosanct and as there was a mistake, the assessee had made this claim before the DRP. He pleaded that the return of capital employed at the entity level using TNMM cannot determine the purchase price of equipment and therefore cannot determine the ALP of equipment purchased by the assessee from the AE.

24. After hearing the rival contentions, we are of the considered opinion that the argument of the ld. counsel for the assessee that the ALP of the equipment purchases and imported by the assessee cannot be determined by computing the "ROCE" at the entity level by using TNMM as the MAM. The assessee states that only 16.51% of its total transactions were from the AE during the year. The PLI was calculated on the entire assets given on lease (operating and finance) and the adjustment of Rs.50.72 crores pertain to the entire ransaction and was not proportionate to the purchase and import of equipment from AE. The ld. DR agrees that a mistake has crept into the computation of ALP for the purpose of determination of the TP adjustment, as it is well settled that the adjustment can be restricted to only quantum of international transaction with the AE.

25. We find strength in the argument of the assessee that the purchase price of the equipment cannot be determined based on "ROCE" adopting TNMM as the MAM. This does not appear to be a correct method. CUP is a more direct method and when internal CUP is available for determination of

ALP, it would be the most direct method and this, in our view, has to be adopted as the MAM.

26. It is also submitted that the cost of imported equipment is the basis on which the assessee determines the rate of return to be charged from the ultimate customer and that if the price of the purchase is inflated, then the rate of return would also be high. The ld. counsel further submitted the only adjustments that could be made is on account of depreciation on these assets, as this is the only item of expenditure that affects the profit & loss account. We would not express any view on this argument.

27. In view of the above discussion, we set aside the matter to the file of the AO for fresh adjudication in accordance with the law. The AO shall, without being influenced with the methodology adopted by the assessee in its TP study, independently decide as to what is the MAM for determination of ALP for the international transaction of purchase of equipment for financial lease from AE. The AO shall consider each and every argument of the assessee and give his conclusions on the argument. With these observations, we set as de the matter to the file of AO for fresh adjudication in accordance with the law.

28. In the result, both the appeals are allowed for statistical purposes.

Pronounced in the open court on this 07th day of June, 2019.

Sd/-	Sd/-
(BEENA PILLAI)	(J. SUDHAKAR REDDY)
Judicial Member	Accountant Member

Bangalore,
Dated, the 7th June, 2019.
/ Desai Smurthy /

Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore. 6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.