Issue remitted to TPO for determining ALP after considering adjustments on account of customs duty, air freight expenses, and foreign exchange fluctuation

**Background**

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Motonic India Automotive Pvt Ltd 1 (taxpayer) has remitted the issue to the Transfer Pricing Officer (TPO) for determining the Arm’s Length Price (ALP) after considering the customs duty adjustment, air freight adjustment, and foreign exchange fluctuation adjustment.

**Facts of the case**

- The taxpayer is engaged in the business of manufacture and testing of automotive components/parts such as throttle body, rocker arm, solenoid valve, LPG gas mixer, vaporiser, LPG tank etc.
- During the course of TP assessment proceedings, the TPO characterised the taxpayer as a distributor and rejected the economic analysis undertaken by the taxpayer and, accordingly, made an upward adjustment of INR2.73 crore to the total income of the taxpayer.
- The Dispute Resolution Panel (DRP) upheld the order of TPO. Aggrieved by the order of DRP, the taxpayer filed an appeal before the Tribunal.

**Taxpayer’s contentions**

The taxpayer contented that following items should have been excluded while determining the Arm’s Length Price (ALP) of the international transactions:

- Customs duty borne by the taxpayer to suit supply and quality parameters laid down by the customers.
- Air freight expenses borne by the taxpayer to import certain consignments from its Associated Enterprise (AE) to suit the manufacturing schedule.
- Foreign exchange loss on account of economic conditions resulting in adverse foreign exchange rates, which was beyond the control of the taxpayer.
- The extraordinary expenses incurred by the taxpayer to penetrate the market and compete with the local manufacturers.

**Tribunal’s ruling**

The Chennai Tribunal held that:

**Customs duty adjustment**

- The TPO is incorrect in stating that the customs duty adjustment is equivalent to central excise in the commercial market.
- The Tribunal, relying on the following judicial precedents, directed the Assessing Officer (AO)/TPO to give suitable adjustments against the customs duty component while determining the ALP:
  i) Skoda Auto India (P) Ltd.2

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1 Motonic India Automotive Pvt Ltd v. ACIT (ITA No.741/Mds/2014 – AY 2009-10) – Taxsutra.com

2 Skoda Auto India (P) Ltd. v. ACIT [2009] 30 SOT 319 (Pune)
ii) Toyota Kirloskar Motors Pvt. Ltd.³

iii) Putzmeister Concrete Machines Pvt. Ltd.⁴

iv) Demag Cranes & Components (India) Pvt. Ltd.⁵

**Air freight adjustment**

- The taxpayer had incurred the air freight charges to transport the raw materials on an urgent basis to meet its customers’ requirements.

- The aforementioned expense is in the nature of abnormal expenses and adjustment had to be made while determining the ALP, as it affects the operating profits of the taxpayer.

- Relying on the decision of the Delhi co-ordinate bench in the case of Transwitch India Pvt. Ltd.,⁶ the Tribunal directed the AO/TPO to consider the air freight charges incurred by the taxpayer while determining the ALP.

**Foreign exchange fluctuation adjustment**

- The Tribunal acknowledged the taxpayer’s contention that it is normal that exchange rate is subject to fluctuation due to economic conditions and, while determining the ALP, one has to consider these factors.

- Relying on the decision of the Hon’ble Tribunals in the cases of Honda Trading Corp. India Pvt. Ltd.⁷ and DHL Express (India) Pvt. Ltd.,⁸ the Tribunal directed the AO/TPO to determine the ALP after considering the foreign exchange fluctuation adjustment.

**Our comments**

The Tribunal relying on Skoda Auto India and other relevant judgments has ruled in favour of the taxpayer with respect to customs duty and other economic adjustments. While this case can be relied upon while arguing before the Tribunal with respect to the aforementioned adjustments, the onus will still be on the taxpayer to prove that these factors have impacted the profitability of the taxpayer vis-à-vis the comparable companies.

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³ Toyota Kirloskar Motors Pvt. Ltd. v. ACIT [2012] 28 taxmann.com 293 (Bang)
⁴ Putzmeister Concrete Machines Pvt. Ltd. v. DCIT, [2014] 49 taxmann.com 436 (Panaji)
⁵ Demag Cranes & Components (India) Pvt. Ltd. v. DCIT [2012] 49 SOT 610 (Pune)
⁶ Transwitch India Pvt. Ltd. v. DCIT [2013] 53 SOT 151 (Del)
⁷ Honda Trading Corp. India Pvt. Ltd. v. ACIT [2014] 146 ITR 591 (Del)
⁸ DHL Express (India) Pvt. Ltd. v. ACIT [2011] 12 ITR(T) 437 (Mum)
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