

IN THE INCOME TAX APPELLATE TRIBUNAL  
PUNE BENCH "A", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT AND  
SHRI VIKAS AWASTHY, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.1260/PUN/2018  
निर्धारण वर्ष / Assessment Year : 2009-10

M/s. Carraro India Private Limited, DCIT, Circle-1(1),  
B-2/2, MIDC, Ranjangaon, Vs. Pune  
Pune – 412 220  
Maharashtra, India  
PAN : AAACC5292M

आयकर अपील सं. / ITA No.1308/PUN/2018  
निर्धारण वर्ष / Assessment Year : 2009-10

DCIT, Circle-1(1), M/s. Carraro India Private  
Pune Vs. Limited,  
B-2/2, MIDC, Ranjangaon,  
Pune – 412 220  
Maharashtra, India  
PAN : AAACC5292M

(Appellant)

(Respondent)

Assessee by

Shri M.P. Lohia &  
Shri Rajendra Agiwal

Revenue by

Shri Sanjeev Ghei

Date of hearing

26-02-2019

Date of pronouncement

27-02-2019

आदेश / ORDER

PER R.S.SYAL, VP :

These are two cross appeals - one by the assessee and the  
other by the Revenue - arise out of a common order of CIT(A)-13,

Pune passed on 27-04-2018, *inter alia*, for the assessment year 2009-10.

2. The first issue raised by the assessee in its appeal is against the confirmation of addition of Rs.75,41,558/- made by the Assessing Officer (AO) on account of transfer pricing adjustment recommended by the Transfer Pricing Officer (TPO). The Revenue in its appeal is aggrieved by the direction of the Id. CIT(A) to treat the entire amount of royalty as a revenue expense as against capital expenditure taken by the AO.

3. Briefly stated, the facts of the case are that the assessee, an Indian company, was set up in 1997 as a joint venture of Carraro SpA of Italy (51%) and Carraro International SA. Luxemburg (49%). The assessee is engaged in the business of designing, manufacturing and marketing mechanical and transmission systems for on-road and off-road vehicles and for stationary application, clutches, hydraulic lifts, axles for agricultural tractors, transmission for loaders and backhoe and planetary drives for construction equipments and other off-highway applications. The assessee reported certain international transactions in Form 3CEB. The AO referred the matter of determination of the arm's length

price (ALP) of the international transactions to the TPO. One of the reported international transactions is payment of “Royalty” with transacted price at Rs.1,01,87,033/-. The assessee applied Comparable Uncontrolled Price (CUP) method as the most appropriate method for demonstrating that the international transaction was at ALP. The TPO noticed that the assessee entered into an Agreement dated 15-12-2008 w.e.f. 01-07-2008 with Carraro SpA, Italy, in terms of which a sum of Rs.75.41 lakh was paid as royalty @ 0.50% of sales. It was opined that there was no justification for making new additional claim of royalty when the earlier royalty agreements were expiring after the period was getting over. The TPO further observed that the assessee paid royalty for use of `Carraro` brand name, which term was part of its own name and all the products manufactured by it legitimately carried the same. He still further noticed that most of the assessee’s customers were Original Equipment Manufacturers (OEMs) and they did not need to look for any logo on the components. It was, therefore, held that there was no justification for a new agreement for the current year pursuant to which royalty of Rs.75,41,558/- was paid. This is how he determined Nil ALP of such transaction of royalty payment. When the matter came up

before the AO, he, vide his final order passed u/s. 143(3) r.w.s.144C(3) of the Income-tax Act, 1961 (hereinafter also called 'the Act'), came to hold that the knowledge obtained through the designs/drawings etc. became the property of the assessee company and hence, it was a capital expenditure. Allowing depreciation @ 25% on Rs.1,08,81,033/- (as against the correct amount of total royalty paid by the assessee during the year at Rs.1,01,81,033/-), he allowed depreciation of Rs.27,20,258/- and made addition for the remaining sum of Rs.81,60,774/-.

4. The Id. CIT(A) noticed that there were two aspects of this issue. The first, being, determination of ALP on brand royalty by the TPO at NIL and second, being, the action of the AO in holding that the brand royalty was a capital expenditure. Relying on the Tribunal order in the case of the assessee for the A.Yrs. 2003-04 to 2008-09, the Id. CIT(A) held that the brand royalty could not be considered as a capital expenditure. On the other aspect, he upheld the action of the TPO in determining the NIL ALP of the international transaction. Whereas the Revenue is aggrieved by the direction given by the Id. CIT(A) in treating the royalty payment as revenue expenditure, the assessee is aggrieved by the upholding of

the determination of Nil ALP of the international transaction of payment of royalty to the tune of Rs.75,41,558/- by the TPO.

5. We have heard both the sides and gone through the relevant material on record. It is noted above that the assessee paid total royalty of Rs.1,01,81,033/- in respect of two agreements viz., Rs.26,39,475/- pursuant to the agreement dated 05-04-2001, which was paid @ 2% both for use of technical knowhow and brand name ; and Rs.75,41,558/- pursuant to the agreement dated 01-07-2008 for use of name and logo of its foreign/associated enterprise @ 0.5%. On a reference made by the AO, the TPO determined Nil ALP in respect of Royalty payment of Rs.75.41 lakh pursuant to agreement dated 01-07-2008. Impliedly, he accepted that payment of Royalty, namely, Rs.26.39 lakh pursuant to the agreement dated 5.4.2001 was at ALP. When the matter came up before the AO for finalizing the assessment, he treated total amount of royalty paid by the assessee under both the agreements, as capital expenditure. After allowing depreciation @25%, he made an addition of Rs.81,60,774/-. Thus, it is apparent that the AO deviated from the order passed by the TPO u/s. 92CA(3) of the Act.

6. The primary question which requires adjudication is as to whether the action of the AO in this regard can be treated as valid? Section 92CA(4), prior to its substitution by the Finance Act 2007 w.e.f. 1.6.2007, provided that on receipt of the order passed by the TPO, the AO shall proceed to compute the total income of the assessee *having regard to* the ALP determined by the TPO. The Finance Act, 2007 substituted the hitherto sub-section (4) with a new sub-section w.e.f. 01-06-2007 providing that “on receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C *in conformity with* the arm’s length price as so determined by the Transfer Pricing Officer”. A conjoint reading of the earlier and existing sub-section (4) of section 92CA makes it explicitly manifest that whereas under the earlier provision, the report of the TPO was not binding on the AO and he could compute the total income of the assessee by just *having regard to* the ALP determined by the TPO. If the AO was not satisfied with the TPO’s opinion on any point determined by the latter, he could deviate from the TPO’s order and proceed in his own way. However, w.e.f. 01-06-2007, the legal position has undergone change. Now, the AO is bound by the order passed by the TPO as

he is required to compute total income *in conformity with* the ALP determined by the TPO.

7. Adverting to the facts of the instant case, it is seen that the TPO, vide his order dated 24.1.2013, accepted payment of Royalty of Rs.26.39 lakh, pursuant to the earlier agreement, at ALP, but proposed transfer pricing adjustment at full for the remaining amount of Rs.75.41 lakh paid pursuant to the new agreement. The AO, vide his final assessment order dated 29.4.2013, treated the entire royalty payment made by the assessee pursuant to both the agreements, as capital expenditure. The view so adopted by the AO, in our considered opinion, is not in accordance with law. The AO ought to have made a transfer pricing addition of Rs.75.41 lakh pursuant to the second agreement only. As the AO proceeded to treat the entire amount as capital expenditure, including the one in respect of which the TPO did not propose any TP adjustment to the tune of Rs.26.39 lakh, we cannot countenance the view of the AO *pro tanto*.

8. It can be seen from page 4 of the final assessment order that the assessee paid a sum of Rs.1,01,81,033 (sic Rs.1,08,81,033) to Carraro SpA, Italy, on account of royalty for use of technical

knowhow and brand name and logo `Carraro`. It has been mentioned in the order that there were following five agreements :-

Sl.No.	Description of items covered	Date	Rate of Royalty
1	506 Transmissions for 45 to 75 HP, clutches and hydraulic lifts	30-09-1997	5%
2	304 Transmissions for 35 to 40 HP	05-04-2001	5%
3	Steering Axle & Accessories for 35 and 55 HP Tractors	05-04-2001	2%
4	Axle for 80HP Tractors and parts thereof	23-10-2003	2%
5	Name, Logo and Trademark Licence	01-07-2008	0.5%

9. The first agreement was entered into on 30-09-1997 under which the assessee was to pay royalty @ 5% on 506 transmissions for 45 to 75 HP, clutches and hydraulic lifts. Copy of this agreement is available on page 249 onwards of the paper book. This agreement provides that the assessee would obtain the design and trade mark license and would be supplied by designs, technology, know-how and technical assistance along with use of the licensed trade mark for a fee determined @ 5% of Net sales price. The term "Net sales price" has been defined to mean any sale made by the assessee in the territory of India. It is thus evident from the clauses of this agreement that the assessee was to pay royalty @ 5% in lieu of not only technical knowhow for specific products but also right to use licensed trade mark owned

by Carraro SpA. The Id. AR stated that this agreement expired in an earlier year and was not relevant for the year under consideration. On 05-04-2001, the assessee entered into an agreement with Carraro SpA, Italy, for use of technical knowhow and trade mark in respect of 304 transmissions for 35 to 40 HP. Copy of this agreement is available at page 311 onwards of the paper book. As per the terms of this agreement, the assessee was supposed to pay royalty @ 5%. This agreement was also stated to have become redundant during the year as its term expired in an earlier year. Agreement at Sl. no.4 dated 23-10-2003 for use of technology and trade mark in respect of axle for 80 HP tractors and parts thereof, was stated to have never been implemented and no payment was ever made in pursuance of this agreement. Agreement at Sl.No.3 was entered into on 05-04-2001. Under this agreement, the assessee was to pay royalty @ 2% for use of technical knowhow and trade mark in respect of steering axle and accessories for 35 and 55 HP tractors. Pursuant to this agreement, the assessee paid a sum of Rs.26,39,475/- during the year under consideration. The Id. AR stated that this Agreement remained operative till 30.6.2008, which was discontinued from 1.7.2008. In addition to that, the assessee paid a further sum of Rs.75,41,558/-

in terms of the agreement dated 01-07-2008 for use of name, logo and trade mark, license. A copy of this agreement is available at page 219 onwards of the paper book. As per this agreement, assessee was to pay royalty @ 0.5% only for use of brand name and not technical know-how. Payment made under this agreement became subject matter of dispute between the assessee and the TPO. Whereas the TPO determined NIL ALP of payment made under this agreement, the case of the assessee is that royalty paid by it is within the range permitted vide Circular No.5, dated 21-07-2003 issued by the Exchange Control Department of the Reserve Bank of India. We have gone through the copy of the circular which has been provided at page 245 of the paper book. As per this circular issued by the Chief General Manager, RBI, royalty @ 8% on exports and 5% on domestic sales is permitted under the automatic route, without any restriction on the duration of royalty payments. Press Note No.9 (2000 series) dated 08-09-2000 issued by the Government of India, Ministry of Commerce and Industry provides that : “Payment of Royalty upto 2% for exports and 1% for domestic sales is allowed under automatic route on use of trade mark and brand name of the foreign collaborator without technology transfer”. It is thus seen

that payment for use of trade mark and brand name, under Press Note No.9 (2000 series), is allowed under automatic route at 1% for domestic sales. The case of the assessee is that it paid royalty @ 0.5% on sales made in India to certain persons other than OEMs and hence such payment should be construed at ALP.

10. Now the question is that when the rate of Royalty actually paid by the assessee for use of trade mark and brand name at 0.5% is less than 1% prescribed under automatic route as per Press Note No.9 (2000 series) issued by the Govt. of India, Ministry of Commerce and Industry, whether such payment can be considered as at ALP? In this regard, it is observed that the Hon'ble Delhi High Court in *Sony Ericsson Mobile Communications India (P) Ltd. Vs. CIT (2015) 374 ITR 118 (Delhi)* has held that Royalty as per Reserve Bank of India's automatic route is not *per se* at ALP. On the other hand, the ld. AR has invited our attention towards a judgment dated 18-11-2015 of Hon'ble Bombay High Court in *CIT Vs. SGS India Pvt. Ltd. (Income Tax Appeal No.1807 of 2013)*, a copy placed on record, in which payment of royalty at less than that prescribed in Press Note No.9 (2000 series) issued by Govt. of India, Ministry of Commerce and Industry, was held to be at ALP on that score alone. In that case, the respondent-assessee used trade

mark of its parent company and paid Royalty for the same ranging between 2.5% to 4% of the revenue generated. For the purpose of transfer pricing, the assessee contended that 3% of the revenue generated should be considered as reasonable for use of trade mark provided by its parent company. In support of such benchmark, that assessee relied on the approval granted by the Foreign Investment Promotion Board (FIPB) dated 25-09-2000. The TPO did not accept the same and placed reliance on the Press Note No.9 (2000 series) issued by Ministry of Commerce and Industry, Govt. of India, wherein royalty was allowed at 1% of domestic sales and 2% of exports for use of trade mark/brand name of a foreign collaborator. The TPO reduced the benchmark to less than 3% for determination of the ALP. When the matter finally came up for consideration before the Tribunal, it observed that as per FIPB directive, the assessee could pay royalty between 5% to 8%. The assessee contended before the Hon'ble High Court that Press Note No.9 (2000 series) as relied by the Revenue, if properly appreciated, would entitle the assessee to royalty payment for use of brand name upto 8% on exports ad 5% on domestic sales in terms of clause (IV) of the Press Note 9. The ld. DR was directed to point out if the case was covered by clause (IV) of the Press

Note No.9 (2000 series) dated 08-09-2000. The ld. DR, after seeking instructions, contended that royalty paid by the assessee at 3%, was at ALP. In view of this position, the Hon'ble Bombay High Court decided the issue in assessee's favour dismissing the appeal by the Department.

11. On going through the above judgment of Hon'ble jurisdictional High Court, it becomes palpable that if the payment of royalty is below the rate prescribed under Press Note No.9 (2000 series) issued by the Govt. of India, Ministry of Commerce and Industry, the same has to be considered at ALP. The ld. DR has not disputed that the rate of royalty paid by the assessee at 0.5% for use of brand logo, is not more than the rate of royalty as per Press Note No.9 (2000 series). Respectfully following the judgment of Hon'ble jurisdictional High Court, which applies in all fours to the facts of the extant case, we hold, in principle, that the payment of Royalty at 0.5% for use of name, logo and trade mark license is otherwise at ALP and does not require any Transfer Pricing adjustment.

12. It can be seen that the assessee paid royalty under agreement dated 05-04-2001 @ 2% in respect of steering axle and accessories

for 35 and 55 HP tractors both towards use of technical knowhow and use of trade mark/brand name. It is further noticed that the assessee paid royalty of Rs.75.41 lakh @ 0.5% on total sales for use of name, logo and trade mark. Payment of Rs.75.41 lakh, as accepted by the Id. AR, is also in respect of sales made by the assessee of the products which were covered under agreement dated 05-04-2001, being, steering axle and accessories for 35 and 55 HP tractors. Thus, it is manifest that the assessee paid royalty for use of logo and trade mark in respect of steering, axle and accessories for 35 and 55 HP tractors, both under the agreement dated 05-04-2001 and once again under the new agreement dated 1.7.20008, which is plainly not permissible. Deduction can be allowed for payment of royalty for use of trade mark license etc. only once and not twice. As royalty for use of trade mark license in respect of steering axle and accessories for 35 and 55 HP tractors is covered within the payment of Rs.26.39 lakh, whose ALP has been determined by the TPO, at the transacted value, the amount of royalty paid by the assessee for use of trade mark license once again under the second agreement for which the TPO proposed TP adjustment of the full amount of Rs.75.41 lakh, cannot be allowed once again. Thus, royalty paid for use of trade

mark license pertaining to steering axle and accessories for 35 and 55 HP tractors, included in the amount of Rs.75.41 lakh is required to be disallowed as a duplicate payment. The Id. AR was fair enough to concede this position. He submitted certain details, as per which a sum of Rs.4,95,166/- has been calculated as duplicate amount of royalty that could be disallowed. While making such a calculation, the Id. AR made a departure from the submission made on the earlier date as per which royalty paid at the rate of 2% for use of technical know-how and trade-mark was discontinued w.e.f. 30.6.2008. It was now stated that only royalty for use of brand name was discontinued w.e.f. 1.7.2008, but royalty for use of technical know-how continued to be paid even after 1.7.2008. The AO/TPO is directed to verify this contention of the assessee on the basis of the relevant documents and then work out the duplicate amount of royalty paid for use of brand/logo, included in the sum of Rs.75.41 lakh, which is to be disallowed.

13. Now we espouse the grounds raised by the Revenue in its appeal against the direction of the Id. CIT(A) for treating payment of royalty as a revenue expenditure as against capital expenditure treated by the AO in the final assessment order.

14. It is seen that the assessee paid similar royalty in earlier years also for use of technical knowhow and trade mark in pursuance, *inter alia*, of three agreements dated 30-09-1997, 05-04-2001 and 05-04-2001. The AO treated such payments as capital expenditure. The issue reached the Tribunal. Vide order dated 18-02-2013, the Tribunal in ITA No.1384/PN/2010 etc. for the A.Yrs. 2003-04, 2004-05 and 2005-06, has decided this issue in favour of assessee by holding payment of royalty is a revenue expenditure. A copy of such order has been placed on record. Once again this issue came up before the Tribunal for the A.Y. 2007-08. Following the order for earlier years, the Tribunal reiterated its view holding the payment of royalty as a revenue expenditure. Nothing has been brought on record to demonstrate that the view canvassed by the Tribunal on this issue for the preceding years has been either reversed or modified in any manner by the Hon'ble High Court. Respectfully following the precedent, we do not approve the action of the AO in treating royalty payment as a capital expenditure. Thus, the grounds taken by the Revenue in this regard, are dismissed.

15. To sum up, out of the total payment of royalty at Rs.1,01,81,033/- in respect of two agreements, the only amount which is to be disallowed is a sum to be calculated afresh, representing duplicate payment in respect of royalty for use of trade mark towards steering, axle and accessories for 35 and 55 HP tractors, included in the sum of Rs.75.41 lakh. The AO is directed to grant relief accordingly.

16. Another issue raised by the assessee in its appeal is against the transfer pricing addition of Rs.4,35,34,908/-. Facts apropos this issue are that the assessee reported an international transaction of payment of Corporate/Management services fee with transacted value of Rs.4,35,34,910/-. The assessee applied "Cost plus" method in the transfer pricing documentation for showing that the international transactions was at ALP. The TPO observed that the assessee entered into two agreements with Carraro SpA, Italy and Carraro Drivetech SpA, Italy during this year, both dated 15-12-2008 effective from 01-07-2008. The assessee paid a sum of Rs.2,87,45,505/- pursuant to agreement with Carraro Drivetech SpA, Italy, for availing Finance, Human Resource, Legal, IT, Business Development and Marketing services and also a sum of Rs.1,47,89,403/- to Carraro SpA, Italy for availing services of

Global Sourcing, Quality Control, Supply Chain management and Measuring strategy etc. The TPO observed that no agreement was existing in the past for such services and it was for the first year that the assessee paid a sum of Rs.4,35,34,908/- on this account. On being called upon to substantiate the receipt of services, the assessee failed to provide any evidence of such services. Since the assessee used its Foreign/AE as a tested party under the “Cost plus” method and further did not give any comparable uncontrolled transactions, the TPO rejected the use of foreign/AE as a tested party and also the method employed. He opined that this transaction could not be aggregated even under the umbrella of Transactional Net Margin Method (TNMM). As there was no evidence of having availed any services under these agreements and further there was neither any need nor benefit derived by the assessee from such alleged services, the TPO determined NIL ALP of this international transaction by applying the CUP as the most appropriate method. This led to recommendation of transfer pricing adjustment of Rs.4,35,34,908/-. The AO made addition for the same. During the course of first appellate proceedings, the assessee furnished certain additional evidence. The Id. CIT(A) called for remand report from the TPO. On consideration of the

entire material and facts, the ld. CIT(A) held that the assessee could not prove conclusively that it had availed services as per the agreements entered into with Carraro SpA, Italy and Carraro Drivetech, SpA, Italy. He, therefore, upheld the Nil determination of ALP of the international transaction, which resulted in sustenance of addition of Rs.4.35 crore. The assessee is aggrieved by the sustenance of such an addition.

17. We have heard both the sides and gone through the relevant material on record. It is seen from the assessee's TP study report that it employed "Cost plus" method as the most appropriate method for showing that the international transactions of receipt of management services was at ALP. The TPO discarded such method and applied the CUP method. However, Nil ALP was determined as the assessee, in the opinion of the TPO, did not avail any services. He further accentuated on the Nil ALP on the ground that the services, if any, did not provide any benefit to the assessee and these were in the nature of shareholder services.

18. The first question is whether the assessee availed any services from its AEs pursuant to the two Agreements? We have gone through the Agreements referred to herein above. Agreement

with Carraro SpA, Italy, refers to a wide range of services to be provided to the assessee, which have been listed under the heads Advice on Finance, Administration, Legal and Controlling; Advice on Human Resources etc.; Advice on Technical Assistance and Support on IT systems; Advice on strategic planning and Group consulting for Business consulting and Development activities; Advice on Business Development and Market Coordination etc. have been mentioned. Annexure-B to the agreement gives different mark-ups on cost, namely, 2, 5% on Human Resources, 10% on Finance and Controlling, 4,7% on IT, 6,3% on Strategic Department, 6,3% on Engineering and 3,10% on Business Development and sales carrying. Similarly the second agreement with Carraro Drivetech SpA, Italy, refers to the services in the nature of Advice on DLEs, Commercial activities; Advice on Cost Planning; Advice and Services of Global Securing; Advice and services of Quality Department; Advice on Manufacturing strategy; and Advice on Supply chain. Mark-ups on such services have been given in Annexure-B, namely, Sales Coordination 3,1%; Cost Planning 3,1%; Global Sourcing 4%; Quality Department 4%; Manufacturing Strategy 6, 3%; and Supply Chain 6, 3%.

19. The Id. AR has drawn our attention towards voluminous documents including e-mails between the assessee company and AEs on wide spectrum of the matters to establish that the services were actually availed. We have gone through some of the e-mails, which go to prove that the assessee did avail services from its AEs. In fact, this material was submitted before the Id. CIT(A) also. In the remand report, though the TPO acknowledged the existence of such a material, but did not alter his earlier stance on extraneous reasons. This evidences that the assessee, in fact, availed the services from its AEs. The TPO favored Nil ALP of the transaction, *inter alia*, on the ground that the assessee was not benefitted by such services. The view point of the TPO that no benefit was derived by the assessee because of such services and hence, ALP should be determined at NIL, is bereft of any force.

20. Once the fact of having availed services from AEs is established, the TPO cannot determine NIL ALP simply by holding that no benefit was received by the assessee. Having or not having a benefit from services is one thing, which cannot be confused with the availing of services, if these are really received. The TPO cannot turn around the determination of NIL ALP simply on the ground that no benefit was received by the assessee from

such services. It is for the assessee to decide the way in which it has to carry on its business. If it feels that services are required to be availed, the TPO cannot reject the allowability of such payment simply on the ground that no benefit was derived. It is not necessary that every incurring of expenditure must necessarily result in to some benefit. Had it been the situation, then no businessman would have ever incurred loss, which is a proposition far away from the stark reality. Once it is proved that the services were availed by the assessee, then his jurisdiction gets restricted to determining the ALP of the transaction. We have noticed above that the assessee did avail services from its AEs. In such a situation, it is held that the view point of the authorities that NIL ALP should be determined because the assessee did not get any benefit out of the services, is rejected. The next question is the determination of the ALP of such transaction.

21. It is seen that the assessee applied 'Cost plus method' in its transfer pricing documentation by taking foreign/Associated enterprise as a tested party and did not give any comparable uncontrolled transactions. This exercise got rejected at the hands of the TPO. In the remand proceedings, the assessee applied the TNMM again with the foreign/associated enterprise as a tested

party. The ld. AR submitted that it put forth one more calculation of the ALP determination under the TNMM with itself as the tested party. Since the foreign/associated enterprise has been taken as the tested party not only in the original transfer pricing documentation, but also during the remand proceedings, we need to decide if the assessee was justified in doing so.

22. For this purpose, we need to visit the provisions of the Chapter X of the Act with the caption "Special Provisions Relating to Avoidance of Tax" dealing with the computation of income from international transactions having regard to ALP. Section 92(1) of the Act provides that : 'Any income arising from an international transaction shall be computed having regard to the arm's length price'. Thus, this provision applies to income of an enterprise from an international transaction, which is chargeable to tax under the Act. The term "international transaction" has been defined in section 92B to mean 'a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of .... or provision of services, or .....'. The methodology for computation of arm's length price of an international transaction has been set out in section 92C(1) to be as per any of the prescribed methods, including the TNMM method.

This method was used by the assessee as the most appropriate method in the remand proceedings. Sub-section (3) of section 92C provides that : 'Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that--(a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2) ; or....., the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him'. Rule 10B dealing with the determination of arm's length price under section 92C provides through sub-rule (1) that for the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method. The mechanism for determining ALP under the TNMM has been enshrined in clause (e) of rule 10B(1), which reads as under :

'(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated

enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base ;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market ;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.'

23. A cursory reading of the above provisions indicates that firstly, a transaction between two or more associated enterprises is called an international transaction; secondly, any income from such an international transaction is required to be determined at ALP;

thirdly, the ALP in respect of such an international transaction should be determined by one of the prescribed methods, which also includes the TNMM. Under this method, the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base, which is then compared with the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction. The modus operandi of determining ALP of an international transaction under this method is that firstly, the profit rate realized or earned by the assessee from a transaction with its AE is determined (say, profit A), which is then compared with the rate of profit of comparable cases (say, profit B) so as to ascertain if profit A is at arm's length vis-à-vis the profit B. If it is not, then, an addition on account of transfer pricing adjustment, subject to other provisions, is made in the hands of the assessee having regard to the difference between the rates of profit A and profit B. The rate of profit of comparable cases (profit B) may be computed from internally or externally comparable cases, depending upon the FAR analysis and the facts and circumstances of each case. Thus

the calculation of profit B may undergo change with the varying set of comparable cases. However, insofar as calculation of profit A is concerned, there cannot be any dispute as the same has to necessarily result only from the transaction between two or more associated enterprises, as is the mandate of sections 92 read with 92B in juxtaposition to rule 10B. The natural corollary which, ergo, follows is that under no situation can the calculation of 'profit A' be substituted with anything other than the profit realized or earned by the enterprise from the international transaction, that is, a transaction between the associated enterprises. So, under the TNMM, it is the profit margin realized by the Indian assessee from the transaction with its foreign/AE, which is compared with that of the comparables. There can be no question of substituting the profit realized by the Indian enterprise with the profit realized by the foreign AE for the purposes of determining the ALP of the international transaction of the Indian enterprise with its foreign AE. Scope of transfer pricing addition under the Indian taxation law is limited to transaction between the assessee and its foreign/AE. We fail to comprehend as to how the profit realized by the foreign/AE can be relevant, when the profit of the Indian enterprise is sought to be ensured at ALP. The underlying object of the

transfer pricing provisions is, *inter alia*, to see that there is no profit shifting from the Indian taxation base by means of the foreign/AE charging more than that charged by comparable independent cases, which fact is ensured by determining the ALP of the international transaction. If foreign AE has, in fact, charged more, then its profit rate will shoot up and the corresponding profit of the Indian enterprise will be squeezed. In that scenario, a comparison of the profit rate of the foreign/AE will run contrary to the mandate of the provisions. Whereas, we were required to determine if the profit charged by the foreign AE is not more than that charged by uncontrolled comparables by seeing the profit rate of the Indian enterprise, we will end up doing a futile exercise of rather viewing the profit rate of the foreign/AE. Suppose the foreign/AE has charged more, then its profit rate will turn out to be higher, which when compared with the lower rate of profit margin of foreign comparables, will show the transaction at ALP, calling for no transfer pricing adjustment. This exercise is not only off the mark, but also runs counter to the rule and spirit of the transfer pricing provisions. Essence of the matter is that it is the profit margin of the Indian enterprise and not that of the foreign AE, which should be compared with the comparables to see if any

increase in the total income of the enterprise chargeable to tax in India, is warranted on account of transfer pricing adjustment. The contention of the ld. AR for considering the profit of the foreign/AE as 'profit A' for the purposes of comparison with profit of comparables, being 'profit B', for determining the ALP of transaction between the assessee and its foreign AE, misses the wood from the tree by making the substantive section 92 otiose and the definition of 'international transaction' u/s 92B and rule 10B becoming redundant. This is patently an unacceptable proposition having no sanction under the Indian transfer pricing law. The requirement under the Indian law is to compute the income from an international transaction between two AEs having regard to its ALP and the same is required to be strictly adhered to in the manner as prescribed. Thus, it is overt that the obligation under the Indian law is to compute the income from an international transaction between two AEs having regard to its ALP and the same is required to be strictly determined as stipulated. The contention, that the foreign/AE be considered as a tested party for determining the ALP of the international transaction, having no statutory sanction, is sans merit and hence jettisoned.

24. The Id. AR relied on the judgment of Hon'ble Delhi High Court in *GE Money Financial Services Pvt. Ltd. Vs. Pr. CIT (ITA No.662/2016) dated 31-08-2016* to contend that foreign/associated enterprise can be a tested party. We have gone through a copy of the Tribunal order dated 08-07-2016 rendered in this case in ITA No.440/Del/2014, a copy of which has also been placed on record by the Id. AR. The assessee in that case adopted foreign/AE as a tested party and used certain foreign comparables. When the matter came up before the Tribunal, it held that the foreign/AE cannot be considered as a tested party. The matter was taken up by the assessee before the Hon'ble High Court, a copy of whose judgment has also been placed on record. In the judgment, the Hon'ble High Court observed that the issue was about the correctness of the Tribunal order in which it was held that Foreign/Associated Enterprises cannot be considered as a tested party. It further observed that the Tribunal remitted the matter to the file of AO/TPO for fresh determination of the ALP. The Hon'ble High Court held in the operative part of its judgment that :  
“This court notices that *for reconsideration* and determination of the appropriate method as well as appropriate comparables and *the tested party*, it would be convenient and appropriate for the *TPO to*

*consider the question which the assessee urges in the present case.*

The TPO is therefore directed to overlook and not feel bound by the observations of the Tribunal and render findings on the merit of the issue". Having said so, the Hon'ble High Court held that "the court is of the opinion that *no question of law arises* since the matter stands remitted, to the TPO". We are unable to find anything from the operative part of the judgment, which has the effect of setting aside of the Tribunal order holding that the Foreign/associated enterprise cannot be considered as a tested party. In fact, the Hon'ble High Court has simply remitted the matter to the TPO for reconsideration and determination, *inter alia*, of "*the tested party*". The TPO was directed to decide this issue independently *de hors* the finding rendered by the Tribunal. No where a direction has been given that the foreign/associated enterprise should be considered as tested party. There is a sea difference in saying that the Tribunal order holding that Foreign/Associated Enterprise cannot be a tested party, has been reversed and saying that the matter be examined afresh independent of the observations of the Tribunal. As the Hon'ble High Court has held that "*no question of law arises since the matter has been remitted*", in our considered opinion, the Id. AR

cannot legally contend that the Tribunal order in the case of GE Money Financial Services Pvt. Ltd. holding that the Foreign/Associated Enterprise cannot be a tested party, has been reversed. It is still further observed that similar view of not accepting foreign/AE as a tested party, has been taken in umpteen number of cases, including the Mumbai Bench of the Tribunal in *Onward Technology Ltd. Vs. DCIT (2013) 36 CCH 46 (Mumbai)* holding that Foreign/ Associated Enterprise cannot be a tested party. Even the Miscellaneous Application filed against this order came to be dismissed in M.A. No.203/Mum/13 vide order dated 17-01-2005. Similar view has been taken in *Aurionpro Solutions Ltd. Vs. ACIT (TS-75-ITAT-2013 (Mum)-TP) - (2013) 27 ITR (Trib) 276 (Mumbai)*. In the light of the foregoing discussion, we are of the considered opinion that no exception can be taken to the view canvassed by the authorities below in rejecting foreign/Associated Enterprise as a tested party.

25. Reverting to the 'Cost plus' method applied by the assessee in its original transfer pricing documentation, we find it as an admitted position that no comparable uncontrolled transaction was cited. Mechanism for determining the ALP under this method has been given in rule 10B(1)(c), which is as under : -

(i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined ;

(ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined ;

(iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market ;

(iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii) ;

(v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise ;

26. It can be seen from the mandate of the rule that the adjusted normal gross profit rate of comparable uncontrolled transactions is applied to the direct and indirect costs incurred by the assessee to find out the ALP of the international transaction. In the absence of the availability of adjusted gross profit rate in comparables uncontrolled transactions, there can be no determination of the ALP. As the assessee has not given any comparable uncontrolled

transactions, its determination of the ALP under the 'Cost plus' method can be considered as only in vacuum carrying no meaning.

27. The Id. AR then submitted that the assessee in the alternate benchmarked the international transaction under the TNMM considering itself as a tested party albeit in the remand proceedings. It was prayed that the alternate approach be accepted. Firstly, we find that there is no discussion in the impugned order on the correctness or otherwise of such a benchmarking. On a specific query, it was admitted that the international transaction under consideration was benchmarked under the TNMM on entity level by aggregating it with other international transactions.

28. In our considered opinion, the contention of the Id. AR for aggregating the payment for Corporate/Managerial services with other international transactions and then applying the TNMM on entity level cannot be accepted. Section 92C(1) of the Act provides that the ALP in relation to the international transaction shall be determined by any of the prescribed methods having regard to the "nature of transaction or clause of transaction". Rule 10A(d) defines the term "transaction" as including 'a number of closely linked transactions'. Thus, it is evident that the two or more

transactions can be aggregated for determination of the ALP, if they are closely linked transactions.

29. The Hon'ble Punjab & Hon'ble High Court in *Knorr Bremse India Pvt. Ltd. Vs. ACIT (2016) 380 ITR 307 (P&H)* considered certain circumstances in which two or more transactions can be aggregated. It noted that the TNMM may establish the aggregate price paid for some independent international transactions to be at ALP. But it would show skewed picture. There may be more margin from one transaction to set off against the other, but that does not mean that the other transactions should be automatically presumed at ALP. Separate ALP should be determined of separate and independent international transactions. Consequence of the above observations is that cross-subsidization is impermissible. Their Lordships held that several transactions between two or more AEs can form a single composite transaction if they are closely linked transactions and the onus is always on the assessee to establish that such transactions are part of an international transaction pursuant to an understanding between various members of a group. The Hon'ble High Court observed that in case of a package deal where each item is not separately valued but all are given a composite price, these are one international transaction. It

went on to hold that where a number of transactions are priced differently but on the understanding that the pricing was dependent upon the assessee accepting all of them together (i.e. either take all or leave all), then it is also an international transaction. But it will be on the assessee to prove that although each is priced separately, but they are provided under one composite agreement. It still further held that each component may be priced differently also, but it will have to be shown that they are inextricably linked that one cannot survive without other. Merely because purchase of goods and acceptance of services lead to manufacture of final product, it does not follow that they are dependent transactions. It is apparent that the case of the assessee does not fall in any of the above three situations.

30. The Hon'ble Delhi High Court in *Magneti Marelli Power Train India Pvt. Ltd. Vs. DCIT (2016) 289 ITR 469 (Delhi)* has held that Royalty and Technical Assistance fees did not form part of composite transaction and these have to be treated as two separate transactions for computing the ALP. SLP against this judgment has since been dismissed in *(2017) 399 ITR (St) 14*. In view of the foregoing discussion, we are not satisfied with the contention put forth on behalf of the assessee that the payment of

Managerial services fee should be aggregated with other international transactions.

31. It is thus held that the methodology adopted by the assessee for computation of ALP in respect of its international transaction of intra-group services by choosing foreign AE as a tested party under the Cost plus method as well as under the TNMM or by aggregating this transaction with others under the TNMM cannot be and is hereby rejected in entirety.

32. Having found that the benchmarking exercise undertaken by the assessee is not as per law, we now proceed to find out if the TPO was right in his point of view. It is noticed that he applied the CUP as the most appropriate method and determined Nil ALP, as in his opinion no services were received by the assessee. The ld. AR argued that the TP addition be deleted because the TPO has not applied any of the prescribed methods. To bolster such a contention, he relied on the Tribunal order dated 30-04-2013 in the case of *M/s. Kodak India Pvt. Ltd. Vs. ACIT* in ITA No.7349/Mum/12, which has been affirmed by the Hon'ble Bombay High Court in *CIT Vs. M/s. Kodak India Pvt. Ltd.* in Income Tax Appeal No.15 of 2014 vide judgment dated

11-07-2016. Copies of the judgment as well as the order of Tribunal have been placed on record.

33. In that case for the A.Y. 2008-09, the TPO determined the ALP based on worldwide revenue break up amongst countries and concluded that India accounted for 1.4% thereof. On that basis, the ALP was determined and adjustment of Rs.79.96 crore was proposed. The assessee contended before the Tribunal that since the TPO did not apply any of the recognized methods for determining the ALP, the addition should be deleted without any restoration for a fresh exercise, which got concurrence of the Tribunal. The Hon'ble High Court also upheld the view taken by the Tribunal. We do not find any application of the *ratio* of judgment laid down in the case of *M/s. Kodak India Pvt. Ltd. (supra)* to the facts under consideration. In that case, the TPO determined ALP based on the worldwide break up of revenue amongst countries and concluded that India accounted for 1.4% thereof and hence, the TP adjustment was proposed accordingly. On the contrary, the TPO in the instant case has categorically mentioned in Para No.8.6 of his order that he was applying the CUP method, under which the ALP was NIL. In our considered opinion, there is a vast difference between the two situations, viz.,

one in which a wrong method is applied and the second in which a correct method is applied but some mistake is committed in application of such a method. Whereas the case of M/s. Kodak India Pvt. Ltd. falls in the first category, the extant case falls in the second category, in which the TPO applied one of the recognized methods, namely, CUP for determining the ALP of the international transaction. It is a secondary thing that the determination under the CUP method was not proper because he took NIL ALP on the ground that the assessee did not avail any services and further no benefit was received. In such a scenario, we are unable to countenance the contention of the ld. AR that the transfer pricing addition of Rs.4.35 crore should be deleted on this score alone.

34. It has been noted above that the TPO proceeded to determine Nil ALP on the reason that the assessee did not avail any services. We have found out *supra* that the services were, in fact, availed by the assessee. Since neither the exercise done by the TPO for benchmarking the international transaction, either originally or during the course of the first appellate proceedings, is sustainable nor the view point of the TPO determining Nil ALP can be affirmed because of the assessee having actually availed the

services, we are of the considered opinion that the ends of justice would meet adequately if the impugned order is set aside and the matter is restored to the file of AO. To sum up, the impugned order on this issue is set aside and the matter is restored to the file of AO for determining the ALP of the international transactions of payment of Corporate/management services afresh as per law after allowing reasonable opportunity of being heard to the assessee. It is directed that the AO/TPO will firstly determine the most appropriate method and then find out the ALP of the international transaction in accordance with our above observations and directions. Needless to say, the assessee will be allowed an opportunity of hearing in such fresh exercise.

35. All other grounds taken by the assessee in its appeal are either general or consequential or pre-mature, which do not require any specific adjudication.

36. In the result, the appeal of the Revenue is dismissed and the appeal of the assessee is allowed for statistical purposes.

Order pronounced in the Open Court on 27<sup>th</sup> February, 2019.

Sd/-  
**(VIKAS AWASTHY)**  
**JUDICIAL MEMBER**

पुणे Pune; दिनांक Dated : 27<sup>th</sup> February, 2019

सतीश

Sd/-  
**(R.S.SYAL)**  
**VICE PRESIDENT**

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:**

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. The CIT(A)-13, Pune
4. The Pr.CIT-1, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "A" / DR 'A', ITAT, Pune;
6. गार्ड फाईल / Guard file.

**आदेशानुसार/ BY ORDER,**

**// True Copy //**

Senior Private Secretary  
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	26-02-2019	Sr.PS
2.	Draft placed before author	27-02-2019	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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