

**IN THE INCOME TAX APPELLATE TRIBUNAL
VISAKHAPATNAM BENCH, VISAKHAPATNAM**

**BEFORE SHRI V. DURGA RAO, HON'BLE JUDICIAL MEMBER &
SHRI D.S. SUNDER SINGH, HON'BLE ACCOUNTANT MEMBER**

**ITA Nos. 279 & 280/VIZ/2017
(Asst. Year : 2007-08 & 2008-09)**

DCIT, Circle-5(1),
Visakhapatnam.

vs.

M/s. SNF (India) Pvt. Ltd.,
Plot No.9, Jawaharlal Nehru
Pharma City, Parawada,
Visakhapatnam.

(Appellant)

PAN No. AAACP 4070 A
(Respondent)

**C.O.Nos. 63 & 64/VIZ/2017
(Arising out of ITA Nos. 279 & 280/VIZ/2017)
(Asst. Year : 2007-08 & 2008-09)**

M/s. SNF (India) Limited,
Plot No.9, Jawaharlal Nehru
Pharma City, Parawada,
Visakhapatnam.

vs.

DCIT, Circle-5(1),
Visakhapatnam.

PAN No. AAACP 4070 A
(Applicant)

(Respondent)

Assessee by : Shri Ajit Kumar Jain – AR.
Department By : Smt. Suman Malik – Sr.DR

Date of hearing : 22/08/2019.
Date of pronouncement : 04/10/2019.

ORDER

PER D.S. SUNDER SINGH, ACCOUNTANT MEMBER

These appeals by the Revenue and the cross objections by the assessee are directed against the common order of

Commissioner of Income Tax (Appeals)-2, Visakhapatnam, dated 27/02/2017 for the Assessment Years 2007-08 & 2008-09. Since the facts and the issues are common the appeals are clubbed and heard together and disposed of by way of this consolidated order.

2. First we take up the appeal for the A.Y. 2008-09 in ITA No. 280/VIZ/2017. Facts of both the cases are identical, however, appeal for the A.Y. 2007-08 is below tax effect of Rs. 50.00 lakhs.

The Department has raised the following grounds of appeal:-

- "1. Whether on the facts and circumstances of the case, the Hon'ble CIT(Appeals) was justified in holding that the TPO did not analyse the payment on account of royalty and technical know-how under TNMM or any other method, contrary to the fact that the TPO held that the tax payer failed the benefit test against payment of royalty for receiving the services and accordingly under CUP, Arm's Length Price is treated as nil.*
- 2. The Ld. CIT(Appeals) has failed to appreciate that even though the tax payer was asked to justify the payment applying the benefit test, which the tax payer could not fulfill.*
- 3. The Ld. CIT(Appeals) failed to appreciate that if the terms and conditions of the agreement are sacrosanct, then there would never be any adjustment to arm's length. The terms and conditions are to be tested between what independent parties would do in an arm's length situation.*
- 4. Royalty payment cannot be aggregated with the other international transactions for the purpose of determining the ALP.*
- 5. Royalty has been paid under a separate agreement and therefore has no relation with the other transactions of the assessee with its AE.*
- 6. Payment of royalty and the other transactions with the AE are not closely related transactions but are separate and independent international transaction and therefore these cannot be treated as closely linked transaction for the purpose of transfer pricing adjustment.*

7. *The Ld. CIT(A) ought to have noticed that the profit margins shown by the assessee is low compared to comparable cases which justifies disallowance of Royalty."*

3. During the appeal hearing, Id.DR submitted that ground Nos. 1 to 3 are related to the benefit test made by the Transfer Pricing Officer (TPO) for allowing royalty payment. Ground Nos.4 to 7 are related to determination of arm's length price (ALP) in respect of payment of royalty to the Associated Enterprises (AEs).

4. Brief facts of the case are that the assessee-SNF India Private Ltd., is a 100% subsidiary of SPCM SA, France has set up its manufacturing unit in Patancheruvu, Hyderabad and is engaged in the business of manufacture and sale of water soluble polymers. The assessee's product range is used in a variety of process industries such as oil drilling, paper manufacturing, sugar, textiles, ceramics, cosmetics and agriculture etc. For the A.Y. 2008-09, during the course of assessment proceedings, the Assessing Officer had observed that assessee had entered into international transactions exceeding the limit prescribed in the Act. Therefore, the issue was referred to the Addl. Director of Income Tax (Transfer Pricing), Hyderabad for determining the ALP of International transaction.

4.1 The assessee has entered into international transaction as under:-

S. No.	Description of transaction	Amount (Rs.)	Method
1	Purchase of various types of polymers and other raw materials	20,94,12,569	TMMM
2	Purchase of finished goods for distribution	1,90,72,758	TMMM
3	Sale of manufactured finished goods	4,03,45,480	TMMM
4	Purchase of equipment's	17,88,971	TMMM
5	Royalty payments under technical know-how agreement	1,75,00,000	TMMM
6	Reimbursement of translation charges	12,79,586	TMMM
	Total	28,93,99,364	

4.2 The financial results for the A.Y. 2008-09 relevant to the F.Y. 2007-08 as per the original return of income filed by the assessee are as under:-

(rupees in crores)

Operating revenue	:	48.90
Operating costs	:	41.68
Operating profit	:	7.2
OP/OR	:	14.76%
OP/OC	:	17.32%

4.3 The tax payer has conducted the transfer pricing study and searched for the comparables by using 'Prowess' data base in search of comparables applying various key words and after applying certain filters, the tax payer has short-listed around 10 comparables, whose arithmetic mean PLI (OP/Sales) was

computed at 11.8% as against the margin of taxpayer of 14.76% and accordingly, the taxpayer held that the transactions are at Arm's Length Price and no adjustment was made. The taxpayer adopted TNMM (Transaction Net Margin Method) as most appropriate Method (MAM) at the entity level.

5. The Ld.TPO segregated the royalty payment and worked out the operating margin (OP/OR) of purchases and sales at 18.34% after excluding the Royalty payment and no adjustment was proposed on purchases and sales. The TPO also viewed that TNMM is MAM for determining the ALP for trading transaction. However, the TPO segregated the Royalty payment and determined the ALP of Royalty at Rs.NIL. The TPO was of the view that the transfer pricing study made by the assessee with regard to payment of royalty was unacceptable, since, the assessee had aggregated the payment of royalty with other transactions. The TPO separated the payment of royalty from trading transactions and proceeded to benchmark and same using CUP method as the transaction is in the nature of intangible which in the opinion of the TPO has to be analysed separately. The TPO referred the decision of ITAT, Mumbai Bench in the case of *UCB India Pvt. Ltd.*, [317 ITR 292 (AT) (Mumbai)] and held that each class of transaction has to be

analysed separately. Therefore, viewed that CUP is an appropriate method to analyse ALP of royalty paid to SPCM SA, France, vide agreement entered on 29/12/2004. The TPO further viewed that the payment made to AEs under prescribed FEMA guidelines cannot be taken as a benchmark and the Transfer pricing is altogether is a different subject and has to be analysed within the ambit of law prescribed u/sec. 92CA of the Act. The TPO examined the aspect of royalty payments made between the group entities and also the approach followed by other countries like USA, Australia, Canada, Germany etc. while examining the royalty payments and also the OECD guidelines. The TPO has opined that unless there is direct benefit derived by the assessee from the tangibles commensurating the payment of royalty or expected to be derived when parties deal with each other at arm's length, ALP of such payment for royalty would be treated as either Rs. NIL or to the extent it is shown that the benefit actually derived from such payment. The TPO asked the assessee to justify the payment made to the AE and substantiate the receipt of intangibles and the benefits derived there from. Since the assessee failed to satisfy benefit test as required, the TPO held that the assessee did not derive any benefit by payment of royalty

to the AE. Therefore, the ALP payment made towards royalty was determined at Rs. NIL. In this case, it is also relevant to mention the observations of the TPO in the TPO's order for the A.Y. 2007-08 in paragraph No.7.4 of paper book at page No.54 which reads as under:-

"As already discussed in the earlier part of the order, the PLI (OP/Sale) of the taxpayer for the year under consideration is at 8.57% as compared to the arithmetic mean of the two comparables selected by the top at 10.45% is significantly lower. Therefore, the taxpayer could not demonstrate the tangible benefits that are derived from the so called purchase of technology from its AE. The uniqueness and usefulness of the so called technology is not demonstrated by the taxpayer. It is a well known fact that the technology becomes obsolete and redundant over a period of time. Therefore, the value of the technology gets eroded as the time lapses. The taxpayer cannot pay royalty indefinitely for the technology which is already gets absorbed over a period of time. In an arms length situation, no independent party pays royalty perpetually without deriving any additional benefits."

5.1 In this case, for the A.Y. 2008-09 the taxpayer has made the royalty payment of Rs. 1.75 crores to the AEs @5% on domestic sales and 8% on external sales. Since the TPO has determined the ALP at Rs.NIL, the Assessing Officer has completed the assessment u/sec. 143(3) r.w.s. 92CA(3) by making the addition of Rs. 1.75 crores representing the ALP of the royalty transaction as per the TPO's order.

6. Against the order of the Assessing Officer, the assessee went on appeal to the Id. CIT(A). The Id. CIT(A) after analysing and

examining the complete details placed before him found that as per the correspondence and evidence, the assessee's plea that it had received technical information from its AE and such technical information provided by the AE was established. The Id.CIT(A) further held that the TPO without considering the e-mail correspondence, has taken a view that the technical services provided in the agreement are general in nature in paragraph No. 16.4 of the Id. CIT(A)'s order. For the benefit of understanding and clarity we extract para 16.4 of the Id. CIT(A)'s order is as follows:-

"16.4 Thus, the perusal of the e-mail correspondence fairly indicate that the Indian entity seeks evaluation reports on the lab trials conducted by it on the product formulation sent by the AE, requested for analysis of competitor products and suggestions to improve their product performance equivalent to the competitor product or find substitute, guidance on the process proposed to be taken by the Indian entity etc. and it is also seen that the AE personnel have carried out evaluation tests on the samples sent by Indian entity, suggested changes in process - such as incorporation of blend/chemical, to improve product stability, performance compared to competitive product, suggestions for further tests and analysis, forwarding of formulations etc. It is also seen that some of the personnel visited India such as Pierre Lyot, Willy Durand, Fabien Blandeau, Cederic Fravero are technical personnel, to whom e-mails were addressed seeking clarification and guidance. Therefore, it can be said that the Indian entity has availed technical information from its AE in the manufacture of products, in the process for manufacturing etc. It is also seen that the information passed on by the AE is after carrying out certain analysis or out of their expertise and experience. Therefore, it cannot be said that they are mere routine information. Some of

the suggestions given by the AE are towards improving the quality of the product to overcome the performance of competitor product, and hence it can be said that these are technical information passed on to improve the process or the quality of the product. It is also seen that the sales revenue and profitability of the Company has increased over the years. Considering these material evidence on record, the assessee's plea that it had received technical information from its AE and has benefits from such technical information provided by the AE remain substantiated. I find that the TPO without considering the e-mail correspondence has taken the view that the technical services provided in the agreement are general in nature, probably as the thrust of argument before the TPO was that as the royalty payment was approved by RBI, it would meet the requirements of ALP."

7. The Id. CIT(A) further held that it is mandatory to benchmark the international transactions as per the relevant TP provisions and the RBI approval for payment of Royalty would not be the criteria. The provisions of section 92C r.w.r. 10B are clear that the ALP in relation to international transactions shall be determined as per the methods prescribed in the Act and the approval of RBI given for remittance of impugned amount to the AE would not in any way fall within the methods prescribed under the act. Thus, the contention of the assessee justifying the payment made to the AE with the approval of RBI was rejected by the Id.CIT(A). The Id.CIT(A) further held that benchmark of royalty as a separate transaction is permissible as the royalty is a separate transaction. Further held that aggregation for

transactions for benchmarking and the selection of the most appropriate method depends on the facts and circumstances of the case such as the nature of transactions to be aggregated taking into account the entire activities and functions of the enterprise, the availability of comparable data etc. and relied on Rule 10C(2) which reads as under:-

"10C. (1) x x x x

(2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:—

(a) the nature and class of the international transaction [or the specified domestic transaction];

(b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(c) the availability, coverage and reliability of data necessary for application of the method;

(d) the degree of comparability existing between the international transaction [or the specified domestic transaction] and the uncontrolled transaction and between the enterprises entering into such transactions;

(e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(f) the nature, extent and reliability of assumptions required to be made in application of a method."

8. The Id. CIT(A) having observed that the assessee had availed the benefit under the royalty agreement and the foreign

AE did not enter into royalty agreement for transfer of know-how with any independent third parties and considering the fact that the TPO after analysing the facts and the benchmarking of the other international transactions could not identify any comparable data for the impugned two assessment years to benchmark the payment of royalty transaction under the CUP method, viewed that CUP method is not most appropriate method and owing to the facts and the circumstances TNMM is most appropriate method in the A.Y. 2007-08 & 2008-09. The assessee adopted TNMM method at entity level aggregating all the international transactions with OP/OR as the PLI.

For the A.Y. 2007-08, the assessee has computed its PLI at 9.9% and has selected 13 comparables and whose average mean of OP/OR was given at 6.42% and claimed that all its international transactions were at ALP. The TPO has selected two comparables taking into account, the current year data and applying appropriate filters, and the average mean of OP/Sales was worked out 10.45%. The TPO also computed the assessee's OP/Sales at 8.57%. The Id.CIT(A) held that the Assessing Officer/TPO may examine whether the assessee's claim that its PLI falls within the range of (+/-) 5% and accordingly determine whether the ALP

requirements are met. If the assessee's PLI as determined by the TPO does not fall within the (+/-) 5% range, the Id. CIT(A) directed the Assessing Officer to make proportionate adjustment by way of determination of ALP.

9. For the A.Y. 2008-09, the assessee had conducted the TP study and benchmarked the arithmetic mean of 10 comparables, with PLI (OP/Sales) was given at 11.85% as against the assessee's PLI of 14.76% adopting TNMM as MAM. Considering the fact that the assessee's PLI is more than PLI of comparables, the Id. CIT(A) held that no adjustment is required. Accordingly, deleted the addition made by the Assessing Officer to the extent of 1.75 crores for the A.Y. 2008-09.

10. Against the order of the Id. CIT(A), the Revenue is in appeals and the assessee filed the cross objections before this Tribunal.

11. During the appeal hearing, Id.DR argued that the assessee has not established before the TPO that it had derived any benefit from intangibles. The TPO has directed the assessee to demonstrate the benefits derived by the tax payer with evidence and the assessee failed to demonstrate that the assessee-company had derived any benefit by payment of royalty to the AE. Therefore, the assessee has not passed through the benefit test

for payment of royalty. Though there is no benefit test method in the transfer pricing scheme, the expenditure wholly and exclusively laid out for the purpose of business is the allowable expenditure as per section 37(1) of the act, hence argued that the department cannot confine itself to the provisions of section 92CA(3) r.w.r. 10B without estimating the very nature of allowability of the expenditure and the T.P provisions have to be read along with the entire scheme of taxation but not to be read alone. The Id.DR argued that for allowing the expenditure satisfaction of conditions in section 37(1) is also required to be proved and argued that the TPO has rightly found that the assessee did not derive any benefit from the payment made for intangibles. Thus, there is no case for making the Royalty payment and the Id. CIT(A) erred in holding that the assessee had received the benefit out of payment of royalty.

Ld.DR further argued that the Id. CIT(A) erred in aggregating the transaction and rejecting the CUP method, the royalty is a separate payment for which the ALP required to be determined. The Act and OECD guidelines permits that the royalty as a separate and independent transaction for benchmarking the international transaction and cannot be linked with other

transactions for the purpose of transfer pricing adjustment. The profit margin shown by the assessee is low comparable to the comparable cases. Thus, argued that the Assessing Officer rightly dealt with the royalty payment as a separate transaction and determined the transfer pricing independently. Since the assessee did not receive the benefit for the intangibles or royalties, the Id.DR supported the order of the TPO/AO and requested to set aside the order of the Id. CIT(A) and allow the appeal of the revenue.

12. On the other hand, Id.AR argued that the TPO has determined the ALP of Royalty payment at Rs.NIL against the payment of Rs.1.75 crores by the assessee which is unjustified and against the transfer pricing scheme and methods specified in Rule 10B of I.T Rules for determining the ALP. The Ld.A.R further submitted that the assessee had entered into an agreement for payment of Royalty with SPCM SA, France for using technology and getting technical information continuously and consistently. As per the agreement, the assessee shall make royalty @5% on domestic sales and 8% on external sales to its AE, SPCM SA. The technical information supplied by the AE is confidential in nature and it is necessary to the assessee to manufacture the products

including transfer of formulation seeds, raw material specification in process quality control process testing and working instructions for making operations and the consequent sheets. The assessee's manufacturing activity is interlinked and interrelated with the continuously supplied technical information from the AE and without technical support from the AE the assessee would not be in a position to undertake the manufacturing operations. The existence of the assessee-company is based on technical assistance provided by the holding company and argued that this assistance is a big benefit to the assessee company as the company is able to coordinate its operations due to technical assistance provided by the AE. Though, the TPO has given finding in Transfer pricing order that the assessee did not derive any benefit out of the payment of the royalty, the Id. CIT(A) after verifying the additional evidence and the information submitted by the assessee during appeal hearing, given a finding that the assessee's claim that it had derived the benefit from technical information provided by the AE was substantiated. Therefore, argued that the assessee had established the benefit received from the AE for payment of royalty.

The TPO separated the Royalty from the remaining transactions and held that CUP method is a most appropriate method for determination of royalty payment, however, the TPO did not bring out any comparable cases to determine the transfer pricing for benchmarking the royalty payment. The royalty payment cannot be separated from the remaining transactions. There is no justification for segregation of royalty, since, all the transactions are interlinked and interrelated and submitted that in the circumstances the TNMM is most appropriate method at the entity level, which the Id. CIT(A) also accepted. The Id.AR further submitted that though the TPO had rejected the comparables for minor deviations, the TPO selected only two comparables instead of 13 comparables submitted by the taxpayer during the transfer pricing proceedings which is not justified. Ld.AR argued that the issue of aggregation of transaction and determination of ALP at Rs. NIL was decided by number of High Courts and Tribunals. The Id.AR relied on the decision of the Hon'ble Telangana and Andhra Pradesh High Court in the case of *DCIT Vs. R.A.K. Ceramics India Pvt. Ltd.* in I.T.T.A.No. 595/2016, dated 23/12/2016. Similarly, Id.AR also relied on the decision of the Hon'ble Bombay High Court in the case of *CIT Vs. M/s. Johnson & Johnson Ltd.*, in ITA

No.1030/2014, dated 07/03/2017 and the decision of the Hon'ble Delhi High Court in the case of Pr.CIT-3 Vs. Frigoglass India Pvt. Ltd., in ITA No. 123/2017, dated 03/03/2017 and argued that once the assessee is having the agreement for payment of royalty, the TPO cannot sit on the judgment for determination of ALP in the case of royalty. Similarly, by placing reliance on the decision of the Hon'ble Bombay High Court in the case of M/s. Johnson & Johnson Ltd., (supra) argued that the disallowance of payment on the basis of assumption that it is excessive, is an action completely *dehors* the provisions of transfer pricing adjustment. By placing reliance on the judgment of the Hon'ble Delhi High Court in the case of *Frigoglass India Pvt. Ltd.* (supra), Id.AR argued that the payment of royalty can be benchmarked using TNMM as the most appropriate method and that commercial expediency for payment of such royalty cannot be questioned. Accordingly, Id.AR argued that in the instant case applying the benefit test is not provided in sec. 92C of the Act and the Assessing Officer has to necessarily apply the method prescribed in rule 10B of the IT Rules for determination of ALP of international transaction. Thus, argued that having not followed any of the method by the TPO, the adjustments made by the TPO at Rs. NIL

is unjustified. Similarly, by relying on the decision of the Hon'ble High Court of Telangana & Andhra Pradesh in the case of R.A.K. Ceramics India Pvt. Ltd. (supra) the Id.AR argued that the transfer pricing adjustments made by the Assessing Officer required to be deleted and requested to uphold the order of the Id. CIT(A).

13. We have heard both the sides and perused the material placed on record.

14. In the instant case, for the A.Y. 2007-08, the assessee has made the payment of royalty to its AE i.e. SPCM SA, France for Rs. 1.10 crores and for the A.Y. 2008-09 the amount of royalty payment was Rs. 1.75 crores. The taxpayer has conducted the transfer pricing study and held that TNMM is most appropriate method at the entity level and on study of transfer pricing, the taxpayer concluded that the PLI (OP/Sales) of the assessee is more than comparable cases and thus held that the international transactions are at ALP. The Ld.TPO also has accepted for trading transactions the TNMM is MAM and did not suggest any adjustment. However he has held that in determining the ALP, the payment of royalty required to be segregated, since, the royalty is an independent and separate transaction. Accordingly, the TPO considered that CUP is the most appropriate method for

determining the ALP of Royalty. For the remaining transactions, the TPO had accepted the TNMM is most appropriate method and no adjustment was made. As far as royalty is concerned, the TPO has made the benefit test and held that the assessee did not derive any benefit out of the royalty payment and the taxpayer could not demonstrate the tangible benefits that are derived from purchase of technology from its sales. Thus viewed that the taxpayer cannot pay indefinitely for the technology which gets absorbed over a period of time. Hence, determined the ALP of the royalty payment at Rs. NIL for the transfer pricing analysis. For the A.Y. 2008-09, against the payment of Rs. 1.75 crores taking the same analysis, the TPO has determined the ALP of royalty at Rs. NIL. Accordingly, the Assessing Officer made the transfer pricing adjustments as suggested by the TPO and passed the assessment order.

14.1 On appeal Id. CIT(A) admitted the additional evidence and examined the correspondence and e-mails and held that the assessee has substantiated the benefits derived from technical information provided by the AE. The Id.AR argued that use of technical information is interlinked and interrelated with the manufacturing activity of the assessee, therefore, submitted that

that the payment of royalty is a mandatory requirement to the assessee for carrying on manufacturing activity of the assessee company. The Id. CIT(A) has completely analysed the issue after giving opportunity to the TPO/Assessing Officer and held that the assessee got technical support from the AE in the manufacturing process and in manufacture of its products. Some of the suggestions given by the AE towards improving the quality of the product to overcome the performance of competitor product and accordingly given a finding that the assessee has received the technical support from the AE. During appeal hearing, Id.DR could not place any evidence to controvert the finding given by the Ld.CIT(A). The above observation made by the Ld.CIT(A) is based on the facts and after analysing the information placed before him therefore we, do not see any reason to differ with the finding of the Id. CIT(A) to hold that the assessee had received technical information from its AE and has benefited from such technical information provided by the AE. The Id.AR relied on the decision in the case of M/s. Johnson & Johnson Ltd. (supra) wherein the Hon'ble High Court of Bombay has held that the TPO is obliged to follow any one of the prescribed methods to determine the ALP as detailed in section 92C(1) of the Act. For the sake of convenience,

we extract the relevant portion of the order which is extracted as under:-

“(ii) The TPO is obliged under the law to determine the ALP by following any one of the prescribed methods of determining the ALP as detailed in Section 92C(1) of the Act. In this case, there is nothing on record to indicate that the TPO had applied any one of the prescribed methods in Section 92C(1) of the Act to determine the ALP before disallowing the payment of Rs.200.82 lakhs incurred by the Respondent on account of publicity and sales management as being excessive and/or payable by its parent, M/s. Johnson & Johnson, USA.

(iii) The impugned order holds that transfer pricing adjustment done by disallowing the payment, on the basis of an assumption that it is excessive, is an action completely dehors the provisions of transfer pricing adjustment found in chapter X of the Act. The determination of the ALP has to be done only by following one of the methods prescribed under the Act.”

14.2 Having accepted that the assessee company has received the technical support from the AE, we are of the view that determination of ALP at Rs. NIL is unjustified and the Assessing Officer/TPO is bound to follow any one of the methods prescribed in the Act to determine the ALP either the royalty as independent transaction or aggregating the transaction at the entity level. Though the Id.TPO has adopted the CUP as MAM for determining the ALP of royalty, TPO did not bring any comparable cases. Therefore adopting the CUP method without the support of any comparable cases would be defective.

15. During the appeal hearing, the Id.AR argued that the payment of royalty is interlinked with the manufacturing activity and other trading transactions, therefore, the TNMM is most appropriate method at the entity level and it is necessary to aggregate the entire transactions without delinking with the royalty payments. The Department could not establish that the royalty is independent and separate transaction for unbundling the royalty from the other transactions to determine the ALP independently. Once it is accepted that the technical support is required for manufacturing the product and it is interrelated the payment of royalty cannot be segregated and the transactions required to be aggregated at the entity level and the ALP required to be determined on the whole transactions. Though the TPO held that the CUP is most appropriate method for determining the transfer pricing of the royalty but did not bring any comparables for determination of the royalty payment. Merely because of some mistakes in comparable cases, the TPO had rejected the comparables furnished by the taxpayer during the transfer pricing proceedings and rejecting the TNMM as most appropriate method which is not justified. The Ld.CIT(A) relied on the decision of Sony Ericson Mobile communications India (P) Ltd wherein the Hon'ble

Delhi High court held that aggregation of transaction is desirable and not merely permissible, if the nature of transaction(s) taken as a whole is so interrelated that it will be more reliable means of determining the Arm's length consideration for the controlled transactions. In the instant case assessee has not availed similar technology from any other third party and the associated enterprise has not provided the technology to any other third party. The Ld.TPO has not brought any comparable cases under CUP method for determination of ALP. Therefore taking in to consideration the entire facts and the materials placed before us we, agree with the Ld.CIT(A) that the TNMM is most appropriate method to determine the ALP at entity level. Having held that TNMM is most appropriate method we refer to the decision of the Hon'ble High Court of Telangana & A.P. in the case of R.A.K. Ceramics India Pvt. Ltd. relied upon by the Id.AR wherein the Hon'ble High Court has held as under:-

"..... once it is admitted by the Revenue that the assessee entered into a royalty agreement with the AE and the assessee claimed benefit from such agreement, in the form of quantum increase in sales with no apparent increase in production, minimal product recalls and low after sales maintenance cost, and consequently paid royalty in terms thereof, it was not for the TPO to determine as to what could be the other reasons for increase in the assessee's sales and profit."

16. In the assessee's case, there is an agreement entered by the assessee for payment of royalty @ 5% on domestic sales and 8% on foreign export. There is no dispute with regard to the genuineness of the agreement entered into by the assessee with the AE. Therefore, the decision of the Hon'ble High Court of Telangana and A.P. in the case of R.A.K. Ceramics India Pvt. Ltd. (supra) supports the case of the assessee.

17. The Id.AR relied on the decision of the ITAT, Delhi in the case of Frigoglass India Pvt. Ltd. (supra) wherein the ITAT held that the payments of royalty can be benchmarked and TNMM is the most appropriate method and the commercial expediency for payment of such royalty cannot be questioned. The decision of the ITAT is upheld by the Hon'ble Delhi High Court and the Department filed SLP before the Hon'ble Supreme Court and the Hon'ble Supreme Court dismissed the SLP. For the sake of convenience, we extract the relevant part of the order of the Tribunal as under:-

"16. We have heard the rival parties at length and carefully perused the material on record. As far as the issue of royalty is concerned, we find that the assessee had filed in the course of the TPO assessment as well as before the DRP, detailed submissions, including agreement between AE and the assessee, justifying how the technical know-how supplied by its AE was crucial to the running of its business. In CIT vs EKL Appliances 341 ITR 241 (Del), the Hon 'ble Delhi High Court had the occasion to consider an issue of disallowance of royalty by TPO because the assessee in that case had been suffering losses, the Hon'ble High Court while holding that so long as the expenditure

or payment by assessee has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning.....

.....Here, in the present appeal, what we see is the TPO sitting on judgment on the business and commercial expediency of the assessee which is erroneous as per the provisions of the Act as laid down clearly by the Hon 'ble Delhi High Court in EKL Appliances (supra). As far as the Department's reliance on the Hon 'ble Delhi High Court's judgment in Abhinandan Investments (supra) and on the decision of the co ordinate I Bench of the Delhi Tribunal in the case of Bombardier Transpiration India Pvt. Ltd. is concerned, these judgments were rendered on a different set of facts and hence the ratio as 'laid down by these are not applicable to the facts of the present appeal.

Furthermore, we are of the opinion that once TNMM has been applied to the assessee company's transaction, it covers within its ambit the royalty transactions in question too and hence the Department's contention for applying the CUP method is erroneous.

Hence, following the ratio of the Hon 'ble Delhi High Court in CIT vs EKL Appliances (supra), we hold that the addition made by the TPO and upheld by the DRP is unsustainable and is liable to be deleted....."

18. In the instant case, there is no dispute that the assessee has derived the benefit from the technical information given by the AE. There was an agreement reduced in writing between the assessee and the AE for payment of royalty and for extending necessary technical support to the assessee for manufacturing product continuously and consistently. The Id. CIT(A) has given a finding that the technical information on the manufacturing the activity was received and benefitted by the assessee. The Id.AR submitted

that the manufacturing activity of company and the continuous technical support for which the royalty is paid are independent and interrelated and as held by the Hon'ble Bombay High Court in the case of M/s. Johanson & Johnson, the TPO obliged to follow any one of the methods prescribed in section 92C of the Act. Instead, the Id.TPO adopted the benefit test which is not one of the prescribed methods. Thus, the order of the TPO is defective in not following the methods prescribed under the Act. Commercial expediency is the business decision of the tax payer and the AO cannot sit and judge the business expediency as decided by the Hon'ble Delhi High Court. The coordinate bench of ITAT, Delhi also held that TNMM is the most appropriate method for benchmarking the royalty payment. On application of TNMM as MAM at the entity level the PLI of the assessee more than the comparable cases, thus the transactions of the assessee company are at Arm's length. Following the judicial precedents discussed in the preceding paragraphs, we hold that determination of royalty at Rs. NIL is unjustified and the most appropriate method for determining the royalty payment is TNMM method at the entity level aggregating all the transactions including the payment for royalty. Accordingly, we hold that the adjustment made by the

TPO is not warranted and the addition made by the Assessing Officer is deleted and the order of the Id. CIT(A) is upheld.

19. For A.Y. 2007-08, the facts are identical and having held that TNMM is the most appropriate method, no adjustment is called for on account of transfer pricing issues. In the instant case, the tax effect involved in this appeal is also less than Rs.50.00 lakhs which is squarely covered by the CBDT Circular No. No.17/2019, dated 08/08/2019, therefore, this appeal is not maintainable. Therefore, the assessee succeeds for the A.Y. 2007-08 both on merits as well as on tax effect. Accordingly, the appeals filed by the Revenue are dismissed.

20. The cross objections filed by the assessee are supporting to the orders of the Id. CIT(A). Having deleted the additions made by the Assessing Officer, the Cross Objections filed by the assessee becomes infructuous, hence, dismissed.

21. In the result, appeals filed by the Revenue and the Cross objections filed by the assessee are dismissed.

Order Pronounced in open Court on this 04th day of Oct., 2019.

Sd/-
(V. DURGA RAO)
Judicial Member

sd/-
(D.S. SUNDER SINGH)
Accountant Member

Dated: 04th Oct., 2019.

vr/-

Copy to:

1. *The Assessee – M/s. SNF (India) Pvt. Ltd., Plot No.9, Jawaharlal Nehru Pharma City, Parawada, Visakhapatnam.*
2. *The Revenue – DCIT, Circle-5(1), Visakhapatnam.*
3. *The CIT-2, Visakhapatnam.*
4. *The CIT(A)-2, Visakhapatnam.*
5. *The D.R., Visakhapatnam.*
6. *Guard file.*

By order

(VUKKEM RAMBABU)
Sr. Private Secretary,
ITAT, Visakhapatnam.