IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K" MUMBAI

BEFORE SHRI SAKTIJIT DEY (JUDICIAL MEMBER) AND
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)

ITA No. 6154/MUM/2011
Assessment Year: 2003-04

Fulford (India) Limited, 8th floor, Platina C-59, G-Block, Bandra Kurla Complex, Bandra (E), Mumbai-400098 **PAN No. AAACF1795L**	Vs.	The Assistant Commissioner of Income Tax (OSD)-2(1), Mumbai
Appellant		**Respondent**

Assessee by : Mr. P. J. Pardiwalla, Sr. Advocate
& Mr. Mathur Agrawal, Advocate
Revenue by : Mr. Anand Mohan, CIT- DR
& Mr. C. Anjaria, DR

Last date of Hearing : 30/08/2019
Date of pronouncement : 25/11/2019

ORDER

PER N.K. PRADHAN, AM

This is an appeal filed by the assessee. The relevant assessment year is 2003-04. The appeal is directed against the order of the Commissioner of Income Tax-15, Mumbai [in short 'CIT(A)'] and arises out of the assessment completed u/s 143(3)(ii) of the Income Tax Act 1961, (the 'Act').

2. <u>The 1st ground of appeal</u>

a) On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in summarily disregarding the transfer pricing documentation maintained by the appellant and in upholding the action of the Assessing Officer ('AO')/Transfer Pricing Officer ('TPO') ascertaining the arm's length price of the international transaction of import of APIs from the Associated Enterprises ('AEs') at Rs.1,06,27,853/- instead of Rs.3,35,37,633/- as determined by the appellant

b) He further erred in: -

i. disregarding the transfer pricing analysis carried out by the appellant;

ii. confirming AO/ TPO's order which has not taken cognizance of the transfer pricing regulations as well as the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued by Organization for Economic Cooperation and Development ('OECD TP Guidelines');

iii. disregarding the economic characterization of the appellant without giving due regard to the functional analysis carried out by the appellant.

iv. confirming the rejection of the Cost Plus Method ('CPM') as the most appropriate method adopted by the appellant and selection of Comparable Uncontrolled Method ('CUP') as the most appropriate method adopted by the AO/TPO, which requires stringent comparability;

v. Confirming the AO/ TPO's order, which was framed based on the data obtained under section 133(6) of the Act and thereby

comparing the purchase prices of the originally researched APIs imported by the appellant from its AEs with the purchase prices of generic raw materials obtained under section 133(6);

vi. disregarding the differences between the transactions of import of originally researched APIs by the appellant from its AEs and the generic raw material imported by third parties;

vii. Confirming AO / TPO's order which has not provided sufficient information to the appellant to adequately examine the comparability analysis and to put forth appropriate counter arguments;

viii. Confirming the AO / TPO's order even though the TPO failed to respond appropriately to the inquiry u/s 250(4) of the Act made by the Ld CIT(A), who had directed the TPO to "examine the efficacy of adoption of CUP as the most appropriate method in light of the standards / guidelines laid down by the Mumbai Tribunal in the case of UCB India Private Limited where the facts are identical with this case".

ix. Without prejudice to above, the Ld. CIT(A) erred in confirming the AO/TPO's order which includes an adjustment to the arms length price of the said international transaction without giving effect to the proviso to Section 92C(2) of the Act. The appellant without prejudice to the above, prays that effect be given to the proviso to Section 92C(2) and accordingly the arm's length price be re-computed.

c) That it be held that the aforesaid international transaction was at arm's length and accordingly the adjustment of Rs 2,29,09,780/- be deleted.

3. Briefly stated, the facts of the case are that the appellant is an indirect subsidiary of Schering-Plough Corporation, USA ('SP') and operates as a public limited listed company. SP indirectly held shareholding of 40% as on 31.03.2003 and balance stock was held by public in general including the institutional investors. The appellant is engaged in the business of manufacturing and marketing pharmaceutical products (finished formulations only) in India. It filed its return of income for the assessment year (AY) 2003-04 on 27.11.2003 disclosing total loss of Rs.46,653,841/-. The appellant had international transaction as defined in section 92B of the Act with its Associated Enterprises (AEs) for the concerned previous year. The international transactions entered into by the appellant with its AE are as under :

Type of international transaction	**Total value of transactions (Rs.)**	**Method selected**
Purchase of raw materials	3,35,37,633	CPM
Purchase of finished goods	21,21,01,670	RPM
Reimbursement (Receipts)	29,46,483	CUP

A reference was made by the AO u/s 92CA(1) in the case of the appellant to the Transfer Pricing Officer (TPO) for computation of arm's length price (ALP) in relation to the international transaction detailed in the audit report in Form No. 3CEB. It is found that the TPO has made an adjustment of Rs.2,29,09,780/- only in respect of purchase of raw materials. He held the purchase of finished goods and reimbursement to be at ALP.

3.1 It is found by the TPO that the appellant manufactures and sells finished formulations in India. It carries out secondary manufacturing of finished formulations using basic raw materials (called actives) or molecules discovered and developed by SP as well as locally purchased actives. During FY 2002-03, the appellant entered into international transaction i.e. purchase of raw material with its AEs for manufacturing finished formulations to be sold in India. The appellant has considered cost-plus-method (CPM) as the most appropriate method to determine the ALP for the said international transaction. The gross profit mark-up to direct and indirect cost of production of the AE manufacturing segment (manufacturing segment having international transaction) as the profit level indicator ('PLI') has been benchmarked against the gross profit mark-up to direct and indirect cost of production of the non-AE segment (manufacturing segment having international transaction). The PLI of the appellant is 56.45% in the AE segment vis-à-vis 27.54% in the non-AE segment and hence, the assessee has concluded that its transactions are at arm's length.

During the course of proceedings, the TPO issued notice u/s 133(6) to a number of cases to find out the rates at which these products are imported by other comparable companies. Details of import of two materials viz Netilmicin Sulphate and Mometasone Furoate were obtained. The value of import in respect of these two items along with quantity and amount as recorded by the TPO are as under :

Sl No.	Active Ingredient	Unrelated companies				FIL
		Name of the Case	Quantity (Kg)	Price per Kg. (USD)	Quantity (Kg)	Price per Kg (USD)
1.	Netilmicin Sulphate	Cipla Ltd.	16	2,060	30.4	12,500
2.	Mometasone Furoate	Ranbaxy Laboratories Ltd.	2.5	11,000	4.8	45,000

The TPO observed that the appellant has paid @ 12,500 USD per Kg. Netilmicin Sulphate (6.07 times) and 45,000 USD for Mometasone Furoate (4.09 times), whereas unrelated companies have paid much lower price.

During the course of proceedings before the TPO, the appellant submitted that it has chosen CPM by dividing the manufacturing segment into two parts viz gross margin earned when raw material is purchased from AE with its gross margin earned when the transaction is with non-AE. It was submitted before the TPO that even if the margin is higher in the AE segment vis-à-vis non-AE segment, the facts are that –

- Each product is having different composition of raw materials, different direct & indirect costs of production and last, but not the least, the price realized by each product will also be different because of innumerable reasons.
- The gross margin does not depend only on the raw material.
- The raw materials purchased from AE and non-AEs are different.
- The products made from these raw materials are also different.
- The market share of each product will be different.

- Each product will be catering to some specific disease and hence, may command different margins.
- It is well known fact that each product made by any company will give different margins. The companies make healthy margin in some products in which it is well established whereas it may make a thin margin or may sell at loss also, sometimes, to get a foothold in the market so that it can reap the benefits on a later stage.

However, the TPO was not convinced with the above explanation of the appellant for the reason that in the instant case the raw material imported by the appellant has been imported by other comparable companies at significantly lower price and therefore a direct comparison of the rates is available and in that context CUP is the most appropriate method. In respect of Netilmicin Sulphate the appellant has made payment to its AEs in excess of USD 10,440 per Kg. Similarly in respect of Mometasone Furorate, it has made payment to its AEs in excess of USD 34,000 per Kg. Therefore, the TPO made a total adjustment of Rs.2,29,09,780/- to the total income shown by the appellant.

The AO followed the above order of the TPO and made similar addition of Rs.2,29,09,780/- u/s 92CA in the order dated 29.03.2006 passed u/s 143(3) of the Act.

4. Aggrieved by the order of the AO, the appellant filed an appeal before the CIT(A). During the course of appellate proceedings, considering the appellant's submissions, the CIT(A) directed the TPO to make an inquiry u/s 250(4) of the Act and send a remand report. The direction so given are at para 8 of the order dated 10.06.2011 passed by

the CIT(A). It contains *inter-alia* the argument of the appellant on the purchase prices of generic APIs obtained from third parties by issuing notice u/s 133(6) of the Act. In response to it, the TPO submitted an interim report and a final report. In the said report, the TPO stated that the information called for u/s 133(6) has been duly confronted to the appellant and sufficient time was given to rebut the same. A copy of the interim report dated 16.08.2010 and final report dated 22.02.2011 were handed over by the CIT(A) to the appellant on 5.5.2011 to file reply, if any. The appellant filed a reply which is at para 3.1.2 of the appellate order.

Having examined the remand report and contentions of the appellant, the Ld. CIT(A) held that (i) CUP method is the 'most appropriate method' to determine the ALP in the case of generic drug manufacturers so long as comparables are available; as the API imported by the appellant was a generic drug and not patent protected, the CUP method could be used, (ii) the argument of the appellant that APIs are 'unique' on the ground that they are better, of proven effectiveness and manufactured using WHO-GMP practices is not acceptable because while the high quality standard dosages confer a certain degree of comfort, it does not affect the comparability of the API with the same API manufactured by competitors, (iii) the prices at which the generic drugs were purchased by the appellant from its AEs were not driven by market forces but on considerations which had no role in a typical arm's length transaction, (iv) the appellant's AE has reduced prices of APIs to compensate the appellant for the low selling price of the drugs which

would not have happened in an arm's length transaction ; the price movements and demand sensitivity to the price indicate that the APIs imported by the appellant were not unique items and that such business models being adopted by pharmaceutical companies leave ample scope for them to manipulate API prices so as to regulate profitability of their controlled entities in the end use jurisdiction, (v) the facts that another arm of the government (Customs) considered the price paid by the appellant to be ALP does not mean that the appellant is relived of the burden of establishing that it is an ALP for transfer pricing purposes, (vi) in respect of the issues regarding reliable accurate adjustments to be made as per Rule 10B(3) of the Rules, the appellant has not given as to what could be the reliable adjustment in this case and further how such an adjustment, if at all existing, are justifiable in the facts of the case.

Accordingly, the Ld. CIT(A) confirmed the adjustment of Rs.2,29,09,780/- made by the AO.

5. Before us, the Ld. counsels for the appellant submit that CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transactions in comparable circumstances. The CUP method requires a high degree of comparability in the products sold or services provided in the controlled and uncontrolled transactions. This standard of comparability is ordinarily extremely difficult to meet. Further, it is explained that the arm's length per unit prices to uncontrolled enterprises is substantially dependent upon factors such as volume, contractual terms, locational differences etc.

and it may not be possible to estimate with reasonable reliability and accuracy, the combined effect of such factors on per unit prices and further, abstract factors such as use of intangibles, makes it difficult to use CUP method for benchmarking purposes.

Referring to the distinction between 'internal comparable' and 'external comparable' the Ld. counsels explain that generally specific details regarding the product or service, contractual terms, geographic market, and other factors involved in internal comparables are more readily available to the parties engaged in the controlled transaction than details regarding such factors for external comparables.

Referring to the case of the appellant, it is submitted by them that (i) it does not purchase these active ingredients from any unrelated party and hence internal CUP has not been considered for these transactions, (ii) as for external CUP, the information on prices and other conditions for purchase of actives at which third parties transact is not available in the public domain and hence external CUP cannot be applied and (iii) accordingly, the CUP method was not considered as the most appropriate method to determine a reliable arm's length benchmark for the operating results of the appellant's manufacturing segment.

Referring to the Cost-Plus-Method (CPM), the Ld. counsels explain that it provides a reliable measure of determining the arm's length result of appellant's manufacturing segment. It is elaborated by them that (i) the CP method examines the gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or

provisions of the same or similar property or service by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, (ii) the appellant imports its active ingredients from SP and since CP method gives the gross margin available after direct and indirect cost of production, which is a good measure of the compensation for the performance of the functions and risks assumed by the appellant, CP method has been selected as a preferred method for determining the arm's length results of the manufacturing segment of the appellant, (iii) based on the analysis of the appellant's overall manufacturing operations, it is understood that the appellant is operating under economic and commercial factors that may be unique to the company.

Thus it is stated by the ld. counsels that the return on direct and indirect cost of production for the AE segment is 56.45% which is higher than the arm's length return of 27.54% earned in the non-AE segment and at the operating profit level also, the AE segment has performed better than the non-AE segment (operating margin of 1.44% in AE segment versus (-) 11.42% in non-AE segment).

The Ld. counsels referred to page, 37,40, 50, 52, 57, 58, 59, 60, 61, 86 of the Paper Book (P/B) filed before the Tribunal as well as before the lower authorities to explain their above contentions.

5.1 Also the Ld. counsels relied on the decision in *UCB India (P.) Ltd. v. ACIT* (2009) 121 ITD 131 (Mumbai-Trib); *DCIT v. Fresenius Kabi Oncology Ltd.* (ITA No. 575/Del/2014) for AY 2005-06 by ITAT Delhi; *Amphenon*

Inter-connect India (P.) Ltd. v. Addl. CIT (2015) 58 taxmann.com 168 (Pune-Trib); *Sony India (P.) Ltd. v. CBDT* (2006) 157 Taxman 125 (Del); *Fulford India Ltd. v. DCIT* (ITA No. 6733/Mum/2013) for AY 2002-03 by ITAT, Mumbai; *Firmenich Aromatics Productions (India) Pvt. Ltd. v. ITO* (ITA No. 7145/Mum/2017) for AY 2013-14 by ITAT, Mumbai; *Dishman Pharmaceuticals & Chemicals Ltd. v. DCIT* (ITA No. 955/Ahd/2012) for AY 2007-08 by ITAT Ahmadabad; *Serdia Pharmaceuticals (India) P. Ltd. v. ACIT* (2011) 136 TTJ (Mumbai) 129; *Commissioner of Central Excise v. Universal Glass Ltd.* (CA No. 894 of 2000) decided by Supreme Court of India; *DCIT v. UCB India Ltd*. (2016) 70 taxmnn.com 164 (Mumbai-Trib); *DCIT v. Dishman Pharmaceuticals & Chemicals Ltd*. (2019) 103 taxmann.com 271 (Ahmadabad-Trib); *Gulbrandsen Chemicals (P.) Ltd. v. DCIT* (2019) 104 taxmann.com 253 (Ahmadabad-Trib); *GS Caltex India (P.) Ltd. v. DCIT* (2018) 96 taxmann.com 614 (Mumbai-Trib) and *Welspun Zucchi Textiles Ltd. v. ACIT* (ITA No. 6539/Mum/2009) for AY 2005-06 by ITAT, Mumbai.

6. *Per contra* the Ld. DRs submit that only in AY 2003-04, the appellant has selected CPM as the most appropriate method ; in subsequent years 2004-05 onwards, it rejected CPM as most appropriate method and instead selected TNMM for same APIs. Thus it is argued by them that this change in stand clearly establishes that selection of CPM as the most appropriate method during the year is not correct and deserves to be rejected as same APIs are involved in subsequent years too.

Referring to CPM, the Ld. DRs submit that as per Rule 10B(1)(c) this method is to be adopted in the case of supply of property or services

to an AE and not to be applied when the enterprise is in receipt of such property or services from an AE as in the instant case. It is further stated by them that the appellant in the present case has artificially divided the manufacturing segments in the two parts (i) with raw materials purchased from AE and (ii) with raw material purchased from non-AE and therefore, the two artificially segregated limbs are compared at gross margin value.

Contending that CPM cannot be applied in the instant case, the Ld. DRs explain that FIL's products mix clearly indicate that the manufactured products are distinct anti-infectives, dermatological, oral steroid and anti-histamine medicines having distinct process, patent, formulations and regulatory requirements. Relying on the decision in the case of *Knorr Bremse India (P.) Ltd*. (2015) 63 taxmann.com 186 (P&H), the Ld. DRs submit that several transactions can form a single composite transaction only if such transactions are inter-linked and inter-oven. Thus it is explained by them that in the instant case CPM is impossible to apply as import of Mometosone, Netlimycin and Dexchlorpheniramine Maleate are distinct international transaction being distinct APIs, governed by distinct product specifications and pricing regulations of exporting as well as importing countries and entirely distinct process through which the end products are manufactured. Hence, their manufacturing into final products cannot be clubbed together to compare gross profits with gross profit of manufacturing of products related to distinct generic or APIs procured from non-AEs.

It is further argued by the Ld. DRs that there is no basis of allocation of operating expenses between AE and non-AE manufacturing segment as Form 3CEB neither recognizes any segmental result nor makes such artificial bifurcation. When the manufacturing centre (Gland Pharma Ltd.) is the same such an attempt will be just an estimation of operating cost among different products.

The Ld. DRs further submit that since APIs imported from AE are off patented and the generic products are easily available in the foreign market as imported by Cipla and Ranbaxy, it is not difficulty for any manufacturer of the formulation to ascertain the rate of such off patented APIs/generic products, since customs data is always available in the public domain.

Referring to the issue, it is explained by them that generics contain same active ingredients as the original formulations and similar in terms of purity, efficacy, dosages form, route of administration, quality and performance characteristics. Same APIs/generics imported by different companies lead to similar generic drugs with different brand names. On the issue of APIs being imported and appellant being the tested party, it is contended by the Ld. DRs that market conditions and regulations in the territory of sale are to be seen for comparability analysis. Referring to the submission of the assessee, the Ld. DRs explain that even the appellant has recognized Cipla and Ranbaxy as the market leader.

The Ld. DRs further submit that it is the assessee which has failed to provide specific characteristics of APIs, contractual terms and other relevant factors of comparability before the TPO.

It is also submitted by them that if the appellant considers itself 'akin to value added distributor' with respect to APIs imported from AEs, it cannot compare the same with manufacturing segment of non-AE drugs as done in its transfer pricing study report and this change stand itself leads to rejection of CPM method as adopted by the appellant.

Finally, it is submitted by them that considering the strong comparability of the products/raw materials in question and the insignificant impact which may be there on account of the facts raised by the appellant i.e. higher standards applied in the manufacturing of the APIs by it's AE, the application of CUP method in this case deserves to be upheld.

The Ld. DRs rely on the decision in *Knorr Bremse India Pvt. Ltd.* (2015) 63 taxmann.com 186 (P&H); *Reliance Industries Ltd*. (2012) 28 taxmann.com 189 (Mumbai- Tribunal); *Noble Resources & Trading India (P.) Ltd* (2016) 70 taxmann.com 200 (Delhi- Trib); *Cargill Foods India Ltd*. (2015) 57 taxmann.com 330 (Pune-Trib); *Tilda Riceland Pvt. Ltd*. (ITA no. 6279/Del/2012) dated 21.02.2014; *Clear Plus India (P.) Ltd* (2011) 10 taxmann.com 249 (Delhi); *Serdia Pharmaceuticals (India) (P.) Ltd.* (2011) 9 taxmann.com 13 (Mumbai ITAT); *Merck Ltd*. (2016) 69 taxmann.com 45 (Mumbai); ITAT order in the assessee's case for A.Y. 2006-07 and A.Y. 2007-08.

7. We have heard the rival submissions and perused the relevant materials on record. The reasons for our decisions are given below. Herein we are concerned with *CPM vrs CUP*.

As mentioned earlier, the Ld. CIT(A), during the course of appellate proceedings, had asked the AO to make further inquiry and submit a remand report u/s 250(4) of the Act. After receipt of the said remand report, he provided a copy of it to the appellant for its comment/reply. Then after receipt of the said reply from the appellant he has passed the order dated 10.06.2011. Therefore, the ground regarding not being given reasonable opportunity of being heard does not arise.

7.1 At this moment, we discuss the case laws relied on by the Ld. counsels.

In *UCB India (P.) Ltd* (supra), the assessee an Indian company was a 100% subsidiary of UCB Belgium (UCB). It was engaged in the business of manufacture and distribution of pharmaceutical products in three main therpatic segment of : allergy and asthama, central nervous system and internal medicines. The assessee manufactured intermediates, bulk drugs and formulations, both in the tablet and capsule form at its own factory. The liquid and injectible form of the products were manufactured on toll basis by third parties. The assessee manufactured some of the active ingredients required for manufacturing of formulations and certain other ingredients were imported by it from its parent company, or were procured locally from third parties. The assessee also imported certain finished formulations from its parent company. Such imports constituted

a small portion of the turnover of the assessee. The assessee marketed its formulations in the domestic market as well as in overseas markets such as Sri Lanka, Bangladesh and Nepal. It had entered into international transactions of purchase of raw material; with its Associated Enterprises (AE). The main items imported were "Piracetam" and "Mesna", which are an Active Pharmaceutical Ingredient (API). The assessee adopted Transactional Net Margin Method (TNMM) for determination of its ALP in connection with its international transaction relating to import of said raw materials from its AEs. The TPO, however, adopted Comparable Uncontrolled Price Method (CUP). On appeal, the CIT(A) rejected various contentions of the assessee and confirmed the findings of the TPO. In further appeal, the Tribunal held that (i) the assessee was in error in comparing the operational margin at the entity level and terming it as TNMM and the adoption of such method was to be rejected, (ii) on the facts and circumstances of the case, the adoption of CUP method by the revenue could also not be considered as the most appropriate method as the same suffered from many deficiencies and infirmities and specifically lack of information and data on comparables. Under these circumstances, the Tribunal remanded the issue to the file of the TPO for fresh adjudication in accordance with law after giving adequate opportunity to the assessee, with the following directions :

a. The assessee should be allowed to file a fresh transfer pricing study report and any other document or evidence, which it could seek to furnish, for the first time, in support of its report and the Assessing Office shall take the same on record and examine the same.

b. The assessee would be free to adopt any method as prescribed by law, if it considered that method as the most appropriate method. TNMM might also be considered, if the transaction or a class of transactions were properly evaluated in accordance with law. In case external comparables were not available due to lack of data in public domain, the Assessing Officer might accept internal comparables including segmental data or internal TNMM.

In *Fresenius Kabi Oncology Ltd*. (supra), the assessee had entered into international transactions with two AEs namely Dabur Oncology PLC and Dabur Neparl Pvt. Ltd. The assessee had adopted TNMM with operating profit earned on sales as the PLI. However, the TPO was not convinced with the above method of the assessee and in turn adopted the CUP method. In appeal, the Ld. CIT(A) deleted the transfer pricing adjustment made by the TPO on this account. The Tribunal, observing that CUP method requires strict compliance and the same was not done by the TPO, affirmed the order of the Ld. CIT(A).

In *Amphenol Interconnect India (P.) Ltd*. (supra), the assessee, a wholly own subsidiary, was engaged in the manufacturing of broad range of inter-connected products and assemblies for voice, video and data communication systems. In appeal, the Tribunal held that "where prices vary on account of various issues i.e. timing of transaction, volume of order and geographical location, then CUP method cannot be applied and it is most appropriate to apply TNMM method."

In *Sony India (P.) Ltd.* (supra), the assessee-company challenged constitutional validity of Instruction No. 3 dated 20.05.2003 issued by CBDT mainly on the ground that by issuance of said Circular, the

Assessing Officer's ultimate decision on computation of ALP is sought to be supplanted by decision of TPO for transactions of value Rs.5 crores and TPO is not bound to follow steps outlined in section 92C which are otherwise mandatory for the AO to follow. The Hon'ble High Court held that the Instruction in question is consistent with statutory objective underlying section 92CA(1) and acts as a guidance to the Assessing Officer in exercise of discretion in referring an international transaction to TPO for determination of its ALP and it is neither arbitrary nor unreasonable and is not *ultra vires* the Act.

In *Amphenon Inter-connect India* (supra), the assessee was engaged in the business of manufacturing of electric connectors, accessories, cable assemblies and system integration for application in various industries. The Hon'ble High Court held that 'where goods exported by assessee to its AE were customized goods and there were geographical differences, volume differences, timing differences, risk differences and functional differences, TNMM would be the most appropriate method".

In *Fulford India Ltd*. (supra) the issues before the Tribunal were (i) addition of Rs.18,25,861/- u/s 68 of the Act (ii) disallowance of business loss/deduction arising as a result of write off of its inventory in the form of finished goods and WIP, and (iii) increase in the opening stock consequent to increase in the closing stock of previous year.

In *Firmenich Aromatics Productions (India) Pvt. Ltd.* (supra), the assessee is engaged in the business of manufacturing of aromatics ingredients, natural and synthetic perfumery, flavoring and derivatives.

The assessee selected TNMM as the most appropriate method for determining ALP of its international transactions with PLI of OP/OC. The TPO applied CUP for 30% of its transactions and TNMM for the rest of the transactions, which eventually led to application of two methods for the same transaction. The Tribunal upheld the stand of the assessee that TNMM is the most appropriate method to arrive at the ALP.

In *Dishman Pharmaceuticals & Chemicals Ltd*. (supra), the assessee adopted TNMM as the most appropriate method. The TPO did not accept TNMM adopted by the assessee for benchmarking of its transactions with its AE. Instead, the TPO changed the method from TNMM to CUP and thereafter, recommended adjustment. The Tribunal, observing that there is no disparity on facts from earlier years affirmed the order of the CIT(A) by holding that the benchmarking on sale price of various products to AEs is to be tested following TNMM.

In *Serdia Pharmaceuticals (India) P. Ltd*. (supra), the Tribunal held that the choice of method of determination of ALP is not an unfettered choice on the part of the taxpayer and this choice has to be exercised on the touchstone of principles governing selection of most appropriate method set out in section 92C(1); where the AO finds that the selection of most appropriate method is not correct, he has the powers as well as corresponding duty to select the most appropriate method and compute the ALP by applying that method. Also it held that as long as appropriate comparables can be found, CUP method will indeed be the most appropriate method in respect of purchase of generic drug, even when such a generic drug is manufactured by its original patent holder;

assessee having imported two active pharmaceutical ingredients (API) from its AEs, CUP method was the most appropriate method for determining the ALP, and the selling prices of related APIs in Indian market constitute good comparables for applying the said method.

In *Universal Glass Ltd.* (supra), the issue before the Supreme Court was whether M/s Universal Glass Ltd. (assessee herein) was right in valuing the bottles manufactured and supplied by them to M/s Jagatjit Industries Ltd. by relying upon the prices charged by the assessee to companies like Dabur, Hamdard, Maaza, Kissan etc. under Rule 6(b)(i) of the Central Excise (Valuation) Rules, 1975. The Hon'ble Supreme Court held that since there were no comparable prices available for determining the normal price under Rule 6(b)(i), the only alternative was to decide the value under Rule 6(b)(ii) by adopting the best judgment principle based on the cost of production and the profits which the assessee would have earned. In the instant case comparable prices are available and therefore the above decision in the context of Central Excise (Valuation) Rules, 1975 is not applicable here.

In *UCB India Ltd*. (supra), the assessee-company was a 100% subsidiary of UCB SA, Belgium. It important APIs (including Piracetam) from its AEs for manufacture and sale of finished drug formulation. The assessee benchmarked the transaction using TNMM. In transfer pricing proceedings, the TPO adopted CUP method for determining ALP. The Tribunal held that "where in respect of a drug formulation imported by assessee-company from its AE, TPO made certain addition to ALP by applying CUP method without commenting upon quality, potency and

other parameters of product purchased by comparables, impugned addition made by the TPO was to be set aside."

In *Dishman Pharmaceuticals & Chemicals Ltd*. (supra), the assessee was engaged in business of manufacturing bulk drugs and fine chemicals. During the relevant year, the assessee sold some of those drugs to its AEs abroad. In order to benchmark said transactions, assessee adopted TNMM as the most appropriate method. However, TPO took a view that since assessee had sold identical products to non-AEs i.e. independent parties, prices at which such sales to independent parties had taken place provided valid inputs for application of CUP method ; thus he applied CUP method and made certain addition to the assessee's ALP. The Tribunal held that "while determining ALP, nature of trade relationship in sense of its impact on functions, asset and risk assumed by AEs have crucial bearing on prices and unless these vital factors are taken into account, application of CUP has no usefulness and since TPO while applying CUP method did not take into consideration aforesaid aspects of case, impugned order passed by him deserved to be set aside."

In *Gulbrandsen Chemicals (P.) Ltd.* (supra), the assessee was engaged in the manufacturing of chemicals for its divergent industrial customers and it sold those products to its AEs located in USA, UK. In transfer pricing proceedings, the TPO noticed that the assessee deviated from stand taken in the earlier years in which internal CUP method was adopted for benchmarking the sale to the AEs and instead computed the ALP of those transactions on the basis of TNMM. However, the TPO was not convinced with the method adopted by the assessee and was of the

view that the internal CUP was the most appropriate method. The Tribunal held that "no addition could be made to the assessee's ALP on the basis of internal CUP method where intra AE transactions were fundamentally different in character and same could not be compared with independent transaction."

In *CS Caltex India (P.) Ltd*. (supra), the assessee was engaged in business of procuring/importing lubricants in bulk from its parent company. The Tribunal held that "CUP method requires high degree of comparison of product/services, geographies and other attributes such as scale of operations, type of market and TNMM will compare operating margins of assessee's business with that of operating margins of companies operating in similar business."

In *Welspun Zucchi Textiles Ltd*. (supra), the assessee was engaged in the business of manufacturing of bathrobes. During the year under consideration, the assessee had exported bathrobes to its AEs. The said transactions were benchmarked by the assessee using CUP method as the most appropriate method. The TPO did not find the stand of the assessee to be acceptable. He adopted TNMM as the most appropriate method. In appeal, the CIT(A) upheld the action of the AO in rejecting the CUP method for benchmarking and applying TNMM. In further appeal, the Tribunal found no infirmity in the order of the CIT(A) confirming the action of the AO in rejecting CUP method for benchmarking and applying TNMM and thus upheld the same.

7.2 Now we turn to the case laws relied on by the Ld. DR.

In *Knorr-Bremse India Pvt. Ltd*. (supra), the assessee carried on business *inter alia* of manufacturing air brake sets for passenger cars and wagon coaches etc. It adopted TNMM as the most appropriate method for benchmarking its activities under the manufacturing and distribution segments. However, the TPO adopted CUP method. The Hon'ble Punjab & Haryana High Court held *inter alia* that several transactions between 'two or more' AEs can form a single composite transaction if such transactions are closely linked.

In *Reliance Industries Ltd.* (supra), the Tribunal held that actuals have to be taken to arrive at correct cost since 'cost plus' method does not contemplate estimation of cost.

In *Noble Resources & Trading India (P.) Ltd*. (supra), the Tribunal held that in case of assessee-company engaged in international transactions of import and export of various agro commodities with AE, CUP was to be applied as the most appropriate method for determining ALP.

In *Cargill Foods India Ltd*. (supra), the Tribunal held that (i) in a case where comparable uncontrolled transaction is possible to identify and locate, CUP method would be most reliable measure of ALP in relation to tested international transaction, (ii) where product i.e. Oil, being transacted is commodity recognized for trading in commodity exchange, price quotation of such exchanges would be relevant material for purposes of carrying out comparability analysis in course of a application of CUP method.

In *Tilda Riceland Pvt. Ltd*. (supra), the assessee is an exporter of brown basmati rice and milled basmati rice to its AEs. It was the contention of the assessee that CUP, being a direct and traditional method is preferable over an indirect method like TNMM. However, the TPO adopted TNMM on the entity level. The Tribunal upheld the CUP method in principle but restored the issue to the file of the AO for determination of ALP as per observations made therein.

In *Clear Plus India (P.) Ltd* (supra), the assessee manufactured all seasons wipers and snow wipers which were exported to AEs. It adopted CUP method for determining sale price of automobile wipers. However, the TPO adopted TNMM for determining the ALP. The Tribunal held that on facts CUP method was most suitable method for determining ALP.

In *Serdia Pharmaceuticals (India) (P.) Ltd.* (supra), The taxpayer, i.e. Serdia Pharmaceuticals India Private Limited (Serdia, in short), is a company incorporated in India and 74% of its share capital is held by Servier International BV (Servier BV, in short), a company incorporated in the Netherlands, and the remaining 26% of its share capital is held by a Mauritius based company by the name of Serdia (Mauritius) Limited. Servier BV, in turn, is a subsidiary of Les Laboratoires Servier France (Servier France, in short), a well-known pharmaceutical company which is said to have its presence in more than 140 countries worldwide, including in Egypt by way of a subsidiary in the name of Servier Egypt Industries Ltd Egypt (Servier Egypt, in short). Serdia is enagegd in the business of producing drugs mainly in the field of anti-hypertension and metabolism. It produces and markets drugs in finished dosage forms

(FDFs), which is what a drug is called when it is ready for end use by the consumer, and in the process of producing these FDFs, the assessee imports active pharmaceutical ingredient (API) from Servier France and Servier Egypt. Serdia is engaged in secondary manufacturing process in the sense it does import the active pharmaceutical ingredients, puts them in a delivery mechanism by combining them with excipients, and thus produce the FDF, i.e. finished dosage form, for consumption by the end user. The FDF is produced and marketed by Serdia, while the API is imported from its AEs. So far as the dispute in the first year, i.e. assessment year 2002-03, is concerned, the FDFs produced by Serdia are Flavedon 20, Flavedon MR (in which Trimetazidine is used as API) and Natrilix and Natrilix SR (in which Indapamide is used as API). In the next two years, i.e. assessment years 2003-04 and 2004-05, the dispute extends to FDF Diamicron and Diamacron MR, which has Gliclazide as API. The issue in dispute is the arm's length price of the above three APIs, i.e. Trimetazidine, Indapamide and Gliclazide, that Serdia is importing from its AEs – namely Servier France and Servier Egypt. The TPO, by adopting CUP method recommended TP adjustment of Rs. 1.95 crores which was accepted by the AO. On appeal, the CIT(A) confirmed the order of the AO. The Tribunal held that as long as appropriate comparables can be found, CUP method is the most appropriate method in respect of purchases of generic drug, even when such a generic drug is manufactured by its original patent holder. It further held that since the APIs in instant case, were generic drugs at relevant point of time and not patent protected, TPO was justified in determining ALP of APIs on basis of

CUP method and selling price of related APIs in Indian market constituted good comparable by applying the said method. Thus it confirmed the determination of ALP by the TPO as sustained by the CIT(A).

In *Merck Ltd*. (supra), the assessee-company is a subsidiary of Merck KgaA, Germany. During the relevant financial period, the assessee imported Bisoprolol Fumerate, an active pharmaceutical ingredient (API) used in manufacturing of finished dosage form (FDF) of medicine. These imports were made from an associated enterprise, i.e. Merck &CIE KG, Switzerland. The total imports during the financial period was 345 kgs for an aggregate consideration of Rs 2,30,12,198. The average cost of this API thus comes to Rs 66,702 per kg. The assessee had claimed these imports to be at arm's length price on the basis of TNMM as OP/OI of the assessee was 12.17% in the pharmaceutical segment, as against the arithmetic mean of 64 comparables which came to 12.30%. However, relying upon the decision of this Tribunal in the case of *Serdia Pharmaceuticals India Pvt Ltd vs ACIT* [(2011) 44 SOT 391 (Mum) holding that CUP method is the most appropriate method for determining arm's length price in the case of generic APIs and armed with the requisite CUP inputs gathered by him under section 133(6), the Transfer Pricing Officer proceeded to compute the arm's length price under CUP method. As number of comparable uncontrolled prices for small quantities as well, the Transfer Pricing Officer adopted the arithmetic mean of prices of Bisoprolol, in the cases where quantities were more than 20 kgs., in the cases of inland sales as also exports. This amount came to Rs 36,831 per kg. The CUP was thus adopted at Rs 36,831 and the arm's length price for purchase of 345

kg was adopted at Rs 1,27,06,695, and the amount paid in excess of this amount, i.e. Rs 1,03,05,503 was recommended for an arm's length price adjustment. When the Assessing Officer proposed to make this ALP adjustment in the daft assessment order, assessee raised an objection before the Dispute Resolution Panel. While the DRP upheld the application of CUP as the most appropriate method, and the course thus adopted by the TPO, the DRP did direct that appropriate adjustment for the quality difference be given. This was to be done in the light of the directions given by the CIT(A) for the assessment year 2004-05. However, the directions given by the CIT(A) for the assessment year 2004-05 were with respect to adoption of simple arithmetic mean rather than weighted average. The contention regarding the API imported by the assessee being of superior quality was categorically rejected by the CIT(A), in his order for the assessment year 2004-05. The Assessing Officer, in response to these directions, computed a relief of Rs 35,35,560 since the ALP based on the simple arithmetic mean was Rs 47,079, as against the ALP based on weighted arithmetic mean which was Rs 36,831, and this difference of Rs 10,248 per kg, for 345 kgs. of imports worked out to Rs 35,35,560. The balance ALP adjustment, i.e. Rs 1,03,05,503 *minus* Rs 35,35,560, of Rs 67,69,943 was thus confirmed for the assessment year 2010-11. As regards the assessment year 2009-10, the ALP adjustment on the same line and in respect of the same API, of Rs 69,76,105 was computed on the basis of simple arithmetic mean of Rs 44,401. The assessee was not satisfied and filed appeal before the Tribunal. The Assessing Officer also filed appeal, so far as the assessment

year 2010-11 is concerned, on the short point that the TPO should have computed weighted average rather than simple average. The Assessing Officer also filed appeal on the DRP's directing that the ALP adjustment being restricted to actual consumption of the API from the AE rather than the total imports of the API from the AE. The Tribunal held that (i) where assessee imported API from its AE which was superior in quality in comparison with locally manufactured API, adjustment for quality was justified, (ii) import price of API can be compared only with domestic prices and cannot be compared with export prices, (iii) where weighted arithmetic mean of comparable prices cannot be used to determine ALP only simple arithmetic mean can be used, (iv) where assessee imported API from its AE, use of CUP method to determine ALP was justified.

In *Fulford (India) Ltd*. (supra), for AY 2006-07 and 2007-08, the Tribunal restored the issues to the file of the AO/TPO for fresh adjudication.

7.3 What is an API ? It has been aptly explained at para 5 in *Serdia Phamaceuticals (India) (P.) Ltd.*(supra) which is reproduced below:-

> "An API may be a patented or generic. A patented API can be produced by the patent holder, and this monopoly allows the pharmaceutical company, which developed the drug, to sell it in a monopoly market and thus allows the company to recoup the cost of developing that particular drug by selling the drug in monopolistic conditions. The patents, however, do not last forever, and the patents have geographical limitations too. Once patent on an API expires or is not valid in a particular geographical location, any pharmaceutical company can manufacture and sell that API. The API then becomes generic in nature,

and the expiration, or inapplicability, of the patent, ends the monopoly of the patent holder."

7.4 Let us examine the cost plus method adopted by the appellant.

The manufactured products as given by FIL (at page 84 of *P/B*) are as under :

Sr. No.	Therapeutic Segment	Product	Indication
1.	Systematic Anti-infectives	Garamycin/Gentamycin inj.	Antibiotic
2.	Systematic Anti-infectives	Netromycin inj.	Antibiotic
3.	Systematic Anti-infectives	Isepamycin	Oncology
4.	Dermatologicals	Elocon	Topical Application
5.	Dermatologicals	Ensamycin	Bacterial Infection
6.	Dermatologicals	Tinaderm	Ringworm Infection
7.	Dermatologicals	Emolene	Dry Skin
8.	Dermatologicals	Shade	Sunscreen Lotion
9.	Oral Steroids	Celestone	Cortico-steroid
10.	Anti-Histamine	Polaramine	Allergy
11.	Anti-Histamine	Alaspan	Allergic Rhinitis
12.	Anti-Histamine	ZadineSyp./Tablet	General Allergy
13.	Others	Drogenil	Antiandrogen-Oncology
14.	Others	Plarium	Anti-Inflamatory

Then the segmental financial information of the appellant for the year ended 31.03.2003 (at page 86 of *P/B*) as reported by the appellant (amount in Rupees '000) are produced below :

Profit & Loss Account	Year ended March 31, 2003	
	Manufacturing Segment	
	AE	Non-AE
Gross Sales (A)	132,515	105,996
Less : Excise duty on goods sold (B)	18,424	14,686

Net Sales	114,091	91,310
Less : Cost of goods sold (C)	66,543	71,265
Gross Profit (D)	47,812	22,886
Operating Expenses (E)	45,907	34,996
Operating Profit (D-E)	1,905	(12,110)
Add : Other Income		
Less : Interest		
Less : Exceptional Items		
Profit Before Tax (PBT)		
Gross Profit/Direct and indirect costs of production	56.45%	27.54%

The application of Cost Plus Method (CPM) provides for (i) ascertaining the direct and indirect costs of property transferred, or services rendered, to the associated enterprises; (ii) ascertaining the normal mark up of profit over aggregate of direct costs and indirect costs in respect of same or similar property or services, or a series of transactions of same or similar property or services, to the unrelated enterprises ; (iii) adjusting the normal mark up, or gross profit, for differences, if any, in the material factors (to give simple examples of such variations, these variations could be risk profile, credit period, market differences, nature of goods or services etc.) ; (iv) applying the mark up or gross profit so arrived at on the aggregate of direct and indirect costs.

The benchmark gross profit in CPM is to be applied on each transaction with AEs. For computing the benchmark, one could take into account a series of same or similar transactions. The application of CPM has to be on transaction basis rather than on global basis, and this

fundamental scheme of CPM is also evident from the plain wordings of Rule 10B which reads as under :

"Cost plus method, by which, -

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 transaction 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."

In the instant case, the appellant's therapeutic segment are distinct i.e. systematic anti-infectives, dermatologicals, oral steroids, anti-histamine having distinct process, patent, formulations and regulatory requirements. Thus CPM is not the appropriate method in the instant case. Accordingly, their manufacturing into final product cannot be clubbed together to compare gross profits with gross profits of

manufacturing of products related to distinct generic or APIs procured from non-AEs.

In the case of *Knorr-Bremse India (P.) Ltd*. (supra), it is held by the Hon'ble Punjab & Haryana High Court that several transactions between 'two or more' AEs can form a single composite transaction, if such transactions are closely linked. It is not so in the case of segmented financial information (manufacturing segment) of the appellant for the year ended 31.03.2003.

Thus the segmented financial information (manufacturing segment) of the appellant for the year ended 31.03.2003 suffers from the above infirmities and therefore does not give a true and fair view. The above ground of appeal can be seen through the lens of deductive inference, in which it is asserted that the conclusion is guaranteed to be true if the premises are true. Here the inference drawn by the appellant is not correct one as it is based on wrong premise.

As a logical corollary, the case-laws relied on by both sides, as narrated hereinbefore, are to be examined for their relevance/applicability to the facts of the present case.

Let us read the suitability of CPM. This method is to be adopted only in cases of supply of property or services to an AE. This method is not to be applied when the enterprise is in receipt of property or services from an AE. Thus the facts in the instant case are not suitable for adoption of CPM.

7.5 The CUP method compares the price charged for goods, property or services transferred between related parties (controlled transaction) to the price charged for similar goods, property or services transferred between independent third parties (comparable controlled transaction) in comparable circumstances and conditions.

We have narrated here-in-before the case laws relied on by the Ld. counsels and Ld. DR. We find that similar issue arose before the Tribunal in the case of *Serdia Pharmaceuticals (India) (P.) Ltd*. (supra) and *Merck Ltd.* (supra).

Serdia is engaged in secondary manufacturing process in the sense it does import the active pharmaceutical ingredients, puts them in a delivery mechanism by combining them with excipients, and thus produce the FDF, i.e. finished dosage form, for consumption by the end user. The Tribunal dismissed the appeal of the assessee and confirmed the validity of CUP method followed by TPO for benchmarking the APIs imported by the assessee. In the above case, the Tribunal observed as under:

> "The TPO noted that while Indapamide was imported by assessee's competitor from Italy at the price of Rs 40,375 per kg , the assessee had imported by the same, from its AE, at the price of Rs 1,89,456 per kg. The TPO further noted that while the assessee had imported Trimetazidine from its Servier Egypt at the price of Rs 52,546 per kg, the same drug was sold by other vendors at much lower rates of Rs 8,150 per kg (Nivedita Chemicals Pvt Ltd), Rs 8,625 per kg (Sharon Pharmachem Limited), Rs 10,558 per kg (Orion) and Rs 11,000 per kg (Trichem)."

As visualized from the above, the rates of the drugs imported by Serdia(India) from its AEs were 5-6 times more than that purchased by the third parties.

In *Merck Ltd.* (supra), the assessee imported API from its AE for manufacture of medicine. The method adopted by the TPO is CUP method. DRP directed to make appropriate adjustment for quality difference between imported goods and comparable goods. On facts, product imported by assessee was superior to locally manufactured API. The TPO had himself allowed a quality adjustment @ 10% in subsequent year. The Tribunal confirmed CUP method and held that it was appropriate to adopt quality adjustment @ 10% in the that assessment year as well.

Facts being nearly identical, respectfully following the orders of the Co-ordinate Bench in *Serdia Pharmaceuticals (India) (P.) Ltd*. (supra) and *Merck Ltd.* (supra), we hold that CUP is the most appropriate method in the instant case.

However, adjustments under CUP method need to be examined by the AO/TPO for the reason that under the CUP method adjustments can be made for differences such as differences in the terms of contract, quantity sold or purchased, nature of market (retail or wholesale), credit period allowed, delivery terms, foreign currency risks etc. which might affect the price in the open market.

7.6 Accordingly, we hold that the TPO/AO has rightly adopted the CUP as the most appropriate method in the instant case with regard to

Netilmicin by the appellant vis-à-vis Cipla Ltd and Mometasone Furoate by the appellant vis-à-vis Ranbaxy Laboratories Ltd. However, as observed above by us adjustments under the CUP method need to be re-examined by the AO. Therefore, we restore the matter to the file of the AO to re-examine that under the CUP method adjustments can be made for differences such as differences in the terms of contract, quantity sold or purchased, nature of market (retail or wholesale), credit period allowed, delivery terms, foreign currency risks etc. which might affect the price in the open market. We direct the appellant to file the relevant documents/evidence before the AO. Needless to say the AO would give the relevant information and reasonable opportunity of being heard to the appellant before finalizing the order.

We also want to make it clear that all the cases relied on by both the sides have been duly taken into consideration while deciding the matter. The omission of reference to some of such cases in the order is either due to their irrelevance or to ease the order from the burden of the repetitive *ratio decidendi* laid down in such decisions.

Thus the 1st ground of appeal is partly allowed for statistical purposes.

8. <u>The 2nd ground of appeal</u>

> On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in upholding the disallowance of interest of Rs.18,22,861/- paid by the appellant on the deposit amount received by it from its prospective distributors.

That the disallowance of the said interest of Rs.18,22,861 is unjustified and should therefore be deleted.

9. The Ld. CIT(A) confirmed the disallowance of Rs.18,22,861/- taken from various parties on the ground that the appellant failed to file confirmations from them. It is the contentions of the Ld. counsels that as all the confirmations of the parties have been filed before the AO, the disallowance of interest of Rs.18,22,861/- be deleted.

Considering the above contentions of the Ld. counsels, we restore the matter to the file of the AO to verify the confirmations and pass an order as per the provisions of the Act, after giving reasonable opportunity of being heard to the appellant.

10. In the result, the appeal is partly allowed for statistical purposes.

Order pronounced in the open Court on 25/11/2019.

Sd/-	Sd/-
(SAKTIJIT DEY)	(N.K. PRADHAN)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai;
Dated: 25/11/2019
Rahul Sharma, Sr. P.S.

Copy of the Order forwarded to :

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

BY ORDER,

//True Copy//

(Dy. /Assistant Registrar)
ITAT, Mumbai