

international transactions were reported in Form No. 3CEB. The AO made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length Price (ALP) of the international transactions. In this appeal, we are concerned only with the first international transaction viz., 'Purchase of raw materials, finished goods, spares and consumables' with transacted value of Rs.18,05,55,266/-. The assessee applied the Comparable Uncontrolled Transaction (CUP) method for demonstrating that the international transaction was at ALP by mentioning in its Transfer Pricing Study Report that : 'MSIL has purchased raw material, finished goods and spares and consumables from its group entities for the F.Y. 2011-12. Mubea Group entities have sold identical or similar raw material/finished goods/spare parts/consumables to third parties as sold to MSIL and data for such transactions is available'. The TPO misjudged the transaction of purchase of raw materials and finished goods etc. as that of sales and rejected the CUP method with the observations given in para 6.1., which fairly indicate that the entire exercise done by him is in the realm of the assessee having made sales of raw materials and finished goods etc. to the Associated Enterprises (AEs) as against the actual transactions of purchase. After rejecting the CUP method, the TPO adopted Transactional Net Margin Method (TNMM) as the most appropriate method. He chose

six companies as comparables with their mean Operating Profit/Operating Cost at 10.47%. Applying it as the benchmark, he determined the ALP and notified the consequential transfer pricing adjustment at Rs.16,61,20,496/-. The Dispute Resolution Panel (DRP) corrected the TPO's misunderstanding of the nature of transaction as sale instead of the actual transaction of purchase. It however, did not countenance the CUP as the most appropriate method and approved the application of the TNMM. Out of six comparables chosen by the TPO, the DRP excluded three companies given at Sl. Nos. 1, 2 and 6 on pages 23 and 24 of the TPO's order. This is how, the AO passed the final assessment order determining the amount of transfer pricing adjustment at Rs.10,33,29,492/-, against which the assessee has come up in appeal before the Tribunal.

3. We have heard both the sides and gone through the relevant material on record. The assessee has raised two fold contentions. Firstly, that the CUP method should be applied for determining the ALP of the international transaction and secondly, in the alternative and without prejudice, if the TNMM is to be applied, then the transfer pricing adjustment should be restricted to proportionate basis. We proceed to examine and evaluate the contentions.

I. WHETHER CUP IS THE MOST APPROPRIATE METHOD:

4. It is seen that the assessee applied the CUP as the most appropriate method, which got repelled at the hands of the authorities below. In order to properly appreciate the contentions, it would be befitting to note the mechanism for determining the ALP under the CUP method as enshrined under Rule 10B(1)(a). It contemplates comparing the price paid in an international transaction with the price paid in a comparable uncontrolled transaction by further providing that if there are differences in the international transaction and the comparable uncontrolled transaction which materially affect the price, then the price of the comparable uncontrolled transaction should be suitably adjusted so as to render it fit for comparison with the price paid in an international transaction.

5. The assessee purchased raw materials, finished goods, spares and consumables aggregating to Rs.18.05 crore from its AEs. The major component is purchase of raw material from four AEs, namely, each from Spain, USA, China and Germany, totaling Rs.15.08 crore. The assessee purchased finished goods from two AEs, namely, each from Germany and Italy amounting to Rs.2.87 crore. The assessee purchased Stores, spares and consumables for the remaining trivial amount from its AEs.

6. Firstly, we espouse the purchase of raw materials. The assessee purchased different types of raw materials from the four AEs situated in different countries and then in order to prove that the purchase transactions of raw material were at ALP, it applied the CUP method by comparing the price paid in transactions with all the four AEs with the price charged by German AE from a German non-AE, namely, 'H&R Spezialfedern'. The purchase by the assessee from its German AE is only worth 1,224 Euros as against the sale made by German AE to a German non-AEs at 20,85,856 Euros. It is on the basis of this price charged by the German AE from a German Non-AE that the assessee tried to show that its purchases of raw materials from all the four AEs were at the ALP. We have examined some of the invoices raised on the assessee by two AEs, namely, from Spain and China. The assessee purchased Steel Wire in Coil from its AE in Spain in different diameters @ 1170 Euros per 1000 kgs. This rate prevailed upto 31st December, after which the rate was slashed down to 1100 Euros per 1000 kgs. Insofar as purchases from Chinese AE are concerned, the assessee purchased ITW (Induction Tampered Wire) with different dimensions at 1580 Euros per 1000 kgs. This rate continued upto December, after which it was reduced to 1331 Euros from 1000 kgs. The assessee has not furnished any invoice of import from its US and German AEs. The DRP has tabulated the

assessee's submission on page 5 of its directions giving break-up of total value of purchases, quantity, and average price paid by the assessee to its four AEs with the price charged by the German AE from a non-AE. On an analysis of the table, it emerges that the assessee purchased total of 16,87,501 kgs from its AE in Spain; 2,54,113 kgs from its AE in the USA; 1,14,947 kgs from its Chinese AE; and 1,000 kgs from its German AE. In the name of comparable uncontrolled transaction, the assessee has given only the transactions of sale made by its German AE to some German non-AE. Whereas purchases from Spain, USA and China constitute 99.95%, the assessee has given no comparable data of these AEs supplying similar raw material to any other non-related entity in India. As regards the remaining 0.05%, the assessee has placed no invoices of the purchases made from its German AE, though it put forth copies of invoices raised by the German AE on German non-AEs. As such, no data of the price charged by the German AE from the assessee is available, which could be compared with the prices charged by the former from non-AEs for ascertaining if the products sold are similar or different. Thus, it is manifested that the assessee has made comparison of the average rate charged by German AE from German non-AEs with the average rate charged by all the four AEs from different countries selling raw material to the assessee in India.

7. At this juncture, it is relevant to highlight that the CUP method requires a greatest degree of comparability between the international transaction and the comparable uncontrolled transaction(s). It is not only the products as such, but also several other relevant factors, which need to be taken into consideration before jumping to the veracity of conclusion of comparability. Rule 10B(2) of the Income-tax Rules, 1962 categorically provides that: ‘the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to’ the four broader parameters given in clauses (a) to (d). Clause (d), which assumes significance in the extant case, provides as follows “*conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location* and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail”. On going through the mandate of clause (d) of Rule 10B(2), it becomes graphically overt that the comparability of an international transaction with an uncontrolled transaction has to be judged, *inter alia*, by considering conditions prevailing in the markets in which respective parties to the transaction operate including the geographical locations. Rule 10B(3) states that: ‘An uncontrolled transaction shall be comparable

to an international transaction, if (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price ... paid in ..such transactions in the open market; or (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences'. On a conjoint reading of Rule 10B(2) with Rule 10B(3), it becomes ostensible that an uncontrolled transaction can be taken into consideration for comparison only if no differences, *inter alia*, the varying geographical locations exist and further in case such differences exist, there should be a mechanism to eliminate the material effects of such differences in a reasonably accurate way. In other words, if no reasonable accurate adjustment can be made to eliminate such material effects, then the comparable has to be eased out.

8. Reverting to the factual position obtaining in the extant case, we find that the so-called comparable transaction, namely, the German AE's transactions with another German non-AE are geographically different from the assessee's transactions with the other three entities situated in Spain, USA and China supplying raw material to the assessee in India. Further, insofar as the transactions with the German AE are concerned, not only the assessee did not furnish any particulars of raw material purchased from it but also that there is

huge difference in the minuscule volume purchased by the assessee at 1,000 kg with that sold by the German AE to German non-AE at 14,52,170 kgs. It goes without saying that a particular product commands varying price in different countries due to host of reasons. For the purposes of the ALP determination under the CUP method, we need to focus on the comparable uncontrolled transactions taking place in India and not world over. As the product similarity is also another *sine qua non* under the CUP method, the best comparable uncontrolled transactions in the given case would have been the four AEs selling similar products to non-AEs in India. The assessee purchasing similar products from non-AEs or a third party in India purchasing similar goods in an uncontrolled situation would have constituted the next best comparable uncontrolled price(s). Neither the best nor the next best comparable uncontrolled transactions are available and further, the assessee has provided no basis to crease out the effect of geographical differences in the transaction so chosen as comparable in terms of rule 10B(3). In such circumstances, we fail to comprehend as to how the sale transactions made by German AE to non-German AEs constitute valid comparable uncontrolled transactions insofar as the assessee's purchases of raw material from Spain, USA, China and Germany are concerned.

9. Now we come to the remaining part of the international transaction of purchase of finished goods. It is seen that the assessee made finished goods purchases from its German AE as well as Italian AE. In order to benchmark these transactions, the assessee relied on a transaction of sale made by its Italian AE to German non-AE. It has been fairly conceded that no comparable data of the sales made by German AE to non-AE is available. Geographical differences, as noted above, do not justify the adoption of the price charged by Italian AE from a German non-AE as a good comparable for the purposes of benchmarking the international transactions in India. The *raison d'être* given in the context of purchase of raw materials *supra* applies with equal force to the purchase of finished goods from the AEs for which no worthwhile comparable uncontrolled transaction is available.

10. No separate argument was advanced *qua* the remaining part of the transaction under consideration, namely, Purchase of Stores, spares and consumables from the AEs.

11. We, therefore, approve the view point taken by the authorities below to the effect that the CUP is not the most appropriate method in the facts and circumstances of the case.

II. IF TNMM IS TO BE APPLIED, THEN PROPORTIONATE ADJUSTMENT SHOULD BE MADE

12. After holding that the CUP method cannot be applied, we now proceed with the alternate and without prejudice argument put forth on behalf of the assessee that the transfer pricing adjustment should be restricted only to the international transactions and not to the non-AE transactions as well. We have noticed above that the TPO selected six companies as comparable and determined their Arm's Length margin and thereafter applied the same to the sales made by the assessee on entity level. The DRP directed to exclude three companies from such list. The Id. AR submitted that if the CUP method is not to be adopted as the most appropriate method, then he has no grievance against the application of the TNMM or any of its other aspects except restricting the transfer pricing addition proportionate to the international transactions.

13. The issue of proportionate adjustment is fairly settled by a judgment of the Hon'ble jurisdictional High court in *CIT Vs. Phoenix Mecano (India) Pvt. Ltd. (2019) 414 ITR 704 (Bom.)*, holding that the transfer pricing adjustment made at entity level should be restricted to the international transactions only. It is pertinent to mention that the Department's SLP against this judgment has since been

dismissed by the Hon'ble Supreme Court in *CIT Vs. Phoenix Mecano (India) Pvt. Ltd. (2018) 402 ITR 32 (St.)*. Similar view has been espoused by the Hon'ble Bombay High Court in *CIT Vs. Thyssen Krupp Industries Pvt. Ltd. (2016) 381 ITR 413 (Bom.)* and *CIT Vs. Tara Jewels Exports (P). Ltd. (2010) 381 ITR 404 (Bom.)*. We, ergo, direct to restrict the transfer pricing addition only to the extent of international transaction under consideration.

14. To sum up, we set-aside the impugned order and restore the matter to the file of AO/TPO for re-determining the ALP of the international transaction of 'Purchase of raw material, sale of finished goods, spares and consumables' under the TNMM but restricting the amount of transfer pricing adjustment only to the international transaction.

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

Order pronounced in the Open Court on 13th October, 2021.

Sd/-
(PARTHA SARATHI CHAUDHURY)
JUDICIAL MEMBER

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

पुणे Pune; दिनांक Dated : 13th October, 2021
सतीश

आदेश की प्रतिलिपि □ ग्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The CIT(A)-13, Pune
3. The PCIT-5, Pune
4. DR, ITAT, 'C' Bench, Pune
5. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,**// True Copy //**

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

		Date	
1.	Draft dictated on	11-10-2021	Sr.PS
2.	Draft placed before author	12-10-2021	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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