* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on : 21.05.2015
Pronounced on : 29.02.2016

\+ **ITA 443/2013**

\+ **ITA 451/2013**

DENSO INDIA LIMITED ………………Appellant

Through: Sh. C.S. Aggarwal, Sr. Advocate with Sh. Prakash Kumar, Advocate.

Versus

COMMISSIONER OF INCOME TAX …………….Respondent

Through: Sh. P. Roy Chaudhuri, Sr. Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT

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1. These two appeals by the assessee require resolution of common questions of law and arise from identical or closely similar circumstances. The questions of law framed in these appeals, on 17.10.2014, are as follows:

> *1. Whether the Transactional Net Margin Method adopted by the assessee is the most appropriate method envisaged under Section 92C(2) of the Income Tax Act, 1961 read with Rule 10C of the Income Tax Rules, 1962 and whether the Income Tax Appellate Tribunal had erred in directing the Assessing Officer to apply Comparable Uncontrolled Price Method?*

2. Whether there is a contradiction in the order of the Income Tax Appellate Tribunal as it has directed that the Transfer Pricing Officer should apply Comparable Uncontrolled Price Method?

2. The appellant assessee is engaged in manufacturing and sale of auto electrical products such as Starters, Alternators, Wiper Motors, CDI, Magnetos etc., for four wheel and two wheel vehicles. Its promoters include two Japanese Companies, which are M/s Denso Corporation, Japan and M/s Sumitomo Corporation, Japan. These promoters' share holding is to the extent of 47.93% and 10.27% respectively. M/s Sumitomo Corporation, Japan is an associate company of M/s Denso Corporation, Japan. The two companies exercise an overall share holding control of 58.20%, sufficient to exercise overall management and control of the assessee.

3. In ITA 443/2013, the facts are that the assessee had filed its return for AY 2002-03, declaring a total income of ₹ 19,44,45,442/- which was originally processed under Section 143(1). It was later taken up for scrutiny during the course of which the AO referred the case to the TPO. In issue is the transfer pricing adjustment pursuant to the ALP determination recommended by the TPO and accepted by the AO to the extent of ₹ 1,36,31,665/-. The AO finalized the assessment on 30.03.2005. The assessee's appeal was allowed by the CIT, who on 30.04.2009 directed the cancellation of the above. The Revenue appealed and was successful before the ITAT which restored the addition of the said transfer pricing adjustment amount of ₹1.36 crores.

4. In ITA 451/2013 for AY 2003-04, the facts are similar except that the adjustment order was to the extent of ₹ 6.83 crores. Of that amount, the TPO had determined the ALP (to be added to the income) at ₹5.86 crores. The AO added a further sum of ₹ 97 lakhs (₹ 97,44,630/-). The assessee's appeal, like for AY 2002-03, was allowed by the CIT(A) on 30.12.2009. The impugned common order of the Tribunal accepted the Revenue's contentions and restored the additions made by the AO pursuant to the TPO's determination.

5. The facts which are common for the specific questions of law framed by the Court are that for both the assessment years 2002-03 and 2003-04, the assessee had procured component level inputs for the manufacture of its products. The total raw material imported was to the extent of ₹ 57,77,00,221 of which the value of imports from Sumitomo Corporation was ₹ 49,86,69,729/- or 86.3% of the total import. It also constituted 37.5% of the total raw material consumed. This figure related to AY 2002-03. Likewise, for AY 2003-04, the facts were much the same and the transfer pricing adjustment leading to addition of ₹ 5.86 crores was recommended by the TPO. The AO, in his order dated 28.03.2006 noticed that there was no difference of facts between the previous year AY 2002-03 and the current year in question, AY 2003-04 in respect of supplies by Sumitomo Corporation and consequently directed addition of ₹ 97,44,630/-. The TPO had determined the ALP at an average margin of 6.92% after eliminating 7 out of the 11 comparable companies since their turnover was less than ₹100 crores. The assessee's turnover was over ₹250 crores. The Profit Level Indicator (PLI) of the assessee, in terms of the documents furnished by it worked out to 4.36%. The adjustment was, therefore, arrived at ₹5.86 crores.

Like for AY 2002-03, the CIT(A) held by his order dated 30.12.2009 that the adjustments were not justified. The CIT(A) followed his previous order and held that the CUP method was not the most appropriate one and that the import prices were not comparable to the prices paid to domestic vendors after indigenisation. The adjustment of ₹ 97,44,630/- was, therefore, deleted. The common order of the ITAT set aside the order of the Appellate Commissioner and restored the adjustments directed by the AO.

6. The appellant/assessee argues that the ITAT fell into error in accepting the AO's decision as opposed to the well reasoned orders of the appellate Commissioner. The assessee urges that to determine if the transaction value of the various raw materials, including payment of royalty, technical knowhow fees etc., is at arms' length, the net profit margin contemplated under Section 92C of the Income Tax Act is determinative. The value of each transaction in respect of every component is to be judged within the net margin derived by the entity. In this regard, reliance is placed upon OECD guidelines, particularly Para 3.9. Learned counsel contends that for the purpose of benchmarking transaction of a broad entity, it is to be considered as a whole or as a class rather than analyzed on a transaction by transaction basis. It is emphasized that all transactions which are integral and ancillary to the main operation of the entity – in the present case, one which engages in manufacturing, have to be taken together. The assessee had appropriately applied the transactional net margin method (TNMM) and in doing so aggregated all the transactions in its transfer pricing report for the purpose of benchmarking international transactions with the operating profit table cast as the relevant profit level indicator (PLI). Since the TPO accepted the value of royalty, technical knowhow and testing fee on the basis of TNMM, he

could not have, in the same order rejected it for the purpose of component purchase and proceeded to apply an entirely different method, i.e. Comparable Uncontrolled Price (CUP) method for arriving at the net value of transactions.

7. Mr. C.S. Aggarwal, learned senior counsel points out that by virtue of Section 92C(1) and (3), statutory guidance in such matters is that the method most appropriate *"having regard to the nature of transaction or class of transactions or class of associated persons or functions"* is to be viewed. Thus, it is not open to the TPO/AO to segregate a set of transactions from a series or class of transactions, in the overall benchmarking exercise to arrive at the PLI. It is urged in this regard that the ITAT's decision, rejecting the assessee's contention that under TNMM, entity level margins have to be compared and that both imports and domestic purchases could be aggregated together is erroneous. Reliance is also placed upon para 3.10 of the OECD guidelines which, it is submitted, grants autonomy to the entity to adopt a "portfolio approach" as a business strategy where the tax payer bundles transactions for the purpose of earning appropriate return across portfolios rather than on a single product within it. These being international commercial transactions cannot be looked into by tax authorities placing themselves in the armchair of the businessmen.

8. Learned counsel for the revenue relied upon the ITAT's orders and held that they were justified under the circumstances of the present case. It was pointed out that the TPO's initial order for AY 2002-03 clearly revealed that Sumitomo Corporation, Japan had exported 83% of the total goods, of the value of 86.3% of the total imports by the assessee and accounted for 37.5% of the total raw material consumed. The precise reason why the TPO

and the AO directed the additions which are in dispute were that Sumitomo Corporation does not manufacture but merely traded in the goods. The assessee was unable to shed any light why it chose to source the materials from Sumitomo Japan, which it could have purchased directly from the manufacturer, i.e. Denso, Japan. Given the close connection between Sumitomo Corporation, Denso and the assessee, the lack of the explanation coupled with other objective factors justified the addition. It was submitted that the facts for AY 2002-03 and 2003-04 are identical. The Revenue was justified in treating Sumitomo Corporation, Japan as the assessee's AE since the TPO correctly deduced that purchases routed through their entity were with the sole objective of camouflaging obvious fact that the assessee made purchases from an AE, i.e. Denso Corporation, Japan which was the manufacturer. The TPO justly concluded that the assessee failed to discharge its responsibility as to the application of the most appropriate method. Consequently, it failed to give reasonable data, i.e. cost of purchase in the hands of Sumitomo Corporation, Japan, for determination of aggregate ALP by retail price method and that no other method except CUP could be applied for ALP determination of the component value from Sumitomo Corporation.

Analysis and conclusions:

9. It is evident from the above discussion that the narrow controversy which this Court is called upon to decide is as to whether the adoption of the CUP method by the revenue authorities was justified. What the assessee urges essentially is that whereas the TP report furnished by it applied the TNMM method which was found acceptable as regards all other transactions/business activities, it was not open to the revenue to segregate a portion and subject it to an entirely different method, i.e. CUP. The assessee

relies upon paras 3.6, 3.9 and 3.10 of the OECD guidelines in support of its contentions. It also relies upon certain rulings of different Benches of the ITAT to urge that such sequential segregation and setting portion of the TP exercise – so to say, to break with the integrity is unjustified and unsupported by the text of the law, i.e. Section 92C of the Income Tax Act. The assessee also relies upon Rule 10E of the Income Tax Rules, which guide the proper approach of the TPO in such matters. In the present case, the reasons for addition of ₹1.36 crores for AY 2002-03 and addition of ₹ 97 lakhs for AY 2003-04 may be seen from the following extracts of the orders made by the TPO and AO respectively.

10. The TPO, for the first year (AY 2002-03) noticed that the assessee had sought to justify imports from Sumitomo Japan by relying upon an agreement of September 2000. That was an umbrella contract merely enabling supply to the assessee of certain components, materials and production testing equipments. The assessee was asked to disclose or provide particulars with respect to components sold to Sumitomo Corporation by Denso, Japan; expenses incurred by Sumitomo Corporation towards storage, clearing charges, Customs Duty etc; agreements, if any, between Sumitomo Corporation and Denso, Japan and broadly reveal what was the business expediency leading to purchase components through the intermediary Sumitomo Corporation instead of buying directly from Denso, Japan, the manufacturer. The assessee's explanations were that Denso's services were essential as a procurement platform through *"innovative logistic activities; preparation of shipping documents, liaison with shipping companies and airlines agents, for the purpose of negotiation with banks; following-up with Denso entities to stabilise production through one time delivery of*

components and raw materials". The assessee further stated that the customs authorities had accepted the import value which could not be questioned by the revenue in income tax proceedings.

11. The TPO rejected the explanation and noticed that Sumitomo Corporation held a substantial holding in the assessee company. He also concluded that the relationship between the assessee, its holding company, Denso and Sumitomo Corporation was such that Denso, Japan could influence the transactions between the assessee and Sumitomo Corporation. This, according to him, fell within the mischief of Section 92B and amounted to an international transaction. The TPO concluded that there was no explanation that could be reasonable sound business practice to support the sourcing of components not manufactured by Sumitomo Corporation. He thereafter concluded as follows:

> *"7.1 The assessee has not submitted any specific evidence to substantiate its argument that cost of production is higher in Japan. It has relied upon general arguments, e.g. high cost of living, difference in wage and electricity charges, ranking in terms of cost etc. The assessee has chosen to ignore certain vital facts. For example, the interest rate in Japan is in the range of 0 to 1% as against 12 to 15% in India in that year. The cost of capital is a major element of cost in any industry. Next, higher scale of economies because of production of large quantities of goods results into substantial cost savings. Further, the indirect taxes in Japan are very low (the Rate of VAT is 5%) as compared to India. The lower tax burden brings down the costs in any economy. It is true that wages are comparatively high in Japan but it is more than effectively neutralized by large scale mechanization, ingenious management techniques, training, infrastructure etc. resulting in economies of scale High productivity, to a very large extent, compensates for the higher wages. The incremental Capital output ratio in Japanese economy is much better than that in India, i.e. 2.5 (appx) against*

4.5 (appx) in India. Japanese industry is known all over the world for their quality management and high efficiency. Therefore, this contention of assessee is not very convincing and not corroborated by concrete facts and evidence.

7.2 It is true that in some cases the prices at which the assessee purchased components and spare parts from SCJ during the year under assessment have been compared with the rates at which purchases were made in the following year(s) from the local parties. Even so, the comparison is not unreasonable and the circumstances of the case. In fact assessee itself has used the data of previous two years while using TNMM for computation of ALP of international transactions. In the absence of information about any other comparables or costing of such components, it is reasonable to have a look at the Uncontrolled Cost of such components during the immediately succeeding year(s). Shorn of legal embellishments, the fact remains that the assessee purchased components and spare parts manufactured by its holding company. Denso Corporation, Japan at the rates which were exorbitant as compared to the rates in the domestic market in the immediately following year(s).

7.3 The facts that Customs authorities did not raise objections to the invoice value of spare parts and components imported from Sumitomo Corporation can in no way take away or abridge the power and the duty vested in the undersigned to satisfy regarding the correctness of the income returned.

COMPUTATION OF ALP

The responsibilities to establish the arm's length nature of the international transaction lies with the assessee. The assessee failed to discharge this responsibility as the method relied upon by it is not the most appropriate method for the reasons discussed above. It has failed to give reasonable data, i.e. cost of purchase in the hands of SCJ to determine the ALP by RPM. Therefore, it clearly emerges from the discussion above that no method other than the CUP, i.e. CPM, RPL, TNMM or PSM, can be applied in this case to determine the ALP of the import of the component

from SCJ. Since the assessee has not brought out any difference in the quality of components purchased from SCJ and from uncontrolled domestic suppliers, the ALP of imports from SCJ can be determined by comparing it with the prices of uncontrolled domestic suppliers. Though, for some components, the indigenization took place in the subsequent years it can still be used as a valid comparable because it gives fairly good idea about the cost of production of such components. Wherever, the indigenization has taken place in the subsequent years, the uncontrolled domestic price for subsequent years is required to be discounted by the underlying rate of inflation in the Indian economy to adjust the effect of inflation to arrive at the comparable uncontrolled price for the year under assessment. For this purpose, the rate of inflation has been taken at 5% per annum. Further, imports aggregating to less than Rs.2 lakhs in the years have also been ignored."

12. For the succeeding year, i.e. AY 2003-04, the AO held as follows:

*"**2. Determination of Arm's Length Price (ALP) w.r.t. International Transactions with M/s. Sumitomo Corporation Japan (SCJ)***

During the year the assessee has imported raw material of Rs.51.54 crores from Sumitomo Corporation Japan (SCJ) out of total import of raw material of Rs.58.29 Crores. Total consumption of raw material has been shown at Rs.138.43 Crores. It means that import from Sumitomo Corporation Japan are 88.42% of total import and 37.23% of total raw material consumed. It was found that during the proceedings of last year, the TPO has found that the said transactions with SCJ have not been reported as international transaction with associated enterprise in Form No.3CEB. The situation remains same this year as well, as international transactions with SCJ have not been incorporated in Form No.3CEB on the ground that share holding of Sumitomo Corporation Japan (SCJ) of 10.27% in assessee company is less than the required limit of 26% of share holding provided under IT Act to make SCJ the associated enterprise of the assessee. After considering assessee's plea and

after giving detailed reasoning, the TPO in AY 2002-03 has held that international transactions undertaken with SCJ are covered by scope of Section 92B(2) of Income Tax Act and most appropriate method to determine arm's length price in respect of international transactions undertaken by assessee with M/s. SCL is Comparable Uncontrolled Priced Method (CUP).

There being no charge in facts and circumstances as compared to last year therefore, during assessment proceedings assessee company was asked to furnish details of components which were imported from associated enterprise (AE) Sumitomo Corporation (SCJ) as well as purchased from domestic suppliers in same year or in subsequent years. The assessee company furnished its reply vide letter dated 24.3.2006 giving details of such components stating that it may not be fair to undertake any comparison between prices charged by Indian vendors and Japanese suppliers as their exist certain differentiating factors. The differentiating factors highlighted by the assessee, have elaborately been discussed by TPO during the course of proceedings of AY 2002-03, the facts remaining same therefore, I rely on TPO's order of last year on the issue of purchases made from Sumitomo Corporation, Japan. After allowing assessee opportunity of being heard and on the basis of details filed before me, arm's length price of imports of various components made from SCJ and adjustments arising out of arm's length price and book entries have been calculated in Annexure-A, taking rate of inflation at 5% per annum and ignoring imports aggregating to less than Rs. 2 lacs during the year, as was the criteria applied in assessment year 2002-03. As per working made in Annexure-A to this order, total income of the assessee will be increased by an amount of Rs.9744630/- which calculating its total income for AY 2003-04 on account of adjustment in arm's length price of international purchase transactions of raw material from SCJ."

13. Section 92 (3) of the Income Tax Act reads as follows:

"(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub-section

(2A) or the determination of the allowance for any expense or interest under sub-section (1) or sub-section (2A), or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into."

Rule 10B reads as follows:

"10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction or a specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a) comparable uncontrolled price method, by which,—
(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
(ii) such price is adjusted to account for differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction;

(b) resale price method, by which,—
(i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated

enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) 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 subclause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
(iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under subclause (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;

(d) profit split method, which may be applicable mainly in international transactions or specified domestic transactions involving transfer of unique intangibles or in multiple international transactions or specified domestic transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—
(i) the combined net profit of the associated enterprises arising from the international transaction or the specified domestic transaction in which they are engaged, is determined;
(ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction:
Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate

of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or the specified domestic transaction ;

(e) transactional net margin method, by which,—
(i) the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in subclause (iii);
(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction;
(f) any other method as provided in rule 10AB."

14. The cumulative effect of various provisions of the Income Tax Act, notably Sections 92, 92C, 92D and 92E read together with Rule 10B and 10D is the obligation to discern, if in a given set of circumstances, the assessee has disclosed international transactions, as well as an ALP. The

ultimate purpose of this exercise- the primary onus of which is upon the assessee, is to ensure that no amount which is otherwise to be designated or treated as income, under law, escapes assessment. The assessee's TP report is to be accurate and based on materials; its explanations for the queries raised by the TPO, convincing and reasonable. The underlying emphasis of the law (Section 92-C) is that the method appropriate to the transaction, amongst the four specified ones, is to be applied. In the judgment of this Court, reported as *Commissioner of Income Tax v. EKL Appliances Ltd.* (2012) 345 ITR 241 (Del), it was held as follows:

> *"It is very imperative on the part of the assessee, to establish before the TPO, that the payments made were commensurate to the volume and quality of services and such costs are comparable. No such efforts was made. No ALP was computed by the assessee. As held by the Assessing Officer, as well as the Commissioner (Appeals), the assessee has not furnished personnel have rendered marketing services to the assessee company. In fact, the assessee company has no revenue which has been derived as a result of these marketing expenses. At the cost of repetition, we state that in the TP report, the company's submission is recorded at Page-30, and it states that the software services obtained by the Deloitte from the third party, are not similar to the services obtained by the Deloitte from the assessee company on account of requirements of different skill, experience, knowledge level, complexity of software projects handled, risk bearing capacity, etc. The entire revenue of the assessee are from the Deloitte. The evidence filed in support of the fact that services are rendered in the form of e-mails show that they are not e-mails relating to marketing, but that they relate only to billing. As rightly pointed out by the learned Departmental Representative, the assessee has no role in interacting with the client to modify, cancel, renew or extend the contract. The assessee cannot, even after expiry of the agreement between the Deloitte and its client, supply services without written consent of Deloitte. Deloitte has to pay the assessee*

irrespective of it getting payment or not within sixty days of raising invoices. Deloitte is responsible for generation of sales management, delivery of projects, maintaining customer relationship and billing and collection. The assessee has no market risk. The argument of the learned Counsel for the assessee that these three marketing personnel project the capabilities of the assessee company so that Deloitte gets work, is not supported by any evidence and, hence, without basis. In our view, under similar circumstances a uncontrolled comparable company would not incur such expenditure. Hence, the ALP is rightly determined at "nil". As no expenditure would have been incurred, there is no necessity to apply a particular method to arrive at such conclusion. In fact, by all the five methods or any one of them, when applied to the fact that there is no necessity of payment, the result of "nil" ALP will come."

15. *Sony Ericsson Mobile Communications India (P) Ltd v Commissioner of Income Tax* (2015) 374 ITR 118 (Del) was a subsequent decision by another Bench of this Court, which reviewed the methodology that TPOs are to adopt while determining ALP. The said judgment held, *inter alia,* that:

"137. The question of aggregation and disaggregation of transactions when the TNM Method or even in other methods is sought to be applied, must have reference to the strength and weaknesses of the TNM Method or the applicable method. Aggregation of transactions is desirable and not merely permissible, if the nature of transaction(s) taken as a whole is so inter-related that it will be more reliable means of determining the arm's length consideration for the controlled transactions. There are often situations where separate transactions are intertwined and linked or are continuous that they cannot be evaluated adequately on separate basis. Secondly, the controlled transaction should ordinarily be based on the transaction actually undertaken by the AEs as has been struck by them. We should not be considered as advocating a broad-brush approach but, a detailed scrutinized ascertainment and determination whether or not the aggregation or segregation of transactions

would be appropriate and proper while applying the particular Method, is necessary.
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140. Sub-section (3), we do not think incorporates a bar or prohibits set offs or adjustments. It states that Section 92, which refers to computation of income from international transaction with reference to arm's length price under sub-section (2) or (2A), would not have the effect of reducing income chargeable to tax or increase the loss, as the as may be, computed by the assessee on the basis of entries in the books of account. Income chargeable to tax or loss as computed in the books is with reference to the previous year. The effect of sub-section is that the profit or loss declared, i.e. computed by the assessee on the basis of entries in the books of account shall not be enhanced or reduced because of transfer pricing adjustments under sub-section (2) or (2A) to Section 92. It states the obvious and apparent. In case the assessed has declared better and more favourable results as per the entries in the books of account, then the income chargeable to tax or loss shall not be decreased or increased by reason of Transfer Pricing computation. Thus, transfer pricing adjustments do not enure to the benefit or advantage the assessed, thereby reducing the income declared or enhancing the declared loss. Pertinently, the Sub-Section makes reference to the income chargeable to tax or increase in the loss on the basis of the entries in the books of account. The concept of set off or adjustments was/is well recognized and accepted internationally and by the tax experts/ commentators. In case the legislative intent behind sub-section (3) to Section 92 was to deny set off, the same would have been spoken about and asserted in different and categorical words. Legislative intent to the contrary should not be assumed."

Sony Ericcson (supra) thereafter discussed the context and ruling in *EKL Appliances Ltd. (supra)* and held as follows:

"147. Tax authorities examine a related and associated parties' transaction as actually undertaken and structured by the parties. Normally, tax authorities cannot disregard the actual transaction or substitute the same for another transaction as per their perception. Restructuring of legitimate business transaction would be an arbitrary exercise. This legal position stands affirmed in EKL Appliances Ltd. (supra). The decision accepts two exceptions to the said rule. The first being where the economic substance of the transaction differs from its form. In such cases, the tax authorities may disregard the parties' characterisation of the transaction and re-characterise the same in accordance with its substance. The Tribunal has not invoked the said exception, but the second exception, i.e. when the form and substance of the transaction are the same, but the arrangements made in relation to the transaction, when viewed in their totality, differ from those which would have been adopted by the independent enterprise behaving in a commercially rational manner. The second exception also mandates that actual structure should practically impede the tax authorities from determining an appropriate transfer price. The majority judgment does not record the second condition and holds that in their considered opinion, the second exception governs the instant situation as per which, the form and substance of the transaction were the same but the arrangements made in relation to a transaction, when viewed in their totality, differ from those which would have been adopted by an independent enterprise behaving in a commercially rational manner. The aforesaid observations were recorded in the light of the fact in the case of L.G. Electronics (supra). Commenting on the factual matrix of L.G. Electronics case (supra) would be beyond our domain; however, we do not find any factual finding to this effect by the TPO or the Tribunal in any of the present cases. However, in L.G.Electronics decision (supra), it is observed that if the AMP expenses and when such expenses are beyond the bright line, the transaction viewed in their totality would differ from one which would have been adopted by an independent enterprise behaving in a commercially rational manner. No reason or ground for holding or the ratio, is indicated or stated. There is no material

> *or justification to hold that no independent party would incur the AMP expenses beyond the bright line AMP expenses. Free market conditions would indicate and suggest that an independent third party would be willing to incur heavy and substantial AMP expenses, if he presumes this is beneficial, and he is adequately compensated. The compensation or the rate of return would depend upon whether it is a case of long-term or short-term association and market conditions, turnover and ironically international or worldwide brand value of the intangibles by the third party."*

16. The factual discussion in this case clearly reveals that the assessee chose to import components not from the manufacturer (which was an AE) but an intermediary. Normally, this would have been a commercial decision, which revenue authorities would not question. However, interestingly, the vendor of the components (which constituted over 85% of the raw materials imported and about 38% of the total raw materials sourced) was also connected with *both* the assessee and the manufacturer. If these realities emerged during the TP exercise, compelling the TPO to closely scrutinize the value of such imports and seek further details from the assessee, to justify its decision, the onus was clearly on the latter to afford a convincing and reasonable explanation. Such of the explanations that were forthcoming, were apparently unconvincing. What the assessee banks upon in its appeal to this Court is the unbending and inflexible acceptance of its TP exercise; according to its logic, a "bundled" or aggregated series or chain of transactions used in the TP report should remain undisturbed. Now, there can be no dispute that the AO would normally accept the figures given, if they do not show features that call for his interference. However, his job also extends to critically evaluating materials and in cases which do require scrutiny, go

ahead and do so. In the process, at least in this case, the unusual features which remained unexplained by the assessee, influenced the TPO and the AO to resort to transfer pricing adjustment and determine ALP by adopting the CUP method for the procurements from Sumitomo Japan. The "second test" spoken of in *Sony Ericcson (supra)* i.e *"the form and substance of the transaction were the same but the arrangements made in relation to a transaction, when viewed in their totality, differ from those which would have been adopted by an independent enterprise behaving in a commercially rational manner.."* was in effect adopted. This Court finds no infirmity in this approach. As a result, the first question framed is answered against the assessee and in favour of the revenue.

17. As far as the second question, i.e the adoption of CUP method being contradictory with the ITAT's decision is concerned, there was no argument on behalf of the appellant. That apart, noticeably at the time of framing the question the Court recorded that it was framed at the insistence of the assessee's counsel. In view of the findings on the first question and in view of these facts, this question too is answered in favour of the revenue and against the assessee.

18. For the foregoing reasons, the appeals fail and are dismissed. No costs.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

FEBRUARY 29, 2016