IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

R/TAX APPEAL NO. 751 of 2019
With
R/TAX APPEAL NO. 752 of 2019
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R/TAX APPEAL NO. 753 of 2019

FOR APPROVAL AND SIGNATURE:

HONOURABLE MR. JUSTICE J.B.PARDIWALA
and
HONOURABLE MR. JUSTICE BHARGAV D. KARIA

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1	Whether Reporters of Local Papers may be allowed to see the judgment ?	NO
2	To be referred to the Reporter or not ?	NO
3	Whether their Lordships wish to see the fair copy of the judgment ?	NO
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?	NO

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THE PRINCIPAL COMMISSIONER OF INCOME TAX, VADODARA 1
Versus
GULBRANDSEN CHEMICALS PVT. LTD.

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Appearance:
MR.VARUN K.PATEL(3802) for the Appellant(s) No. 1
MR S.N. SOPARKAR, SR. ADV WITH MR B S SOPARKAR(6851) for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR. JUSTICE J.B.PARDIWALA**
and
HONOURABLE MR. JUSTICE BHARGAV D. KARIA

Date : 03/02/2020

ORAL JUDGMENT
(PER : HONOURABLE MR. JUSTICE BHARGAV D. KARIA)

(PER : HONOURABLE MR. JUSTICE BHARGAV D. KARIA)

1. These Tax Appeals under Section 260A of the Income Tax Act, 1961 (for short 'the Act, 1961') are at the instance of the Revenue and are directed against the orders passed by the Income Tax Appellate Tribunal, Ahmedabad 'D' Bench, Ahmedabad (for short 'the Tribunal').

2. Tax Appeal No. 751 of 2019 is arising out of the order of the Tribunal dated 12.02.2019 in ITA No. 2276/AHD/2013 for A.Y. 2008-09.

3. Tax Appeal Nos. 752 of 2019 and 753 of 2019 are arising out of the common order of the Tribunal dated 12.02.2019 for A.Y. 2007-08 in ITA No. 760/AHD/2012 filed by the revenue and ITA No. 874/AHD/2012 filed by the assessee.

4. Since common issues are arising in these appeals, the same were heard analogously and are being disposed of by this common order. For the sake of convenience, Tax Appeal No. 753 of 2019 is treated as the lead matter.

5. The revenue has proposed the following three questions of law as substantial questions of law for the consideration of this Court so far as Tax Appeal Nos. 752 of 2019 and 753 of

2019 are concerned, which pertains to A.Y. 2007-08:

(a) Whether in the facts and circumstances of the case, the learned ITAT has erred in law and on facts in deleting the upward adjustment of Rs.2,78,02,502/- made by the AO/TPO and confirmed by CIT (A) on account of Transfer Pricing adjustments in respect of international transactions of sale of chemical products by the assessee to its Associated Enterprises (Aes)?

(b) Whether in the facts and circumstances of the case, the learned ITAT has erred in law and on facts in rejecting the TPO's approach of rejecting the Transactional Net Margin Method (TNMM) and adopting Comparable Uncontrolled Price (CUP) Method as Most Appropriate Method (MAM)?

(c) Whether in the facts and circumstances of the case, the learned ITAT has erred in law and on facts in allowing following appropriate adjustments claimed by the assessee for material differences in contractual term, underlying commercial circumstances, functions, risk and other economic factors between assessee's transactions with AEs vis-à-vis assessee's transactions with non AEs while applying the Comparable Uncontrolled Price (CUP) method:

vi. Adjustment on account of business volumes difference.

vii. Adjustment for advance payment received from AE.

viii. Adjustment for marking and selling expenses not required to be incurred for AE sales vis-à-vis non AE sales.

ix. Adjustment for credit risk not required to be borne by the assessee for AE sales vis-à-vis non AE sales.

x. Adjustment for interest free ECB loan received from AE?

6. Brief facts of the case are as under:

6.1. It appears from the material on record that the respondent – assessee filed his return of income for A.Y. 2007-08 on 05.11.2007 declaring the income at Rs.99,43,677/-. The case of the assessee was selected for scrutiny assessment and a notice under Section 143(2) and 142 (1) of the Act, 1961 were issued.

6.2. The Assessing Officer referred the case to the Transfer Pricing Officer (TPO) under Section 92CA(1) of the Act, 1961. The TPO passed an order dated 19.10.2010 under Section 92CA (3) of the Act, 1961 determining the total transfer pricing adjustment of Rs.3,91,40,456/- by discarding the Transactional Net Margin Method (TNMM) and adopted Comparable Uncontrolled Price (CUP) method as Most

Appropriate Method (MAM) by the assessee in respect of the international transactions.

6.3. On the basis of the order passed by the TPO, the Assessing Officer adopted the upward transfer pricing calculated by the TPO and passed the assessment order.

6.4. The Assessing Officer adopted the CUP method as Most Appropriate Method (MAM), due to following reasons as recorded by the Tribunal in the impugned order:

"5. The material facts and circumstances of the case are like this. The assessee company is a wholly owned subsidiary of EW Limited, Mauritius- a group entity of Gulbrandsen Inc, USA and Gulbrandsen EU Limited UK inasmuch as the shareholders of EW Limited, i.e. Peter Gulbrandsen and Donald Gulbrandsen, are also majority shareholders of Gulbrandsen Inc, USA and Gulbrandsen EU Limited UK. The assessee is engaged in the manufacturing of chemicals for its divergent industrial customers, its product range includes Aluminium Chloride Anhydrous (ANH), Meno N Butyl Trichloride (MBTC), Stannic Chloride (TTC), Dibutyl Tin Oxide (DBTO)/ Dibutyl Tin Tin Dilaurate (DBTAA) and Tri Chloro Benzene and these products are supplied to the industries including petrochemical industry, pharmaceutical and chemical intermediate users. The assessee has also sold these products to

its AEs, namely Gulbrandsen Chemicals Inc, USA, and Gulbrandsen EU Limited, UK. During the course of assessment proceedings, the matter regarding ascertainment of arm's length price was referred to the Transfer Pricing Officer. The Transfer Pricing Officer noticed that the assessee had, deviating from the stand taken in the earlier years in which internal CUP method was adopted for benchmarking the sale to the AEs, computed the arm's length price of these transactions on the basis of Transactional Net Margin Method (TNMM). In effect thus, the assessee moved, in the current year, from internal CUP to TNMM. This, however, did not find favour with the TPO. The TPO was of the view, for the detailed reasons set out in his order, that, given the facts of the case, the internal CUP was the most appropriate method and it has been used all along in the earlier years. The reasoning adopted by the TPO was like this. It was noted that the assessee had sold 40% of its products to the associated enterprises, and earned margin of PBIT/Cost at 2.07%, as against the sale of 70% of its products in the immediately preceding year and earning margin of PBIT/Cost at - 3.26%. The TPO computed the total cost per kg for each type of chemicals and compared it with average sale rate to AEs so as to compute the GP/Cost (%) and noted that "the assessee has charged very nominal margin to the AEs". Coming to the Internal TNMM adopted by the assessee and the TPO's view that the basis of allocating the overheads was not clear, it was explained by the assessee that revenue and expenses have been allocated on actual basis wherever these are

directly allocable, and wherever these are not directly allocable, the allocation has been done on the basis of appropriate allocation key such as ration of sales quantity, sales revenue, total revenue. It was also explained that the segmental details have been reconciled with entity level audited accounts. The assessee further submitted that "in case if in your view there are any inappropriate cost allocations, we would appreciate if you can kindly let us know which cost allocations are not appropriate and why these are not appropriate so that we can accordingly clarify and explain on those aspects". While the TPO did not have any specific comment on this request, he simply rejected the explanation of assessee as "not accepted". It was also explained to the TPO that the CUP method is not really appropriate to the facts of this case as the assessee has long term business arrangements with the AEs, whereas there are no such long term arrangements with non AEs and that the contractual, economic, commercial, functional and risk profile differences, between the AE transactions vis-à-vis non AE transactions, make the comparison of prices irrelevant. The attention was invited to the fact that, as also stated in OECD Guidelines for Multinational Enterprises and Tax Administrators, application of CUP method "requires high degree of comparability not only in the products sold and services provided but also in the economic circumstances in which the respective AE and non AE transactions take place". It was thus submitted that the economic circumstances in which sales have taken place with the AEs are not at all

comparable with the economic circumstances in which non AE sales have taken place. It was also explained that the AEs, to which the assessee has sold the products, are resellers whereas non AEs are end consumers, and that while these AEs are located in US and UK, the non AE customers are in Asia and Middle East. Emphasis thus was placed on the fact that the geographical location of markets was different and the comparison was thus inappropriate. It was also highlighted that the volume of sales to the AEs was substantially higher than sales to non AEs. The attention was also invited to the fact that while AEs make, on an average, 17 months advance payment for the purchases while non AEs are extended 60-90 days credit period. It was thus contended that there was no credit risk to AE sales. The assessee further pointed out that the AEs also reimburse the assessee the basic research and development costs with 110% mark up under long term business arrangement, over and above the sale price, and that the assessee has also benefited from interest free ECB loans from the AEs. None of these submissions impressed the TPO. The TPO noted the objections of the assessee for the application of Internal CUP but rejected the same mainly on the ground that "since 2003-04, the assessee company has been using internal CUP as the most appropriate method" and "the assessee company has shifted from internal CUP method to internal TNMM without giving any appropriate reasons. So the contention of the assessee is rejected". As regards the justification of TNMM on the ground that the volume of sales to the AEs is several times higher than the

sale to non AEs, the TPO observed that "it means that the assessee has sold huge volume to AEs at a lower rate and shifted the huge profits from India to other countries" and, therefore, "the contention of the assessee is not acceptable". As regards the credit period and advance payments, the TPO observed, on a superficial note again, "contention of the assessee is considered but is not acceptable because in USA and UK market, the price of TTC, MBTC and DBTC are higher than non AE price rate". As regards guaranteed purchase of 50% production, the TPO observed that "it is seen that the assessee has been earning profits only from the non AE transactions (and) at least 50% guaranteed selling to AEs mean that the assessee is making loss and shifting the profits from India to other countries". On reimbursement of R&D costs also, the Assessing Officer did only observe, in rather general terms, that the plea is "not acceptable because the assessee has sold the products to its AEs at very lower rate and shifted the profits from India to outside India" The same was the comment in respect of interest free ECB loans from the AEs. As for the need of adjustment on account of various factors, the TPO simply observed that "the assessee has charged very nominal margin to its AEs (and) therefore, there is no any issue for any adjustment". He then proceeded to make the adjustment by observing as follows:

10. Computation of Arm's Length Price

Product	**Sales to AE Quantity (kgs)**	**Sales to AE: Avg. rate**	**Sales to non-AE Uncontrolled price rate**	**Difference**	**Adjustment**
TTC	*113800*	*227*	*253*	*26*	*2958800*

MBTC	*351036*	*371.41*	*465.18*	*93.77*	*32316646*
DBTO	*56852*	*351.84*	*409.27*	*57.43*	*3265010*
Total Transfer Pricing Adjustment Rs.3,91,40,456/-					

6.5. Being aggrieved by the upward Arm's Length Price adjustment (ALP) made by the Assessing Officer on the basis of the order passed by the TPO, the assessee carried the matter in appeal before the CIT (A).

6.6. However, CIT (A) confirmed the order passed by the Assessing Officer observing that, 'regardless of merits into adjustments made by the appellant, the fact remains that adjustment to make control and uncontrolled transactions comparable were possible in appellant's case. It was also observed that, "further, it is an accepted position that CUP is a superior method to other methods, if available." The CIT (A) relying upon the decision of the Tribunal in case of ***Serdia Pharmaceuticals India Pvt. Ltd. v. ACIT*** by Mumbai ITAT reported in ***(2011) 44 SOT 391 (Mum.)*** and held that the adjustments were possible but same were rejected on the merits including in respect of volume discount, credit terms, marketing and selling function and consequent costs,

credit risk, reimbursement of R & D costs, interest from ECB loan and all such factors. As the TPO observed that there is a huge difference between the sale price of *Meno N Butyl Trichloride i.e.* MBTC to its USA based AE and UK based AE, inasmuch as the same product was sold to USA based AE for Rs.412.95 and to UK based AE for Rs.370.13. According to the CIT (A) such difference indicated that sales to USA based AE was much above the ALP. The CIT (A) therefore, observed that, 'the appellant has not explained the vast difference between the prices charged for the same chemical from two AEs in the same period.' And therefore, 'the adjustment claimed by the appellant and the calculation done by the appellant to arrive at ALP after adjustments is not acceptable' and 'determination by the TPO of ALP of transactions to be average sale price to non-AEs over the year, without carrying out adjustments is upheld'. The CIT (A) however, reduced the ALP adjustment to Rs.2,78,02,502/- by observing as under:

"3.3.2 Appellant's contentions in para 3.2.2 of its submissions regarding

mistakes in quantification of transfer pricing addition under CUP method by Id. TPO are now taken up. It is pointed out by the appellant that for the products MBTC and DBTO, TPO compared consolidated average price for both the AEs with non-AE average price. Each sale transaction to the AEs constituted a separate international transaction, arm's length price of which was required to be determined in accordance with Section 92 of the I.T. Act. The Comparable Uncontrolled Price (CUP) for each of the 4 chemicals was determined by the TPO to be the average sale price charged by appellant to non-AEs. Each transaction of sale of chemicals to the AEs needed to be benchmarked with reference to the CUP and if the CUP exceeded the sale price to AE for a particular transaction, only then transfer pricing adjustment was warranted. TPO's approach in working out adjustment on the basis of consolidated average sale price for both AEs for MBTC & DBTO was therefore erroneous; AE-wise aggregation of transactions for each chemical for the purpose of benchmarking and working out transfer pricing adjustment is however acceptable in this case, since it does not result into an outcome different from transaction-wise benchmarking. Thus, only AE-wise segregation of sale transactions for each chemical needs to be done. Appellant's submissions in respect of DBTA sale also have merit and are accepted. Accordingly, transfer pricing adjustment of Rs.2,78,02,502/- worked out by the appellant is directed to be substituted in place of adjustment of Rs.3,91,40,456/- worked out by TPO subject to verification by

the AO of arithmetical correctness of the working done by the appellant."

6.7. The assessee being aggrieved and dissatisfied by the order passed by the CIT (A) carried appeal before the Tribunal, whereas, the Revenue also filed a cross-appeal for the reduction of ALP adjustment made by the CIT (A). The Tribunal considered the question as to which is the most appropriate method for ascertainment of Arm's Length Price in the facts of the case. The Tribunal considered the well established principle that as long as it is reasonably possible to apply direct method of ascertaining the Arm's Length Price of a transaction, such a direct method will have an edge over application of an indirect method of ascertaining the Arm's Length Price. The Tribunal relied upon the decision of the coordinate Bench of the Tribunal in case of ***ACIT v. MSS India Ltd.*** reported in ***(2009) 32 SOT 132 (Pune)*** and Serdia Pharmaceuticals India Pvt. Ltd. (supra) and has observed as under:

"…Going by this principle, all other things being equal, a direct method like Comparable Uncontrolled Price (CUP)

*method will have an edge over an indirect method like Transactional Net Margin Method (TNMM). That does not, and cannot, however mean that whatever be the fact situation, CUP is always a preferred method because of one of the essential prerequisite for application of any method of ascertaining the ALP is the inputs necessary for that purpose. Whatever may be inherent edge of the direct methods of determining arm's length price of an international transaction over indirect methods of determining the arm's length price of international transactions, selection of the most appropriate method for determining arm's length price under the transfer pricing provisions, in a particular fact situation, is not an academic exercise which can be decided de hors the peculiar facts of that situation, and, therefore, there cannot be any straight-jacket formulas holding application of a particular method in case of a particular type of product or service. While rule 10B(1) of the Income Tax Rules 1962, provides that arm's length price in relation to an international transaction shall be determined by any of the methods, "being the most appropriate method", set out therein, Rule 10 C(1) provides the mechanism for selecting the most appropriate method "**which is best suited to the facts and circumstances of each particular transaction" and "which provides the most reliable measure of arm's length price of the international transaction".** Rule 10C(2) further provides that in selecting the most appropriate method as specified in rule 10C(1), certain factors are to be taken*

into account:
(a) the nature and class of the international transaction;
(b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
(c) ***the availability, coverage and reliability of data necessary for application of the method;***
(d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions; (e) ***the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;***
(f) the nature, extent and reliability of assumptions required to be made in application of a method
[Emphasis, by underlining, supplied by us]

10.*What is clear from the above analysis is that a method of determining arm's length price, to be held as a 'most appropriate method' (MAM), should be, as provided in rule 10C(1), a method "****which is best suited to the facts and circumstances of each particular transaction****" and a method and "****which provides the most reliable measure of arm's length price of the international transaction****". Under rule 10C(2)(c), "****the availability, coverage and reliability***

of data necessary for application of the method *" is one of the crucial factors determining suitability of a method of determination of arm's length price in a particular fact situation. Similarly, it is also important to* ***determine whether accurate adjustments can be made for the differences between the international transactions and the comparable uncontrolled transactions,*** *and unless such adjustments can be made the related method cannot be said to be most appropriate method. We have already seen as to how, in the CIT(A)'s analysis, suitable adjustments could not be made even though in his opening observations in the operative portion of the order, he stated that suitable adjustments can indeed be made. The inability to make suitable adjustments, therefore, does take the method outside the ambit of most appropriate method. Quite clearly, therefore, unless suitable reliable data inputs necessary for application of a particular method, as CUP in this case, are available, CUP method cannot be said to be most appropriate methods on the facts of this case. Let us, therefore, first examine whether sufficient inputs were indeed available.*

11. At the outset, it is important to note that what has been relied upon by the TPO is Internal CUP data but then rather than taking the comparable uncontrolled price of the transaction, the TPO has compared average of intra-AE transactions and independent transactions. This approach, though in the case of application of Cost Plus Method, has been rejected by a coordinate bench of this Tribunal in the

case of ***ACIT Vs Tara Ultimo Pvt Ltd [(2012) 143 TTJ 91 (Mum)****], though the same reasoning will be equally applicable in respect of the CUP as well as the computation mechanism, in that respect, is materially similar. In this case, speaking through one of us (i.e. the Vice President), the coordinate bench had observed as follows:*

The way this rule works, the benchmark gross profit is to be applied on each transaction with the AEs , while, for computing the benchmark, one could take into account a series of same or similar transactions. In other words, while setting the benchmark, one can take into account several transactions with unrelated enterprise on what can be termed as 'global basis', essentially in respect of same or similar property or services though, the benchmark so arrived at cannot be applied on the global basis i.e. the average of gross profit earned from same or similar transactions with AEs. *The application of CPM has to be on transaction basis rather than on global basis, and this fundamental scheme of cost plus method is also evident from the plain wordings of Rule 10 B as well.* ***Any other view of the matter will result in incongruities.*** *For example, if our average mark up to unrelated enterprises is 20 per cent. and we charge a mark-up of 2 per cent in one transaction with AE and 38 per cent in another transaction with the AE, both these transactions, by applying the mark up on global basis, will meet the test of ALP whereas in the first case, the mark up charged is certainly not a mark-up resulting in an ALP. In this particular case, for example, the normal*

mark up in transactions with has been computed at 16.31 per cent. and the average of mark up on sales to AEs having been taken at 17.08 per cent. entire sales to AEs has been taken at ALP, but, the mark up in the many cases is clearly less than benchmark. To give one example, at page 221 of the paper-book, margin of 14.15 per cent (4 invoices), 13.95 per cent. 13.81 per cent. 14 per cent (4 invoices), 14.14 per cent (2 invoices), and 14.16 per cent is given by assessee's own computation, and, on the same page, on one invoice, the assessee has shown a margin as high as 27 per cent. The cost plus method, therefore, has not been correctly applied. In any case, one of the most important input, i.e. diamond, has been imported at a price for which no ALP documentation is available and the price of imports have been taken into account in computation of costs as well. The costs of inputs have not been verified either. No efforts are made to show that the terms of sale to the AEs and all other relevant factors are materially similar vis-a-vis the transactions with independent enterprises. The CPM is applied by comparing gross profit on sales, whereas the method requires comparison of mark up on costs on transactions with AEs vis-a-vis mark up on costs on transactions with non AEs [Emphasis, by underlining, supplied by us now]

12. It is also important to note that the TPO has justified application of internal CUP on the basis of deviations in prices at which products are sold to different AEs and, by implication, using one intra AE price to bench the other

intra AE price. That is wholly incorrect. It is well settled in law that it is only an uncontrolled price which can be compared with controlled price and used for any benchmarking. This position has been well summarized in a coordinate bench decision in the case of Sabic Innovative Plastic India (P.) Ltd. v. Dy. CIT [2013] 59 SOT 138/35 taxmann.com 177 (Ahd.), and we are in considered agreement with the same.

13. When comparing the prices of products sold in intra AE transactions vis-à-vis independent transactions, it is not sufficient to compare the prices de hors the economic circumstances in which the respective AE and non AE transactions take place. This principle is beyond any doubt or controversy. In the OECD Guidelines for Multinational Enterprises and Tax Administrators, it is clearly stated that application of CUP method "requires high degree of comparability not only in the products sold and services provided but also in the economic circumstances in which the respective AE and non AE transactions take place". In the UN Transfer Pricing Manual, it is observed that "degree of comparability between controlled and uncontrolled transactions is typically determined on the basis of a number of attributes of the transactions or parties that could materially affect prices or profits and the adjustment that can be made to account for differences" and then it is observed that "these attributes, which are usually referred to as the five comparability factors, include: (i) Characteristics of the property or

service transferred; (ii) Functions performed by the parties taking into account assets employed and risks assumed, in short referred to as the "functional analysis" (iii) Contractual terms; (iv) Economic circumstances; and (v) Business strategies pursued". Clearly, therefore, the significant variations in economic circumstances and contractual terms can take seemingly comparable transactions outside the ambit of comparability."

6.8. After considering the aforesaid principles, the Tribunal applied the same to the facts of the case, as under:

"14. We have noted huge and crucial variations in payment terms of the transactions with the AEs vis-a-vi transactions with non AEs. The CIT(A) has rejected the adjustments in this respect on account of irrelevant factors such as assessee claiming only 8% adjustment in the financial year 2005-06, as against 20% adjustment sought in this year, even though the transactions were under the same agreement. That is immaterial. What is material is that there is huge difference in the payment terms. The CIT(A) has also noted the deviations in the advance payment terms of 120 days under the agreement and the actual advance payment of 17 months on average. He has also noted that in three invoices on non-AEs the credit period was 60 days but then he declines to treat these evidence as support for the claim that in all cases similar credits were given. However, what is clear that there is clearly significant variation

in payment terms. As a matter of fact, at page 29, learned CIT(A) himself notes that "as per the agreement, advance payment was to facilitate appellant's purchases, working capital etc which, in turn, ensured uninterrupted supply to the AE". He does accept that he was given analysis sheet showing 17 months advance payment but rejects it as agreement refers to only 120 days advance payment. That does not belittle the fact that whatever may have been payment terms under the intra AE agreement, the payment was actually received substantially in advance. The question we must ask ourselves is that whether such substantial advance payments, which ensure availability of working capital to the assessee, can be compared with normal business transactions allowing, on the contrary, credit period to the customers. The answer is clearly in negative as the economic circumstances in which these two sets of transactions operate are substantially different. The very character of these transactions is different.

15. It is also important to bear in mind the undisputed fact that the AE had an obligation to buy at least 50% of its products and the assessee was reseller rather than an end user. These contractual terms and the difference in functions also seriously affect the comparability. The reasons given by the CIT(A) for rejecting these variations are wholly superficial and devoid of any legally sustainable merits. The variations in quantities between the AEs and the non AEs cannot be ignored either. There is no dispute that there

is huge variations in quantities sold to the AEs vis-à-vis the quantities sold to the non-AEs but the CIT(A) has rejected the plea on the basis that "there is no consistent pattern or correlation between the volume and sale prices" and that "there is no reference to any volume discount in the agreement". That is again a superficial approach. Whether there is a mention of the volume discount or not or whether there is always a direct relation between the prices and volumes, the fact remains that the transactions with such huge variations, as in this case, cannot be considered to be comparable transactions and that is the consistent approach in benchmarking analysis. The scale of transactions is an important economic factor affecting the comparability. We have also noted that the AEs have reimbursed R&D costs, with mark up, to the assessee. The AEs have also given interest free ECB loans. These are also equally important factors. When we take the transactions with the AEs in the light of these surrounding economic and contractual realities, in our considered view, the transactions with non AEs, on the facts of this case and as a whole, are not comparable at all. We cannot consider the price of the product in isolation with all these factors, and that is the reason why the comparability under CUP ceases to be relevant as these factors are clearly missing in non AE transactions. We have also noted that Rule10 B(1)(a)(ii) itself provides that "such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into

such transactions, which could materially affect the price in the open market" but then while CIT(A) uphold the application of CUP method on the ground that adjustments can indeed be made, he rejects the adjustments on merits. That is clearly incongruous. When he admits that no adjustments can be made on merits, the very foundation of his decision to uphold application of CUP method ceases to hold good. In any case, having perused the material on record, we are of the considered view that accurate adjustments cannot be made to nullify the impact of absolutely fundamental variations in the terms of the intra AE and non AE transactions, and since accurate adjustments cannot be made, for this reason alone, CUP method ceases to be workable on the facts of this case. The contradiction in the approach is also evident from the fact that the CIT(A) has upheld application of CUP method on the sole basis that accurate adjustments can be made to take care of variations in the intra AE and independent transactions but then one of the points made before us, in the written submissions, is that "if total adjustment of 36% claimed in those years was allowed, prices would come down to such unrealistic levels that one of the international transaction, including sales to non AEs, were made anywhere neat them". Clearly, there is no meeting ground between these diametrically opposed stands by the authorities. As regards the decision of coordinate bench in the case of Serdia Pharmaceuticals (supra), that was a case in which no dispute was raised with respect to the comparables cases except on account of quality for which suitable adjustment

was allowed. This precedent, therefore, does not offer any help to the case of the revenue.

16. A lot of emphasis has been placed on the fact that the assessee on its own was using the Internal CUP method in past, and, there was, thus, no good reason to deviate from the same. It is for this main reason that the application of TNMM has been declined by the authorities below. Nothing, however, turns on this plea. What is before us is the question as to which method is most appropriate method for ascertaining the arm's length in the present year. We do not see how this question is to be adjudicated simply on the basis of what has been accepted by the assessee, on his own, as the most appropriate method in the earlier years. Such a choice of method in the earlier years, in our humble understanding, cannot act as an estoppel against the assessee. In our considered view, the decision as to what is the most appropriate method on the facts of this case is to be taken in the light of the facts and material on record before us in the present year. The past conduct of the assessee, with regard to the selection of the most appropriate method for ascertaining arm's length price for the present assessment year, is not really decisive. We, therefore, reject this plea of the revenue authorities as well."

6.9. The Tribunal thereafter referred to the decision of the Coordinate Bench relied on behalf of the assessee in the case of ***DCIT v. Dishman Pharmaceuticals & Chemicals***

Ltd. reported in ***45 SOT 37 (2011)***, wherein, the Tribunal considering the factors relating to the determination of Most Appropriate Method for computing ALP adjustments and came to the conclusion that CUP method cannot be applied in each and every case. The Tribunal, therefore, in the facts of the case, held as under:

> *"19. In view of the above discussions and following the consistent view being taken by the coordinate benches, in our considered view, the application of CUP method was indeed not justified on the facts of the present case. The intra AE transactions, on the facts of this case, were so fundamentally different in character in economic circumstances and contractual terms, that these cannot be compared with the independent transactions entered into by the assessee. We, therefore, reject the stand of the authorities below on this issue.*
>
> *20. We have noted that the assessee has applied TNMM by comparing the profits on transactions with AEs and the non AEs and no specific defects have been pointed out in the allocation of costs in the segmental accounts which are duly reconciled with entity level consolidated accounts. We have also noted that dealing with the Internal TNMM adopted by the assessee the TPO had expressed the view that the basis of allocating the overheads was not clear, in response to which it was explained by*

the assessee that revenue and expenses have been allocated on actual basis wherever these are directly allocable, and wherever these are not directly allocable, the allocation has been done on the basis of appropriate allocation key such as ration of sales quantity, sales revenue, total revenue. It was also explained that the segmental details have been reconciled with entity level audited accounts. The assessee had further submitted that "in case if in your view there are any inappropriate cost allocations, we would appreciate if you can kindly let us know which cost allocations are not appropriate and why these are not appropriate so that we can accordingly clarify and explain on those aspects". We have noted that the TPO did not have any specific comment on this request and he simply rejected the explanation of assessee as "not accepted". In appeal also, no specific adjustments were suggested to the allocations made in the segmental accounts and the discussions were confined to generalities. In these circumstances, we see no reasons to disturb the internal TNMM adopted by the assessee. We, therefore, delete the impugned ALP adjustment of Rs 2,78,02,502."

6.1. Learned Standing Counsel appearing for the revenue Mr. Varun K. Patel submitted that the Tribunal has committed an error in law and on facts in rejecting the approach of the TPO of adopting Comparable Uncontrolled Price (CUP) method as Most Appropriate Method (MAM) and

further erred in allowing various adjustments claimed by the assessee for material differences in contractual term, underlying commercial circumstances, functions, risk and other economic factors between the transactions of assessee with AEs vis-à-vis the transactions of the assessee with non-AEs while applying the CUP method as under:

i. Adjustment on account of business volumes difference.
ii. Adjustment for advance payment received from AE.
iii. Adjustment for making and selling expenses not required to be incurred for AE sales vis-à-vis non AE sales.
iv. Adjustment for credit risk not required to be borne by the assessee for AE sales vis-à-vis non AE sales.
v. Adjustment for interest free ECB loan received from AE.

6.2. Mr. Varun Patel further submitted that, Indian Transfer Pricing Regulations as well as OECD guidelines state that the transactional profit method should ideally be applied on a transaction to transaction basis, but in appropriate situation transactions may be grouped or aggregated. It was submitted that, the relevant controlled

transactions may best be aggregated if it is impractical to analyze all profits of each individual transactions or if such transactions are so inter-related that this is the most reliable means of benchmarking the outcome of the transaction against the arm's length outcome. Reference was made to Rule 10A (d) of the Income Tax Rules, 1962 (for short 'the Rules'), wherein, it is defined that "transaction" includes a number of closely linked transactions. It was therefore submitted that if the appropriate method adopted by the assessee by applying TNMM is to be given any credence then in case of any enterprise all its international transaction would be closely interlinked because all the transaction of an enterprise in one way or the other are connected to the overall operation and objective of the company, and the basis of comparability and analysis on a transaction to transaction basis would lose its meaning.

6.3. It was further submitted that by following the TNMM and by clubbing all the international transactions for all the products, the assessee has failed to follow the Letter and Intent of TNMM as described in law.

6.4. Learned advocate for the Revenue, in support of his submission referred to the decision of the ITAT Ahmedabad 'D' Bench in case of ***Effective Teleservices (P.) Ltd. v. Deputy Commissioner of Income Tax*** reported in ***(2019) 19 taxman.com 98 (Ahmedabad-Trib.)***. He relied upon the following observations made by the Tribunal as under:

> *"6. We have heard the rival contentions of both the parties and perused the materials available on record. At the outset we note that similar issue related to internal CUP method was raised in assessee's own appeal in Effective Teleservices (P.) Ltd. v. Asstt. CIT (2019) 90 taxman.com 390 (Hyd.- Trib.) where issue was decided in favour of assessee by the ITAT vide order dated 16-01-2018 by observing as under:*
> *"10. We have given thoughtful consideration to the orders of the authorities below. We find that the assessee is eligible for tax holiday u/s. 10A of the Act, therefore, we do not find any merit in holding that the assessee manipulated the prices and shifted the profits to the overseas jurisdiction for avoiding taxes in India. Moreover, the taxes rates in the USA are higher than the tax rates prevailing in India. Moreover, the AE of the appellant company has incurred losses in providing end to end services to third parties. If the assessee had directly undertaken contracts with the third parties in USA, it would also have incurred operating losses as against operating profits*

earned while undertaking transactions with AEs.

11. We find that the appellant company has earned average hourly rate from its AE business at Rs. 274.39 per hour. As against the same, the average hourly rate from Non AE business was Rs. 108.82 per hour. Thus, the average hourly rate earned from AE business was more than Non AE business. The only reason for rejecting the assessee's contention is that the pricing mechanism in case of AE as well as Non AEs was different; therefore, CUP is not applicable. In our considered opinion, merely because pricing mechanism is different, internal CUP should not have been rejected.

12. We find that the TPO has mentioned in the order that the risk profile of AE and non AE is entirely different. In our considered opinion, reasonable accurate adjustment cannot be made for such risk differences and if the risk adjustment is made, the same would further reduce the average hourly rate charged from AE which is, as mentioned elsewhere, lower than the average hourly rate charged from AE. Therefore, in our understanding of the facts, internal CUP should have been accepted as most appropriate method."

6.1 Similarly, the identical issue related to internal TNMM method was also raised in assessee's own appeal of assessment year 2009-10 in Effective Teleservices (P.) Ltd. (supra) where issue was decided in favour of assessee by the ITAT vide order dated 16-01-2018 by observing as under:

"13. For the sake of completeness of the adjudication, rejection of internal TNMM analysis undertaken by the appellant during the course of transfer pricing assessment should not have been rejected.

We find that the appellant company has provided identical services to AE as well as non AEs and functions performed, assets used and risks assumed in AE as well as non AE business were similar. Therefore, in our considered opinion, even internal TNMM can be considered as most appropriate method. We find that the operating margin of the appellant from the AE segment was derived at 30.90% and the operating margins in the non AE segment was derived at Rs. 74.92%.

14. The TPO rejected the internal TNMM analysis on the basis that as the appellant has made operating loss in non AE business, the transactions with non AEs are not at independent rates and they have been undertaken only to increase capacity utilization. The total turnover of Non AE segment of Rs. 5.67 lacs as against the turnover of Rs. 1909.60 lacs in the case of international transactions with AE. The ld. CIT(A) confirmed the rejection by holding that the turnover of the third party segment is very much less compared to that with AE. The ld. CIT(A) further held that the appellant has not proved the allocation of the common cost between AE and non AEs and whether they are scientific and at arm's length. We find that the TPO has nowhere disputed the common cost allocation made by the appellant. We also find that the ld. CIT(A) has also never raised any doubt on the allocation. Insofar as the difference in the turnover, we find that the Tribunal Delhi Bench in the case of Lummus Technology Heat Transfer BV Vs. DCIT 42 taxmann.com 342 has held as under:-

5. Rule 10B(1)(e) of the Income Tax Rules, which deals with the Transactional Net Margin Method, provides requires that

"the net profit margin realised by the enterprise (i.e. the assessee) from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base" is compared with " the net profit margin realised by the enterprise (i.e. the assessee) or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base" - of course, subject to comparability adjustments which could affect the amount of net profit margin in uncontrolled conditions. It is not at all necessary, as the authorities below seem to suggest, that such net profit computations, in the case of internal comparables (i.e. assessee's transactions with independent enterprise), are based on the audited books of accounts or the books of accounts regularly maintained by the assessee. hi our considered view, all that is necessary for the purpose of computing arm's length price, under TNMM on the basis of internal comparables, is computation of net profit margin, subject to comparability adjustments affecting net profit margin of uncontrolled transactions, on the same parameters for the transactions with AEs as well as Non AEs, i.e. independent enterprises, and as long as the net profits earned from the controlled transactions are the same or higher than the net profits earned on uncontrolled transactions, no ALP adjustments are warranted. It is not at all necessary that such a computation should be based on segmental accounts in the books of accounts regularly

maintained by the assessee and subjected to audit. We are, therefore, of the view that the authorities below were in error in rejecting the segmental results on the ground that the segmental accounts were not audited and that these segmental accounts were not maintained in the normal course of business. As regards vague generalizations by the TPO to the effect that these accounts are manipulated, that allocation basis of expenses is unfair and that these accounts conceal true profitability, we find that these observations are too sweeping and generalized the observations to have any merits. In any event, learned counsel for the assessee has painstakingly taken us through the segmental accounts, pointed out the basis of allocation of the expenses. We have noted that the allocation of expense is on the man hour basis, which is quite fair and reasonable, and that every person has to punch in hours on a specific project. We have also noted that all these details and expense allocation basis were also before the TPO and even then, no specific defects were pointed out by the TPO. Taking into account all these factors, as also entirety of the case, we are of the considered view that the TPO indeed erred in rejecting the segmental accounts and thus declining to accept the internal comparable. We are also of the view that the size of the uncontrolled transaction or transactions being smaller, by itself, does not make these transactions incomparable with the transactions in controlled conditions. Size of the comparable does matter in entity level comparison because scale of operations substantially vary and so does the underlying profitability factor, but

in a transaction level comparison within the same entity, mere difference in size of the uncontrolled transactions does not render the transaction incomparable. If the size of uncontrolled transaction is too big, it may call for an adjustment for volume business. If the size of the uncontrolled transaction is too small, it may provoke an inquiry by the TPO to ensure that it is not a contrived transaction outside the normal course of business or with regard to other significant factors surrounding smallness of such transaction. However, in our considered view, in none of these cases, a comparable can be rejected on the basis of its size per se. In this view of the matter, the authorities below were clearly in error in rejecting the internal comparable, i.e. profitability of assessee's transactions with non AEs, on the ground that the volume of business with non AEs was too small vis-a-vis business with AEs. In view of these discussions, as also bearing in mind entirety of the case, the assessee was quite justified in adopting internal TNMM and comparing the profit earned on its transactions with AEs with profit earned with non-AEs. Accordingly, the ALP adjustment of Rs. 2,72,42,940/- deserves to be deleted. We order so. The assessee gets the relief accordingly. 15. The Tribunal Hyderabad Bench in the case of NTT Data Global Delivery Services Limited. 63 taxmann.com 92 had taken a similar view and followed the findings given in the case of Lummus Technology Heat Transfer BV (supra).”

6.2 Respectfully following the same we are of the view that assessee rightly benchmarked the transaction by choosing the internal CUP method as most

appropriate method and alternatively also rightly benchmarked the internal TNMM method as most appropriate method to determine the ALP. Accordingly, the appeal of the assessee is allowed."

6.5. It was also submitted that the Tribunal has failed to consider that the assessee has not taken into account very important factor for determination of the ALP on the basis of the determination of the price in different geographies as compared to sale of products to associate enterprise of the assessee, then non-associated enterprises of the assessee situated in the different parts of the world. It was submitted that, non-AE situated in non-developed countries or charge at a lesser price in the sale of products to AE situated in countries, viz. USA which are developed countries. The difference on this account needs to be considered, which has not been taken into account by the assessee. It was further submitted that, in economics, Purchasing Power Parity (PPP) is a condition between countries where an amount of money has the same purchasing power in different countries. Considering the PPP, instead of making any reduction in Non-AE price due to adjustments, the assessee was required to increase the Non-AE price which is not being

taken into account for the purposes of calculation of ALP.

6.6. It was therefore submitted that, the ALP of sales to the AE in respect of ANH and MBTC are benchmarked using CUP as Most Appropriate Method by the TPO.

6.7. It was further submitted that, the assessee has failed to discharge the onus by carrying out the benchmarking in using the most appropriate method and in such scenario; the benchmarking carried out by the TPO represents the best possible approach.

7.1. On the other hand, learned Senior Advocate Mr. S.N. Soparkar assisted by learned advocate Mr. B.S. Soparkar submitted that, the questions of law proposed by the revenue are in realm of questions of facts and as the Tribunal being the final fact finding authority has arrived at a conclusion on the basis of the material produced before it that the TNMM applied by the assessee is the Most Appropriate Method (MAM) for the purpose of computation of ALP, and therefore, no interference is required to be made in the findings given by the Tribunal.

7.2. It was further submitted by the learned

Senior Advocate appearing for the assessee – respondent that the Tribunal on the facts of the present case has held that the assessee has applied TNMM by comparing the profits on transactions with the AE and the Non-AEs and no specific defects have been pointed out in the allocation of costs in the segmental accounts which are duly reconciled with entity level consolidated accounts, and in such circumstances, the method adopted by the assessee was considered as Most Appropriated Method. It was also submitted that the Tribunal has also given a finding that the application of CUP method was not justified on the facts of the present case, as the intra AE transactions were fundamentally different in character in economic circumstances and contractual terms and these cannot be compared with the independent transactions entered into by the assessee.

7.3. It was therefore submitted that, the difference of opinion between the Tribunal and that of CIT (A) and TPO as to appropriateness of one or other methods cannot *per-se* be a ground for interference because appropriateness of the method unless shown by the contrary to Rules, specially Rule 10B and 10C of the Rules, the same

cannot be considered as substantial question of law under Section 260A of the Act, 1961. In support of his submissions, learned Senior Advocate placed reliance upon the decision of the Delhi High Court in the case of ***Principal Commissioner of Income-Tax-6 v. Make My Trip India (P.) Ltd.*** reported in ***(2017) 399 ITR 297 (Delhi).***

7.4. Learned Senior Advocate further relied upon the decision of the Coordinate Bench of this Court in the case of ***Principal Commissioner of Income-tax, Gandhinagar v. Tudor India (P.) Ltd.*** reported in ***(2019) 11 taxman.com 450 (Gujarat)*** to submit that the entire scheme of the transfer pricing has been considered by this court and as such the Tribunal has come to the conclusion on the basis of the material on record as per the provision for the transfer pricing in the act,1961. It was therefore submitted that no interference is required to be made in the impugned order of the Tribunal as no substantial question of law arises there from.

8. Having heard the learned advocates appearing for the receptive parties and having gone through the material on record, it appears from the facts of the case that the Tribunal

considering the material on record has given the finding of fact that the TNMM applied by the assessee is the correct method and the application of CUP method was not justified, in view of the fact that intra AE transactions were fundamentally different in character in economic circumstances and contractual terms and these cannot be compared with the independent transactions entered into by the assessee.

9. The Tribunal has further discarded the view of the TPO dealing with the internal TNMM adopted by the assessee with regard to the basis of allocating the overrates being not clear, by observing that the revenue and expenses have been allocated on actual basis wherever the same were directly allocable and wherever the same were not directly allocable, allocation was made on the basis of the appropriate allocation key such as ratio of sales quantity, sales revenue and total revenue. The Tribunal also found that the segmental details have been reconciled with entity level audited accounts. It was also found that the TPO did not have any objection with regard to the allocation made by the assessee, but explanation given by the assessee was simply rejected as “not accepted”. The CIT (A) also

did not refer to any flow to the allocations made in the segmental accounts and discussed the issue on generalities only. In such circumstances, the Tribunal after considering in detail the facts of the case as stated in paras-14 and 15 of the impugned order reproduced hereinabove, has come to the conclusion that the internal TNMM adopted by the assessee is just and proper.

10. In decision of ***Principal Commissioner of Income-tax, Gandhinagar v. Tudor India (P.) Ltd.*** (supra) this Court has considered the entire scheme of the transfer pricing and has observed as under:

> "11. The Karnataka High Court, in the case of Pr. Commissioner of Income Tax, Bangalore & Ors. vs. Softbrands India P. Ltd., reported in (2018) 406 ITR 513 had the occasion to consider the special provisions relating to the Avoidance of Tax in Chapter-X of the Act comprising of Sections 92 to 94-B with regard to the assessment to be done for the computation of income from international transactions on the principles of "Arm's Length Price" (ALP) and the relevant Rules for computation of such income under the aforesaid provisions of Chapter-X in the form of Rule 10-A to 10-E in the Income Tax Rules, 1962. We may quote the relevant portion of the judgment;
>
> *"Perspective of International Trade and Transactions:*
>
> *4. With the ever increasing international Trade and transactions, particularly, in the Software Industries and Bangalore, being the Silicon Valley of India where many big, small and medium size Software Industries have their Offices and Units in this Software Industry, and Bengaluru is a hub of*

this Service Industry and essentially the Indian Companies have business linkages with large Companies spread worldwide particularly in the Western Hemisphere of the Globe.

5. The implementation of the Tax laws in this field in a smooth, clear and quick manner is of utmost importance to build an image of an efficient Tax Administration both at Departmental level and in Judicial Courts so that the economic activity in such borderless trade thrives and enures to the benefit of the Indian economy at large and Software Industry in particular.

While the special provisions have been made for computation of 'Arm's Length Price' to arrive at a fair assessment of income taxable in the hands of the Indian Resident Companies and these special provisions also provide for an elaborate and in-depth analysis of huge data of the comparable cases of other similarly situated Companies to arrive at a fair 'Arm's Length Price' and for that, Special Cells and designated Authorities have been created under the Income Tax Act, 1961, but still retaining the normal provisions for assessments of appeals in the Indian Income Tax Act about the remedial Forums or the appeal mechanisms and the Income Tax Appellate Tribunal constituted under Section 253 of the Act continues to be the final fact finding body under the Act even with regard to the assessments of the international transactions under the Special Chapter X as aforesaid and the appeal to the Constitutional Courts as provided in Section 260-A to High Court and Section 261 to the Hon'ble Supreme Court are applicable to these special assessments under Chapter X as well. "

12. In para-11 of the judgment, the Hon'ble Court diluted upon the following three questions;
"[I] The analysis of the provisions relating to the Transfer Pricing/ determination of the 'Arm's Length Price';

[II] The Scheme of procedure of assessment and appeals to the Tribunal and High Court/Supreme Court.
[III] The scope of interference by High Court under Section 260-A of the Act in these type of cases. "

13. The Court, thereafter, expressed its prima facie opinion as regards the transfer pricing adjustments.

> *"Prima Facie Opinion:*
>
> *15. We are of the considered opinion that this entire exercise of making Transfer Pricing Adjustments on the basis of the comparables is nothing but a matter of estimate of a broad and fair guess-work of the Authorities based on relevant material brought before the Authorities including the Appellate Tribunal, but nonetheless the Tribunal being the final fact finding body remains so for this Special Chapter X also and therefore, unless this Court is satisfied that a substantial question of law is arising from the order of the Tribunal, the appeal under Section 260-A cannot be entertained at the instance by either the Revenue or the Assessee and the exercise of fact finding or 'Arm's Length Price' determination or 'Transfer Pricing Adjustments' should be allowed to become final with a quietus at the hands of the final fact finding body, i.e. the Tribunal."*

14. The Court, thereafter, undertook a comparative analysis of Section 260-A of the Act, 1961, Section 100 and Section 103 of the CPC and proceeded to observe as under:

> *"16. We would analyze the provisions of Section 260-A of the Act in a little more detail but we are of the firm opinion that the entry into the High Court under Section 260-A of the Act is locked with the words "Substantial questions of law" and the key to open that lock to maintain such appeal can only be the perversity of the findings of the Tribunal in these type of cases and the perversity in the findings not only*

averred by the appellant before this Court but, established on the basis of cogent material which was available before the Authorities below including the Tribunal and the findings arrived at by the Tribunal can be so held to be perverse within the well settled parameters for determining the same as perverse. It is not allowed to either of the parties, i.e. the Assessee or the Revenue to invoke the jurisdiction of this Court under Section 260-A of the Act merely because the Tribunal comes to reverse or modify the findings given by the lower Authority, viz. Transfer Pricing Officer (TPO) or Dispute Resolution Panel (DRP) which comprises of three Commissioners and the Revenue or the assessee may feel dissatisfied, because of the reversal or modification of such findings by the Tribunal resulting in leaving out of certain comparables or adding on of certain comparables for determining the 'Arm's Length Price' in the hands of the Assessee Company.

17. Unless such perversity in the findings of the Tribunal is established we are of the opinion that the appeals under Section 260-A of the Act cannot and should not be entertained at the instance of either of the parties and the present cases before us, we find that the Tribunal has given cogent reasons and detailed findings upon discussing each case of comparable corporate properly and therefore, we find ourselves unable to call such findings of the Tribunal perverse in any manner so as to require our interference under Section 260-A of the Act.

18. We now take up the analysis of Section 260- A of the Act which we have already said is in pari materia with Sections 100 and 103 of the Civil Procedure Code.

19. The said provisions are quoted below for ready reference and comparison.

Section 260-A of the Income Tax Act, 1961 reads as under:

"260A - Appeal to High Court:

(1) An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal [before the date of

establishment of the National Tax Tribunal], if the High Court is satisfied that the case involves a substantial question of law.

(2) [The [Principal Chief Commissioner or] Chief Commissioner or the [Principal Commissioner or] Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the
High Court and such appeal under this sub-section shall be-]
(a) filed within one hundred and twenty days from the date on which the order appealed against is [received by the assessee or the [Principal Chief Commissioner or] Chief Commissioner or [Principal Commissioner or] Commissioner];
(b) [*******]
(c) in the form of a memorandum or appeal precisely stating therein the substantial question of law Involved.
[(2A) The High Court may admit an appeal after the expiry of the period of one hundred and twenty days referred to in Clause (a) of sub-section (2), if it is satisfied that there was sufficient cause for not filing the same
within that period.]
(3) Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.
(4) The appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question:
Provided that nothing in this sub- section shall be deemed to take away or abridge the power of the Court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.
(5) The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded

and may award such cost as it deems fit.
(6) The High Court may determine any issue which -
(a) has not been determined by the Appellate Tribunal;
or
(b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1).

[(7) Save as otherwise provided in this Act, the provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to appeals to the High Court shall, as far as may be, apply in the case of appeals under this Section.]

Sections 100 and 103 of the Code of Civil Procedure, 1908 read thus:

"Section 100 - Second Appeal.

(1) Save as otherwise expressly provided in the body of this Code or by any other law for the time being in force, an appeal shall lie to the High Court from every decree passed in appeal by any Court subordinate to the High Court, if the High Court is satisfied that the case involves a substantial question of law.
(2) An appeal may lie under this section from an appellate decree passed ex- parte.

(3) In an appeal under this section, the memorandum of appeal shall precisely state the substantial question of law involved in the appeal.
(4) Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate the question.
(5) The appeal shall be heard on the question so formulated and the respondent shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question:
Provided that nothing in this sub- section shall be deemed to take away or abridge the power of the Court to hear, for

reasons to be recorded, the appeal on any other substantial question of law, not formulated by it, if it is satisfied that the case involves such question."

Section 103 - Power of High Court to determine issues of fact -
In any second appeal, the High Court may, if the evidence on the record is sufficient, determine any issue necessary for the disposal of the appeal, -
(a) which has not been determined by the lower Appellate Court or both by the Court of first instance and the lower Appellate Court, or
(b) which has been wrongly determined by such Court or Courts by reason of a decision on such question of law as is referred to in section 100."

What is a Substantial Question of Law?

20. From a bare comparison of the provisions quoted above and as discussed in various judgments of the Constitutional Courts, which we will refer in brief herein below, it is clear that the Scheme of both Section 260-A in Income Tax Act, 1961 and Section 100 r/w. Section 103 of the Code of Civil Procedure are in pari materia and in same terms.
21. The existence of a substantial question of law is sine qua non for maintaining an appeal before the High Court. While the appeal to High Court under Section 260-A of the Act may be a First appeal in the sense from the order of final fact finding by the Tribunal under the Income Tax Act, whereas the Second Appeal on substantial question of law before High Court under Section 100 would lie against the Judgment and Decree of the first Appellate Court disposing of an appeal against the Judgment and Decree of a Trial Court, but nonetheless it is the third round of consideration at the level of the High Court, where the facts and law both have been screened, discussed and analyzed by the Authorities or the Courts below and therefore the tenor and color of the words "substantial question of law" in both these

enactments remains the same.

22. The High Court has power to not only formulate the substantial questions of law and rather it has the duty to do so and can also frame additional substantial questions of law at a later stage, if such a substantial question of law is involved in the appeal before it under these provisions and the appeal should be heard and decided only on such substantial questions of law after allowing the parties to address their arguments on the same. The extended power given to the High Courts to decide even an issue under Sub- section (6) of Section 260-A of the Income Tax Act, which is in pari materia with Section 103 of the Civil Procedure Code and which says that the High Courts may determine any issue which (a)has not been determined by the Tribunal or (b) has been wrongly determined by the Tribunal, can be so determined by the High Court, only if the High Court comes to the conclusion that 'by reason of the decision on substantial question of law rendered by it', such a determination of issue of fact also would be necessary and incidental to the answer given by it to the substantial question of law arising and formulated by it.

23. The argument raised by the learned counsel for the Respondent Assessee before us by making a disjuncted reading of Clause (a) and Clause (b) of Sub- Section (6) of Section 260-A of the Income Tax Act, 1961 to submit that the High Court can touch upon the issues of facts also in an appeal under this provision bereft of substantial question of law, is a misconceived argument.

24. In our opinion, both the Clause (a) and Clause (b) of Sub-Section (6) of Section 260-A of the Act are circumscribed by the words 'by reason of the decision on such question of law as is referred to in Sub-section (1)'. Therefore, even if an issue which has not been determined by the Tribunal, which was required to be so determined in terms of the answer to the

substantial question of law given by the High Court, such an issue not determined by the Tribunal could also be decided by the High Court with reference to Clause (a) and more so, if such an issue has been wrongly decided according to the answer given by the High Court to such a substantial question of law, then also the High Court can set it right to fall in line with the answer given by the High Court to such a substantial question of law raised before it and determined by it in terms of Clause (b) thereof.

25. Sub-section (6) of Section 260-A of the Act, therefore, does not give any extended power, beyond the parameters of the substantial question of law to the High Court to disturb the findings of fact given by the Tribunal below.

26. Sub-section (7) inserted in Section 260-A of the Act by the Finance Act of 1999 with effect from 01/06/1999 after a period of about 8 months of substituting the new provisions of Section 260-A to the Act as they now stand by Finance Act of 1998, with effect from 01/10/1998 was only to clarify and support that the parameters of Sections 100 & 103 of the Civil Procedure Code and other provisions of Civil Procedure Code relating to appeals of High Court shall apply to the appeals under Section 260-A of the Income Tax Act also.

27. The insertion of Sub-section (7) in Section 260-A of the Act does not give any new or extended powers to the High Court and the pre-existing provisions from Subsection (1) to Sub-section (6) in Section 260-A of the Act already had all the trappings of Sections 100 and 103 of the Civil Procedure Code.

Case Laws on Substantial Question of Law:

28. In the leading and the first and foremost case on the interpretation of Section 100 of the Code of Civil Procedure Code, the Constitution Bench of the Hon'ble Supreme Court in the case of Sir Chunilal V. Mehta and Sons Limited Vs. Century Spinning and Manufacturing Co. Limited AIR 1962 SC

1314, held in para.6 as under:

> *"6. We are in general agreement with the view taken by the Madras High Court and we think that while the view taken by the Bombay High Court is rather narrow the one taken by the former High Court of Nagpur is too wide. The proper test for determining whether a question of law raised in the case is substantial would, in our opinion, be whether it is of general public importance or whether if directly and substantially affects the rights of the parties and if so whether it is either an open question in the sense that it is not finally settled by this Court or by the Privy Council, or by the Federal Court or is not free from difficulty or calls for discussion of alternative views. If the question is settled by the highest Court or the general principles to be applied in determining the question are well settled and there is a mere question of applying those principles or that the plea raised is palpably absurd the question would not be a substantial question of law."*

29. In the case of Santosh Hazari Vs. Purushottam Tiwari (Deceased) by LRs., [2001] 3 SCC 179, another Three Judges' Bench of the Honble Supreme Court explained the meaning of the substantial questions of law in paras.11 and 12 in the following manner.

> *"11. Even under the old Section 100 of the Code (pre-1976 amendment), a pure finding of fact was not open to challenge before the High Court in second appeal. However the Law Commission noticed a plethora of conflicting judgments. It noted that in dealing with second appeals, the courts were devising and successfully adopting several concepts such as, a mixed question of fact and law, a legal inference to be drawn from facts proved, and even the point that the*

case has not been properly approached by the courts below. This was creating confusion in the minds of the public as to the legitimate scope of second appeal under Section 100 and had burdened the High courts with an unnecessarily large number of second appeals. Section 100 was, therefore, suggested to be amended so as to provide that the right of second appeal should be confined to cases where a question of law is involved and such question of law is a substantial one. (See Statement of Objects and Reasons.) The Select Committee to which the Amendment Bill was referred felt that the scope of second appeals should be restricted so that litigations may not drag on for a long period. Reasons, of course, are not required to be stated for formulating any question of law under sub-section (4) of Section 100 of the Code; though such reasons are to be recorded under proviso to sub-section (5) while exercising power to hear on any other substantial question of law, other than the one formulated under sub-section (4).

12. The phrase "substantial question of law", as occurring in the amended substantial, as qualifying "question of law", means - of having substance, essential, real, of sound worth, important or considerable. It is to be understood as something in contradistinction with - technical, of no substance or consequence, or academic merely. However, it is clear that the legislature has chosen not to qualify the scope of "substantial question of law" by suffixing the words "of general importance" as has been done in many other provisions such as Section 109 of the Code or Article 133(1)(a) of the Constitution. The substantial question of law on which a second appeal shall be heard need not necessarily be a substantial question of law of general importance. In Guran

> *Ditta v. T. Ram Ditta", the phrase "substantial question of law" as it was employed in the last clause of the then existing Section 110 CPC (since omitted by the Amendment Act, 1973) came up for consideration and their Lordships held that it did not mean a substantial question of general importance but a substantial question of law which was involved in the case as between the parties. In Sir Chunilal V. Mehta & Sons Ltd. v. Century Spg. And Mfg. Co. Ltd. the Constitution Bench expressed agreement with the following view taken by a Full Bench of the Madras High Court in Rimmalapudi Subba Rao v. Noony Veeraju."*

30. In the case of Hero Vinoth (Minor) Vs. Seshammal [2006]5 SCC 545, the Two Judges' Bench of the Hon'ble Supreme Court following the earlier precedents, summarises the principles in the following manner.

The relevant portion of the said judgment at para.24 is quoted below for ready reference:

> *"24. The principles relating to Section 100 CPC relevant for this case may be summarized thus:*
>
> *(i) An inference of fact from the recitals or contents of a document is a question of fact.*
>
> *But the legal effect of the terms of a document is a question of law. Construction of a document involving the application of any principle of law, is also a question of law. Therefore, when there is misconstruction of a document or wrong application of a principles of law in construing a document, it gives rise to a question of law.*
>
> *(ii) The High Court should be satisfied that the case involves a substantial question of law, and not a mere question of law. A question of law*

having a material bearing on the decision of the case (that is, a question, answer to which affects the rights of parties to the suit) will be a substantial question of law, if it is not covered by any specific provisions of law or settled legal principle emerging from binding precedents, and involves a debatable legal issue. A substantial question of law will also arise in a contrary situation; where the legal position is clear, either on account of express provisions of law or binding precedents, but the Court below has decided the matter, either ignoring or acting contrary to such legal principle. In the second type of cases, the substantial question of law arises not because the law is still debatable, but because the decision rendered on a material question, violates the settled position of law.

(iii) The general rule is that High Court will not interfere with the concurrent findings of the courts below. But it is not an absolute rule. Some of the well-recognised exceptions are where (i) the courts below have ignored material evidence or acted on no evidence; (ii) the courts have drawn wrong inferences from proved facts by applying the law erroneously; or (iii) the courts have wrongly cast the burden of proof. When we refer to "decision based on no evidence", it not only refers to
cases where there is a total dearth of evidence, but also refers to any case, where the evidence, taken as a whole, is not reasonably capable of supporting the finding."

31. In the case of Vijay Kumar Talwar Vs. Commissioner of Income Tax, Delhi, [2011] 1 SCC 673, comparing the provisions of Section 260-A of the Act with Section 100 of the Civil Procedure Code, the Hon'ble Supreme Court held that in the absence of demonstrated perversity in the findings of

the Tribunal, the Court cannot interfere and a finding of fact may give rise to a substantial question of law, only if it is perverse.

Paragraphs 23 and 25 of the said judgment is quoted below for ready reference:-

> *"23. A finding of fact may give rise to a substantial question of law, inter alia, in the event the findings are based on no evidence and/or while arriving at the said finding, relevant admissible evidence has not been taken into consideration or inadmissible evidence has been taken into consideration or legal principles have not been applied in appreciating the evidence, or when the evidence has been misread. (See Madan Lal v. Gopi Narendra Gopal Vidyarthi V. Rajat Vidyarthi, Commr. Of Customs v. Vijay Dasharath Patel, Metroark Ltd. v. CCE and W.B. Electricity Regulatory Commission v. CESC Ltd.).*
>
> *25. We are of the opinion that on a conspectus of the factual scenario, noted above, the conclusion of the Tribunal to the effect that the assessee has failed to prove the source of the cash credits cannot be said to be perverse, giving rise to a substantial question of law. The Tribunal being a final fact-finding authority, in the absence of demonstrated perversity in its finding, interference therewith by this Court is not warranted."*

15. The Court, thereafter, proceeded to explain the scheme of assessment of the Transfer Pricing Cases.

"Scheme of Assessment of the Transfer Pricing Cases:

32. Let us briefly now discuss the Scheme of assessment under Chapter X relating to Transfer Pricing cases of International Taxation under these provisions in income arising from international transactions which shall be computed having regard to the

'Arm's Length Price' (Sec.92).

33. Section 92-A defines an 'Associate Enterprise' viz., the Company which participates directly or indirectly, or through one or more intermediaries, in its Management or control or Capital of the other Enterprise by holding more than 26% of the share holding in such other Enterprises and satisfy the other criterias as stated in Section 92-A of the Act.

34. The word 'International Transaction' is defined in Section 92-B of the Act.

35. The most important provision concerning us in this batch of cases is Section 92-C of the Act which provides for 'Computation of Arm's Length Price' and the said provision stipulates that the 'Arm's Length Price' in relation to the international transactions shall be determined by following any of these methods enumerated in Section 92-C of the Act which is considered to be the 'Most Appropriate Method' by the Authorities under the Act. The methods provided are:

Clause (a): Comparable Uncontrolled Principles Method (CUP);
Clause (b): Resale Price Method (RP)
Clause (c): Cost Plus Method (CP)
Clause (d): Profit Split Method (PS)
Clause (e): Transactional Net Margin Method (TNMM); and
Clause (f): such other Method as may be prescribed by the Board.

36. It appears from the true facts of the various cases before us and the arguments of the learned counsels that the TNNM Method appears to be the most popular and widely adopted Method for determining the 'Arm's length price' in which the Operating Profit Margin of comparable Companies are considered by the Authorities and applied to the cases of the Assessees to determined the 'Arm's Length Price' and make Transfer Pricing Adjustments.

Rules 10-A, 10-AB, 10-B, 10-C & 10-CA of the

Income Tax Rules, 1962 prescribe the manner for working out 'Arm's Length Price' under aforesaid prescribed Methods.

37. Section 92-CA of the Act envisages that the Assessing Authority, if he considers necessary or expedient so to do, he can with the previous approval of the Principal Commissioner, refer the computation of 'Arm's Length Price' to Transfer Pricing Officer (TPO), another Departmental Authority only, who is supposed to have special knowledge and training for computing the 'Arm's Length Price' in the international transactions. The Report of the Transfer Pricing Officer is binding on the Assessing Authority as per Section 92-CA (4) of the Act, but where the Assessee raises an objection against the Draft Assessment Order of the Assessing Authority based on such Report of the Transfer Pricing Officer, the Assessee Company within 30 days can either accept the said Draft Order or file its objections before the Dispute Resolution Panel (DRP) and the Assessing Officer as per Section 144- C of the Act. The said Dispute Resolution Panel comprises of a Collegium of three Principal Commissioners or Commissioners of Income Tax constituted by the Board as defined in Section 144-C (15) of the Act and it has to comply with the principles of natural justice by giving an opportunity of hearing to the Assessees. The order passed by the Assessing Authority in pursuance of the directions of the Dispute Resolution Panel (DRP) is directly appealable to the Income Tax Tribunal under Section 253 (1) (d) of the Act. Section 254 of the Act empowers the Appellate Tribunal to pass such orders on the appeals 'as it thinks fit' after giving an opportunity of hearing to both the parties.

38. From the aforesaid Scheme of assessment with regard to international transactions, it is clear that the process of determination of 'Arm's Length Price' has to be undertaken by the Expert Wing of the Income Tax Department which is manned by

Transfer Pricing Officer (TPO) and at the higher level by a Collegium of three Commissioners in the form of Dispute Resolution Panel (DRP) whose orders on questions of facts are appealable before the highest fact finding body, viz., the Appellate Tribunal.

39. The process of determination of 'Arm's Length Price' as observed above, necessarily takes into account the comparable cases of other similarly situated or nearly similarly situated Corporate Entities whose data are in public domain or on the Data Bases like Prowess and Capital Line Data Base etc. "

16. The Court, thereafter, proceeded to discuss whether any substantial question of law could be said to be involved in the matter.

"No Substantial Question of Law Arises in these Cases:

40. The dispute essentially before us is the pairing and matching such comparables with the Transfer Pricing Analysis of the profit margins given by the Assessee himself during the course of determination of such 'Arm's Length Price'.

41. The shades of arguments raised by both the sides before us in these appeals and most of which have been filed by the Revenue are that either the wrong Filters have been applied or Filters have been wrongly applied, particularly qua Turnover Filter giving a far too wide or narrower range of comparables or even though comparable Entities were functionally different entities from the Entities in the list of Departmental comparables, as against the comparables sought to be provided by the assessees but the Revenue Department generally insists on their inclusion to get high profit ratio leading to higher Transfer Pricing adjustments, whereas the assessee would like to keep the comparables in a narrower range to justify its Transfer Pricing Analysis and profits declared.

42. In sum and substance, we find that such an exercise having been undertaken by the Authorities below may have resulted not only in high pitched Transfer Pricing Adjustments in the declared profits of the Assessee, but a flood of such appeals go before the Tribunal itself where finally the inclusion or exclusion of comparables has been determined by the Tribunal on due analysis giving its own reasons.

43. The contention raised before us that in view of some different views taken by the Tribunal by different Benches at different places, the present appeals under Section 260-A of the Act deserve to be entertained and admitted by this Court for laying down certain Guidelines about the Filters or Most Appropriate Method to be adopted for determination of the 'Arm's length price', does not, in our considered opinion falls within the parameters of the substantial question of law. None of the sides was able to point out any perversity in the Orders of the Appellate Tribunal in this regard.

44. *This Court cannot be expected to undertake the exercise of comparison of the comparables itself which is essentially a fact finding exercise. Neither the sufficient Data nor factual informations nor any technical expertise is available with this Court to undertake any such fact finding exercise in the said appeals under Section 260-A of the Act. This Court is only concerned with the question of law and that too a substantial one, which has a well defined connotations as explained above and findings of facts arrived at by the Tribunal in these type of assessments like any other type of assessments in other regular assessment provisions of the Act, viz. Sections 143, 147 etc. are final and are binding on this Court. While dealing with these appeals under Section 260-A of the Act, we cannot disturb those findings of fact under Section 260-A of the Act, unless such findings are exfacie perverse and unsustainable and exhibit a total*

nonapplication of mind by the Tribunal to the relevant facts of the case and evidence before the Tribunal.

45. Otherwise if the High Court takes the path of making such a comparative analysis and pronounces upon the questions as to which Filter is good and which comparable is really comparable case or not, it will drag the High Courts into a whirlpool of such Data analysis defeating the very purpose and purport of the provisions of Section 260-A of the Act. Therefore what we observed above appears to us to be the sustainable view that the key to the lock for entering into the jurisdiction of High Court under Section 260-A of the Act is the existence of a substantial question of law involved in the matter. The key of ex-facie perversity of the findings of the Tribunal duly established with the relevant evidence and facts. Unless it is so, no other key or for that matter, even the in-consistent view taken by the Tribunal in different cases depending upon the relevant facts available before it cannot lead to the formation of a substantial question of law in any particular case to determine the aspects of determination of 'Arm's Length Price' as is sought to be raised before us. "

17. The Court, thereafter, expressed its concern for giving primacy to the Tribunal in the area of fact finding.

"46. Undoubtedly, the Income Tax Tribunal is the final and highest fact finding body under the Act. It is manned by Expert Members (Judicial Members are selected from District Judges or Advocates and Accountant Members selected from practicing Chartered Accountants or persons of CIT level in the Department). Therefore this quasi-judicial forum is expected and as some of the nicely articulated Judgments and Orders from the Tribunal would indicate, the Orders passed by the Tribunal should normally put an end and quietus to the findings of facts and factual aspects of assessment. The lower Revenue Authorities cannot be allowed to

make it their prestige issue, if their stand is not upheld by the Tribunal and agitate against their Orders before the higher Courts by resort to Section 260-A or Section 261 of the Act merely because they are dissatisfied with the findings of facts by the Tribunal.

47. In the case before us now, the pick of comparables, short-listing of them, applying of filters, etc., are all fact finding exercises and therefore the final Orders passed by the Tribunal are binding on the lower Authorities of the Department as well as High Court.

48. The Tribunal of course is expected to act fairly, reasonably and rationally and should scrupulously avoid perversity in their Orders. It should reflect due application of mind when they assign reasons for returning the particular findings.

49. For instance, while dealing with comparables or Filters, if un-equals like Software Giant Infosys or Wipro are compared to a newly established small size Company engaged in Software service, it would obviously be wrong and perverse. The very word "comparable" means that the Group of Entities should be in a homogeneous Group. They should not be wildly dissimilar or unlike or poles apart. Such wild comparisons may result in the best judgment assessment going haywire and directionless wild, which may land up the findings of the Tribunal in the realm of perversity attracting interference under Section 260-A of the Act. "

18. *In the last, the Court concluded as under:*

"The procedure of assessment under Chapter X relating to international transactions as indicated above is already a lengthy one and involves multiple Authorities of the Department. A huge, cumbersome and tenacious exercise of Transfer Pricing Analysis has to be undertaken by the Corporate Entities who have to comply with the various provisions of the Act and Rules with a huge Data Bank and in the first instance they have to satisfy that the profits or the income from transactions declared by them is at 'Arm's length' which analysis is invariably put to

test and inquiry by the Authorities of the Department and through the process of Transfer Pricing Officer (TPO) and Dispute Resolution Panel (DRP) and the Tribunal at various stages, the assessee has a cumbersome task of compliance and it has to satisfy the Authorities that what has been declared by them is true and fair disclosure and much of the Transfer Pricing Adjustments is not required but the Tax Authorities have their own view on the other side and the effort on the part of the Tax Revenue Authorities is always to extract more and more revenue. This process of making huge Transfer Pricing Adjustments results in multi- layer litigation at multiple Fora. After the lengthy process of the same, the matter reaches the Tribunal which also takes its own time to decide such appeals. In the course of this dispute resolution, much has already been lost in the form of time, man-hours and money, besides giving an adverse picture of the sluggish Dispute Resolution process through these channels. If appeals under Section 260-A of the Act were to be lightly entertained by High Court against the findings of the Tribunal, without putting it to a strict scrutiny of the existence of the substantial questions of law, it is likely to open the flood-gates for this litigation to spill over on the dockets of the High Courts and up to the Supreme Court, where such further delay may further cause serious damage to the demand of expeditious judicial dispensation in such cases.

Conclusion:

55. A substantial quantum of international trade and transactions depends upon the fair and quick judicial dispensation in such cases. Had it been a case of substantial question of interpretation of provisions of Double Taxation Avoidance Treaties (DTAA), interpretation of provisions of the Income Tax Act or Overriding Effect of the Treaties over the Domestic Legislations or the questions like Treaty Shopping, Base Erosion and Profit Shifting (BEPS), Transfer of

Shares in Tax Havens (like in the case of Vodafone etc.), if based on relevant facts, such substantial questions of law could be raised before the High Court under Section 260-A of the Act, the Courts could have embarked upon such exercise of framing and answering such substantial question of law. On the other hand, the appeals of the present tenor as to whether the comparables have been rightly picked up or not, Filters for arriving at the correct list of comparables have been rightly applied or not, do
not in our considered opinion, give rise to any substantial question of law.
56. We are therefore of the considered opinion that the present appeals filed by the Revenue do not give rise to any substantial question of law and the suggested substantial questions of law do not meet the requirements of Section 260-A of the Act and thus the appeals filed by the Revenue are found to be devoid of merit and the same are liable to be dismissed.

57. We make it clear that the same yardsticks and parameters will have to be applied, even if such appeals are filed by the Assessees, because, there may be cases where the Tribunal giving its own reasons and findings has found certain comparables to be good comparables to arrive at an 'Arm's Length Price' in the case of the assessees with which the assessees may not be satisfied and have filed such appeals before this Court. Therefore we clarify that mere dissatisfaction with the findings of facts arrived at by the learned Tribunal is not at all a sufficient reason to invoke Section 260-A of the Act before this Court.
"

19. The Delhi High Court, in the case of CIT vs. EKL Appliances Ltd., reported in (2012) 345 ITR 241 (Delhi), in context with Section 92CA of the Act, had observed as under:

"It seems to us that the decision taken by the Tribunal is the right decision. The TPO applied the CUP method while examining the payment of brand fee/ royalty. The CUP

method which in its expanded form is known as "comparable uncontrolled price" method is provided for in Rule 10B(1)(a) of the Income Tax Rules, 1962. It is one of the methods recognised for determining the ALP in relation to an international transaction. Rule 10B(1) says that for the purposes of Section 92C(2), the ALP shall be determined by any one of the five methods, which is found to be the most appropriate method, and goes on to lay down the manner of determination of the ALP under each method. The five methods recognized by the rule are (i) comparable uncontrolled price method (CUP), (ii) re-sale price method, (iii) cost plus method, (iv) profit split method and (v) transactional net marginal method (TNMM). The manner by which the ALP in relation to an international transaction is determined under CUP is prescribed in clause (a) of the sub-rule (1) of Rule 10B. The following three steps have been prescribed: -

"(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 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;"

The Organization for Economic Co-operation and Development ("OECD , for short) has " laid down "transfer pricing guidelines" for Multi-National Enterprises and Tax Administrations. These guidelines give an introduction to the arm's length price

principle and explains article 9 of the OECD Model Tax Convention. This article provides that when conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises then any profit which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, if not so accrued, may be included in the profits of that enterprise and taxed accordingly. By seeking to adjust the profits in the above manner, the arm's length principle of pricing follows the approach of treating the members of a multi-national enterprise group as operating as separate entities rather than as inseparable parts of a single unified business. After referring to article 9 of the model convention and stating the arm's length principle, the guidelines provide for "recognition of the actual transactions undertaken" in paragraphs 1.36 to 1.41. Paragraphs 1.36 to 1.38 are important and are relevant to our purpose. These paragraphs are reproduced below: -

> *"1.36 A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapters II and III. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.*
>
> *1.37 However, there are two particular circumstances in which it may, exceptionally, be both appropriate and*

legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. The first circumstance arises where the economic substance of a transaction differs from its form. In such a case the tax administration may disregard the parties' characterization of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterize the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price. An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract (as previously indicated in paragraph 1.10). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in their entirety (and not simply by reference to pricing) to

those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

1.38 In both sets of circumstances described above, the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions as may have been structured by the taxpayer to avoid or minimize tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm's length dealings. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties dealing at arm's length."

The significance of the aforesaid guidelines lies in the fact that they recognise that barring exceptional cases, the tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transactions. The reason for characterisation of such restructuring as an arbitrary exercise, as given in the guidelines, is that it has the potential to create double taxation if the other tax administration does not share the same view as to how the transaction should be structured.

Two exceptions have been allowed to the aforesaid principle and they are (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner.

There is no reason why the OECD guidelines should not be taken as a valid input in the present case in judging the action of the TPO. In fact, the CIT (Appeals) has referred to and applied them and his decision has been affirmed by the Tribunal. These guidelines, in a different form, have been recognized in the tax jurisprudence of our country earlier. It has been held by our courts that it is not for the revenue authorities to dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. We may refer to a few of these authorities to elucidate the point. In Eastern Investment Ltd. v. CIT, (1951) 20 ITR 1, it was held by the Supreme Court that "there are usually many ways in which a given thing can be brought about in business circles but it is not for the Court to decide which of them should have been employed when the Court is deciding a question under Section 12(2) of the Income Tax Act". It was further held in this case that "it is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned". In CIT v. Walchand & Co. etc., (1967) 65 ITR 381, it was held by the Supreme Court that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the Revenue. It was further observed that the rule that expenditure can only be justified if there is corresponding increase in the

profits was erroneous. It has been classically observed by Lord Thankerton in Hughes v. Bank of New Zealand, (1938) 6 ITR 636 that "expenditure in the course of the trade which is unremunerative is none the less a proper deduction if wholly and exclusively made for the purposes of trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense". The question whether an expenditure can be allowed as a deduction only if it has resulted in any income or profits came to be considered by the Supreme Court again in CIT v. Rajendra Prasad Moody, (1978) 115 ITR 519, and it was observed as under: -

> *"We fail to appreciate how expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of Section 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income."*

It is noteworthy that the above observations were made in the context of Section 57(iii) of the Act where the language is somewhat narrower than the language employed in Section 37(1) of the Act. This fact is recognised in the judgment itself. The fact that the language employed in Section 37(1) of the Act is broader than Section 57(iii) of the Act makes the position stronger.

In the case of Sassoon J. David & Co. Pvt. Ltd. v. CIT, (1979) 118 ITR 261 (SC), the Supreme Court referred to the legislative history and noted that when the Income Tax Bill of 1961 was introduced, Section 37(1) required that the expenditure should have been incurred "wholly, necessarily and

exclusively" for the purposes of business in order to merit deduction. Pursuant to public protest, the word "necessarily" was omitted from the section.

The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

Even Rule 10B(1)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/ brand fee, because it has been suffering losses

continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised.

Apart from the legal position stated above, even on merits the disallowance of the entire brand fee/ royalty payment was not warranted. The assessee has furnished copious material and valid reasons as to why it was suffering losses continuously and these have been referred to by us earlier. Full justification supported by facts and figures have been given to demonstrate that the increase in the employees cost, finance charges, administrative expenses, depreciation cost and capacity increase have contributed to the continuous losses. The comparative position over a period of 5 years from 1998 to 2003 with relevant figures have been given before the CIT (Appeals) and they are referred to in a tabular form in his order in paragraph 5.5.1. In fact there are four tabular statements furnished by the assessee before the CIT (Appeals) in support of the reasons for the continuous losses. There is no material brought by the revenue either before the CIT (Appeals) or before the Tribunal or even before us to show that these are incorrect figures or that even on merits the reasons for the losses are not genuine.

We are, therefore, unable to hold that the Tribunal committed any error in confirming the order of the CIT (Appeals) for both the years deleting the disallowance of the brand fee/ royalty payment while determining the ALP. Accordingly, the substantial questions of law are answered in the affirmative and

in favour of the assessee and against the Revenue. The appeals are accordingly dismissed with no order as to costs."

11. We are of the view that in view of above dictum of law the findings of fact recorded by the Tribunal in the impugned order cannot be termed as perverse or contrary to the evidence on record. The Tribunal has taken into consideration the voluminous documentary evidence on record for the purpose of coming to the conclusion of adoption of TNMM by the assessee as the Most Appropriate Method of arriving at ALP. The Delhi High Court in the case of **Make My Trip India (P.) Ltd. (supra)** has also held that difference of opinion as to the appropriateness of one or the other method cannot be gone into in the appeal under Section 260A of the Act, 1961 by observing as under:

"5. The Court is of the opinion that no substantial question of law arises. The difference of opinion between the CIT (A) and the TPO, as to the appropriateness of one or the other methods, cannot per se be a ground for interference; the appropriateness of the method unless shown to be contrary to the Rules specially Rules 10B and 10C, in the opinion of the Court, are hardly issues that ought to be gone into under Section 260A of the Income-tax

Act."

12. In the overall view of the matter, we are convinced that the decision of the Tribunal is correct and requires no interference and no question of law much less any substantial question of law can be said to have arisen from the impugned order of the Tribunal. In the result, these appeals fail and are hereby dismissed, with no order as to costs.

(J. B. PARDIWALA, J)

(BHARGAV D. KARIA, J)

Pradhyuman//