IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

1. **INCOME TAX APPEAL No.182 of 2013** (O&M)
DATE OF DECISION: 06.11.2015

M/s. Knorr-Bremse India Pvt. Ltd.

…..Appellant

versus

Assistant Commissioner of Income Tax, Circle-I, Faridabad.

…..Respondent

2. **INCOME TAX APPEAL No.172 of 2013** (O&M)

Commissioner of Income Tax, Faridabad.

…..Appellant

Versus

M/s Knorr Bremse India P. Ltd.

…..Respondent

CORAM:- HON'BLE MR.JUSTICE S.J.VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE G.S. SANDHAWALIA

Present: Mrs. Radhika Suri, Senior Advocate with
Ms. Rinku Dahiya, Advocate for the assessee

Mr. Tejinder K. Joshi, Advocate for the Revenue

..

S.J. VAZIFDAR, ACTING CHIEF JUSTICE:

These are cross appeals under Section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal (ITAT) allowing partly the assessee's appeal against the order of the Assistant Commissioner of

Income Tax assessing the assessee's income at Rs.6,25,65,160/- and initiating penalty proceedings. The appeals pertain to the assessment year 2007-08.

The assessment order was passed in accordance with the directions issued by the Dispute Resolution Panel (DRP) which in turn were passed on the objections filed by the assessee against the draft assessment order of the Assistant Commissioner of Income Tax-the AO which in turn was in accordance with the order of the TPO-Additional Commissioner of Income Tax. The Assessing Officer (AO) had made a reference to the TPO for determining the arm's length price (ALP) of certain international transactions entered into by the assessee with its associated enterprises (AEs).

2. The assessee's appeal was admitted by an order dated 11.09.2014 on the following substantial questions of law raised in paragraph-15 of the appeal:-

> "A. Whether on a true and correct interpretation of section 92C(1) r/w 92CA(3) of the Income Tax Act the Tribunal was right in law in upholding an adjustment to the declared value of following International Transactions:
>
> (i) Professional consultancy of Rs.1,52,07,206/-
>
> (ii) Management fee for support services of Rs.1,40,56,800/-.
>
> B. Whether, the order of the Tribunal is perverse for non-consideration of relevant material, the evidence placed on record and submissions made by the Appellant and reaching a conclusion that the services availed were in the nature of shareholder activities and that the benefit received by appellant was only incidental and passive association benefit."

At the hearing before us on 04.08.2015, we permitted the following questions of law to be raised:-

> "1. Whether in facts and circumstances of the case the Income Tax Appellate Tribunal was correct in law in holding that the Transfer Pricing Officer could apply the CUP METHOD (comparable uncontrolled price method) to analize three international transactions relating to operating costs separately even though NPM (operating profits to sales ratio) as PLI under TNM had been accepted on all other international transactions when aggregated together?
>
> 2. Whether in the facts and circumstances of the case the Income Tax Appellate Tribunal was correct in law in holding that the transfer pricing officer could compute the arms length price ALP at nil on account of professional consultancy fee paid and management fee paid by the Appellant by using the Cup Method even though no comparable had been referred to by the Transfer Pricing Officer?"

The Department's appeal was admitted on the following substantial question of law:-

> "Whether, on the facts and in the circumstances of the case, the Hon'ble ITAT was right in law in deleting the addition of Rs.1,61,36323/- (60% of Rs.2,68,93,871/-) made by the Assessing Officer on the basis of the order of the TPO on account of consultancy charges, whereas the objection raised by the assessee on the addition has already been rejected by the DRP on this issue on the ground that SAP license and MS office have been purchased at a lower rate benefiting the assessee."

3. We have not dealt with each of these questions separately in view of our findings on certain questions of law. These questions of law would be relevant in determining the correctness of the orders of the Transfer Pricing Officer, the Dispute Resolution Panel and the Tribunal in respect of the determination of the arm's length price by them and,

therefore, also in answering the questions of law raised in the appeals. The determination of the arm's length price by the authorities is based on certain findings of law which we have dealt with in the judgment. The entire computation of the arm's length price, therefore would have to be reconsidered and reassessed based on our findings. We are, therefore, left with no alternative but to remand the matter to the Tribunal for fresh consideration in light of our findings on the questions of law.

4. The assessee is a wholly owned subsidiary of Knorr-Bremse Asia Pacific (Holding) Limited (KBAP). KBAP was formally known as Knorr-Bremse Far East Limited. It carries on business *inter alia* of manufacturing air brake sets for passenger cars and wagon coaches, shock absorbers for passenger cars and locomotives, distributor or valves, computer control break system, tread break units and brake accessories. The assessee's business is segregated into two parts, namely, manufacture and distribution. During the assessment year, it entered into various international transactions with its AEs. We will refer to these transactions shortly. The assessee had prepared a transfer pricing report which adopted the Transactional Net Margin Method (TNMM) considering it to be the most appropriate method for the purpose of benchmarking its activities under the manufacturing and distribution segments separately. The assessee has

described its manufacturing and distribution functions as follows:-

Manufacturing functions: The manufacture of the products, referred to earlier, is through its manufacturing facility in Faridabad, Haryana. For this purpose, it imports raw material and components mainly from its group companies. About 40 to 45 per cent of the assessee's purchases were of imported goods of which about 90 per cent were from its group companies. Ninety-three per cent of the purchase from the group companies was from Knorr-Bremse Systeme Fur Schienenfahrzeuge (KBSFS) and New York Air Brake. For the purpose of manufacturing, the assessee relied on the technical support and assistance provided by its group companies. The assessee also exports the manufactured goods to its AEs, imports components and spares for the brake systems from its group entities on a free-of-cost basis for replacement of spares for brake systems sold earlier by the group entities and supplies goods as samples on a free-of-cost basis to its group entities.

Distribution Function: Manufacturing is the assessee's primary activity. It also imports from its group companies certain brake systems for distribution in India based on firm orders from domestic customers. It also procures goods from unrelated third parties in India and exports the same to its group entities. As these purchases are against firm orders, the assessee does not maintain an inventory for the same.

5. The major international transactions undertaken by the assessee with its AEs during the assessment year 2006-07

are noted in the order of the Transfer Pricing Officer as under:-

"No.	Name of transaction	Amount (Rs. In Crores)		Method of Benchmarking
		Received/ Receivable	Paid/ Payable	
1.	Purchase of raw material & consumables		10.68	TNMM
2.	Testing Charges	0.23	-	
3.	Professional consultancy	-	1.52	
4.	Reimbursement to expenses	-	0.03	
5.	Purchase of finished goods	-	5.92	Trading Function
6.	Sale of raw material & consumables	10.9		Aggregated with Manufacturing & Trading Function
7.	Purchase of capital items	-	9.62	
8.	SAP development support charges	0.06		
9.	Design support charges	0.15	-	
10.	Technical assistance	0.05	-	
11.	Management fees for support services		1.41	
12.	SAP consultancy charges		2.69	Aggregated with Manufacturing & Trading Function
13.	SAP License Fees	-	1.41	
14.	Software license fees	-	0.27	
15.	Advance license fees	-	0.48	No Benchmarking required
16.	Recovery of expenses	0.86	-	
17.	Materials/Products imported free of costs as replacement/samples during the warranty period		NIL	
18.	Use of technical know-how	-	NIL	
19.	Supply of materials at free of costs as samples/warranty	NIL"		

The main grievance of the assessee is that item Nos.3,8,11 and 13 were valued separately by the authorities by the Comparable Uncontrolled Price Method (CUP Method). The

assessee's contention is that the entire matter ought to have been determined by the TNMM.

6. While benchmarking the international transactions in its manufacturing segment, the assessee selected five independent comparable companies, the mean profit level indicator (PLI) of which was 8.47% against the assessee's margin of 9.01% from its manufacturing operations. With reference to its distribution activities, the assessee selected the comparables whose mean PLI was 3.53% against the assessee's margin of 5.20%. The assessee accordingly contended that its transactions with its AEs were more competitive than the ALP.

7. As regards item No.3 of the table – "Professional consultancy", the assessee's case is that during the financial year it received these services from KBSFS for improving its production and logistic processes. It received *inter alia* assistance in planning expansion of its production facilities, provision of internal machining, support for production, coordination of maintenance activities, provision of technical support to the sourcing team in connection with supplier identification, marketing team and international production team in connection with tools, measurement, programming, etc. A team of experienced professionals visited the assessee's vendors and performed various activities in respect of standardisation and improvement of the processes at the vendors' sites. They accordingly worked to improve the quality of the product, material development, manufacturing process, infrastructure, logistics, etc. The assessee has furnished the

details of the work performed by three such professionals, namely, one Schwestermann, one Ms. Rita Ricken and one Moll. Suffice it to note at this stage that the details of the work performed by each of the professionals is specified in the appeal and Mrs. Suri, the learned senior counsel for the assessee, co-related these functions with the voluminous documentary evidence in support thereof including correspondence, bills and worksheets. Mrs. Suri also relied upon the fact that said Ms. Rita Ricken's salary from the AE was Euros 75,298.00 but that the assessee had paid/reimbursed her only to the extent of Euros 63,000.00. This, she contended, established beyond doubt that the amount paid was not only reasonable but was, in fact, lower than what Ms. Rita Ricken is paid by the AE. There is no question, therefore, according to her, of the amount paid being more than the ALP. The bills also indicate the days spent by these professionals and the hours worked by them.

8. Item-11 of the table refers to the management fee for support services which was also separately assessed by the authorities by applying the CUP Method. The assessee's case, in this regard, is that during the assessment year, it availed management support services from its said AE KBAP which acted as a regional service centre for providing management and operational support services to its group companies in the Asia Pacific Region. These services are provided under a management support agreement dated 01.01.2003 and includes business development, marketing, project management services, human resource support services, accounting, financial support and controlling services and IT support services. Service fee

was paid by the assessee to KBAP computed on the basis of the expenses incurred by the KBAP. The assessee's case is that the expenses were based on the time spent and expenses actually incurred. Documentary evidence in this regard was also produced before the authorities and in these appeals.

9. The assessee's case is that these transactions were inextricably linked to the manufacturing and distribution functions performed by it and they were, therefore, aggregated and analyzed with the assessee's manufacturing and distribution functions. According to the assessee, there is no direct comparable as per the CUP Method for transactions of this nature. Further, the transactions being closely and intrinsically linked with the core business activities, the FAR analysis stipulated under Rule 10B(2) read with Rule 10A(d) calls for an aggregation. Further, still, according to the assessee, the various international transactions jointly contribute to the profitability of the manufacturing and distribution activities and the PLI. Lastly, it was contended that the PLI margin of manufacturing or distribution activities cannot be computed unless all direct costs attributable thereto are also considered along with it.

The assessee referred to the transfer pricing study in support of its contentions.

10. The AO referred the international transactions to the TPO for determination of the ALP under Section 92CA. The TPO issued a notice dated 29.09.2010 calling upon the assessee to submit the following:

"1. Identify each of the Services actually received by you from the AEs for which the amount has been paid.

2. Please submit the contemporaneous documentary evidence to show that these services have actually been received by you.

3. Please state the details of payment made by you for each of the availed services.

4. Please furnish the copy of account of the AEs (providing the services) in your books of accounts and your copy of accounts in the books of AEs (providing the services).

5. How the payment has been quantified? Also please state as to whether any cost benefit analysis was done? If so the details thereof should be furnished. The cost benefit analysis should be (a) with reference to the cost of the services and benefit received there from and (b) services received from AEs vis a via (*sic*) independent parties.

6. Whether any such services have been availed from independent parties?

   If yes the details of such expenditure may be furnished.

7. Furnish the copy of agreement with AEs for receiving such services.

8. Please state as to what tangible and direct benefit has been derived by you.

9. Documentary evidence of cost incurred by the AE for rendering each type of services purportedly received by you and the mark up applied, if any by the AE.

10. Whether AE is rendering such services to any other AEs/independent parties. If yes the details thereof whether such payments are paid by any independent concern or entity in any other country through which Knorr Bremse/AE Group carries on similar business as that of you. If yes, copies of the agreements for such services and also the basis on which such payments are paid.

11. If the AE has rendered services to more than one entities including you, then the basis of allocation amongst various entities. Also furnish the basis of choosing a particular allocation key.

Please note that in the event of your being unable to provide these details in a satisfactory manner, the

> arms length price in respect of all these transaction amounting to Rs.7,29,00,346 shall be reduced to 'nil'."

The assessee furnished the details and filed a reply dated 18.10.2010.

11. Before dealing further with the order of the TPO, it would be convenient to set out the following provisions of the Act and the Income Tax Rules.

The relevant provisions of the Act are as follows:-

> "**92-B. Meaning of International Transaction**.—(1) For the purposes of this section and Sections 92, 92-C, 92-D and 92-E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.
>
> **92-C. Computation of arm's length price**.—(1) The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:—
> (*a*) comparable uncontrolled price method;
> (*b*) resale price method;
> (*c*) cost plus method;
> (*d*) profit split method;
> (*e*) transactional net margin method;
> (*f*) such other method as may be prescribed by the Board.
>
> (2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:
>
> **Provided** that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:
>
> ….. ….. ….. …..

(*d*) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of Section 92-D.

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

Provided that no deduction under Section 10-A or Section 10-AA or Section 10-B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVII-B, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise."

12. The relevant Rules are as follows:-

"10A. For the purposes of this rule and rules 10B to 10E,-

(a) "uncontrolled transaction" means a transaction between enterprises other than associated enterprises, whether resident or non-resident;

(b) "property" includes goods, articles or things, and intangible property;

(c) "services" include financial services;

(d) "transaction" includes a number of closely linked transactions.

10B.(1) For the purposes of sub-section (2) of section 92C, the arms length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:

(a) comparable uncontrolled price method, by which,

(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(ii) such price is adjusted to account for differences, if any, between the international transaction 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 arms length price in respect of the property transferred or services provided in the international transaction;

(b) ……..

(c) ……..

(d) …….

(e) transactional net margin method, by which,

(i) the net profit margin realised by the enterprise 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;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions,

which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arms length price in relation to the international transaction."

13. The TPO by his order dated 27.10.2010 noted that for the manufacturing segment, the assessee had selected the TNMM as the most appropriate method with Net Profit Margin (NPM) as the PLI. From the major international transactions tabulated above, the TPO segregated the ones at serial nos.3, 8, 11, 12 and 13 and tabulated the same separately. For the purpose of this appeal it will be convenient to set out this table as well which also indicates the payments against each of the services.

"Professional consultancy	15,207,206
Management fee for support services	14,056,0800
SAP consultancy charges and other expenses	26,893,871
SAP License Fees	14,064,063
Software	2,678,406
Total	72,900,346"

The TPO noted that under the above provisions of the Act and the Rules each class of transaction has to be examined having regard to the ALP by applying the most appropriate method. He held that the said services are a class of transactions of their own and, therefore, require separate analysis. He, therefore, analysed the said segregated services/transactions separately under the CUP Method observing that the Act does not preclude the TPO from applying the appropriate method for each class of transaction like

payment for these services and also to apply the TNMM at the enterprise level. He held that when a taxpayer is involved in distinct activities they have to be analysed separately by applying the most appropriate method in each case.

As we mentioned earlier, the TPO had issued a notice dated 29.09.2010 calling upon the assessee to furnish certain information and that the assessee furnished the same *inter alia* by its reply dated 18.10.2010. The order of the TPO refers to the same which includes some of the facts we set out earlier. The assessee also indicated as to how it had benefited from the services rendered by its AEs. It stated, for instance, that there was an increase in its exports by 196% in FY 2006-07 and 59% in FY 2007-08 and that there was an increase in the gross margin by 40% and 36% in these FYs, respectively. It also set out the benefits from the implementation of the SAP. The assessee had explained at considerable length the services rendered by its AEs and the details of the payments made which included payments for the expenses actually incurred by the professionals. These payments included not only the consultancy fees but also out-of-pocket expenses, such as, for travel and boarding and lodging. The observations of the TPO, in this regard, are important and are as follows:-

> "The assessee has stated that the these services payments have contributed to the improved client services and profitability of the assessee. The assessee has however not been able to substantiate that the payment for these services has actually increased the profits of the assessee. The assessee should have been able to show that the level of increase in profit post the these services agreement in April 2006 has increased. It has been unable to do that. The assessee has only mentioned that the gross profit has increased.

> Regular increases in profits are a normal incidence in business. Besides that, it has been pointed out earlier that the payment of these services is actually a payment for services. Therefore, there is actually no basis for the assessee to make a claim that its clientele have actually increased pursuant to the payment of 'Business Service'.
>
> The OECD guidelines lay down the principle that the basis of indirect charge will have to answer the benefit test. Para 7.24 of the OECD guidelines further states, "To satisfy the arm's length principle, the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept." Therefore, the assessee cannot escape its responsibilities of having to show the actual benefit it has received. The assessee will also have to demonstrate that independent parties would be inclined to make such a payment in similar circumstances."

We will deal with these observations later.

The TPO thereafter proceeded to deal with each of the segregated services that he considered separately.

Regarding the professional consultancy services, the TPO observed that formal training sessions were not held for the assessee's employees; that the cost accruing to the AE in this regard would be very small; that this kind of training would be picked up by the employees on the job and that it is not as if the employees were being given training in respect of all the maritime laws and other regulations that are prevalent all over the world; that the documents do not evidence "formal training"; that the invoices do not contain a description of the services and that the assessee had only relied upon some minutes of the meeting and monthly detailed reports of said Ms. Rita Ricken and that the assessee had supplied two pages of task-sheets which neither proved the delivery of services nor any benefit derived from the claimed services. It is also important to note that once again the TPO

observed that the assessee had not been able to provide any evidence that its employees had actually been benefited from the same. The TPO held that no independent enterprise would have made the payment.

The TPO then dealt with the management support services by dealing with each of the ingredients thereof, namely, business development, human resource services, accounting, financial support and controlling services, IT services and SAP consultancy services.

(A) With respect to business development, the TPO merely observed that no tangible benefits have been demonstrated by the assessee.

(B) With respect to human resource services, the TPO held that the assessee should not be expected to make a payout for the same and that the AE had set the standards for the protection of its interests in the assessee's affairs; that the service can be classified as an incidental service; that the assessee had not been able to provide any evidence that the AE was providing any tangible assistance to it; that the assessee's employees were providing all the necessary support that it was in need of for its operations in India and that the assessee had not provided any evidence that the services were actually provided.

(C) With respect to accounting, financial support and controlling services, the TPO held that the assessee had not been able to bring out anywhere that the AE had some special local knowledge that the assessee lacked; that without the AEs' support it would have been at a loss to manage its

affairs and that the level of support indicated in the correspondence is expected from the AE without any charge since the assessee is a subsidiary and the SAP system was implemented because of alignment with the global network. The TPO further held that the assessee had sufficient local help to allow it to overcome the legal challenges at the local level, if any. It was further held that the kind of services referred to were at best duplicate services for which the assessee need not make any separate payment.

(D) With reference to IT services, the TPO held that the assessee had not been able to provide any proof as to the complex problems that the AE had solved which the assessee would have been unable to; that the support services related to creation of codes, solving initial problems on account of implementation of SAP and that the implementation of hotline services and ongoing support were expected from the AE without any charge. The correspondence was held to be merely routine day-to-day correspondence which does not establish the services and any tangible benefits having been derived therefrom. The TPO concluded that no independent party would pay such huge amounts for the said services.

(E) With respect to SAP consultancy services, the TPO observed that the assessee has mentioned that the expenses had been capitalised during the year but that during the discussion with the assessee's authorized representative, it had been observed that depreciation was being claimed and charged to the profit and loss account during the year. The TPO held that since depreciation was being claimed, this item

had a bearing on the profitability of the assessee and, accordingly, the claim with respect to the capitalised nature of assessee fees did not have any force and that the transaction had to be benchmarked.

The TPO held that the circulation of the Project Report Handbook did not justify the consultancy fee received. He further held that the few e-mails between the assessee and its AE and the service agreement did not quantify the services received nor any tangible benefit received out of it.

It is important to note that the TPO observed that no independent enterprise would be able to pay out a portion of its profit before it knows what is the cost incurred by the service provider and that the assessee had failed to follow this basic tenet of independent behaviour. It is also important to note that the TPO observed that India is a hub of global ITs and ITES and that it is not believable that certain problems could be solved only by the AEs. Hence, he concluded that the assessee need not have made any payment on account of this service. He emphasised that the AEs were providing assistance which could have been obtained at the local level in India.

After considering the position in various other countries, the TPO concluded as under:-

> "Universally, such payments are being treated at arm's length only when it is proved substantially by the taxpayer that such services were actually received and further proving that such received services have benefited it. In most of the countries like UK, USA, Germany etc it is an established position that a subsidiary does not to have to pay for the auditing, accounting and such other functions performed by the parent company as owner of the subsidiary company. If the subsidiary were an independent company it would

neither require such services nor would it pay for the same.

CONCLUSION:

Following the discussion in the preceding paras of this order, it is concluded that the assessee has not been able to demonstrate that an independent party would have made the following payments as the assessee has done.

Professional Consultancy	15,207,206	Debited to Profit & Loss Account
Management fee for support services	14,056,800	
SAP consultancy charges and other expenses	26,893,871	Capitalized in Fixed asset schedule
Total	56,157,877	

Therefore, by the application of CUP, the arm's length price in respect of the transactions mentioned above and amounting to Rs.5,61,57,877/- is determined at 'nil'.

The assessing officer shall accordingly enhance the income of the assessee by the amounts debited to Profit & Loss Account and shall disallow the depreciation on the items, on which the depreciation is being claimed. The Assessing Officer may examine the feasibility of initiating penalty proceedings u/s 271(1)(c) of the Act in accordance with Explanation 7 of the same.

In respect of other transactions no adverse inference is drawn."

14. The Assistant Commissioner of Income Tax - AO accordingly prepared a draft assessment order dated 20.12.2010 and assessed the assessee's income at Rs.6,25,65,160/- together with interest and also initiated penalty proceedings.

15. The assessee filed its objections on 01.09.2011 to the draft assessment order before the DRP.

The DRP by its order dated 03.09.2011 issued directions under Section 144C(5) of the Act. With respect to the TPO having rejected the assessee's approach of aggregating the closely linked transactions, the DRP merely held that it

found the reasoning of the TPO to be logical and agreed with him. Nothing further was stated.

With regard to the assessee's objection to the TPO having used the CUP Method for benchmarking certain services only, the DRP observed that the SAP licence and MS Office had been purchased at lower rates benefiting the assessee and to that extent the benefit test for the assessee was clear and that the assessee must be given the benefit. The TPO was directed to verify and re-compute the ALP, if necessary.

With regard to the appointment of Ms. Rita Ricken, the DRP observed that the e-mails did not show that any sales logistics work and that she merely coordinated training sessions which were restricted to a few people and not all end-user employees. It was further observed that the TPO had analysed these services and benefits and that no cost allocation fee has been furnished to the DRP either. The assessee's contention in this regard was, therefore, rejected. The DRP accordingly directed the AO to complete the assessment as per the directions.

16. The AO thereafter by an order dated 03.10.2011 assessed the total tax payable at Rs.1,93,79,968/-.

17. The assessee filed an appeal before the ITAT. The appeal was disposed of by the order of the Tribunal dated 31.10.2012 which is impugned in the present appeals.

18. The Tribunal made a reference to the documents and the evidence submitted. The references indeed are many. One of the questions would be whether the evidence was properly and adequately considered and analysed.

The Tribunal agreed with the TPO that the assessee's approach did not conform to the Transfer Pricing Regulations. The important findings of the Tribunal are as follows:-

The impugned transactions relating to payment of Rs.1,52,07,206/-, Rs.1,40,56,800 and Rs.2,68,93,871/- under the heads Professional Consultancy, Management Fee for support services and SAP Consultancy Charges were distinguishable and separate international transactions carried out by the assessee with its AE. Each transaction was, therefore, required to be benchmarked separately. The transactions were shown to be closely linked with each other. The assessee had not demonstrated as to how the transaction-by-transaction approach was not possible. It had also not been shown as to whether there has been any real or tangible benefit by carrying out such international transactions with the AEs. The appellant did not compute the net profit margin realised from each such transaction and had not produced any material to establish that the available data of comparable transactions, if any, was unreliable or inadequate. Having rendered these findings, the Tribunal observed that there is no guidance in India regarding the criteria for choosing a particular method and that the law does not provide for priority for any particular method to be applied. The tribunal, however, observed that the OECD and certain other countries considered the CUP Method to be the most direct method for determining the ALP. The Tribunal, therefore, rejected the TNMM in respect of the said three transactions and upheld the TPO and DRP's adoption of the CUP Method in respect thereof. With respect

to the evidence produced by the assessee, the Tribunal merely held as under:-

> "9.2. After hearing the parties with reference to material on record, we find that the authorities below have not conclusively held that the assessee could not enter into such a transaction nor had they disallowed the same by holding that such an expenditure is not assessee's business expenditure. The DRP as well as the authorities below have merely elucidated that the payments are reimbursement in respect of Ms. Rita Ricken and other personnel's case to serve the interest of share holders. By saying so they have only described the circumstance under which the international transaction has been entered by the appellant, so as to test the benefit that can be said to have reached the assessee. It, therefore, cannot be said to have questioned the commercial expediency of such transactions entered by the appellant. The I.T. rules contain exhaustive detail regarding nature of information and documents which are required to be maintained by the assessee. Rule 10D(1) of the I.T. Rules, 1962 also mandates the maintainability of record of uncontrolled transactions to be taken into account in analysing the comparability of the international functions entered into by the assessee. It, therefore, is obligatory on part of the appellant to maintain such record and produce the same before the TPO to show that it has benchmarked the international transaction at ALP. This obligation, however, has not been discharged by the assessee.
>
> 9.3. The appellant in the present case is also not shown to be willing to pay any amount for such services, if it were, so provided by an independent enterprise or if the same would have been performed in house. The DRP is found to have considered these services as non-beneficial for the recipient and did not take it as chargeable services. The perusal of e-mails and other contemporaneous record only goes to reveal that incidental and passive association benefit has been provided by the associate enterprise. In this view of the matter there could neither be any cost contribution or cost reimbursement nor payment for such services to the AE. The TPO, therefore, has rightly adopted Nil value for benchmarking the arm's length price in respect of both these services. We, therefore, do not find any reason to interfere with the well reasoned conclusion reached by the AO on this count. The grounds raised in appeal in this respect, therefore, stand rejected."

19. The appeal was partly allowed by the Tribunal against which the Revenue is in appeal in ITA No.172 of 2013. The Tribunal found that the SAP licence and MS Office had been

purchased at a lower rate and had benefited the assessee. The Tribunal further noted that this was, in fact, the finding of the DRP and, accordingly, the DRP was not justified in upholding the conclusion of the TPO for making addition to the assessee's income on that account. The Tribunal, accordingly, directed the AO to delete the addition on that account and allowed the grounds raised in appeal by the assessee.

20. A reading of the orders of the TPO, the DRP and of the Tribunal makes it clear that one of the main reasons for not accepting the assessee's case was that the assessee had not been able to substantiate that the payment for the services had actually increased its profits. As we noted earlier, the TPO, in fact, further held that the assessee should have been able to show the level of increase in profit post the said transactions.

21. We are unable to agree with this finding. The answer to the issue whether a transaction is at an arm's length price or not is not dependent on whether the transaction results in an increase in the assessee's profit. This would be contrary to the established manner in which business is conducted by people and by enterprises. Business decisions are at times good and profitable and at times bad and unprofitable. Business decisions may and, in fact, often do result in a loss. The question whether the decision was commercially sound or not is not relevant. The only question is whether the transaction was entered into *bona fide* or not or whether it was sham and only for the purpose of diverting the profits.

22. The TPO observed that regular increase in profits is a normal incidence in business. This is entirely incorrect. All businesses are not profitable. All decisions do not enhance profitability. Losses are also an incidence of business. Many are the failed business ventures of people and enterprises.

23. Enterprises, businessmen and professionals constantly experiment with different business models, theories and ventures. The aim indeed is to further the business, to enhance their profits. So long as that is the aim, it is sufficient for the purpose of the Income Tax Act. In a given case, profit may not even be the motive. Even so it would not indicate that the transactions in question are not at an arm's length price. Whether a transaction is entered into at an arm's length price or not must depend upon the facts of each case relating to the transaction *per se, i.e.,* the transaction itself. Profit is only a possibility and a desired result with or without the aid of an international transaction. Every business venture is not necessarily profitable or successful. All business ventures do not succeed equally or uniformally. Indeed, if an assessee is able to establish financial or other commercial benefits arising from a transaction, it would further strengthen its case. But if it cannot do so, it does not weaken it.

24. The profit earned by an assessee could be for reasons other than those relating to the international transactions or by virtue of international transactions as well as by virtue of other factors. In that event, the

assessee having profited from the venture involving the international transactions, obviously, would not establish that the arm's length price was correct or justified.

25. It would make no difference even if the profit is entirely on account of the international transaction. In fact, even if it is established that on account of an international transaction an assessee's venture has profited, it does not necessarily establish that the transaction was entered into at an arm's length price. Mere profitability does not indicate that the transaction which was responsible for the enhancement of the profits was at an arm's length price. That an international transaction has enabled an assessee to earn profit is one thing and the price paid for the same is another thing altogether. Profit is a motive and the aim of a venture. The factors that are involved in achieving this objective are the means of achieving this end. Absent any special term in the contract, the seller of goods or the provider of services is not concerned whether its purchaser profits from the use that the goods or services are put to. It is concerned with the same only in so far as the usefulness of its products and services enhances the value thereof and consequently furthers its own commercial interests. Merely because an assessee profits by the use of the goods supplied or the services rendered, it does not follow that the same were sold or supplied at an arm's length price. Conversely, merely because an assessee does not profit from the use of the goods or services it does not follow that they were not sold at an arm's length price.

26. A view to the contrary would cause considerable confusion and lead to arbitrary, if not illogical, results. A view to the contrary would then raise a question as to the extent of profitability necessary for an assessee to establish that the transaction was at an arm's length price. A further question that may arise is whether the arm's length price is to be determined in proportion to the extent of profit. Thus, while profit may reflect upon the genuineness of an assessee's claim, it is not determinative of the same.

27. Mrs. Suri's reliance upon a judgment of the Delhi High Court in *CIT vs EKL Appliances Ltd., [2012] 345 ITR 241 (Delhi)* is well founded. In that case, the TPO noticed that the assessee had been incurring huge losses year after year and concluded, therefore, that the payment of royalty to the AE was not justified as the technical know-how/brand fee agreement with the AE had not benefited the assessee in achieving profits from its operations. The TPO also noticed that the assessee had itself thereafter stopped the payment and concluded, therefore, that the justification for payment of brand fee was questionable. The Division Bench held:

> 22. 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.

We are in respectful agreement with these observations.

28. The absence of profit may at the highest be a factor while considering whether the transactions were genuine or not. That would depend upon the facts of each case. However, mere absence of profit would not be a ground for holding that the transactions are not genuine and ought not to be taken into consideration in the assessment proceedings.

29. We hasten to add that in the case before us the assessee has, in fact, contended that it has benefited from the international transactions entered into by it with its AEs. However, even assuming that this has not been established, it would make no difference.

30. Mrs. Suri relied upon a judgment of the Delhi High Court in *Commissioner of Income-Tax vs. Cushman and Wakefield (India) Pvt. Ltd., [2014] 367 ITR 730 (Delhi)*. The Division Bench held:-

> "35. The Transfer Pricing Officer's report is, subsequent to the Finance Act, 2007, binding on the Assessing Officer. Thus, it becomes all the more important to clarify the extent of the Transfer Pricing Officer's authority in this case, which is to determining the arm's length price for international transactions referred to him or her by the Assessing

> Officer, rather than determining whether [such services exist or benefits have accrued. That exercise - of factual verification is retained by the Assessing Officer under Section 37 in this case.] Indeed, this is not to say that the Transfer Pricing Officer cannot - after a consideration of the facts - state that the arm's length price is 'nil' given that an independent entity in a comparable transaction would not pay any amount. However, this is different from the Transfer Pricing Officer stating that the assessee did not benefit from these services, which amounts to disallowing expenditure. That decision is outside the authority of the Transfer Pricing Officer. …… ……. …. .
>
> 36. In this case, the issue is whether an independent entity would have paid for such services. Importantly, in reaching this conclusion, neither the Revenue, nor this Court, must question the *commercial wisdom* of the assessee, or replace its own assessment of the commercial viability of the transaction. The services rendered by CWS and CWHK in this case concern liaising and client interaction with IBM on behalf of the assessee-activities for which, according to the assessee's claim-interaction with IBM's regional offices in Singapore and the United States was necessary. These services cannot - as the Income-tax Appellate Tribunal correctly surmised-be duplicated in India insofar as they require interaction abroad. Whether it is commercially prudent or not to employ outsiders to conduct this activity is a matter that lies within the assessee's exclusive domain, and cannot be second-guessed by the Revenue." *[brackets provided by us]*

We respectfully agree with the observations. We, however, do not express any view regarding the observations bracketed by us.

31. The TPO, in the case before us, had observed as under:-

> "The OECD guidelines lay down the principle that the basis of indirect charge will have to answer the benefit test. Para 7.24 of the OECD guidelines further states, "To satisfy the arm's length principle, the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept." Therefore, the assessee cannot escape its responsibilities of having to show the actual benefit it has received. The assessee will also have to demonstrate that independent parties would be inclined to make such a payment in similar circumstances."

The TPO's conclusion in the last but one sentence does not follow from the OECD Guidelines quoted by him. The OECD Guidelines merely state that the result must be consistent with what comparable independent enterprises would have been prepared to accept. We do not see how from this observation it follows that the assessee cannot escape its responsibility of having to show the actual benefits it had received.

32. The Tribunal has also held in paragraph 7.2 that the assessee has failed to show whether there has been any real or tangible benefits by entering into the said transactions.

33. It is obvious, therefore, that this aspect weighed considerably with the authorities in rejecting the assessee's case even on merits. Considering these observations, we would presume that had the assessee established that the transactions had resulted in increased profitability, the assessee's contention on merits also would have been accepted. In any event, they would have enhanced the assessee's ability to establish the case on merits. The DRP and the Tribunal had rejected the assessee's contention regarding the true value of the services rendered by the assessee's AEs and its officers. It will be necessary, therefore, for the authorities to re-assess even the evidence on record in the light of our decision that the mere failure to establish that the transactions resulted in a profit does not indicate that they were not at an arm's length price. We hasten to reiterate that even if profit is established, it does not necessarily follow that the transaction was at an arm's length price.

34. Whether the transaction was at an arm's length price or not must be determined on relevant factors.

As we mentioned earlier, the assessee selected TNMM as the most appropriate method for benchmarking the international transactions tabulated above and while doing so divided its operations into the manufacturing and distribution segments. For the manufacturing segment, the assessee selected the TNMM with net profit margin as the PLI. The assessee selected five comparable companies which had earned a margin less than that of the assessee in the manufacturing and distribution segments. It, therefore, claimed that the major international transactions were at an arm's length price.

35. The TPO observed that as per the Act each class of transaction has to be examined having regard to the arm's length principal by applying the most appropriate method. In a given case, however, two or more classes of transactions may be telescoped into a separate transaction altogether and thereby fall within yet another class of transaction. The TPO also observed that the payments towards the said five transactions, namely, those at serial Nos.3, 8, 11, 12 and 13 of the table were a class of transactions of their own and the payment for the same required separate analysis. He held that for the transfer pricing study these service transactions ought to be analyzed separately under CUP Method. He further held that the Act does not preclude the TPO from applying the appropriate method for each class of transaction like payment for services and also apply TNM Method at the enterprise level.

36. Mrs. Suri, on the other hand, contended that the various components of a transaction cannot be subjected to different methods of transfer pricing. Thus, in the present case, she submitted that a few of the international transactions could not be segregated from the other international transactions and computed separately under the CUP Method while retaining the assessment of the remaining transactions under the TNM Method. She submitted that this approach would lead to skewed results. She submitted that assuming that the TNM Method was not the appropriate method in respect of the said transactions and the arm's length price thereof ought to be assessed by the CUP Method, all the other transactions also must be assessed by the CUP Method.

37. We will assume that the various international transactions were entered into with respect to the final commercial venture undertaken by the assessee, be it the manufacture and the sale of goods or the provision of services by it. The AO or the TPO, as the case may be, is required to determine the arm's length price in relation to "an international transaction". The acquisition of various items/components in the assessee's venture could indeed be telescoped into and form a single transaction. For instance, in the case of a package deal where each item of the package is not separately valued but all the components thereof are given a composite price, the transactions form but one composite transaction. An assessee may enter into one composite transaction with its AE involving the provision of various services or the sale of various goods. A party may opt for a single window facility where all the services and/or

goods are provided under a composite agreement. Each of the components may even be priced differently. If it is established that each transaction was so inextricably linked to the other that the one could not survive without the other, it could be said that it formed a part of a transaction and that it was an international transaction. Take, for instance, a case where an AE offers to provide a bouquet of services and goods to the assessee each priced differently but on the understanding that the pricing was dependent upon the assessee accepting all the services and/or all the goods. In that event, it would not be open to the assessee to accept only some of the goods or the services at the prices indicated. It either takes all or none. This would normally constitute one transaction.

38. Section 92B itself contemplates an international transaction "between two or more associated enterprises". It is not necessary, therefore, that an international transaction must be between only two parties. There can be a single composite transaction "between two or more associated enterprises". This is clear from the opening words of Section 92B that for the purposes of Sections 92, 92B, 92C, 92D and 92E, international transaction means a transaction between two or more associated enterprises. The subsequent part of Section 92B makes this clearer by providing that the international transaction means a transaction between two or more associated enterprises in the nature of purchase, sale, etc. and shall include "a mutual agreement or arrangement between two or more associated enterprises". Thus, "a mutual agreement or arrangement" meaning thereby a single agreement or arrangement

is contemplated between “two or more” associated enterprises. It would follow then that several transactions between “two or more” AEs can form a single composite transaction. The doubt, if any, in this regard is set at rest by Rule 10A(d) which provides that for the purposes of Rule 10A and Rules 10B to 10E, “transaction” includes a number of closely linked transactions”. Thus, the closely linked transactions can in a given situation be components of a single composite transaction.

39. The assessee would, however, have to prove that although each sale and each provision of service is priced separately, they were all provided under one composite agreement which constitutes an international transaction.

40. We are, however, unable to agree with Mrs. Suri’s contention that as the services and goods are utilized by the assessee for the manufacture of the final product they must be aggregated and considered to be a single transaction and the value thereof ought to be computed by the TNMM. Merely because the purchase of each item and the acceptance of each service is a component leading to the manufacture/production of the final product sold or service provided by the assessee, it does not follow that they are not independent transactions for the sale of goods or provision of services. The end product requires several inputs. The inputs may be acquired as part of a single composite transaction or by way of several independent transactions. In the latter case, the sale of certain goods and/or the provision of certain services from out of the total goods purchased or services availed of by an

assessee together can form part of a separate independent international transaction. In such an event, the AO/TPO must value this group of sale or purchase of goods and/or provision of services as separate transactions.

41. The TNM Method may establish the aggregate price paid for the goods and services received under independent transactions to be an arm's length price. This, however, would give a skewed picture. One of these independent transactions may be at a bargain and the pricing, therefore, is not objected to by the department. This bargain may be for a variety of reasons and in a variety of circumstances unconnected however to the other transactions. The value of the other transactions, on the other hand, may be overestimated and would not be at the arm's length price. In that event, for the purpose of the Act, the price of the second transaction cannot possibly be taken to be the arm's length price for it was not the arm's length price. It does not become the arm's length price merely because the bargain struck with respect to the first transaction balanced the inflated price of the second although the two transactions were independent of each other. The two transactions are different and, therefore, the arm's length price of each of them must be determined separately. The question, therefore, in each case must first be whether the sale of goods or the provision of services was a separate independent agreement or whether they formed part of an international transaction i.e. a composite transaction.

42. Mrs. Suri relied upon the following observations of the Division Bench of the Delhi High Court in *Sony Ericsson Mobile Communications India Pvt. Ltd. v. Commissioner of Income Tax, (2015) 374 ITR 118 (Delhi)*:-

> "101. However, once the Assessing Officer/Transfer Pricing Officer accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/ segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(1)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible."

It is obvious that the Division Bench considered the expenditure towards AMP as part of the overall transaction in respect whereof the TNM Method was adopted and, therefore, held that it could not be segregated and valued as a separate international transaction. The judgment, therefore, does not assist the assessee.

43. It follows, therefore, that if the TPO had correctly come to the conclusion that the said five items were not connected to the rest, he was justified in determining the arm's length price thereof separately from and independent of the others. It would be neither logical nor rational in that

event to club several independent and unconnected transactions for the purpose of determining the arm's length price. If, on the other hand, it is established that the sale of various goods and/or the provision of services formed one composite indivisible transaction, TNM Method cannot be applied selectively to some of the components and the CUP or any other method to the remaining components.

44. In the present case, all the items tabulated above were not provided by the same entity. They were provided by different entities. That these entities were all part of the same group is not determinative of the issue whether they were part of a single international transaction. Each party to the group is a separate legal entity. We do not rule out the possibility of there being a single international transaction where goods are sold and/or services are supplied by various entities within a group under a single transaction. That, however, would depend upon the facts of each case. The onus would be on the assessee to establish that though the goods were supplied and/or the services were rendered by different legal entities they were part of an international transaction pursuant to an understanding between the various members of the group. This would be an issue of fact for the determination of the authorities under the Act.

45. In the present case, during the assessment year the assessee received professional consultancy services from KBSFS for improvement of its production process including planning of new machines, provision of internal machinery support, co-ordination of maintenance activities and provision of

technical support. However, the assessee availed management support services from another AE i.e. KBAP which acted as a regional service centre for providing management and operational support services pursuant to an agreement. The transactions were not entered into with merely one AE. They were entered into with various entities within the group. This is clear from the transfer pricing study relied upon by the assessee itself. Throughout the report, the reference is to the group entities in the plural. Our attention has not been invited to anything that suggests that these various transactions formed a composite agreement, to wit that the various agreements with the various group entities were, in fact, part of one single indivisible transaction. Nor was our attention invited to anything that suggests that the pricing in respect of each transaction was dependent upon or inter-related to the pricing of the other transactions with the group entities. *Prima facie* at least, it appears, therefore, that each transaction was separate and independent of the other. As we intend remanding the matter, it will be open to the assessee to contend otherwise. It is for the assessee to establish that though these services were provided by different entities they formed a part of an international transaction and were not separate independent international transactions.

46. There is yet another issue of law which, in our view, is important and requires consideration. The TPO referred to the management support services. The same fell within four categories, namely, business development, human resource services, accounting, financial support and

controlling services and IT services. With regard to the same, the TPO held that the assessee had sufficient local help to allow it to overcome the legal challenges at the local level. The TPO held that there was no reason to believe that the AEs provided assistance that the assessee could not obtain at the local level in India. Mr. Joshi, the learned counsel appearing on behalf of the respondent, submitted that for these and other services, the appellant could always have availed of the services of personnel and enterprises in India.

47. That, however, in our view, cannot be a ground for rejecting a claim for deduction. Nor can that be a ground for assuming that the consideration paid for the same is not the genuine arm's length price. Absent any law, an assessee cannot be compelled to avail the services available in India. It is for the assessee to determine whose services it desires availing of and whose goods it intends purchasing. It is certainly understandable if the assessee prefers to deal with its group entities/AEs. This is for a variety of reasons which are far too obvious to state. So long as there is no bar in law to the assessee availing the services of a particular party, the authorities under the Act must determine whether the consideration paid for the same is at an arm's length price or not.

48. The TPO also held that no independent enterprise would pay out a portion of its profit big or small before it knows the cost incurred by the service provider. The TPO held that the assessee had failed to follow this basic tenet of independent behaviour.

49. A purchaser of goods or of services is not concerned with the price at which its vendor of goods or supplier of services in turn acquired the same. This, at the highest, would be a factor while negotiating the purchase of goods or the acquisition of services. Even if the vendor or supplier acquired the assets or the know-how as a gift, it would be irrelevant as far as the onward sale thereof is concerned. The purchaser determines the price it is willing to pay for the goods or services independent of what the same cost its vendor/service provider. The TPO, therefore, proceeded on an entirely erroneous basis while computing the arm's length price.

50. We have with respect disagreed partly with the approach adopted and the legal principles applied by the authorities while computing the arm's length price. We have also disagreed with Mrs. Suri's contention that the TNM method ought to be applied to the various transactions merely because each of them aided and resulted in the manufacture of the assessee's final product. It is not possible to assess the weightage given to each of these questions by the authorities while determining the arm's length price. There is nothing on record that indicates the same. It is not necessary that each aspect would have been given the same weightage. Further, this would be so not merely in computing the quantum but also the very question as to whether the services were rendered by the AEs and availed of by the assessee. These are issues of fact which must, in the first instance at least, be determined by the authorities under the Act.

51. As we are remanding the matter, it is not necessary to deal with the voluminous evidence produced and relied upon by the assessee. The authorities have come to the conclusion that the same did not reflect that any valuable services were in fact rendered. As we are remanding the matter, we do not wish to make any observation in this regard, least it prejudices either of the parties while considering the matter upon remand. Suffice it to state that the assessee has relied upon voluminous evidence which cannot be ignored. The same must be considered and analyzed. It cannot by any stretch of imagination be held that the evidence is irrelevant. For instance, the assessee has produced all the invoices and proof of payments including in respect of services rendered by the employees of the AE's. The assessee has also established that such employees of the AE had actually visited India. Mrs. Suri also relied upon the tax structure in Germany and in India in support of her contention that the transactions were genuine. It is also difficult to understand the basis on which it was held that some of the services rendered were only shareholder activities. The nature of the services *prima facie* at least does not indicate that the said four transactions, which have been separated and segregated and the ALP whereof was determined by the CUP Method, were shareholder activities.

52. We intend remanding the matter as the entire approach of the authorities in determining the ALP would be different in view of our above observations. Even the appreciation of the evidence produced and relied upon by the assessee would be different. For instance, even assuming that the assessee has not established that the international

transactions with its AEs resulted in its having earned profit, it would make no difference. The ALP would still have to be calculated on the basis of the transactions and in accordance with the provisions of the Act. Further, it would be necessary for the TPO to determine the ALP of the transactions if they are otherwise genuine.

53. There is another aspect which requires further clarification and elucidation. The Tribunal upheld the contention on behalf of the assessee that the TPO is no authority to judge the allowability of the business expenditure. This finding is based on the judgment of the Delhi High Court in *CIT vs EKL Appliances Ltd. (supra)*. The relevant findings of the Tribunal, in this regard, have already been reproduced above.

On the one hand, in paragraph 9.2, the Tribunal interpreted the order of the DRP to mean that the DRP has only described the circumstances under which the international transactions had been entered into so as to test the benefits that can be said to have reached the assessee and that it cannot be said to have questioned the commercial expediency of such transactions entered into by the assessee. On the other hand, in paragraph, 9.3, the Tribunal held that a perusal of the e-mails and the other contemporaneous record reveals that only the incidental and passive association benefit had been provided by the associate enterprise. In fact, the TPO and the DRP did question the commercial expediency of the transactions entered into by the assessee. Indeed, they went a step further. The TPO, for instance, held that the description in the invoices of the work done by the AEs'

representatives/employees did not really convey anything, that there was no description of the services actually rendered and that the correspondence/other documents did not prove the delivery of services nor the benefits derived therefrom.

In this regard, it is also pertinent to note Mrs. Suri's grievance that the TPO did not even seek any explanation or particulars regarding the details mentioned in the invoices and in the correspondence regarding the nature of assistance rendered by the employees of the AEs.

Thus, on the one hand, commercial expediency is recognized but on the other it is held that the transactions were really not for the benefit of the assessee. The matter would have to be considered/re-considered in view of the observations in this judgment.

54. This brings us to the appeal filed by the Revenue/respondent in ITA-182-2013. The Revenue is aggrieved by the decision of the Tribunal directing the AO to delete the addition with respect to the SAP Consultancy charges in the sum of Rs.2,68,93,871/- to the assessee's income. The Tribunal found that the DRP had recorded a finding that the SAP Licence and MS Office had been purchased at a lower rate and to that extent the benefit test for the recipient is clear and the assessee must be given the benefit. The Tribunal further noted that in the same breath the DRP upheld the conclusion of the TPO and decided not to interfere with the order of the TPO. The Tribunal held that since the DRP had reached a finding that the SAP Licence and MS Office had been purchased at a lower rate and had benefited the assessee, it was not proper to uphold the conclusion of the TPO for adding the said amount

to the assessee's income. The Tribunal held that the assessee had discharged the onus that the international transactions had been benchmarked at an arm's length price in respect of the SAP Licence and, accordingly, directed the AO to delete the addition.

55. Had the matter rested only on the question of appreciation of facts, we would not have and indeed could not have interfered in appeal. However, in view of our findings on the questions of law in the assessee's appeal, it would be necessary for the authorities to consider this matter afresh in the light of those observations as well. It would be necessary upon remand for the authorities under the Act to consider whether the transactions ought to be separately benchmarked or whether the TNM Method ought to be adopted in respect of the same as well.

56. In the circumstances, the order of the Tribunal is set aside and the matter is remanded to the Tribunal. It would be for the Tribunal to decide whether to consider the evidence on record itself or to further remand the matter. Both the appeals are accordingly disposed of.

(S.J. VAZIFDAR)
ACTING CHIEF JUSTICE

06.11.2015
parkash*

(G.S. SANDHAWALIA)
JUDGE

Note: Whether reportable: YES