IN THE INCOME TAX APPELLATE TRIBUNAL

"J" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND

SHRI N.K. PRADHAN, ACCOUNTANT MEMBER

ITA no.3668/Mum./2008
(Assessment Year : 2003–04)

Asstt. Commissioner of Income Tax
Range–10(1), Mumbai ……. Appellant

v/s

Netafim Irrigation India Pvt. Ltd.
1st Floor, 297, CST Road
Vidyanagri, Kalina ……. Respondent
Mumbai 400 098
PAN – AAACE4738J

ITA no.4837/Mum./2009
(Assessment Year : 2004–05)

Asstt. Commissioner of Income Tax
Range–10(1), Mumbai ……. Appellant

v/s

Netafim Irrigation India Pvt. Ltd.
1st Floor, 297, CST Road
Vidyanagri, Kalina ……. Respondent
Mumbai 400 098
PAN – AAACE4738J

ITA no.1874/Mum./2011
(Assessment Year : 2005–06)

Asstt. Commissioner of Income Tax
Range–10(1), Mumbai ..... Appellant

v/s

Netafim Irrigation India Pvt. Ltd.
1st Floor, 297, CST Road
Vidyanagri, Kalina ..... Respondent
Mumbai 400 098
PAN – AAACE4738J

Revenue by : Shri Manish Kumar Singh
Assessee by : Shri K.K. Ved

Date of Hearing – 29.01.2019	Date of Order – 25.04.2019

O R D E R

PER SAKTIJIT DEY. J.M.

The aforesaid appeals pertaining to the same assessee have been filed by the Revenue challenging three separate orders passed by the learned Commissioner (Appeals), Mumbai, for the assessment years 2004–05, 2004–05 and 2005–06.

ITA no.3668/Mum./2008
A.Y. 2003–04

2. The only dispute for which the Revenue has preferred this appeal is on account of deletion of addition made towards transfer pricing

adjustment to the arm's length price of the royalty paid by the assessee to its overseas Associated Enterprise (AE)

3. Brief facts are, the assessee, an Indian Company, was formed in pursuance to a joint venture agreement between Netafim Yiftah Irrigation Equipment & Drip systems, Israeal (Netafim, Israel), Excel Industries Ltd. and Jalbindu Agritech Pvt. Ltd. (Jalbindu) on the share holding of 75%, 15% and 10% respectively. The assessee undertakes manufacturing, assembling and marketing in India of Typhoon family of non–pressure compensated Driplines and Botton Drippers and provides technical and extension service according to customers' needs before, during and after sales. During the previous year relevant to the assessment year under dispute, the assessee had entered into a number of international transactions with its overseas AEs as enlisted below and by aggregating to such transactions the assessee has benchmarked them by applying Cost Plus Method (CPM):–

Nature of Transaction	*Value of Transaction*	*Method Used for Bench Mark*
Import of raw material, store and consumables	*₹69,03,563*	*CPM*
Import of traded finished goods	*₹2,34,99,840*	*CPM*
Import of machinery	*₹3,23,20,061*	*CPM*
Payment of royalty	*₹56,30,506*	*CPM*

4. After verifying the transfer pricing study report, the Transfer Pricing Officer accepted the aggregation and benchmarking of all international transactions with the AEs, except, the transaction relating to payment of royalty to the AE. Insofar as payment of royalty is concerned, the Transfer Pricing Officer issued a show cause notice to the assessee to justify its claim that the payment of royalty is at arm's length by furnishing similar payment by other AEs to Netafim, Israel. In response, the assessee submitted its reply on 14th March 2006, stating that the payment of royalty is consistent with the cost incurred by Netafim, Israel, with regard to its own proprietary intellectual property secured through a long list of innovative patents in which the said company invests its R&D efforts on a routine basis. It was submitted, the assessee is one of the several manufacturing facilities of Netafim, Israel, across the world. As a manufacturing facility, the assessee uses the Netafim, Israel, proprietary intellectual property and patents development by third party and paid for by Netafim, Israel. It was submitted, other manufacturing facilities of Netafim, Israel in USA, Australia, South Africa, etc., were also charged royalty like the assessee. It was submitted, royalty charges are determined based on a technical knowhow agreement and on the basis of product manufactured and the clients committed for. In this context, the assessee also furnished a list of patents owned by Netafim, Israel, which are used in different manufacturing facilities across the world.

The Transfer Pricing Officer after considering the submissions of the assessee and material on record observed that assessee's claim that the royalty payment is at arm's length cannot be accepted due to the following reasons.

> *i) RBI/SIA approvals upon which the assessee is relying does not constitute an arm's length benchmark.*
>
> *ii) The assessee failed to provide the details of cost of development of Technology by its associated enterprise and how the associate enterprise recovered or intended to recover the same from third parties or from other group entities.*
>
> *iii) The assessee failed to furnish the rates of royalty paid other group concerns or associated enterprises.*

5. After rejecting the benchmarking of royalty charges paid to the AE, the Transfer Pricing Officer ultimately held that the arm's length price of royalty payment to the AE has to be determined as nil. Accordingly, he recommended for the addition of the royalty paid of ₹ 56,30,506. On the basis of the aforesaid decision of the Transfer Pricing Officer, the Assessing Officer made the addition in the assessment order. Being aggrieved with the addition so made, the assessee preferred appeal before the first appellate authority.

6. In course of hearing of appeal before the first appellate authority, the assessee challenged the determination of arm's length price of royalty payment at nil. Further, to justify the payment of royalty, the assessee again furnished various documentary evidences including the

agreement dated 18th September 1975, between Netafim, Israel, and Hydroplan Group to demonstrate that Netafim, Israel, incurred cost for acquiring intellectual property. Further, the assessee also submitted that the AE increases additional R&D cost to tailor its drippers as per different market needs and to improve efficiency in usage and product. In this context the assessee furnished a working of royalty and R&D investment at 5%. Further, it was submitted, during the year 2002 all the intellectual property costs were recovered through royalty charges with the exception of China. In this context, the assessee furnished a chart before the first appellate authority indicating the cost of dripper and other materials and royalty charged. Since a part of the aforesaid submissions and workings were not furnished before the Transfer Pricing Officer, learned Commissioner (Appeals) forwarded them to the Transfer Pricing Officer seeking his comments. Vide letter dated 29th January 2008 the Transfer Pricing Officer offered his comments in respect of assessee's submissions and workings by referring to his observations while dealing with the issue in assessee's own case for the assessment year 2004–05. After considering the report of the Transfer Pricing Officer in the context of the submissions made by the assessee and the material on record, learned Commissioner (Appeals) admitted the additional evidences furnished by the assessee and proceeded to decide the issue in favour of the assessee on the following reasoning:–

"i) As required by Rule 10B(2) of the Income–tax Rules, 1962, the payment of royalty is made in accordance with the SIA approval and in compliance with statutory regulations in India – the laws and government orders in force.

ii) The "whole entity approach" accepted by the TPO also benchmarks the international taxation in respect of payment of royalty.

iii) The transaction between the appellant and its AEs is essentially at arm's length since they have been arrived at after prolonged negotiations / deliberations between the JV partners.

iv) the appellant has also furnished evidence that royalty payments have also been made to Netafim, Israel by the associates in USA and Australia.

v) Though in case of China there is no payment in the form of royalty the average price charged per 1000 drippers is lower than average price charged to the appellant even after including royalty payments.

vi) The comparative of the Costs Charges for Drippers charged by Netafim Israel from China, India and USA shows that the average price of the drippers sold to India is lowest and hence there is no overcharging on account of royalty."

Accordingly, he deleted the addition made by the Assessing Officer.

7. The learned Departmental Representative submitted, since the assessee failed to furnish the details of cost incurred by Netafim, Israel for development of technical knowhow, the Transfer Pricing Officer was justified in rejecting the CPM applied by the assessee. He submitted, in

such situation, the only method which could have been applied to determine the arm's length price of royalty payment is CUP method. He submitted, since the assessee failed to furnish the details of royalty payment, the Transfer Pricing Officer determined the arm's length price of royalty as nil. The learned Departmental Representative submitted, learned Commissioner (Appeals) has erroneously deleted the addition by holding that the Transfer Pricing Officer has followed "whole entity approach", therefore, there was no need to benchmark the royalty separately. Referring to sections 92(1) & 92C(1) of the Act as well as rule 10B(1) of the Rules and certain OECD guidelines, the learned Departmental Representative submitted, each international transaction should be benchmarked independently. Further, he submitted, for benchmarking the arm's length price RBI/SIA approval cannot be considered as a CUP as it is not provided under rule 10B(1)(a). Further, he submitted, OECD transfer pricing guidelines of 2010 also do not provide such comparability. He submitted, merely because payment of royalty was after prolonged negotiation and deliberation between the parties it cannot be treated to be at arm's length unless it is compared with price paid in respect of similar uncontrolled transactions. He submitted, the royalty paid by the assessee cannot be compared with royalty paid by USA or Australian AEs since they are controlled transactions. Further, he submitted, the conclusion of learned Commissioner (Appeals) that the cost charged

for drippers by the AE to the assessee is of no relevance since what is to be benchmarked is the payment of royalty. Thus, he submitted, the deletion of adjustment made by the Transfer Pricing Officer is improper. In support of his contention, learned Departmental Representative relied upon the following decisions:−

i) Denso India Ltd. v/s CIT, [2016] 68 taxmann.com 55 (Del.);

ii) SKOI Braveries Ltd. v/s ACIT, ITA no.6175/Mum./2011, dated 18.01.2013; and

iii) A.W. Faber Castell India Pvt. Ltd. v/s DCIT, ITA no.1037/ Mum./2017, dated 12.04.2017.

8. The learned Authorised Representative submitted, as per rule 10B(1)(c) for working out the margin one never needs to consider the costs incurred by the AE which are charged to the tested party. He submitted, to justify the benchmarking of royalty payment as well as other international transaction under CPM, the assessee had furnished the transfer pricing study report which has not being doubted by the Transfer Pricing Officer. In this context, he drew our attention to the transfer pricing study report to show the reasons for which CPM was selected as most appropriate method. He also referred to the details furnished indicating the cost included in calculating the margin of the assessee. He also drew our attention to the computation of cost plus margin of the assessee. Further, he also drew our attention to the computation of cost plus margin of the comparable companies. The

learned Authorised Representative submitted, on the request of the Transfer Pricing Officer, the assessee has also provided the updated single year margin of comparable companies for the assessment year 2003−04. He submitted, in the order passed, the Transfer Pricing Officer has not made any adverse observations on the comparability analysis done by the assessee. He submitted, the bench marking done by the assessee under CPM by aggregating international transactions has not been specifically disputed by the Transfer Pricing Officer. Therefore, he submitted, the contention of the Revenue that CPM is not the right method for determining the arm's length price of royalty payment is not correct. He submitted, the contention of the Department that the whole entity approach is not provided under law is unacceptable since the payment of royalty is closely linked to the other international transactions, hence, cannot be evaluated separately. In this context, he relied upon the following decisions:−

i) Sony Erections Mobile Communications India Pvt. Ltd. v/s CIT, [2015] 374 ITR 118;

ii) Cummins India Ltd. v/s ACIT, [2015] 68 SOT 14;

iii) Demag Cranes and Component India Pvt. Ltd. v/s DCIT, [2015] 30 taxmann.com 364;

iv) Panasonic India Pvt. Ltd. v/s ITO, [2010] 7 taxmann.com 117; and

v) Intimate Fashion India Pvt. Ltd. v/s ACIT, [2012] 24 taxmann.com 80.

9. The learned Authorised Representative submitted, the order passed by the Transfer Pricing Officer would reveal that while determining the arm's length price of the royalty payment at nil, he has not applied any of the prescribed methods. He submitted, for the first time before the Tribunal, the Revenue has came up with altogether new plea that Transfer Pricing Officer has applied CUP method. He submitted, it is well settled principle of law that the Transfer Pricing Officer has to benchmark the international transaction by applying any one of the prescribed methods and he cannot determine the arm's length price at nil. In support of such proposition, he relied upon the following decisions:–

i) CIT v/s Liver India Exports Ltd., [2017] 78 taxmann.com 88 (Bom.);

ii) DCIT v/s CLSA India Ltd., [2013] 33 taxmann.com 260 (Mum.);

iii) CIT v/s Kodak India Pvt. Ltd., ITA no.15/2014, dated 11.07.2016;

iv) CIT v/s Johnson & Johnson Ltd., ITA no.1291/2014, dated 03.04.2017; and

v) CIT v/s Merck Ltd., ITA no.272/2014, dated 08.08.2016.

10. In support of his contention that the learned Departmental Representative cannot make out a new case, which is not the case of the Transfer Pricing Officer, the learned Authorised Representative relied upon the following decision:–

i) *Mahindra & Mahindra Ltd. v/s DCIT, [2009] 122 TTJ 577 (Mum.)(SB); and*

ii) *CIT v/s Mahindra & Mahindra Ltd. [2014] 365 ITR 560 (Bom.).*

11. Further, the learned Authorised Representative submitted, RBI/SIA approval is a valid CUP and can be used to bench mark the transactions has been approved in various judicial precedents. In this context, he relied upon the following decisions:–

i) *M. Spicer India Pvt. Ltd. v/s ACIT, ITA no.2948/Pun./ 2016, dated 11.12.2018;*

ii) *Spicer India Ltd. v/s ACIT, ITA no.251/Pun./2014, dated 10.02.2017;*

iii) *Cadbury India Ltd. v/s ACIT, [2014] 147 ITD 487, (Mum.); and*

iv) *Mondelez India Foods Pvt. Ltd. v/s ACIT, [2016] 70 taxmann.com 112.*

12. Without prejudice to his submission that the Transfer Pricing Officer has not applied CUP, he submitted, for benchmarking the payment of royalty CUP is not the most appropriate method. He submitted, if the Transfer Pricing Officer was of the view that CPM is not the most appropriate method, he could have determined the arm's length price of royalty paid by applying TNMM as the most appropriate method. In this context, he relied upon the following decisions:–

i) *DCIT v/s CLSA India Ltd., [2013] 33 taxmann.com 260 (Mum.); and*

ii) Frigo Glass India Pvt. Ltd. v/s DCIT,, [2017] 83 taxmann.com 38 (Del.).

13. We have considered rival submissions and perused material on record. We have also applied our mind to the decisions relied upon. The factual matrix relating to the disputed issue reveals that the assessee has entered into various international transactions with its AE Netafim, Israel, including payment of royalty. It is also a fact that in the transfer pricing study report, the assessee has aggregated all international transactions including payment of royalty and benchmarked them applying CPM as the most appropriate method. It is evident, the Transfer Pricing Officer has accepted the benchmarking of all international transactions under CMP except the payment of royalty. It further transpires from the material on record, to alternatively support its claim that the payment of royalty is at arm's length, the assessee has relied upon RBI / SIA approvals for payment of royalty. It is evident, the Transfer Pricing Officer rejected the benchmarking of royalty paid to Netafim, Israel done by the assessee in the transfer pricing study report basically for the reason that the assessee failed to provide the details of cost incurred by the AE for development of technology and further, it failed to furnish the rates of royalty paid by the other group concerns. Of course, the Transfer Pricing Officer has also observed that RBI / SIA approvals cannot be

considered for benchmarking the payment of royalty. Having done so, it is apparent, the Transfer Pricing Officer has not proceeded to benchmark the payment of royalty by applying any of the prescribed methods provided under the statute. Without assigning any reason, the Transfer Pricing Officer has determined the arm's length price of the royalty payment at nil. Prima−facie, it appears, the determination of arm's length price of royalty payment at nil by the Transfer Pricing Officer is completely on ad−hoc basis without following the due process of law as provided under the statute. Law is fairly well settled by the Hon'ble Jurisdictional High Court as well as different Benches of the Tribunal that the Transfer Pricing Officer is duty bound to determine the arm's length price of international transaction by applying any one of the prescribed methods. This principle has been propounded by the Hon'ble Jurisdictional High Court time and again which can be seen from the following decisions:−

i) CIT v/s Kodak India Pvt. Ltd., ITA no.15/2014, dated 11.07.2016;

ii) CIT v/s Johnson & Johnson Ltd., ITA no.1291/2014, dated 03.04.2017;

iii) CIT v/s Merck Ltd., ITA no.272/2014, dated 08.08.2016; and

iv) CIT v/s Lever India Exports Ltd., [2017] 78 taxmann.com 88.

14. Undisputedly, the assessee has benchmarked the payment of royalty by applying CPM. If the Transfer Pricing Officer was not

convinced with the benchmarking of the assessee, he should have independently benchmarked the arm's length price of royalty payment by adopting any one of the prescribed methods which he has failed to do. That being the case, the determination of arm's length price at nil on purely ad−hoc basis without assigning any valid and acceptable reason is legally unsustainable. Therefore, the addition made on account of adjustment made to the arm's length price of royalty payment deserves to be deleted.

15. Having held so, it is now necessary to deal with some of the submissions made by the learned Departmental Representative. The learned Departmental Representative has submitted that the Transfer Pricing Officer determined the arm's length price of the royalty payment by applying CUP method. Firstly, neither the order passed under section 92CA(3) of the Act by the Transfer Pricing Officer nor any other material even remotely demonstrate that the Transfer Pricing Officer has applied CUP method while determining the arm's length price of royalty payment at nil. Therefore, the learned Departmental Representative while arguing the issue before us has given a completely new dimension to the order of the Transfer Pricing Officer, which is otherwise not forthcoming from the said order. The issue is whether the learned Departmental Representative can introduce such fresh and completely new argument at this stage. On

going through the provisions of the Act, it is evident that the Transfer Pricing Officer has to determine the arm's length price of an international transaction by applying a prescribed method. Section 92C of the Act prescribes the methods under which arm's length price can be computed. Rule 10B of the Rules lays down the mechanism for computation of arm's length price under different methods. As per rule 10B(i)(a), for determination of arm's length price of international transaction under CUP, the price charged or paid for property transferred or service provided in a comparable uncontrolled transaction or a number of such transactions have to be identified and making adjustment to such price, as may be required, it has to be taken as an arm's length price of the international transaction between the AEs. A perusal of the order passed by the Transfer Pricing Officer does not reveal any such exercise being undertaken by the Transfer Pricing Officer. The learned Departmental Representative has also not brought to our notice any material to demonstrate that the mechanism prescribed under rule 10B(i)(a) was followed by the Transfer Pricing Officer for determining the arm's length price at nil. Therefore, even assuming that CUP method has been applied by the Transfer Pricing Officer, it is apparent that he has not undertaken the exercise provided under rule 10B(i)(a) for determining the arm's length price. Therefore, the contention of the learned Departmental Representative that the arm's length price of royalty has been determined at nil by applying

CUP method is totally unacceptable. Further, in case of Denso India Ltd. (supra), cited by the learned Departmental Representative, the Hon'ble Jurisdictional High Court has approved the decision of the Transfer Pricing Officer in applying TNMM for benchmarking the arm's length price of royalty paid. In case of CLSA India Ltd. (supra) and Frigo Glass India Pvt. Ltd. (supra) cited by the learned Authorised Representative, the Tribunal has rejected applicability of CUP method for determining the arm's length price of royalty payment and has held that TNMM is the most appropriate method to determine the arm's length price of royalty payment. In the facts of the present appeal, while arguing in favour of applicability of CUP, the learned Departmental Representative has submitted that since the assessee failed to furnish rates at which royalty was paid by other group entities, the Transfer Pricing Officer determined the arm's length price at nil. The aforesaid argument of the learned Departmental Representative is unacceptable simply for the reason that the Transfer Pricing Officer could not have determined the arm's length price under CUP by applying the rate of royalty paid by other group entities since they are controlled transactions. Whereas, rule 10B(1)(a) mandates that the price charged for an uncontrolled transaction / transaction should be considered as a CUP. As regards the justifiability of payment of royalty qua RBI/SIA approvals, we must observe that in the decisions cited by the learned Authorised Representative, the Tribunal

has held that the rate at which payment of royalty was approved by the RBI/SIA can be considered as arm's length price. In the case of A.W.Faber Castell India Pvt. Ltd. (supra) cited by the learned Departmental Representative, though, the Tribunal has observed that arm's length price of royalty needs to be determined in accordance with the Transfer Pricing regulations, however, the bench also observed that if an authority by way of specific approval has allowed a particular rate of payment, it does carry persuasive value and can act as one of the supportive tools for carrying out benchmarking of transaction relating to payment of royalty. Insofar as the decision of the Tribunal in Skol Breweries (supra) cited by the learned Departmental Representative, we must observe that the Tribunal has observed that press note of Ministry of Commerce fixing rate of royalty under FDI policy cannot be considered to be relevant for determination of arm's length price under the Act. However, following the well settled proposition of law that the view favourable to the assessee has to be taken, we are inclined to follow the decisions cited by the learned Authorised Representative holding that the determination of arm's length price as approved by the RBI/SIA is valid. On the basis of the aforesaid reasoning, we uphold the decision of the learned Commissioner (Appeals) in deleting the addition made on account of transfer pricing adjustment.

16. In The result, Revenue's appeal is dismissed.

ITA no.4837/Mum./2009
A.Y. 2004–05

ITA no.1874/Mum./2011
A.Y. 2005–06

17. The facts and issues involved in these two appeals are identical to ITA no.3668/Mum./2008. In fact, the Transfer Pricing Officer while recommending transfer pricing adjustment on payment of royalty in Assessment Year 2005–06 has referred to his decision in assessment year 2003–04 and 2004–05. Therefore, our decision therein will apply mutatis mutandis to these two appeals as well. In view of the aforesaid, we uphold the decision of the learned Commissioner (Appeals) in deleting the additions made on account of Transfer Pricing Officer in these two appeals also.

18. In the result, appeals are dismissed.

Order pronounced in the open Court on 25.04.2019

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

MUMBAI, DATED: 25.04.2019

Copy of the order forwarded to:

(1) The Assessee;

(2) The Revenue;

(3) The CIT(A);

(4) The CIT, Mumbai City concerned;

(5) The DR, ITAT, Mumbai;

(6) Guard file.

True Copy
By Order

Pradeep J. Chowdhury
Sr. Private Secretary

(Sr. Private Secretary)
ITAT, Mumbai