

**IN THE INCOME TAX APPELLATE TRIBUNAL
“L” Bench, Mumbai**

Before Shri R.S.Padvekar (JM) and Shri Rajendra Singh(AM)

ITA No.5307/M/2008
Assessment Year 2003-04

The ACIT 11(1), Room No.439,
Aayakar Bhavan, M.K.Marg,
Mumbai 400 020.

M/s.NGC Network (India) Pvt. Ltd.
6th floor, B Wing, Litolier Chambers
Andheri Kurla Road, Marol Naka,
Andheri (E), Mumbai 400 053.

PAN : AABCN 1401 A

Appellant

Respondent

Revenue by : Shri Narender Singh
Assessee by : Shri Porus Kaka & Shri Divesh
Chawla

O R D E R

PER RAJENDRA SINGH (AM)

This appeal by the revenue is directed against the order dated 31.3.2008 of CIT(A) for the assessment year 2003-04. The only dispute raised is in relation to Transfer Pricing adjustments made by the AO which has been deleted by the CIT(A).

2. Briefly stated the facts of the case are that the assessee who was mainly engaged in distribution and marketing of National Geographic Channel and the Adventure One Channel and rendering of post production services to media companies, had international transactions totaling Rs.13,75,27,281/- with its associated enterprises i.e. M/s. NGC Asia LLC. The details of transactions were as under :

| Sr No | Name and address of Associated Enterprise (AE) | Country of tax residence of AEs | Description of transaction with AEs | Amount received/receivable | Amount paid/payable as per books of account |
|-------|----------------------------------------------------------------------------------------|---------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|---------------------------------------------|
| 1 | NGC Network Asia LLC, 1145 Seventeenth Street, N.W. Washington Dc 200361, USA | USA | (i) Dubbing services rendered by the company (ii) Production and post production service (iii) distribution rights acquired for national geographic and adventure one channels | 2,40,11,107 76,70,111 | 10,58,46,063 |

3. The AO with the approval of concerned CIT had referred the matter for determination of arms length price to the Transfer Pricing Officer (TPO) but the reference was not accepted by the TPO due to paucity of time.

4. AO therefore asked the assessee to submit details regarding computation of arms length price along with supporting documents. From the details filed the AO noted that the assessee had determined the arms length price on the basis of financial analysis of the companies as per details given below:

| Name of the Company | Operating margin on operating costs (%) - 2003 |
|----------------------------------------|------------------------------------------------|
| Engineers India Ltd | 31.26% |
| Gilcon Project Services Ltd. | 8.11% |
| Kitco Ltd. | -9.73% |
| NIS Sparta Ltd. | 11.83% |
| Priya International Ltd. | 11.18% |
| RITES Ltd. | 20.94% |
| Ujjwal Ltd. | 3.21% |
| Water & Power Consultancy Services Ltd | 1.05% |
| Arithmetic mean | 9.73% |

5. The AO from analysis of the nature of activities of the above comparable cases noted that those companies were engaged mainly in providing technical consultancies and professional services and they were totally different from the assessee both from functional and operational point of view. The AO therefore asked the assessee to explain as to why the comparables used by it should not be rejected. The AO also gave a list of comparables collected by him as per details given below:

| | Mar-03 | Mar-03 | Mar-03 | | |
|---------------------------------------|---------------|---------------------|--------|-------------------------------------|----------|
| Company Name | Pbit nnrt noi | Pbit nnrt noi/sales | Sales | Economic activity | NIC code |
| Aastha Broadcasting Network Ltd. | 0.17 | 0.02 | 7.04 | Television broadcasting media | 92 |
| Asianet Communications Ltd. | 12.44 | 0.25 | 49.11 | -do- | " |
| E T C Networks Ltd. [merged] | 16.17 | 0.37 | 43.79 | -do- | " |
| Innetwork Entertainment Ltd. | 3.08 | 0.11 | 27.86 | -do- | " |
| New Delhi Television Ltd | 24.09 | 0.23 | 103.03 | -do- | " |
| RPG Netcom Ltd. | 1.24 | 0.03 | 39.86 | Cable television broadcasting media | " |
| Raj Television Network Ltd. | 5.01 | 0.16 | 30.48 | Television broadcasting media | " |
| Sahara One Media & Entertainment Ltd. | 0.96 | 0.02 | 63.42 | -do- | " |
| T V Today Network Ltd. | 49.12 | 0.45 | 108.49 | -do- | " |
| Zee Telefilms Ltd. | 132.75 | 0.28 | 479.56 | -do- | " |
| Zee Turner Ltd. | 1.56 | 0.09 | 17.94 | -do- | " |

6. The assessee vide letter dated 22.2.2006 submitted that it had conducted a search in respect of local channel companies but these companies were not acceptable as a comparative case due to unavailability of information or substantial related party transactions. A search was also conducted using the key words "distribution" "distributors" in Prowess but functions performed by those companies and risk profile were found to be different. A search had also been conducted for the industry type, "distribution of satellite television channels"; 'distribution'; 'distributors' under CapitalLine but it was found that there were no heads for "the distribution of satellite television channels". The assessee thereafter attempted to identify the companies undertaking similar functions. It was noted that the activity of the assessee of distribution of rights

in respect of satellite television channels was similar to trading function and the assessee therefore went for the trading in computer software which were intangible products as the right of distribution of television channels was also intangible. The assessee thus explained that considering the circumstances of the case companies trading in software were the only companies which could be used as comparables for the business of distribution of channels. As regards the comparable selected by the AO the assessee submitted that the comparables selected by the AO were engaged in broadcasting in television channels which was different from the business of distribution of channels in which the assessee was engaged. It was accordingly urged that the comparables selected by the assessee should be accepted.

7. The AO after considering the explanation of the assessee came to the conclusion that neither the comparables selected by the assessee nor those by the AO were proper comparable cases. He therefore observed that in a situation like that when no comparables were available, the assessee's own case should be the best comparable. It was noted by him that in the last year the assessee had paid the license fee @ US\$ 1 lac per year i.e. US\$ 12 lacs for the whole year and claimed that the rate of license fees was at arms length. During year the assessee had paid a fixed fee of US\$ 22 lacs for the period from 1.4.2002 to 31.3.2003 which came to US\$ 183333. The AO noted that the assessee had distribution agreement dated 21.2.2001 with NGC Asia. Vide addendum dated 1.1.2002 to the said agreement, it was agreed that NGC India would pay NGC Asia license fees of US\$ 10 lacs for the period 1.3.2001 to 31.12.2002 and thereafter US\$ 1 lac pm from 1.1.2002 to 30.6.2003 again vide addendum dated 27.1.2003 the license fees was increased from US\$ 1 lac per month to US\$ 22 lacs for the whole year which worked out to US\$ 183333

per month. The AO asked the assessee to explain the enhanced license fee. The assessee explained the position vide letter dated 14.03.2006:

"4. *in the year 2001, when NGC Asia first decided to make a foray into India, the license fee was decided as USD 1,00,000 per month, this was giving cognizance to the fact that it would take some time for a new and novel channel such as National Geographic Channel to establish a subscriber base in the initial periods, 'Accordingly, NGC India made a license fee payment of USD 12,00,000 to NGC Asia for assessment year 2002-03..... However, over a period of time, National Geographic Channel started becoming popular and enlarged its subscriber base in India. By June 2003, the subscriber base of national Geographic Channel almost doubled to 1,01,94,191. Given the increase in the subscriber base, which was being monitored by NGC Asia, NGC Asia re-negotiated the license fee from USD 12,00,000 to USD 22,00,000. Further, the subscription revenue earned by NGC India have progressively increased from Rs.19,69,90,262/- in A.Y.2002-03 to Rs.26,05,44,496/- in A.Y.2003-04, the above clearly demonstrates that the increase in license fee is justifiable given the substantial increase in subscriber base for NGC and the increase in subscription revenues."*

8. The AO on analysis of the reply given by the assessee above noted that the claim that license fees had increased because of increase in revenue was not correct. He noted that increase in revenue in A.Y.2003-04 over the previous year was only 32.26% whereas the increase in license fees was by

84.66%. The assessee explained the retrospective increase in license fees on the ground that negotiations regarding the increase in license fees were taking place for the last two financial years i.e. F.Y.2002-03 and 2003-04 and the agreement was reached only in January 2003. AO however did not accept the explanation. It was observed by him the rate of hiring transponders or hiring satellite had gone down over the year and after digitalization capacity of transponders had also increased many folds. Further availability of higher capacity digital transponders had led to higher competition amongst various transponders and therefore increase in license fees could not be because of increase in transponder fees/ satellite hire charges. It was also observed by him the subscription base of the assessee had almost stabilized and there were no basis for increase in license fees with retrospective effect. He therefore rejected the explanation of the assessee and adopted the license fees paid by the assessee in the immediate preceding years @ USD 1 lac per month as the arms length price for the period from 1.4.2002 to 31.1.2003. However for the months of February, 2003 and March, 2003 he accepted the license fees declared by the assessee at USD 183333 per month to be at arms length. He thus disallowed a sum of USD 833330 (Rs.3,04,70,868/-) for the period from April 2002 to January, 2003 and added to the total income.

9. The assessee disputed the decision of AO and submitted before CIT(A) that the selection of comparables cited by the assessee which were engaged in the business of trading/ distribution of software was justified. It was also submitted that the AO had rejected the TNMM method applied by the assessee and followed comparable uncontrolled price (CUP) method but used assessee's own data in the previous year which was not an uncontrolled transaction. It was also pointed out that the assessee had undertaken proper due diligence in

determining the arms length price and therefore analysis/comparables could not be arbitrarily rejected by the AO. Reliance was placed on the decision of the tribunal in case of Mentor Graphics (India) Pvt. Ltd. (109 ITD 101). The assessee also submitted that the observation of the AO that the subscriber base had stabilized was not correct because the subscriber base had almost doubled from five million in the mid 2001 to ten million in mid 2003. CIT(A) was convinced by the arguments advanced by the assessee. It was observed by him that the AO after rejecting the TNMM method applied by the assessee had not given any finding as to which one of the five methods prescribed under rule 10B was to be applied. He appeared to have applied the CUP method but used assessee's own data in the previous year which could not be called as uncontrolled transaction. CIT(A) also observed that the TPO in A.Y.2004-05 i.e. in the subsequent year accepted the methodology used by the assessee regarding selection of comparables and method of determination of arms length price. It was also observed by him that the AO had accepted the license fees paid by the assessee for the last two months to be at arms length and had not accepted the revision of rate with retrospective effect. The decision to increase the license fees and the date from which it would be effective was a commercial decision which had not been examined by the AO properly. CIT(A) therefore held that the transfer pricing study made by the assessee had to be accepted as per which there was no adjustments required. He therefore directed the AO to delete the addition of Rs.3,04,70,868/-. Aggrieved by the said decision the revenue is in appeal.

10. Before us the Learned DR appearing for the revenue assailed the order of CIT(A). It was argued that the comparables selected by the assessee were not really comparables as the cases selected were different both from operational

and functional point of view. Therefore the computation made by the assessee regarding transfer pricing adjustments was not correct. It was also submitted that the assessee had used enterprise level profit for comparison which was not correct as it was the transactional profit which should be considered. It was thus submitted that on the facts and in the circumstances of the case the assessee's own transactions in the previous year which were accepted as at arm's length price had been rightly applied.

11. The Learned AR on the other hand argued that the assessee had carried out due diligence in selection of comparables and the latest data available on the date of due diligence had been applied. It was also submitted that though the companies selected operated in different fields the assessee had used data relating to software segments only, for the purpose of comparison which was the intangible segment comparable to the assessee. It was also submitted that the AO had himself not accepted the comparables selected by him and it was not proper for him to reject the cases selected by the assessee. The Learned AR also pointed out that in the subsequent year the TPO had accepted the same comparables and the TNMM method used by the assessee as in this year and therefore the method followed by the assessee had to be accepted. It was further pointed out that the AO having accepted the license fees for the last two months of the year as at arm's length price, he was not correct in rejecting the license fees paid for the previous 10 months of the year. It was accordingly urged that order of CIT(A) should be confirmed.

12. We have perused the records and considered the rival contentions carefully. The dispute is regarding transfer pricing adjustments made by the AO on account of license fees paid to M/s. NGC Asia LLC, an associated enterprise

of the assessee. The assessee is engaged in the business of marketing and distribution of satellite television channels. During the year a sum of Rs.13.75 crores became payable to the associated enterprise mentioned above for various services as mentioned in para 2 earlier. The international transactions with associated enterprises are regulated by section 92 as per which the transactions have to be at arms length price and in case of any difference adjustments is required to the total income on account of any payment to associated enterprise. There are various method prescribed under the provisions of section 92C read with rule 10B to determine arms length price. These methods are transactional net margin method (TNMM); comparable uncontrolled price (CUP) method; resale price method (RPM); cost plus method (CPM); and profit split method (PSM). The assessee in this case applied TNMM method and for this purpose had conducted due diligence to find out the comparables. However no direct comparables dealing with distribution of satellite channels were found due to non availability of information or due to substantial related party transactions in those cases. The assessee therefore selected the business segment of trading in computer software which according to it was close to its business of distribution of channels as in both the cases products dealt with were intangible. The various companies selected by the assessee are mentioned in para 4 above. However for the purpose of comparison the assessee confined only to computer software segment of those companies and on that basis the assessee found that the payment made by it to the associated enterprises was at arm's length and no adjustment was required to make. The AO in this case had made reference to the TPO. However the reference due to some administrative difficulties was not accepted. The AO had therefore made its own selection of comparable as listed in para 5 earlier. However the AO agreed that both, the comparables selected by the assessee

and those by him were not suitable for comparison due to difference in nature of business. The AO therefore compared the assessee's own payment to its associated enterprises in the immediate preceding year for the purpose of comparison on the ground that in that year the said payment was found to be at arm's length as no adjustments were made.

13. The assessee in the immediate preceding year i.e. A.Y.2001-02 had paid license fees @ USD 1 lac per month. However the assessee vide agreement dated 27.1.2003 revised the license fee to USD 183333 per month with retrospective effect from 1.4.2002. The AO has held that such steep increase in license fees by 84.66% with respect to last year was not justified as corresponding increase in revenue was only 32.26%. The AO had therefore made the adjustments on the basis of license fees paid in the immediate preceding year.

14. The case of the assessee is that the enhanced license fees @ USD 183333 per month for the last two months for the assessment year i.e. February and March 2003 had already been accepted by the AO and therefore there was no reason for not accepting the enhanced fees for the earlier period of the year. The assessee has also submitted that subscriber base had almost doubled from mid 2001 to mid 2003 and the negotiation regarding increase in license fees was in progress for quite some time and the agreement had arrived at only in January, 2003 which was the reason for increase with retrospective effect. It has also been submitted that the assessee's own transactions in the earlier year could not be adopted for comparison as these were controlled transactions with associated enterprise. Another argument advanced by the assessee is that the comparables selected by the assessee as

well as method of computation of TP adjustments had accepted by the AO in the subsequent year i.e. A.Y.2004-05 and therefore there was no reason for not using these comparables in the present year.

15. We have considered the various aspects. The AO had accepted the license fees for the month of February and March 2003 to be at arm's length. However the steep increase given from the beginning of the year with retrospective effect has not been accepted. The reasons given by the AO is that over the year there has been decline in rate of hiring transponders/ satellite due to availability of higher capacity digital transponders and higher competition amongst various transporters. There would have been no difficulty if retrospective increase was with respect to an unrelated party because these are commercial decisions which the assessee may take according to its business needs and cannot be questioned unless they are found not genuine. The position is however different in case of transactions with a related party as in the present case, which has to be compared to unrelated party transactions to find out the arm's length price. In this case arm's length price has been computed by the assessee with respect to certain comparables as mentioned in para 4 using TNMM. These comparables and the method of computation of arm's length price has been accepted by the department in the subsequent assessment year i.e 2004-05. Therefore in our view comparables selected by the assessee have to be adopted for the purpose of computation of transfer pricing adjustments this year also. However, it is noted that the assessee has worked out the arm's length price on the basis of transactions relating to the comparable for A.Y.2002-03 as at the relevant point of time complete details in respect of A.Y.2003-04 were not available. In our view when the facts and figures in relation to the relevant assessment year i.e. A.Y.2003-04 are now

available then the transfer pricing adjustments have to be computed based on the said facts and figures. In case working is to be made on the basis of figures for assessment year 2002-03, then in our view the transactions in assessee's own case for the said year which have been found to be at arm's length in that year should be adopted as basis as the business being same, it will give better results. Merely because the transaction is with an associate enterprise cannot be the ground to reject it as a comparable when the transaction is at arm's length. However as we have held earlier, in our view it will be most appropriate to compare the transactions for the same year i.e. A.Y.2003-04 for which the figures are available in respect of comparables which have already been accepted by the department. We therefore set aside the order of CIT(A) and restore the matter to the file of AO for re-working of the transfer pricing adjustments using TNMM on the basis of facts and figures available for assessment year 2003-04 in respect of the comparable selected by the assessee and pass fresh order after allowing opportunity of hearing to the assessee.

16. In the result the appeal of the revenue is partly allowed for statistical purpose.

17. The order was pronounced in open court on 23.02.2011.

Sd/-
(R. S. PADVEKAR)
JUDICIAL MEMBER

Sd/-
(RAJENDRA SINGH)
ACCOUNTANT MEMBER

Date : 23.02.2011
At : Mumbai

Copy to :
1. The Appellant
2. The Respondent

3. The CIT(A), Mumbai concerned
4. The CIT, Mumbai City concerned
5. The DR "L" Bench, ITAT, Mumbai

// True Copy//

By Order

Assistant Registrar
ITAT, Mumbai Benches, Mumbai

Alk