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IN THE INCOME TAX APPELLATE TRIBUNAL

"E" BENCH, MUMBAI

BEFORE SHRI S.V. MEHROTRA, ACCOUNTANT MEMBER. AND

SHRI VIJAY PAL RAO, JUDICIAL MEMBER

ITA No.7098/Mum./2010
(Assessment Year : 2006–07)
Date of Hearing: 15.2.2011

M/s. Tecnimount ICB Pvt. Ltd.
Tecnimount ICB House, Bldg.no.2
504, Chincholi Bunder
Link Road, Malad (West) ………..………. Appellant
Mumbai 400 064 – AAACI2628B

v/s

ACIT–9(3), Aayakar Bhavan
M.K. Road, New Marine Lines ..…….………. Respondent
Mumbai 400 020

Assessee by : Shri M.P. Lohia a/w Shri Manoj Anchal and Shri Tejas Shah

Revenue by : Shri Hemant Lal a/w Ms. Malti Shridharan

O R D E R

PER S.V. MEHROTRA, A.M.

This appeal has been filed by the assessee as per the provisions contained under section 253(d) of the Income Tax Act, 1961 (for short *"the Act"*), relating to the appeals to the appellate Tribunal for assessment year 2006–07, against the order dated 30th August 2010, passed by the Assessing Officer under section 143(3) of the Act, for assessment year 2006–07, in pursuance to the directions given by the Dispute Resolution Panel (herein after for short *"DPR"*) under section 144C(13) of the Act,

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2. Brief profile of the assessee company is like this. The assessee company is a joint venture between Tecnimount Edison Group based in Italy and the Kapadia Group based in India. Tecnimount Edison Group is an Italy based engineering and construction group with worldwide operations. The group is the market leader in the polyolefin sector with strong capability in polymers, oil and gas and petrochemicals. It is one of the leading EPC company in India. The assessee company was initially set–up by Shri Narendra Kapadia. In the year 1996, Tecnimount SpA, one of the leading EPA companies in Europe, acquired 50% equity and company was re–christened as Tecnimount ICB Pvt. Ltd. The assessee company is engaged in the activities like EPC lump sum turnkey contracts, engineering design services, supervision services, translation services and feasibility studies. It also renders onshore / offshore design and engineering services and field construction supervision services. The assessee company primarily renders engineering design services and field construction supervision services to various entities within the Tecnimount Group. The trained technical personnel available with the assessee company are utilised by the Tecnimount Group for execution of assignments across the globe. The services are rendered either from India or by deputation of personnel of the Tecnimont offices or at the field construction sites. The assessee company is compensated on an hourly basis on actual man–hours spent, as captured by time sheets. Hourly rates vary for different activities such as piping design, civil design, instrumentation design, electrical design, machinery design, etc., and the experience and skill set of the personnel involved in performing the services. The assessee company is the preferred vendor in case of outsourcing of engineering services within or outside the group. Therefore, during the year under consideration, it had entered into transactions with its Associated Enterprises as well as non–associated enterprises. The international transactions undertaken by the assessee company with its Associated Enterprises (herein after for short *"A.Es"*), during the financial year ended 31st March 2006, were as under:–

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S.no.	*Nature of International Transactions*	*Transaction value (Amount in INR)*
1.	*Supply of equipment*	*90,747,040*
2.	*Instrumentation and construction contract*	*90,701,562*
3.	*Field construction supervision activity for projects executed by Associated Enterprises (A.Es)*	*108,194,521*
4.	*Project management activity in connection with projects executed by A.Es*	*66,308,301*
5.	*Engineering design activity*	*15,469,702*
6.	*Software service*	*661,334*
7.	*Payment of consultancy fee*	*1,490,608*
8.	*Payment of service charges*	*6,060,484*
9.	*Reimbursement of expenses*	*5,005,024*
10.	*Recovery of expenses*	*87,582,863*

3. In order to determine the arm's length price of the international transactions reference under section 92CA(1) of the Act, was made to the Transfer Pricing Officer (hereinafter for short referred to as "*TPO*") by the DCIT–9(3), Mumbai, on 2nd September 2008. The order passed under section 92CA(3) of the Act, is contained from Pages–229 to 241 of the paper book. Out of the international transactions noted above, transactions from serial no.1 to 6, relate to receipts of ₹ 37,21,00,000 in respect of various services and serial no.7 to 9, relate to recovery of amount of ₹ 8,75,82,863 from it's A.Es at actual cost on behalf of whom the said expenditure were incurred. The TPO, in Para–5, of his order, has observed that the assessee had benchmarked its transactions relating to supply of equipment and rendering of technical services to A.Es using TNMM using PLI as operating profit to operating cost. He further pointed out that the assessee used external comparables available for benchmarking using data for the years 2004, 2005 and 2006. Arithmetic mean of these comparables comes to 4.78%. He further noted the assessee's contentions that while the profit margin on costs of the comparable comes to 4.78%, it had earned a margin of 33.32% on cost in respect of income from A.Es, which is better than that earned by the comparables and, therefore, the transactions were at arm's length.

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4. The TPO issued show cause notice dated 26th October 2009, which has been reproduced in Para–5.1 of TPO's order. In the show cause notice issued by the TPO, it was, inter–alia, pointed out that the basis of allocation of expenditure had not been provided and no documents had been submitted to substantiate the same. It was further pointed out that it is not clear whether the working tallies with the Profit & Loss a/c or not. Therefore, the basis of working out the margin in respect of sales to A.Es could not be relied upon. It was further pointed out that on an entity level, the assessee had earned a net loss @ 0.97%. TPO referred to section 92C and pointed out that multiple year data could be used only if the facts and circumstances so warrant. He, therefore, separately computed average net margin as a percentage of operating cost by using March 2006 data and average margins of comparable companies selected by the assessee which worked out to 9.16% on costs. The TPO did not consider the loss making companies results viz. Toyo Engg. Judicial U.B. Engg. Ltd. The TPO computed the amount to be adjusted to the arm's length price of sales / service at ₹ 10,86,80,340. He further pointed out that since the arm's length value of sales / service did not fell within the 5% range, he proposed to make an adjustment of ₹ 10,86,80,340. The detailed computation is given at Page–6 of TPO's order.

5. The assessee, in its reply dated 28th and 29th October 2009, pointed out that it had earned higher margins in respect of income from A.Es vis–a–vis income from non A.Es. The assessee referred to Rule 10B(1)(e) and pointed out that the assessee had computed net profit margin from international transactions separately and, therefore, in view of the above rule, the same should have been considered and entity level analysis should not have been done. The assessee also pointed out that it had calculated margin of comparable companies based on segmental data, wherever applicable, while the TPO had considered the margin directly from the prowess data base without considering the segmental data. Further, it was pointed out that the loss making companies should not be rejected. Further, multiple data should be considered in place of data for the financial year 2005–06 only.

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6. The TPO, after considering assessee's submissions, observed that the assessee had provided the split Profit & Loss a/c in respect of income from A.Es and non A.Es. The direct expenses were allocated on actual basis and indirect expenses were allocated based on two separate allocation keys. He pointed out that the assessee did not provide any details as to how direct expenses for each segment were captured. He noted the accounting policy explained by the assessee at Pages–10 and 11 of the order and pointed out that the same was very complex. The recognition of the revenue and costs both was dependent on various factors such as the level of completion of work, the profitability from the project, etc. He pointed out that there could be instances where income in respect of A.Es' contract is booked but not in respect of non A.Es' contract due to difference in stages of completion. He further pointed out that no authenticated documents were produced to prove the genuineness of split Profit & Loss a/c. The segmental accounts were not part of the audited accounts submitted by the assessee. He, therefore, held that the split Profit & Loss a/c could not be relied on and, accordingly, entity level margin comparison vis–a–vis the comparable companies had to be done.

7. As regards margin of comparable companies considering the segmental data wherever applicable, he accepted the assessee's contention and, accordingly, the margin as provided by the assessee were considered to be the arm's length benchmarks. However, loss making companies were rejected. He also considered the data for financial year 2005–06 only as against for the three years considered by the assessee and computed the arithmetic means at 6.57% in regard to operating profit to operating cost as given in Para 5.29 of his order and computed the adjustments to be made for arriving at arm's length price at ₹ 8,94,37,237. The working given in Para 5.2.11. is as under:–

> *"5.2.11 As regards margins of assessee are lower than the margins of comparable companies, an adjustment to the arm's length price of the sales / services to A.Es is warranted. The working of the adjustment are as follows:–*

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Particulars		*Amount (₹)*
Operating costs	*A*	*1,123,002,149*
Arm's length profit margin on costs	*B*	*6.57%*
Arm's length profit	*C = A + B*	*73,781,241*
Arm's length value of sales	*D = A + C*	*1,196,783,390*
Less: value of non–A.Es sales	*E*	*740,052,838*
Arm's length value of A.Es sales	*F = D – E*	*456,730,552*
95% thereof	*G = F * 95%*	*433,894,025*
Actual value of A.E sales	*H*	*372,082,458*
Adjustment amount	*I = F – H*	*84,648,094*

The arm's length payment which should have been received by the assessee from it's A.Es for supply and services is thus calculated at ₹ 456,730,552. However, the assessee has received an amount of ₹ 372,082,458. Thus, an adjustment of ₹ 8,46,48,094 is being made to the income of the assessee on account of payment received by the assessee from it's A.Es for supply and ser vices. (Adjustment of ₹ 8,46,48,094)"

8. The Assessing Officer, vide his order dated 19th November 2009, after making adjustments as per the order of the TPO, proposed the total income at ₹ 13,83,14,700, as against the returned income of ₹ 4,92,87,464, as under:–

Total income as per return of income		*4,92,87,464*
Add: Additions as discussed		
(i) Transfer pricing adjustments on a/c of mark–up on reimbursement of costs	*43,79,143*	
(ii) Transfer pricing adjustment on a/c of payment received for supplies and services	*8,46,48,094*	*8,90,27,237*
Total Income		*13,83,14,701*
R/o to …….		*13,83,14,700*

9. Against this draft order, the assessee filed objections before the Dispute Resolution Panel (herein after for short *"DRP"*) in respect of

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variations made by the Assessing Officer. The assessee, inter–alia, took following objections before the DRP:–

"a) Rejection of segmental account is not proper;
b) Use of single year data;
c) Excluding other income from operative income;
d) Rejection of loss making company (UB engineering limited); and
e) Adjustment to the total cost rather than cost attributable to AE."

10. The DPR confirmed the findings of the TPO as regards rejection of segmental account, inter–alia, observing that although the assessee had filed audited account before it, the same was not considered as the same should have been filed before the TPO. The DRP also confirmed the findings of the TPO as regards adopting single year data observing that this approach was in conformity with the transfer pricing regulation in India. The DRP further pointed out that multiple year data can only be applied if the assessee had applied multiple data in its price setting mechanism. DRP further held that the data relating to U.B. Engineering Ltd., is comparable and, therefore, required to be included as comparable and, hence, to this extent, DRP did not agree with the findings of the TPO in excluding the comparables which were loss making. Insofar as action of TPO in making adjustment to the total cost rather than the cost attributable to A.Es was concerned, DRP confirmed the same after taking into consideration the fact that the decision of Mumbai Bench of this Tribunal in Tow International Pvt. Ltd., Tara Jewels Exports Pvt. Ltd. and Tara Ultimo Pvt. Ltd. v/s ACIT, reported in 2010–TIOL–166–ITAT–Mum, and appeal had been filed before the Bombay High Court.

11. On the last issue, which relates to denial of +/– 5% as per the provisio to section 92C(2) of the Act, the DRP observed that the provision is clarificatory and procedural in nature and the arm's length price determined by the TPO does not fall within +/– 5% range and, therefore, no adjustment is required. The Assessing Officer gave effect to these directions vide his order dated 30th August 2010. The assessee is aggrieved and is in further appeal before the Tribunal.

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12. Grounds no.1 and 3, are general in nature, hence, no separate adjudication is required.

13. Grounds no.2, 9 and 10, reads as under:–

> *2. On the facts and in the circumstances of the case and in law, the Assessing Officer has erred in making an addition of ₹ 8,90,27,237 to the total income of the appellant based on the transfer pricing adjustment determined by the TPO.*
>
> *9. Non–consideration of business income as operational revenue*
>
> *Without prejudice to the above, the learned AO/TPO erred in holding that the other business income viz. write back of liabilities, write back of provisions, etc., should not be considered as part of the operational revenue while computing the net profit of the appellant.*
>
> *10. Without prejudice to the above, the learned AO/TPO should have excluded attributable expenses incurred for earning such income and other non–operating income from the operational cost while computing the operating margin of the appellant."*

14. During the course of hearing, the learned Counsel for the assessee did not wish to press the aforesaid grounds of appeal. Learned Departmental Representative, on the other hand, did not dispute the submissions of the learned Counsel for the assessee. Consequently, these grounds of appeal are dismissed as not pressed.

15. Ground no.4, reads as under:–

> *"4. On the facts and in the circumstances of the case and in law, the Assessing Officer has erred in making an addition of ₹ 43,79,143 being transfer pricing adjustment on account of five percent mark–up on the amount of reimbursement of expenses received by the appellant from it's AEs."*

16. Learned Counsel for the assessee did not wish to press this ground of appeal before us due to smallness of the tax effect. Consequently, this ground of appeal is also dismissed as not pressed.

17. The issue arising out of grounds no.5, 6, 7 and 8, relate to rejection of segmental analysis made by the assessee.

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18. Before us, learned Counsel for the assessee referred to Pages–168 to 170 of the paper book wherein the petition for permitting to file additional evidence before the DRP–II is contained and submitted that the assessee furnished audited segmental results to substantiate the genuineness of segmental profitability. He referred to section 144C(6)(c) to point out that the DRP is required to issue the directions in regard to the objections filed by the assessee on the evidence furnished before it. He further referred to rules framed by the board in pursuance to section 144C(14) titled *"Income Tax (Disputes Resolution Penal) Rules, 2009"*, and referred to Rule–4(3)(b) r/w proviso and pointed out that the DRP should have taken into consideration the additional evidence filed by the assessee particularly when there was no variation in the figures and only the procedural requirement of getting the segmental results audited was fulfilled. Learned Counsel for the assessee further submitted that the DRP segmental results had to be taken into consideration and not the results at entity levels. He further referred to Page-75 of the paper book wherein Profit & Loss a/c of assessee company for the year ended 31st March 2006, is contained and referred to internal Page-8 of TPO's order to demonstrate that he had taken into consideration the total operating cost aggregating to ₹ 1,12,37,84,938. He referred to Page-62 of the paper book wherein the assessee's segmental results are contained in which the operating profit to operating cost is computed @ 33.32%. Learned Counsel further pointed out that, as against this, the TPO had applied 6.57% to the total operating cost of ₹ 1,12,30,02,149, and has determined the arm's length profit at ₹ 73,81,241, after rejecting the segmental results. Learned Counsel submitted that this issue is covered by following decisions:-

(i) ACIT v/s M/s. Tej Diamond, (ITA no.5034/Mum./2007, order dated 15.2.2010) reported as 2010–TII–27–ITAT–MUM–TP;

(ii) *ACIT v/s M/s. Twinkle Diamond, 2010–TII–09–ITAT–MUM–TP, wherein it has been held that "++ TNMM requires comparison of net profit margins realised by an enterprise from an international transaction or an aggregate of a class of international transactions and not comparisons of operating margins of enterprises. In the case of UCB India P. Ltd. (2009–TIOL–184–ITAT–MUM) it has been held that section 92C read with Rule 10B(1)(e) deals with Transactions Net Margin Method and it refers to only net profit margin realised by an enterprise from an international transaction or a class of such transaction, but not operational margins of enterprises as a whole;*

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(iii) *M/s. Star Pite, 45 DTR 65 (Mum.);*
(iv) *Golwala Diamonds, ITA no.2346/Mum./2006; and*
(v) *UCB India Pvt. Ltd. v/s ACIT, 121 ITD 131 (Mad.).*

19. Learned Counsel further pointed out that the assessee had relied on the decision in IL. Jin Electronics (I) Pvt. Ltd. v/s ACIT, (2010) 36 SOT 227 (Del.), wherein at Page-239, it was observed as under:-

> *"15. The assessee has also taken one alternative ground out of the total raw materials consumed by the assessee for manufacturing print circuit boards, only 45.51 per cent of the total raw materials were imported through assessee ' s associate concerns, and, therefore, any adjustment, if any called for, can only be made to the 45.51 per cent of the total turnover, and not to the total turnover of the assessee. After considering the facts of the case, we do not find any difficulty in accepting this contention of the assessee that at best only 45.51 per cent of the operating profit can be attributed to imported raw material acquired from assessee's associate concerns. <u>In the present case, the AO has calculated the operating profit on the entire sales of the assessee, which in our considered opinion, is not justified</u>, when it is admitted position that only 45.51 per cent of raw material has been acquired by the assessee from its associate concerns for the purpose of manufacturing items. The assessee has stated that the operating profit if applied to 45.51 per cent of the turnover would come to Rs.35,52,573 as against operating profit of Rs.24,35,175 booked by the assessee, and the difference thereof would only be called for to be made as addition to the profit shown by the assessee. We, therefore, direct the AO to modify the assessment and make the adjustment only to the extent of difference in the arm ' s length operating profit with adjusted profit with reference to the 45.51 per cent of the turnover, and not to the total turnover of the assessee. Therefore, to this extent, the addition made by the AO and further confirmed by the CIT(A) is reduced. We order accordingly." [<u>emphasis supplied</u>]*

20. Learned Counsel further submitted that benefit of variation / reduction of 5% from the arithmetic mean as per proviso to section 92C of the Act is to be given to the assessee as per his option as has been held in following decisions:–

"1. IL. Jin Electronics (I) Pvt. Ltd. v/s ACIT, (2010) 36 SOT 227 (Del.)
2. T Two International Pvt. Ltd., 2010–TIOL–166–ITAT–Mum;
3. Tej Diamond (ITA no.5034/Mum./2007, order dated 15.2.2010;
4. Twinkle Diamond (2010 TII 09 ITAT Mum TP) (Mum ITAT);
5. Startex Networks (I) Pvt. Ltd., (2010 TII 13 ITAT Del. TP); and
6. M/s. Starlite, 45 DTR 65 (Mum.) (Trib.)."

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21. Learned Counsel, in the alternative, submitted that even if adjustment is to be made on entity level operating results, the same can be done only to A.Es' transactions as against entire transactions of business. For this proposition, he relied on the following decisions:–

"1. Sony (I) P. Ltd., 114 ITD 448 (Del.);
2. Philips Software, 26 SOT 226 (Bang.);
3. Develop[ment Consultants P. Ltd., 115 TTJ 577 (Kol.);
4. Skoda Auto India, 30 SOT 319 (Pune);
5. Schefenacker Motherson Ltd., 123 TTJ 14 (Del.);
6. Toshiba India P. Ltd., TII 14 ITAT Del. TP;
7. Customer Services India P. Ltd., 30 SOT 486 (Del.);
8. SAP India 6 ITR (Trib.) 81 (Bang.); and
9. ACIT v/s UE Trade Corporation (I) Pvt. Ltd., 2011–TII–ITAT–Del. TP.

22. Learned Departmental Representative relied on the findings of the TPO and also the assessment order passed in pursuance to the direction issued by the DRP under section 144C(5). She submitted that the assessee had not substantiated the correctness of segmental results and, therefore, the TPO observed that the authenticated documents were not produced to prove the genuineness of split Profit & Loss a/c and further observed that the segmental accounts were not part of the audited account submitted by the assessee. She, therefore, submitted that DRP rightly rejected assessee's request for considering additional evidence. However, she submitted that even if the audited statement filed before the DRP as additional evidence are to be admitted by the Tribunal then the matter needs to be restored back to the file of Assessing Officer as he has not considered the segmental results. Further, she pointed out that there is a vide variation between profit margin of A.Es and non A.Es' transactions which needs to be examined. She referred to Page-16 of paper book wherein the details of international transactions are given and further referred to Page-20 of the paper book wherein the nature of these international transactions has been given. She submitted that supply of equipment, instrumentation of construction contract, field construction, supervision activity for projects executed by A.Es, project management activities in connection with projects executed by A.Es, engineering design services, software services are entirely different nature of

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transactions and, therefore, the profit margin is also different in respect of all these transactions. She submitted that all the international transactions comprised in different activities have to be taken into consideration if the segmental figures are to be taken as benchmark for determining the profitability. In this regard, learned Departmental Representative referred to Rule-10A(d) of the Act and pointed out that this rule defines the meaning of transaction as used in computation of arm's length price and includes the number of closely linked transactions. She pointed out that unless the transactions are closely linked, they have to be treated as separate transactions and profitability determined accordingly. She further referred to Rule-10B(e) which deals with procedure relating to determination of arm's length price by Transactional Net Margin method and pointed out that the term used is *"An International Transaction"* in clause (i) and, therefore, each and every international transactions has to be examined. She submitted that the Assessing Officer should look at each international transaction in depth. Learned Departmental Representative further vehemently opposed the submission of learned Counsel that in terms of proviso to section 92C, the assessee is entitled to benefit of variation / reduction of 5% from the arithmetic mean. She submitted that as per proviso only, if arm's length price falls within +/–5% range, the assessee can exercise its option for adopting the other price. As regards ground no.14, learned Departmental Representative submitted that the same would be relevant only if assessee's plea for adopting segmental result is rejected.

23. We have heard the rival submissions, perused the orders of the lower authorities and the materials available on record. At the outset, we may point out that there is no dispute between the assessee and the Department over the method adopted for determining the arm's length price being TNM method. The next issue for consideration is whether to apply TNM method at entity level or at transactional level for determining the arm's length price. The assessee had submitted segmental results for its transactions with A.E's and transactions with non A.Es. The TPO rejected the segmental results as contained at Page-62 of paper book on the ground that the same were not

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authenticated and also did not form part of audited financial statement of accounts. Learned Counsel, during the course of hearing, submitted before us that this objection was not brought to the notice of assessee. However, when it received the order, then it got the segmental results duly audited and filed the same before the DRP as additional evidence vide its petition dated 4th May 2010. The DRP has summarily rejected the assessee's additional evidence observing that the same was not filed before the DRP. Therefore, the first issue which arises for our consideration is regarding scope of powers of DRP regarding entertaining additional evidence. In this regard, we may refer to legal provisions which have to be taken into consideration when additional evidence is filed before the DRP. Section 144C, deals with reference to DRP and sub sections 5, 6 and 14, read as under:-

> *"5. The Dispute Resolution Panel shall, in a case where any objection is received under sub–section (2), issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.*
>
> *6. The Dispute Resolution Panel shall issue the directions referred to in sub–section (5), after considering the following, namely –*
>
> > *(a) draft order;*
> > *(b) objections filed by the assessee;*
> > *(c) report, if any, of the Assessing Officer, valuation officer or transfer pricing officer or any other authority;*
> > *(d) records relating to the draft order;*
> > *(e) evidence collected by, or caused to be collected by, it; and*
> > *(f) result of any enquiry made by, or caused to be made by, it*
>
> *14. The Board may make rules for the purposes of the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed under sub–section (2) by the eligible assessee."*

Rule 4 of Income Tax (Disputes Resolution Penal) Rules, 2009, deals with procedure for filing objections before DRP, which reads as under:-

> *"4. Each panel shall have a secretariat for receiving objections, correspondence and other documents to be filed by the eligible assessee and shall also be responsible for issuing notices, correspondence and direction if any, on behalf of the panel."*

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A combined reading of section 144C r/w Rule 4 of Income Tax (Disputes Resolution Penal) Rules, 2009, clearly show that the DRP had to take into consideration the evidence furnished by the assessee before issuing any directions. The proviso to Rule-4B Income Tax (Disputes Resolution Penal) Rules, 2009, clearly deals with additional evidence and requires that it should be separately filed along with application stating the reasons for so doing. In the present case, learned Counsel has pointed out that there is no variation in the segmental results submitted by it in course of proceedings before TPO and audited segmental results filed before the DRP. The only objection for not considering the same was that they were not audited. This was only a procedural requirement and once the same was complied with, the audited segmental accounts should have been admitted as additional evidence by the DRP in order to impart substantial justice to the assessee. We, therefore, admit the audited segmental results filed by the assessee vide its petition dated 4th May 2010, and restore the matter back to the file of Assessing Officer for denovo consideration in accordance with law.

24. Now, coming to the main issue whether the segmental results are to be taken into consideration or profit margin at entity level is to be considered, we find that Chapter-X incorporates special provisions relating to avoiding of tax in regard to international transactions and income from international transactions has to be determined at arm's length price. Therefore, as per the provisions contained under sections 92 to 94, international transactions are to be taken into consideration. Therefore, segmental results are to be considered and not the profit at entity level. As regards the submissions of learned Department Representative that with reference to segmental results, each and every international transaction has to be considered separately because all the activities are separate and profit margin will be different. Learned Counsel objected to these submissions pointing out that it is not the appeal filed by the Revenue but by the assessee. He also submitted that the Tribunal has no power of enhancement and only segmental results have to be considered. On this count, we find

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that TPO has not at all considered the segmental results and, therefore, we refrain from making any observations with reference to the submissions made by the learned Departmental Representative and consider it appropriate to only observe that the Assessing Officer will consider the segmental results and determine the arm's length price in accordance with law. Consequently, these grounds of appeal are allowed for statistical purposes in terms of our above observations.

25. Ground no.8, reads as under:-

> *"8. Rejection of loss making comparables*
>
> *On the facts and in the circumstances of the case and in law, the learned A.O./TPO erred in rejecting the margins of loss making companies while computing the arithmetic means of comparable companies."*

26. The TPO had excluded loss making companies for arriving at arithmetic means of comparable companies. However, DRP has not accepted these findings of TPO and has held that U.B. Engineering Ltd., which was a loss making company required to be included as comparable. Learned Counsel pointed out that while giving effect to DRP's directions, the Assessing Officer has again excluded the same.

27. Having heard the rival submissions and having perused the orders of the lower authorities and the materials available on record, we direct the Assessing Officer to comply with the direction of DRP in this regard. We order accordingly. This ground is, thus, allowed.

28. The issue arising out of grounds no.12 and 13, deal with the issue regarding benefit of variation / rejection of 5% from arithmetic mean.

29. The DRP, while issuing directions under section 144C(5), observed that as regards benefit of +/- 5% adjustment, as per proviso to section 92C(2), the same being clarificatory and procedural in nature, does not call for adjustment in the arm's length price, determined by the TPO because the arm's length price determined by the TPO does not fall within +/- 5% range.

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30. Learned Counsel for the assessee referred to paper book Page no.253, containing case law where decision of Tribunal in Sony India Pvt. Ltd. v/s DCIT, (2008) 114 ITD 448 (Del.), is contained and referred to Page-270 of the paper book wherein the Tribunal has observed as under:-

> *"Circular No. 12, dt. 23rd Aug., 2001 does not help to solve the problem. The said circular was issued prior to introduction of the proviso. However, it is a settled law that when a proviso is introduced, the Courts have to look at the language in which the proviso is expressed. Only in cases of ambiguity, it is permitted to go beyond the language and consider the intention of the legislation. As far as the first limb of proviso is concerned, the same has general application. The controversy is relating to the second limb/portion of the proviso to s. 92C(2) where "an option" is given to the taxpayer to take ALP which may vary from the arithmetic mean by an amount not exceeding 5 per cent of such arithmetic mean. Here again, there is no controversy that taxpayer can take ALP which is not exceeding 5 per cent of the arithmetic mean. The "option", as is clear from the language is to take ALP which is not in excess of 5 per cent of the said mean. The word "option" as per The Law Lexicon is synonymous with "choice" or "preference". Therefore, it is the choice of the assessee to take ALP with a marginal benefit and not the arithmetical mean determined by the most appropriate method. There is nothing in the language to restrict the application of the provision only to marginal cases where price disclosed by the assessee does not exceed 5 per cent of the arithmetic mean. The ALP determined on application of most appropriate method is only an approximation and is not a scientific evaluation. Therefore, the legislature thought it proper to allow marginal benefit to cases who opt for such benefit. Both in the first as also in the second limb, implications of determined ALP are the same except for the marginal benefit allowed to the assessee under the second limb. Hence, second limb is applicable even to cases where the taxpayer intends to challenge ALP taken as arithmetic mean and determined through the most appropriate method. Option is given to the assessee as in some cases, variation not exceeding 5 per cent of arithmetic mean might not suit the assessee and, therefore, assessee in such cases should not be put to a prejudice. Otherwise, there is no difference between the first and the second limb of the provision as far as right of the assessee to challenge the determined price is concerned. The second limb only allows marginal relief to the assessee at his option to take ALP not exceeding 5 per cent of the arithmetic mean. Therefore, benefit of the second limb of the proviso to s. 92C(2) is available to all assessees irrespective of the fact that price of international transaction disclosed by them exceeds the margin provided in the proviso.—Development Consultants (P) Ltd. vs. Dy. CIT (2008) 115 TTJ (Kol) 577 relied on."*

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31. He further referred to the decision in ACIT v/s U E Trade Corporation (India) Pvt. Ltd., 2011–TTI–04–ITAT–DEL–TP, wherein also the decision in Sony India Pvt. Ltd. (supra) was followed. Thus, the assessee's contention is that it is entitled for standard deduction of 5% in arm's length price determined on the basis of arithmetic mean. He also referred to the decision in Philips Software Centre Pvt. Ltd. v/s ACIT (2008) 119 TTJ 721 (Bang.), wherein at Page-399, while summarizing its conclusion, Tribunal, inter-alia, observed as under:-

> *"5.71 We, therefore, summarise our conclusion as follows : (i) Since the basic intention behind introducing the TP provisions in the Act is to prevent shifting of profits outside India, and the assessee is claiming benefit under s. 10A of the Act, the TP provisions ought not to be applied to the assessee. (ii) Circular No. 14 of 2001 issued by the CBDT is binding upon the TPO. (iii) There was no infirmity in the TP study conducted by the assessee, and the TPO erred in disregarding the same for the purpose of computing framing the assessment and making the transfer pricing adjustment. (iv) The TPO or the AO needs to satisfy and communicate to the taxpayer the relevant clause under s. 92C(3) which has been triggered by the assessee, which has necessitated the application of the TP provisions. In the instant case, since this was not demonstrated to the assessee, the transfer pricing order is void. (v) The TPO erred in conducting a fresh study for the purpose of passing his order. The study conducted by the TPO is not in conformity with the provisions of rr. 10B(4) and 10D(4). (vi) The TPO erred in disregarding the most appropriate method adopted by the assessee in the TP study, and also in using the Prowess database. The TPO did not provide any reason for deviating from the TP study in respect of these matters. (vii) The TP study cannot be ignored by the TPO, in the absence of any deficiency or insufficiency. Further, the order passed by the TPO appears to have been passed with the intention of making a higher transfer pricing adjustment. (viii) For the purpose of comparability, companies with even a single rupee of transactions with AE cannot be considered as comparables. (ix) Adjustment needs to be made to the margins of the comparables to eliminate differences on account of different functions, assets and risks. More specifically, adjustment needs to be made for : (a) Differences in risk profile. (b) Difference in working capital position. (c) Differences in accounting policies. (x) The TPO has grossly erred in 'normalising' the profits of super profit companies. Such companies should have been excluded from the list of comparables."*

32. Learned Department Representative referred to Circular dated 23rd August 2001, which was issued prior to the insertion of proviso to section 92C(2), wherein the Board had decided as under:-

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"(i) The Assessing Officer shall not make any adjustment to the arm's length price determined by the taxpayer, if such price is upto 5% less or upto 5% more than the price determined by the Assessing Officer. In such cases the price declared by the taxpayer may be accepted."

33. We have heard the rival submissions, perused the orders of the lower authorities and the materials available on record. We find that this issue is covered by the decision in Sony India Pvt. Ltd. (supra) relied on by the assessee wherein it has been held as under:-

"Circular No. 12, dt. 23rd Aug., 2001 does not help to solve the problem. The said circular was issued prior to introduction of the proviso. However, it is a settled law that when a proviso is introduced, the Courts have to look at the language in which the proviso is expressed. Only in cases of ambiguity, it is permitted to go beyond the language and consider the intention of the legislation. As far as the first limb of proviso is concerned, the same has general application. The controversy is relating to the second limb/portion of the proviso to s. 92C(2) where "an option" is given to the taxpayer to take ALP which may vary from the arithmetic mean by an amount not exceeding 5 per cent of such arithmetic mean. Here again, there is no controversy that taxpayer can take ALP which is not exceeding 5 per cent of the arithmetic mean. The "option", as is clear from the language is to take ALP which is not in excess of 5 per cent of the said mean. The word "option" as per The Law Lexicon is synonymous with "choice" or "preference". Therefore, it is the choice of the assessee to take ALP with a marginal benefit and not the arithmetical mean determined by the most appropriate method. There is nothing in the language to restrict the application of the provision only to marginal cases where price disclosed by the assessee does not exceed 5 per cent of the arithmetic mean. The ALP determined on application of most appropriate method is only an approximation and is not a scientific evaluation. Therefore, the legislature thought it proper to allow marginal benefit to cases who opt for such benefit. Both in the first as also in the second limb, implications of determined ALP are the same except for the marginal benefit allowed to the assessee under the second limb. Hence, second limb is applicable even to cases where the taxpayer intends to challenge ALP taken as arithmetic mean and determined through the most appropriate method. Option is given to the assessee as in some cases, variation not exceeding 5 per cent of arithmetic mean might not suit the assessee and, therefore, assessee in such cases should not be put to a prejudice. Otherwise, there is no difference between the first and the second limb of the provision as far as right of the assessee to challenge the determined price is concerned. The second limb only allows marginal relief to the assessee at his option to take ALP not exceeding 5 per cent of the arithmetic mean. Therefore, benefit of the second limb of the proviso to s. 92C(2) is available to all assessees irrespective of the fact that price of international transaction disclosed by them exceeds the margin provided in the proviso.—Development Consultants (P) Ltd. vs. Dy. CIT (2008) 115 TTJ (Kol) 577 relied on."

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34. Respectfully following the aforesaid decision, these grounds of appeal are allowed. However, in the arm's length price, to be determined by the Assessing Officer, an adjustment is contemplated in the proviso, is to be made at the option of the assessee.

35. Ground no.14, reads as under:-

> *"14. Without prejudice to the above grounds in appeal, on the facts and in the circumstances of the case and in law, the learned A.O/TPO erred in applying the Arm's length profit margin based on costs to the entire operating costs of the appellant instead of restricting the same to the operating costs attributable to the A.E transaction."*

36. As regards applying of arm's length margin to both A.Es and non A.Es' transactions, learned Counsel submitted that the arithmetic mean determined by the Assessing Officer, in any case, is to be applied only to international transaction aggregating to ₹ 23 crores and not to the entire transaction aggregating ₹ 112 crores regarding A.Es and non A.Es both.

37. Having heard the rival submissions and having perused the orders of the lower authorities and the materials available on record, we find that this is an alternative plea raised by the assessee that if the operating profit to operating cost at the entity level are to be applied, then the same should be applied only to the international transactions with A.Es and not to non associated transactions. As we have already held that segmental accounts are to be considered, therefore, the issue arising out of this ground of appeal is only academic in nature and, hence, dismissed.

38. In the result, this appeal is partly allowed in terms indicated above.

Order pronounced in the open Court on 25.2.2011.

Sd/- **VIJAY PAL RAO** **JUDICIAL MEMBER**	Sd/- **S.V. MEHROTRA** **ACCOUNTANT MEMBER**

MUMBAI, DATED: 25.2.2011

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Copy to:

(1) The Assessee

(2) The Respondent

(3) The CIT(A), Mumbai, concerned

(4) The CIT, Mumbai City concerned

(5) The DR, "E" Bench, ITAT, Mumbai

TRUE COPY
BY ORDER

Pradeep J. Chowdhury
Sr. Private Secretary

ASSISTANT REGISTRAR
ITAT, MUMBAI BENCHES, MUMBAI