IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved Date : 05.07.2021

Pronounced Date : 16.07.2021

CORAM

THE HON'BLE MR.JUSTICE M. DURAISWAMY
AND
THE HON'BLE MRS.JUSTICE R. HEMALATHA

Tax Case Appeal Nos.1253 & 1254 of 2010

The Commissioner of Income-Tax,
Pondicherry. ... Appellant in both TCA's

Vs.

M/s.Tweezerman (India) Private Limited,
Pondicherry. ... Respondent in both TCA's

COMMON PRAYER: Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961 against the orders of the Income Tax Appellate Tribunal, Chennai "A" Bench, dated 15.04.2010 passed in I.T.A.Nos.1130 & 1032/Mds/2009 for the assessment year 2004-2005.

In both TCA's

For Appellant : Mr.J.Narayanaswamy
Senior Standing Counsel

For Respondent : Mr.Srinath Sridevan

C O M M O N J U D G M E N T

(Common Judgment of the Court was delivered by R.HEMALATHA, J.)

The appellant/Revenue, in TCA.No.1253 of 2010 and TCA.No.1254 of 2010, has challenged the order of Income Tax Appellate Tribunal 'A' Bench, Chennai in ITA.No.1130/Mds/2009 and ITA.No.1032/Mds/2009 respectively for the Assessment Year 2004-2005. The assessee/respondent is a manufacturer of beauty products such as Tweezers, cuticle pushers, etc, and is 100% Export Oriented Unit (EOU). The assessee/Company had filed its return on 01.11.2004 admitting an income of Rs.46,68,240/- for the Assessment Year 2004-2005. Actually the export sales turnover was Rs.15,06,43,051/- for the Financial Year ending 31.03.2004, out of which, Rs.12,51,67,670/- was claimed as deduction under Section 10-B of Income Tax Act, 1961 (hereafter referred to as Act) in respect of the net profit of Rs.13,05,22,622/03. The return was processed under Section 143(1) which resulted in a refund of Rs.9,070/- and the same was granted. Subsequently, the case was selected for scrutiny and notices under Sections 143(2) and 142(1) of the Act were issued. The Assessing

Officer made a reference to the Transfer Pricing Officer to determine the Arm's Length Price (ALP) under Section 92(A)(1). Consequently, based on the Transfer Pricing Officer's order dated 15.12.2006, the assessment was completed under Section 143(3) of the Income Tax Act and the Assessing Officer had determined the taxable income of the Company for the Assessment Year 2004-2005 at Rs.4,06,01,372/- by restricting the deduction claimed under Section 10-B to Rs.8,97,67,670/-. The Assessing Officer had disallowed Rs.3,54,00,000/- and treated the amount as deemed income under the head "Other Sources". This was also based on a written admission by the assessee. The Assessing Officer also concluded that out of the total turn over of Rs.15,06,43,051/-, income of Rs.12,51,67,670/- worked out to a whopping profit margin of 83.1% which was very high and the Transfer Pricing Officer also had determined the Arm's Length Price and since the assessee Company itself had admitted that the excess profit as Rs.3.54 Crores, it was accepted by the Assessing Officer as the amount of disallowance, by excluding it from business profits. The Assessing Officer in the order had also excluded the value of scrap sales to the tune of Rs.4,61,040/- from the business profits and also the interest income from bank amounting to Rs.47,40,332/-. Besides these, a sum of Rs.5,20,137/-, being 10% of the

income of Rs.52,01,372/- admitted under the head "Other Sources" also was disallowed by the Assessing Officer. Thus, in the order dated 28.12.2006, the Assessing Officer had raised a net demand of Rs.1,71,96,404/- including an interest of Rs.43,07,853/- charged under Section 234-B, an interest of Rs.5,699/- levied under Section 234-C and an interest of Rs.9,070/- levied under Section 234-D of the Act. The Assessing Officer had rejected the revised calculation of the assessee dated 28.12.2006 stating that the actual excess profit was not Rs.3.54 Crores as admitted earlier in writing as there was an error in calculation. The respondent/assessee, aggrieved over this order, appealed to the Commissioner of Income Tax (Appeals) – XII, Chennai.

2.The Commissioner of Income Tax (Appeals), in her Order dated 17.03.2009, had discussed threadbare every point raised by the respondent/assessee who was the appellant and allowed the appeal partly and also

a) directed the Assessing Officer to determine the net profit in respect of the turnover of Rs.3.54 Crores keeping in mind the 83.1% profit margin to arrive at the portion permissible to be deducted under Section 10-B of the Act.

b) decided to allow 5% of Rs.47,40,332/- representing the interest income from Bank as expenses to earn the interest income assessed under the head “Other Sources”.

c) rejected the plea of the appellant as regards the charging of interest under Section 234-B and Section 234-D.

3.This order of the Commissioner of Income Tax (Appeals) was contested by both the parties in the respective appeals in ITA.No.1130/Mds/2009 and ITA.No.1032/Mds/2009 before the Income Tax Appellate Tribunal, “A” Bench, Chennai. The assessee/respondent had disputed the decision of the Commissioner of Income Tax (Appeals) on three counts.

a) The decision of the Commissioner of Income Tax (Appeals) in not accepting the revised calculation of excess of profits over the arms length price and brushing it aside as an 'after thought' as the actual figure was only US $ 1,85,702 (about Rs.1.29 Crores) and not Rs.3.54 Crores as admitted earlier by the assessee earlier, is illogical.

b) The assumption of the Assessing Officer that the assessee Company and the importer of the goods are closely associated and had arrangements to make more than ordinary profits was without any

evidence and had no rationale. The decision of Commissioner of Income Tax (Appeals) to direct the Assessing Officer to rework the excess profits by treating the amount of Rs.3.54 Crores as turnover and applying 83.1% (profit margin) on Rs.3.54 Crores to be deducted under Section 10-B, was arbitrary and without any convincing reason.

c) The decision to disallow the income from the sales of scrap was also wrong as it was purely a business income and entitled for deduction under Section 10-B.

4.The Revenue in its appeal had contended that

a) There was a close connection between the assessee Company and the US Company to which the former was exporting the products, manufactured by it. The shareholder by name Shri.Dal La Magna held 70% equity in the US Company and a 32.5% to 35% share holding in the assessee Company and the profits disclosed by the assessee Company was abnormally high at 83.1% and the claim of higher deduction in India was only to avoid payment of taxes. In such circumstances, the Commissioner of Income Tax (Appeals) having directed the Assessing Officer to reduce the disallowance further by computing 83.1% of Rs.3.54 Crores treating it as turnover is wrong and liable to be quashed.

b) The Commissioner of Income Tax (Appeals) had erred in directing the Assessing Officer to allow 5% of the interest income as expenditure especially when the assessee had not adduced any evidence to substantiate it.

5.The Income Tax Appellate Tribunal in its order had deleted in toto the reduction of eligible profits of the assessee to the tune of Rs.3.54 Crores terming it as 'ordinary profits'. The Income Tax Appellate Tribunal also struck down the decision of the Commissioner of Income Tax (Appeals) regarding 5% of interest income from Banks to be allowed as deduction. Thus the effect of the Income Tax Appellate Tribunal's order was

a) Removing the entire amount of Rs.3.54 Crores which was declared as the excess profit above the Arm's Length Profit and giving a huge relief to the assessee, thus partly allowing the assessee's appeal.

b) Striking down the decision of the Commissioner of Income Tax (Appeals) regarding the inclusion of 5% of interest income as expenditure relatable to the calculating of interest income, thereby partly allowing the Revenue's appeal.

6.These appeals in the present T.C.A.Nos.1253 & 1254 of 2010 are against the order of the Income Tax Appellate Tribunal on the following substantial questions of law and additional substantial question of law:

i. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in allowing the incorrect exemption under Section 10 (7) of the Income Tax Act, 1961, as determined under Section 92CA (3) of the Income Tax Act, read with Section 143 (3) of the Income Tax Act, 1961

ii. Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in allowing the incorrect exemption under Section 10(7) of the Income Tax Act, 1961, as determined under Section 92CA (3) of the Income Tax Act, even though the Appellate Tribunal, on the basis of the materials available on record, ought to have set aside the assessment order to the assessing officer / Transfer Pricing Officer to expand the scope of comparable uncontrolled price for finding the new Arms Length Price?

Additional Substantial Questions of Law in TCA 1253/2010:

i. Whether on the facts and in the circumstances of the case the Tribunal was right in not considering and appreciating that the assessee had agreed and admitted to the excess export profit before the TPO with reasons and explanations and the Assessing Officers

had assessed the said admitted excess export profit for exclusion from exemption u/d 10B r.w.801A.

ii. Whether on the facts and in the circumstances of the case the Tribunal was not perverse and right in holding that the assessing officer had to substantiate the basis of excess export profit agreed and admitted by the assessee and failure of the assessing officer to substantiate will lead to allowance of exemption u/s.10B r.w.801A of agreed and admitted excess export profit.

iii. Whether on the facts and in the circumstances of the case the Tribunal was right in giving weightage to the assessees retraction before assessing officer at the last moment of passing of assessment orders and by ignoring the principle of law that admission is the best form of evidence.

Additional Substantial Question of Law in TCA 1254/2010 :

i. Whether on the facts and in the circumstances of the case the Tribunal was right in not considering the revenues appeal relating to the order of CIT(A) to exclude only 83.1% of the profit admitted by the assessee as against the stand of the revenue that the entire 100% of the profit admitted by the assessee had to be excluded from the exempt income.

7.Before going into the merits of the case, it is important for us to get some insight into the basics of the entire ambit of international transactions and how the Income Tax Act looks at them.

a) (i) Commercial transactions between the different parts of the multinational groups may not be subject to the same market forces shaping the relations between two independent firms. One party transfers to another, goods or services for a price. That price is known as 'transfer price'. This may be arbitrary and dictated with no relation to cost and added value, diverge from the market forces. Transfer price is, thus, a price which represents the value of goods or services between independently operating units of an organisation. It also refers to the value attached to transfers between unrelated parties which are controlled by a common entity.

(ii) Suppose a Company 'A' purchases goods for Rs.100/- and sells it to its associated Company 'B' in another country for Rs.200/-, who in turn sells in the open market for Rs.400/- then Company 'B' earns a profit of Rs.200/-. Had 'A' sold it direct, it would have made a profit of Rs.300/- but by routing it through 'B', 'A' restricted the profit to Rs.100/-, permitting 'B' to appropriate the balance. The transaction between 'A' and 'B' is arranged and not governed by market forces. The profit of Rs.200/-

is, thereby, shifted to the country of the 'B'. The goods is transferred on a price (transfer price) which is arbitrary and dictated (Rs.200/-) but not on the market price (Rs.400/-). Thus the effects of transfer pricing is that the parent company or a specific subsidiary tends to produce insufficient taxable income or excessive loss on a transaction. For instance, profits accruing to the parent company can be increased by setting high transfer prices to siphon off profits from subsidiaries domiciled in high tax countries, and low transfer prices to move profits to subsidiaries located in low tax jurisdiction.

b) Arms length Price (ALP) means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. In other words, it is the price at which a willing buyer and a willing unrelated seller would freely agree to transact or a trade between related parties that is conducted as if they were unrelated, so that there is no conflict of interest in the transactions. Both parties in the deal are acting in their own self interest and are not subject to any pressure or duress from the other party. Section 92-F of Income Tax Act, 1961 defines ALP as the price applied (proposed to be applied) when two unrelated persons enter into a transaction in uncontrolled conditions.

c) The relationship of Associated Enterprises (AE) is defined by Section 92-A of the Act to cover direct/indirect participation in the management, control or capital of an enterprise by another enterprise. It also covers situations in which the same person (directly or indirectly) participates in the management, control or capital of both the enterprises.

d) The burden of proving the arm's length nature of a transaction lies with the tax payer. If the tax authorities, during audit proceedings on the basis of material, information or documents in their possession, are of the opinion that the arm's length price was not applied to the transaction or that the tax payer did not adduce adequate and correct documents/information/data, the total taxable income of the tax payer may be recomputed after a hearing opportunity is granted to the tax payer.

e) There are five methods prescribed by Section 92-C of the Act to determine the Arm's Length Price. No particular method has been accorded a greater or lesser priority. The most appropriate method for a particular transaction would need to be determined having regard to the nature of transaction, class of transaction or associated persons and functions performed by such persons, as well as other relevant factors. It

further provides that where more than one arm's length price is determined by applying the most appropriate transfer pricing method, the arithmetic mean of such prices shall be the arm's length price of the international transaction. Indian Regulations do not recognize the concept of arm's length range but requires the determination of a single arm's length price.

8.With all these basic principles, the order of Commissioner of Income Tax (Appeals) is gone into first. It is found that the Commissioner of Income Tax (Appeals) has observed thus:

> *"Admittedly, the profit margin of the appellant company for the impugned accounting period is extraordinarily high being 83.1% and it is only one party to whom the company had made the exports which is its close associate. And, so, the party to whom the appellant company had exported did have a close connection with the appellant company. This fact cannot be denied. The real difficulty involved in this case is to hit upon the correct comparables to decide about the Arms Length Price and its fairness. The appellant company had not been in a position to pinpointedly bring comparables either in India or elsewhere in any part of the world to show that the rates at which it had sold to the Associate*

concern were reasonable and were comparable with the rates at which similar products were sold by other concerns located in India or even anywhere in other parts of the world. In fact, the appellant company itself had come upon a German concern which had been producing and marketing products similar to that of the appellant company and further, the company itself had arrived at an excess profit of Rs.3.54 Crores by adopting the results of the German firm.

Having accepted the close connection between the appellant company and the other concern in the US, the question to be decided is whether the rate at which the company had sold its products to the US firm was exorbitantly high just because it enjoys exemption from taxation of its profits u/s 10B and on the other hand, the profits were siphoned off by the other firm or the profits were taken back by the other concern in some way or the other.

The facts clearly show that even if it be that the common shareholder was holding only 35% of the shares of the Indian company, still, substantial amounts of the profits of the Indian company had been passed on to this shareholder and the Indian company had not paid tax on the same. He happens to be the founder of the US

company also. And so, naturally, if there were Indian shareholders in his place, the situation could be different and the resident shareholder would have been subjected to Indian tax laws.

.....Regarding the various points raised by the appellant's representative on the Assessing Officer's action of making a reference to the Transfer Pricing Officer, it is seen that there is nothing irregular on the decision taken by the Assessing Officer to refer the appellant's case to the Transfer Pricing Officer. Obviously, the conditions laid down u/s.92CA(3) have been satisfied in the appellant's case and therefore, the Assessing Officer made a reference to the Transfer Pricing Officer. But at the same time, it is not as if the Assessing Officer had fully relied upon the findings given by the Transfer Pricing Officer in his order dated 15.12.2006. In fact, as stated earlier, the Transfer Pricing Officer had determined the excess profit at Rs.733.42 lakhs for the impugned account period whereas, the Assessing Officer had been fair in confining himself to denying the benefit of deduction u/s.10B to the appellant to the extent of Rs.3.54 Crores only. The Assessing Officer had done well in taking such a decision, because, this working had been given by the appellant company itself by taking a German firm as

comparable. So, there is enough logic in the Assessing Officer's action. In this view of the matter, whatever points raised by the appellant's representative regarding the views expressed by the Transfer Pricing Officer or regarding the views expressed by the Assessing Officer on the remarks made by the Transfer Pricing Officer etc., will not hold water. One has to go by the tests laid down by the ITAT in the decision cited by the appellant's representative himself and one has to compute the Arm's Length Price necessarily for the purpose of determining the reasonableness of the profits which the appellant company had claimed as exempt from taxation.

.....If the appellant company had sold to other customers who were not connected with it and compared the rates at which it had sold to its Associate concern with the rates at which it had exported to other customers it would have amounted to it having fully discharged its onus. That is, if the appellant company were in a position to show that the rates at which it had sold the products to other customers are the same rates at which it had sold to its Associate concern, then, it would have amounted to the appellant company having discharged its onus. But, there is no such occasion that the company could find.

In view of the foregoing discussions, it is held that the impugned order need not be interfered with and the same is confirmed in toto."

9.On the same aspect, the Income Tax Appellate Tribunal had a different view point. The Income Tax Appellate Tribunal in its order had observed thus.

" We have considered the rival submissions. A perusal of the order of the TPO for the relevant assessment year shows that the TPO has verified the arms length price and has confirmed that no adjustment on account of transfer pricing was required to be made. The provisions of transfer pricing related to international transaction between two or more associated enterprises. The intention of the provisions of transfer pricing are to see to it that when international transactions are done between two or more associated enterprises, the affairs of the enterprises are not adjusted in such a manner as to deprive the country or the local associated enterprises of the correct revenue, which would result in the reduction of the taxable income of the local associated enterprises in the country. In the present case, undisputedly, the TPO has confirmed that the local associated enterprises being the assessee herein has received the revenue due to it and there is no adjustment made in the affairs on the

associated enterprises so as to deprive the revenues of the assessee in the country. Reading of the provisions of Section 10B shows that the deduction of the profits and gains derived by the assessee from 100% export oriented undertaking is granted. The provisions of Section 10B(7) provides for the applicability of the provisions of Section 801A(10) and sub-section (8) when computing the profits and gains of the 100% export oriented undertaking. The provisions of sub-section (10) of section 801A which has been invoked in the present case provides that if the Assessing Officer is of the opinion that owing to the connection between the assessee carrying on the eligible business with another person the business between them is so arranged so that as a result of the business transacted between the eligible person an other person, the profits of the eligible persons is inflated so as to claim the exemption provided, then the Assessing Officer, while computing the profits and gains of the eligible business for the purpose of granting deduction can readjust the amount of profit as would be reasonably be derived from such eligible business. Here, in the present case, the TPO has categorically given a finding that the income of the assessee is at arms length. One must keep in mind that the intention of transfer pricing is also on similar lines as 801A(10) in so far as under the provisions of transfer pricing it is to verify as to whether

the local associated enterprise is getting its right share of revenue and as per Section 801A(10). It is to verify and adjust the profits of an eligible business so that under the garb of the eligible business the taxable income of an associated enterprise is not reduced by shifting its income to the eligible business. However, he has given a further fact in his order that the PLI of the assessee is higher than the mean of the PLI of the comparable cases.

.....At the time of hearing, the Id. DR was vehemently of the view that the transfer pricing action by the TPO at the behest of the Assessing Officer was a separate proceedings and the Assessing Officer while completing the assessment by invoking provisions of Section 10B(7) read with Section 801A(10) was doing an independent action though using the evidence and documents which had been submitted before the TPO. Even if this submission of the Id. DR is accepted, then it becomes incumbent upon the Assessing Officer to specify as to why he feels that the profits disclosed by the assessee is higher than the ordinary profits which might be expected to rise in the assessee's business.

The provisions of section 801A(10) does not give an arbitrary power to the Assessing Officer to fix the profits of the assessee. The Assessing Officer has to

specify as to why he feels that the profits of the assessee is being shown at an higher figure, which he has done by alleging the close proximity between the assessee and the USA company with whom te assessee is transacting. He has further to show as to how he has computed the ordinary profits which he deems to be the ordinary profit which the assessee might be expected to generate. Here, the Assessing Officer failed in so far as he has blindly taken a calculation which the assessee has given before the TPO which the assessee himself has admitted to be erroneous and the errors have been corrected and the fresh calculation given. This calculation is also not a calculation for determining the ordinary profits which the assessee might be expected to generate.

.....The fact that the Assessing Officer has also not shown any calculation on the basis of which he has determined Rs.3.54 Crores is the excess profit received by the assessee cannot stand in view of the fact that he has not shown as to what he feels is the actual ordinary profits which the assessee could have generated nor he has shown any particulars he has used for arriving at such a figure especially when the assessee himself has filed the calculation showing the error in the difference between the profits and the arms length price as filed before the TPO. Under these circumstances, we are of the

view that the reduction of the eligible profits of the assessee by an amount of Rs.3.54 Crores as done by the Assessing Officer by invoking the provisions of Section 801A(10) read with Section 10B(7) of the Act is unsustainable and consequently the same is deleted in toto.

.....In Revenue's appeal in I.T.A. No.1032/Mds/2009 in ground No.2, the Revenue has challenged the action of the Id. CIT(A) in directing that only 83.1% of the profit margin of Rs.3.54 Crores was liable to be excluded for computing the deduction under Section 10B of the Act. We have already held in the assessee's appeal that no portion of the profits are declared by the assessee are to be excluded for computing the deduction under Section 10B. Consequently, this ground of the Revenue would no more survive for consideration in so far as our findings on this issue in the assessee's appeal would apply. Under the circumstances, ground No.2 of the Revenue's appeal stands dismissed.

10.The Income Tax Appellate Tribunal further opined that the Assessing Officer failed in so far as he had blindly taken a calculation which the assessee has given before the TPO which the assessee himself

had admitted to be erroneous and the errors have been corrected and fresh calculations given.

11.The Commissioner of Income Tax (Appeals) believed the contention of the Assessing Officer that the two firms that is the exporter in India and the Importer in the USA were closely associated with common shareholder and substantial profits of the Indian Company were siphoned off by him and that there was certainly loss to the Revenue under the Indian Income Tax Act, and the Assessing Officer in this regard was categorical when observing as under.

> *"These provisions are intended to plug the undue claim of exempted income by resorting to super profit arrangements. It is not necessary that both the closely connected persons must be assessed in India. The Act did not mean to specify that this Section be applicable in the case of closely connected persons who are assessed in India. Since the super profit was possible and realisible between Indian persons with any other Indian or Non-Indian persons, the Section 10B(7) itself so states as "any person who is closely connected on the business" what is not intended in the Section of the Act cannot be imported so as to say that the other closely connected person was not an Indian assessable entity. Therefore,*

*the assessee's contention is against the provisions of the Section 10B*7 r.w.s 80-1A(10) of the Act."*

" Further, the taxability or otherwise of the other closely connected person in India is immaterial since by such an arrangement between the assessee and the other closely connection person, the assessee is realising a super profit which is claimable as 100% exempted income. The ultimate benefit is that the USA stake holder is enjoying 32.5% share holding in the Indian Company who is also the beneficiary. Therefore, the business arrangement was so based both for a personal benefit to the Indian share holder and the foreign share holder."

12.The Income Tax Appellate Tribunal was silent about this aspect restricting its comment only about the jurisdiction of the Assessing Officer. The observation on this aspect was

"The provisions of section 80-1A(10) does not give an arbitrary power to the Assessing Officer to fix the profits of the assessee. The Assessing Officer has to specify as to why he feels that the profits of the assessee is being shown at an higher figure, which he has done by alleging the close proximity between the assessee and the USA company with whom the assessee is transacting."

13.Mr.J.Narayanaswamy, learned Senior Standing Counsel for the appellant/revenue was categorical in arguing that the assessee/respondent was attempting to evade tax and that the Income Tax Appellate Tribunal's order did not discuss on the close association between the exporter and the foreign buyer and also the assessee's own submission regarding the arm's length price and excess profit. According to him, the subsequent retraction of its own submission by the assessee was unacceptable. It was further contended that the onus of proving the arm's length price was with the assessee and it was based on his calculation, the excess profit was accepted, since no perfect comparables were found for the products manufactured and exported by the assessee company. It was also argued that the TPO independently arrived at an arm's length price using TNMM method comparing the assessee company with its own sister concern M/s.Ital Beauty Nippers (India) Pvt. Ltd., and another Delhi based M/s.Rahul Electricals and Electronics and the excess profit so arrived was much higher at Rs.5.18 Crores.

14.Per contra, Mr.Srinath Sridevan, learned counsel for the assessee was of the view that the three important ingredients of Section 80-1A(10) were not established by the Revenue and therefore, the power

under this Section cannot be invoked. The three ingredients were

a) the assessee must be in an eligible business

b) Assessee must have a transaction with a related entity

c) Assessee and the related entity must deliberately organise their affairs so as to generate profits which are more than ordinary profits being earned in the line of business. The onus being on the Revenue, it was contended, the same was shifted on the assessee by the Revenue.

15.Mr.J.Narayanaswamy, learned Senior Standing Counsel for the Revenue, per contra, argued that the product itself had no comparables and the one which was compared i.e., M/s.Rahul Electricals and Electronics, New Delhi was much less to the assessee company in terms of the turnover as contended by the assessee. In fact, it was argued, that the excessive profits over the Arm's Length Profit was much higher at Rs.5.18 Crores when 'Transactional Net Margin Method' was employed on M/s.Rahul Electricals and Electronics and M/s.Ital Beauty Nippers (India) Pvt. Ltd., all in the same line of business to determine the Arm's Length Price instead of the Comparable Uncontrolled Price method applied by the assessee (to determine the Arm's Length Price) with another German Company, which was a competitor. It is not true to state

that the revenue had not made any analysis and assessment to arrive at the 'Arm's Length Price' and thereby determine the excess profits. TNMM method was applied by the Revenue and to ensure level playing field the Assessing Officer accepted the result of the Comparable Uncontrolled Price (CUP) method employed by the assessee and following was the hand written note put up in the Assessment Orders.

> *"**Note not to the Assessee:** The TPO suggested in his letter dated 15.12.2006 that Arm's Length Price determined in TPO proceedings may be made the basis for determination of the excess profits under Section 10B(7). On this basis the excess profit would have been Rs.5.18 Crores. However, it is felt that such a figure has been arrived at, on comparison with a stray case based in Delhi with low turnover of around Rs.1 crore. Therefore, in order to make a reasonably strong order, the assessee's own submission before the TPO has been made the basis."*

It is pertinent to note that the sister concern M/s. Ital Beauty Nippers (India) Pvt. Ltd., also had a common shareholder with the assessee Company, it was contended.

16.A cursory glance into the two methods i.e. “Comparable Uncontrolled Price method” and “Transactional Net Margin method” reveals that Comparable Uncontrolled Price method (CUP) is applied when price is charged for a product or service. This is a comparison of prices charged for the property transferred or service provided in a controlled transaction to a price charged for property or services transferred in a Comparable Uncontrolled transaction. The TNMM (Transactional Net Margin Method) requires establishing comparability level at a broad functional level. It requires comparison between net margin derived from operation of the uncontrolled parties and net margin derived by an associated enterprise on similar operation. The net profit margin earned by an associate enterprise is compared with net profit margin of uncontrolled transactions to arrive at arm's length price.

17.As already pointed out the superiority of any particular method to arrive at the ALP is ruled out. The TPO and the Assessing Officer had accepted the assessee's own written submissions and determined the excess profit at Rs.3.54 Crores which was the result of the CUP method worked out by the assessee. It is not true that the TPO / Assessing Officer did not make any spade work to arrive at the ALP. The products

manufactured by the assessee was exported exclusively only to the importer Company in U.S. M/s.Tweezerman Corporation. The sister concern of the assessee company M/s.Ital Beauty Nippers Pvt. Ltd., is also in the same line of activity and has a common shareholder. The only difference is that the common shareholder, between the M/s.Tweezerman Corporation US and the M/s.Tweezerman India Pvt. Ltd., is a foreigner while that between M/s.Tweezerman India Pvt. Ltd., and M/s. Ital Beauty Nippers India Pvt. Ltd., is an Indian shareholder. The TPO / Assessing Officer had employed the TNMM method and the excess profit so arrived was Rs.5.18 Crores. But in the TNMM calculation one of the Indian Companies M/s. Rahul Electricals and Electronics had a very low turnover and also was not dealing exclusively with the product which the assessee company was dealing with. They had other products too. Thus CUP method was found to be more appropriate and it was the discretion of the revenue to accept it. Subsequently, the assessee company gave a revised calculation dated 28.12.2006 for a much lesser amount citing error in calculation eventhough initially they had admitted excess profit of Rs.3.54 Crores. The revised calculation mentioned the excess profit as US $ 1,85,702. Strangely, the Income Tax Appellate Tribunal has not discussed this aspect also. The Income Tax Appellate

Tribunal's order is perverse on the following counts:

a) Shifting of the onus of arriving at the ALP and resultant excess profit to the Revenue.

b) Underplaying the all-important aspect of close association between the importer and the exporter.

c) Totally ignoring the contents of the revised calculation submitted by the assessee company that the excess profit was US $ 1,85,702

d) The conclusion of Income Tax Appellate Tribunal that there was no spadework / calculations done by the Assessing Officer / TPO.

18.The Assessing Officer and the CIT(A) were right in observing that

a) The two companies were closely associated and had common shareholder who was a foreigner

b) The revised calculation by the assessee company was clearly an 'after thought' after knowing very well that the Assessing Officer had accepted its earlier submission of Rs.3.54 Crores excess profit.

c) The contention that with a limited source of fund of just Rs.5.57 Crores the assessee company was earning more than Rs.12.50 cores in itself showed that the profit was overstated by pricing the

products high.

d) The email correspondence relied upon by the Assessing Officer was furnished by the assessee company itself and it showed that there exists a close relationship between the importer and exporter in which lower margin by the importer is discussed. This clearly reveals that the margins of the exporter is known to the importer.

e) The mail dated 05.04.2006 reads as "we are working on clearly low margin than you and we are also asked to cover a significant share of the salary of Latz even though he is with you for Tweezerman India which also comes on top of us."

f) One Mr.Da La Magna holds 70% of equity shares in the USA Company M/s.Tweezerman Corporation USA and also 32.5% to 35% in M/s.Tweezerman India Pvt. Ltd.,

g) The revised calculation submitted by the assessee company was not accepted as it had no actual error in it but contained two new European comparables to arrive at the ALP and therefore considered as an 'after thought' by the Assessing Officer.

h) The profit margin for the impugned accounting period was more than 12% of the profit margin of the earlier year.

19.We also find that the CIT(A) in her order had suddenly deviated from her narration of her observation and concluded that "he (Assessing Officer) ought to have excluded only 83.1% of Rs.3.54 Crores for the purpose of recomputing the deduction under Section 10B". This could have been correct had the TNMM method been followed. But Rs.3.54 Crores was determined based on the CUP method employed by the assessee based on the comparables in the German market. The CIT(A) after holding that "the impugned order need not be interfered with and the same is confirmed in toto" was inconsistent in reducing the disallowance by considering Rs.3.54 Crores as turnover and applying the profit margin of 83.1% on the same. 83.1% margin was arrived by the TNMM method but the accepted excess profit of Rs.3.54 Crores was arrived at by applying the CUP method.

20.Mr.Srinath Sridevan, learned counsel for the assessee-company relied on the decisions in the following cases to reiterate that there was no real 'substantial questions of law' involved in the present case and as much the High Court has no jurisdiction to step into the exclusive jurisdiction of the Income Tax Appellate Tribunal or Income Tax authorities.

i. In "*(1999) 3 Supreme Court Cases 722", "Kondiba Dagadu Kadam Vs. Savitribai Sopan Gujar and Others"* the Apex Court had held that as per the amended Section 100 of the Code of Civil Procedure, 1908, no Court has the power to add to or enlarge the conditions of appeal and that the Court must distinguish between a questions of law and a substantial questions of law.

ii. In *"(2006) 5 Supreme Court Cases 545", "Hero Vinoth (Minor) Vs. Seshammal",* the Apex Court had held that a substantial question of law has to be one involved in the case and cannot be one of general importance.

iii. In *"(2020) SCC Online 676", "Nazir Mohamed Vs. J.Kamala and Others",* the Apex Court had held that "if the general principles to be applied in determining the question are well settled and the only question was of applying those principles to the particular fact of the case it would not be a substantial question of law"

These were all not related to the present case directly as they pertained to what a substantial question of law is and whether the High Court had any jurisdiction.

He also relied on the following decisions:

i. *"(2018) 97 taxmann.com 521 (SC), (Principal Commissioner of Income Tax, Jaipur -II Vs. Vedansh Jewels (P). Ltd.,"* the Apex Court held that there has to be a material to indicate the course of business had been so arranged as to inflate profits and there also has to exist a close connection between the assessee-company and the foreign buyer for invoking provisions under Section 10AA(9) read with Section 801A(10).

ii. *"(2012) 26 taxmann.com 336 (Bombay), (Commissioner of Income Tax-7 Vs. Schmetz India (P). Ltd.,"* the High Court of Bombay had held that merely because the assessee makes extraordinary profits, it would not lead to the conclusion that the same was organised/arranged.

iii. In another case M/s.A.T. Kearney India Pvt. Ltd.,. Vs. ITO, the ITAT, New Delhi had decided that the Assessing Officer cannot simply rely on the Transfer Pricing Officer's (TPO's) report without first satisfying that there existed an arrangement between the assessee and the overseas related party.

All these rulings / decisions are not directly applicable to the facts of the present case. In the instant case the close association between the seller and the buyer and their 'arranged' pricing were adequately substantiated

by the Transfer Pricing Officer (TPO) / Assessing Officer (AO) / CIT(A).

21.We therefore uphold that part of the CIT(A)'s order which confirms in toto the Assessing Officer's order as regards the ALP and the resultant excess profit to be treated as deemed income under 'other sources'. The ITAT's order of deleting the disallowance of Rs.3.54 Crores is set aside. However, as regards the value of scrap sales, the levy of interest and the 5% of interest income taken as expenditure, we find no infirmity in the ITAT's order.

22.Thus substantial question of law No.1 and additional substantial questions of law 1 to 3 and 1 in TCA 1253 &1254/2010 respectively are answered in favour of the revenue. As regards the substantial question of law No.2 in both the appeals it was observed by the CIT(A) that the practical difficulty was of hitting upon correct comparables to arrive at the ALP for this particular product and therefore the submission of the assessee was accepted even though it was lower than the excess profit over ALP arrived at by the Transfer Pricing Officer (TPO) by another method. This observation of CIT(A) is acceptable and answers the substantial question of law No.2.

23.In the result, the appeals filed by the Revenue are allowed and the order of the Assessing Officer is restored. No costs.

Index : Yes/No [**M.D., J.**] **[R.H., J.]**
Internet : Yes **16.07.2021**
mtl

M. DURAISWAMY, J.
and
R. HEMALATHA, J.

mtl

To

1.Income Tax Appellate Tribunal A Bench,
Chennai.

2. The Commissioner of Income-Tax,
Pondicherry.

Pre-delivery Judgment
in
Tax Case Appeal Nos.1253 & 1254 of 2010

16.07.2021