

**IN THE INCOME TAX APPELLATE TRIBUNAL
KOLKATA 'C' BENCH, KOLKATA**

(Before Sri J. Sudhakar Reddy, Accountant Member & Sri Aby T. Varkey, Judicial Member)

ITA No. 1783/Kol/2017
Assessment Year: 2005-06

Deputy Commissioner of Income Tax, Circle-11(1), Kolkata.....Appellant

Vs.

M/s. EPCOS India Pvt. Ltd.....Respondent
Kulia Kanchrapara Road
Kalyani, Nadia
PIN - 741 251
[PAN : AAACE 4000 H]

Appearances by:

Shri Sanjay Paul, Addl. CIT D/R & Shri Supriyo Pal, JCIT, Sr. D/R, appearing on behalf of the revenue.
Smt. Rituparna Sinha, FCA & S.C. Giri C.A., appeared on behalf of the assessee.

Date of concluding the hearing : January 15th, 2020

Date of pronouncing the order : July 10th, 2020

ORDER

Per J. Sudhakar Reddy, AM :-

This appeal filed by the assessee is directed against the order of the Learned Commissioner of Income Tax (Appeals) - 22, (hereinafter the "Id.CIT(A)"), passed u/s. 250 of the Income Tax Act, 1961 (the 'Act'), dt. 18/04/2017 for the Assessment Year 2005-06.

2. At the outset we find that there is a delay of 5 (five) days in filing of this appeal by the assessee. After perusing the petition for condonation, we are convinced that the assessee was prevented by sufficient cause from filing the appeal on time. Hence the delay is condoned and the appeal is admitted.

3. The assessee is an Indian company which is engaged in the business of manufacture and sale of electronic components in India and abroad. These electronic components are primarily used in electronics industry. The assessee entered into the following international transactions with its associated enterprises during the previous year relevant to the assessment year 2005-06.

Table No. 1 - International Transactions

Sl. No.	Nature of International Transactions	Amount Rs.
1.	Purchase of Raw Materials & Components	96,05,434

2.	Sale of Finished Goods	65,60,50,486
3.	Payment of Royalty	93,70,670
4.	Receipt of Indenting Commission	2,95,50,194
5.	Payment for Information Technology Support	3,11,86,169
6.	Payment for Marketing Support	2,48,53,793
7.	Payment for Sales Margin	4,35,28,375
8.	Payment of interest on External Commercial Borrowing	1,87,00,616
9.	Miscellaneous Payments	3,31,626
10.	Reimbursement of Expenses	74,56,923

The assessee applied the Transactional Net Margin Method (TNMM) at the entity level which was not accepted by the Transfer Pricing Officer (TPO) in relation to the following international transactions: (i) purchase of raw materials (INR 96,05,434), (ii) payment of royalty (INR 93,70,670) and (iii) receipt of indenting commission (INR 2,95,50,194/-) and (iv) payment for Sales Margin (INR 4,35,28,375/-). The TPO adopted the transaction-by-transaction approach in relation to those four international transactions and directed the Assessing Officer to make/add the following arm's length price ('ALP') adjustments in his order:

Table No. 2 – ALP adjustments directed by the TPO

Sl. No.	Nature of International Transactions	Value (INR)	ALP Adjustments (INR)
1.	Purchase of Raw Materials & Components	96,05,434	5,98,693
2.	Payment of Royalty	93,70,670	51,17,098
3.	Receipt of Indenting Commission	2,95,50,194	2,78,73,247
4.	Payment for Sales Margin	4,35,28,375	40,42,400

3.1. The Commissioner of Income Tax (Appeals) [CIT(A)], in his appellate order dt. 18/04/2017, deleted the ALP adjustments made in the assessment order as per the direction of the TPO, for the reasons given therein.

4. Aggrieved the Revenue is in appeal before us. The grounds of appeal challenge the action of the CIT(A) in deleting the following ALP adjustments:

Table No. 3 – ALP adjustments under dispute before the Hon’ble Tribunal

Sl. No.	Nature of International Transactions	Value (INR)	ALP Adjustments (INR)
1.	Purchase of Raw Materials & Components	96,05,434	5,98,693
2.	Payment of Royalty	93,70,670	51,17,098
3.	Receipt of Indenting Commission	2,95,50,194	2,78,73,247
	Total	4,85,26,298	3,35,89,038

Grounds of appeal taken by the Revenue

4.1. Ground no. 1 is directed against the action of the CIT(A) in determining the arm’s length price of the international transactions based on aggregate benchmarking approach under TNMM instead of transaction-by-transaction approach.

Findings of the Id. TPO

4.2. In paragraph no. 5.1.2 contained in page no. 10-11 of the TPO’s order, the TPO has held that the international transactions undertaken by the assessee are different in their nature and scope and their separate evaluation is possible. The TPO was of the view that the entity level benchmarking undertaken by the assessee does not find favour, either on facts or in law. The TPO has examined the international transaction involving payment of royalty by the assessee to its associated enterprise for use of intangible. He has held that the combined approach of benchmarking does not and cannot evaluate this aspect and therefore such evaluation is proved to be inadequate and improper. The TPO has further examined the international transaction involving receipt of indenting commission by the assessee from its associated enterprise and held that the said international transaction is not related to manufacturing activity of the assessee and hence, the said transaction should not be evaluated on the combined approach basis.

Findings of the Id. CIT(A)

4.3. The CIT(A)'s decision has documented his decision in this regard is in paragraph no. 7 / sub-paragraph no. 1 contained in page no. 34 of his order. The CIT(A) has noted that the international transactions involving purchase of raw materials and components (INR 96,05,434/-) and payment of royalty (INR 93,70,670/-) are closely linked transactions as the aforesaid transactions emanate from a common source i.e. manufacture and supply of electronic components by the assessee. He held that the assessee is justified in determining the arm's length nature of these international transactions under the TNMM at the entity level on aggregate basis. Under the TNMM, the profit level indicator of the assessee for the relevant previous year stood at 5.33%, whereas the arithmetic mean of the profit level indicators of the independent comparable companies for the FY 2004-05 stood at 5.58%. Hence, he held that the aforesaid international transactions entered into by the assessee with its AEs are at arm's length under the TNMM by virtue of the Proviso to sub-section (2) to section 92C of the Act.

4.3.1. The Id. D/R, relied on the order of the TPO. He argued extensively that the T.P. provision mandate transactions by transaction evaluation of ALP and submitted that the TPO has given cogent reasons as to why the ALP determined by him is correct in law. He took this Bench through the order of the TPO and prayed that it be upheld.

Submission of the assessee before us.

4.4. The Id. Counsel for the assessee relied extensively on the findings of the Id. CIT(A). In support of this order, the Id. CIT(A), the assessee has filed an affidavit on 5th November, 2018, the relevant part of which is as under:

- It is stated in paragraph no. 7 that the assessee cannot adopt transaction-by-transaction approach in respect of the international transactions involving (i) purchase of raw materials/components/goods-in-transit (GIT) from associated enterprises, (ii) payment of royalty to associated enterprise and (iii) receipt of indenting fees from associated enterprise, due to the unavailability of data of comparable uncontrolled transaction separately for each of the international transactions as aforesaid.

- It is stated in paragraph no. 8 that the assessee applies the Transactional Net Margin Method on aggregate basis at the entity level in respect of the international transactions referred to in paragraph no. (7) and documents the same in the Transfer Pricing Study Report maintained under section 92D of the Income-tax Act, 1961, read with rule 10D of the Income-tax Rules, 1962 which is filed with the Ld. TPO during the course of proceedings under section 92CA(3) of the Income-tax Act, 1961.

- It is stated in paragraph no. 9 that the assessee has not purchased the same raw materials / components / GIT as those purchased by the assessee from the four associated enterprises incorporated in Spain, Brazil, Hungary and Germany respectively (as referred to in clause 8A to Appendix B of Form No. 3CEB), from unrelated suppliers in the countries in which the associated enterprises are incorporated and the aforementioned associated enterprises have not sold the same raw materials / components / GIT as those sold by them to the assessee as aforesaid, to the unrelated customers in India.

- It is stated in paragraph no. 10 that during the relevant financial year, the assessee has not obtained technical know-how / assistance in relation to manufacture of goods having been comparable to that obtained by the assessee from EPCOS AG, Germany (as referred to in Appendix D to clause 9 of Form No. 3CEB), from any unrelated party incorporated in Germany and hence, has not paid royalty to any unrelated party incorporated in Germany.

- It is stated in paragraph no. 11 that during the relevant financial year, EPCOS AG has not rendered technical know-how / assistance in relation to manufacture of goods having been comparable to that rendered by EPCOS AG to the Company (as referred to in Appendix D to clause 9 of Form No. 3CEB), to any unrelated party in India and hence, has not received royalty from any unrelated party in India.

- It is stated in paragraph no. 12 that during the relevant financial year, the assessee has not rendered indenting service having been comparable to that rendered by the assessee to EPCOS AG, Germany (as referred to in Appendix E-2 to clause 10 of Form

No. 3CEB), to any unrelated party in Germany and hence, has not received commission from any unrelated party in Germany.

- It is stated in paragraph no. 13 that during the relevant financial year, EPCOS AG has not received indenting service having been comparable to that received by EPCOS AG from the Company (as referred to in Appendix E-2 to clause 10 of Form No. 3CEB), from any unrelated party in India and did not pay indenting commission to any unrelated party in India.

4.2. The Id. Counsel for the assessee refers to the provision of clause (c) of sub-rule (2) of rule 10C of the Income-tax Rules, 1962, wherein it is provided that in selecting the most appropriate method as specified in sub-rule (1), one of the factors that has to be taken into account is the availability, coverage and reliability of data necessary for application of the method. As mentioned in the affidavit referred to hereinabove, the assessee could not apply transfer pricing method on transaction-by-transaction basis in relation to the international transactions under dispute before the Hon'ble Tribunal [i.e. (i) purchase of raw materials & components from associated enterprises (INR 96,05,434), (ii) payment of royalty to associated enterprise (INR 93,70,670) and (iii) receipt of indenting fees from associated enterprise (INR 2,95,50,194)] due to the unavailability of comparable uncontrolled transaction separately for each of the international transactions as aforesaid.

4.3. The Id. Counsel for the assessee further refers to the provision of rule 10A (d) of the Income-tax Rules, 1962, wherein it has been provided that: *“(d) “transaction” includes a number of closely linked transactions.”* It is the contention of the assessee that the three international transactions under consideration emanate from the same source i.e. the business of the assessee involving manufacture and sale of electronic components and hence, the aforesaid transactions can be termed as closely linked transactions as per rule 10A(d) and benchmarked on combined basis under the TNMM.

4.4. The Id. Counsel for the assessee further pointed out by the CIT(A) in paragraph no. 7 / sub-paragraph no. 1 contained in page no. 34 of his order, the international transactions involving purchase of raw materials and components (INR 96,05,434) and

payment of royalty (INR 93,70,670) are closely linked transactions because the aforesaid transactions emanate from a common source i.e. manufacture and supply of electronic components by the assessee. The raw materials and components are consumed by the assessee for the purpose of manufacture of its finished products. The assessee pays royalty to EPCOS AG for acquiring know-how to manufacture DC capacitors and AC/DC stacked film capacitors in India.

4.5. That the international transaction involving receipt of indenting commission (INR 2,95,50,194) by the assessee from EPCOS AG, Germany, it is noted that EPCOS AG manufactures electronic components at its own manufacturing facility in Germany and the assessee provides marketing service to EPCOS AG in relation to the said products in India, Bangladesh, Bhutan, Nepal and Sri Lanka and receives indenting commission in return for the marketing services rendered in the aforesaid countries. The assessee submits that the aforesaid arrangement expands the product range offered by the assessee to the unrelated customers in India, Bangladesh, Bhutan, Nepal and Sri Lanka. The assessee now markets not only its own manufactured products but also the products manufactured by EPCOS AG. This enables the assessee to attract more customers who will be keen to buy the products manufactured by the assessee as well as the products manufactured by EPCOS AG from a single supplier i.e. the assessee. Thus, the aforesaid marketing service arrangement entered into between the assessee and EPCOS AG actually promotes the sales of the assessee and hence, the international transaction under consideration is closely linked to the business of the assessee.

4.6. In support of the application of the TNMM in relation to closely linked transactions, the assessee places reliance on the following decisions:

- (i) Decision of the Hon'ble Kolkata Tribunal in the case of *DCIT vs. EPCOS Ferrites Ltd* reported in [2019] 102 taxmann.com 422 (Kolkata - Trib.) for AY 2002-03 & AY 2003-04 (name of the company changed to EPCOS India Pvt Ltd after subsequent merger), wherein the Hon'ble Tribunal accepted the application of the TNMM at the entity level in relation to the following international transactions: import of raw materials, import of tools and capital equipment, payment, for service charge for its services, sales support, marketing and advertisement and sorting services,

export of tools, export of finished goods and payment of royalty for technical know-how.

(ii) Decision of the Hon'ble Pune Tribunal in the matter of *Demag Cranes & Components (India) (P.) Ltd vs. Deputy Commissioner of Income-tax reported in [2013] 30 taxmann.com 364 (Pune - Trib.)* wherein the Hon'ble Tribunal has explained the term 'closely linked transactions' and held that in appropriate circumstances where closely linked transactions exist, the same should be treated as one composite transaction and a common transfer pricing analysis be performed for such transactions by adopting the most appropriate method.

(iii) Decision of the Hon'ble Pune Tribunal in the matter of *Cummins India Ltd vs. Addl. CIT reported in [2015] 53 taxmann.com 53 (Pune - Trib.)*, wherein the Hon'ble Tribunal accepted application of the TNMM at the entity level in relation to (a) import of components and spares of IC engines, (b) export of components and spares of IC engines, (c) receipt of services such as access to customised part catalogue, international site licence etc., (d) receipt of IT support service, (e) payment of training fees, (f) rendering of service (warranty claims lodged with associated enterprises) and (g) provision of technical services.

1.1 Decision of the Hon'ble Pune Tribunal in the matter of *DCIT vs. Tetra Park India (P) Ltd reported in [2017] 86 taxmann.com 257 (Pune - Trib.)*, wherein the Hon'ble Tribunal accepted application of the TNMM at the entity level in relation to (a) import of raw materials, spares and components, processing/distribution equipment and filling machines, (b) import of filling machines, processing equipments, spare parts etc. for resale, (c) import of capital goods, (d) export of finished goods and processing equipment, (e) sale of fixed assets, (f) technical service, design service and services in the nature of education & training etc. received by Tetra Park India, (g) commission received, (h) reimbursement of expenses to associated enterprises and (10) reimbursement of expenses from associated enterprises.

4.7. The assessee's contention is that the TPO has accepted entity level TNMM in the assessee's own case for different assessments years as mentioned hereinbelow.

Table No. 1 – Status for prior assessment years and succeeding assessment years			
Assessment Years	Purchase of raw materials & components from AEs	Receipt of indenting commission from AE	Payment of royalty to associated enterprise
AY 2003-04	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	It was the contention of the assessee that the aforesaid transaction was at arm's length because the same was approved by the Reserve Bank / SIA. Further, the assessee performed entity level TNMM analysis which covered this transaction. An ALP Adjustment was directed by the TPO. However, the said adjustment was deleted by the CIT(A). No appeal lies before the Hon'ble Tribunal due to low tax effect.
AY 2004-05	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	It was the contention of the assessee that the aforesaid transaction was at arm's length because the same was approved by the Reserve Bank / SIA. Further, the assessee performed entity level TNMM analysis which covered this transaction. An ALP Adjustment was directed by the TPO. However, the said adjustment was deleted by the CIT(A). No appeal lies before the Hon'ble Tribunal due to low tax effect.
AY 2006-07	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	It was the contention of the assessee that the aforesaid transaction was at arm's length because the same was approved by the Reserve Bank / SIA. Further, the assessee performed entity level TNMM analysis which covered this transaction. No adjustment was directed by the TPO.
AY 2007-08	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	It was the contention of the assessee that the aforesaid transaction was at arm's length because the same was approved by the Reserve Bank / SIA. Further, the assessee performed entity level TNMM analysis which covered this transaction. No adjustment was directed by the TPO.
AY 2008-09 to AY 2010-11	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	Method applied by the assessee: TNMM No adjustment was directed by the TPO.	No transaction

4.8. That the Hon'ble Tribunal vide order dated 15/12/2017 for the assessment year 2011-12 (bearing ITA No. 278/Kol/2016 and ITA No. 322/Kol/2016) and AY 2012-13 (bearing ITA No. 506/Kol/2017) set aside the transfer pricing adjustments made by the TPO with the direction to re-adjudicate only on the issues on which the TPO had found the assessee's international transactions not to have been at arm's length. The re-adjudication was directed to be done based on 27 additional evidences filed by the assessee before the Hon'ble Tribunal (which were required for the adoption of the 'transaction-by-transaction' approach) with the prayer to adopt 'transaction-by-transaction' approach in place of the 'entity level benchmarking' approach' (i.e. aggregation approach) adopted in the Transfer Pricing Study Reports filed by the assessee with the TPO. In this connection, it may please be noted that the TPO ordered transfer pricing adjustments only on the following international transactions:

Table No. 2 - Transfer pricing issues involved in appeal for AY 2011-12 & AY 2012-13

AY 2011-12	AY 2012-13
(a) Payment for intra-group services (IT support and other services)	(a) Payment for intra-group services (IT support and other services)
(b) Sales Margin	(b) Sales Margin
(c) Sale of ferrite	(c) Sale of ferrite
	(d) Non-compete fee, Management fee and fee for R&D services
	(e) Payment for intangible

4.9. That the Hon'ble Tribunal vide order dated 28/10/2018 (bearing ITA No. 2528/Kol/2017) for AY 2013-14 restored the impugned arm's length price adjustments back to the TPO for simultaneous adjudication with the cases for AY 2011-12 and AY 2012-13, since the transfer pricing issues involved in appeal for AY 2013-14 were mostly the same as those involved in appeal for AY 2011-12 and AY 2012-13.

Transfer pricing issues involved in appeal for AY 2013-14:

- (a) Payment for intra-group services (IT support and other services)
- (b) Sales Margin
- (c) Sale of ferrite
- (d) Management services
- (e) Mechanical services

4.10. That the transfer pricing issues involved in appeal for AY 2005-06 (bearing ITA No. 1783/Kol/2017) were completely different from the transfer pricing issues involved in appeals for AY 2011-12, AY 2012-13 and AY 2013-14.

Transfer pricing issues involved in appeal for AY 2005-06:

- (a) Payment made for purchase of raw materials / components
- (b) Receipt of indenting commission
- (c) Payment of royalty

4.11. As mentioned in the affidavit filed by the assessee referred to hereinabove, the assessee could not adopt transaction-by-transaction approach for the AY 2005-06 due to unavailability of comparable uncontrolled transaction separately for each of the international transactions as aforesaid.

5. On careful consideration of all the facts of this case, the arguments of both the sides and the material available on record, we hold that the Transactional Net Margin Method in relation to the impugned international transactions at the entity level, is accepted and this ground of the revenue is dismissed.

Ground No. II

6. Ground no. II is directed against the action of the CIT(A) in rejecting the Comparable Uncontrolled Price (CUP) Method for benchmarking the transaction of purchase of raw materials/components and adopting TNMM on an entity level for determining arm's length price of the said transaction.

Facts

6.1. The assessee has imported raw materials from four associated enterprises incorporated in Spain, Brazil, Hungary and Germany respectively (as referred to in clause 8A to Appendix B of Form No. 3CEB) during the relevant financial year for a sum of INR 96,05,434/-. It is the contention of the assessee that that the aforesaid

international transaction involving purchase of raw materials & components by the assessee from associated enterprises at arm's length under the TNMM.

Findings of the Id. TPO

6.2. The Id. TPO noted that the assessee purchases identical type of raw materials & components from EPCOS Brazil and EPCOS Electronic Components S.A. Malaga, Spain (associated enterprises) as well as from unrelated suppliers and the prices charged by the aforesaid associated enterprises to the assessee, in some cases, are higher than the prices charged by unrelated suppliers to the assessee for identical type of raw materials & components. For the purpose of undertaking benchmarking analysis on transaction-by-transaction basis, the TPO compares the prices charged by EPCOS Brazil to the assessee with the prices charged by Beer & Blumenauer (Germany) and Bharat Products (India) to the assessee for identical types of raw materials & components. The TPO further compares the price charged by EPCOS Electronic Components S.A. Malaga, Spain to the assessee with the prices charged by Steiner (Germany), Sung Moon (Korea), Sun Polymers (India), Vishay (India), Hafner Josef (Germany), Electro Crimp (India), Seolin (Korea), Ujjwish Udyog (India), Shiba Container (India), Modiplast (India) and Vogt (Switzerland) to the assessee for identical types of raw materials & components. The TPO, based on the data made available to him by the assessee, computed the negative variance (=price paid to unrelated supplier – price paid to associated enterprise) amounting to INR 598693.20 (=74804.18+523889.02). Thus, the TPO directed an ALP adjustment of INR 5,98,693/-.

Findings of the CIT(A)

6.3. The CIT(A) has noted that in respect of purchase of raw materials and components, the TPO applies the CUP Method erroneously without having regard to the factor of comparability namely 'conditions prevailing in the market in which the respective parties to the transactions operate' as prescribed under clause (d) of sub-rule (2) of rule 10B of the Income-tax Rules, 1962 ('Rules'). The TPO compares the prices paid by the assessee to EPCOS Brazil (South America) with the prices paid by the assessee to Beer & Blumenauer (Germany) and

Bharat Products (India) for identical products. The TPO compares the prices paid by the assessee to EPCOS Malaga (Spain) with the prices paid by the assessee to Steiner (Germany), Sung Moon (Korea), Sun Polymers (India), Vishay (India), Hafner Josef (Germany), Electro Crimp (India), Seolin (Korea), Ujjwish Udyog (India), Shiba Container (India), Modiplast (India) and Vogt (Switzerland) for identical products. Further, the TPO has not considered that import of raw materials & components from associated enterprises constitutes an insignificant part of the total purchase of raw materials and components during the relevant financial year. The TPO fails to appreciate that voluminous purchase from unrelated supplier would result in lower purchase price in the open market. In view of the above, the CIT(A) has held that the TPO erroneously applies the CUP Method without appreciating the basic tenet of comparability analysis as provided in the Indian Transfer Pricing Regulation and various decisions of the Hon'ble Tribunals of our country in this regard. The CIT(A) has therefore rejected the CUP Method and accepted the entity level TNMM undertaken by the appellant in respect of this international transaction on aggregate basis. The CIT(A) has directed the Assessing Officer (AO) to delete the arm's length price adjustment of Rs. 5,98,693/-.

6.4. We have considered rival submissions on this issue. The provision of clause (d) of sub-rule (2) of rule 10B of the Income -tax Rules, 1962, which provides that for the purposes of sub-rule (1) of rule 10B, the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the *conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.*

6.5. We now consider the case law on this issue

i) the Hon'ble Mumbai Tribunal in the matter of Gharda Chemicals Ltd. v. Dy. CIT reported in [2010] 35 SOT 406 which *inter alia* reads as under:

"15. The Internal CUP method envisages comparing the uncontrolled transactions of the assessee itself with other unrelated parties so as to determine the ALP with the AE. However, the External CUP method disregards the price charged or paid by the assessee to or from its unrelated parties and contemplates the comparison of the price so charged from or paid to its AE with some external independent reliable price data under similar circumstances of transactions with AE. Ordinarily the Internal CUP method should be preferred over the External CUP method as it neutralizes several distinguishing factors, such as the local factors and the economies available or unavailable to the assessee in particular, having bearing over the comparison of price charged from unrelated parties and AE. The essence of determining ALP under CUP method is to ensure that the price charged by the Indian Enterprise from its AE should be consistent with that charged from unrelated parties under similar circumstances. The importance of the "similar circumstances" cannot be lost sight of in this context because a round cannot be compared with a square and a rectangle with a triangle. In other words, the uncontrolled transactions which are contemplated for comparison should be alike, if not identical. Similarity between the two sets of transactions can be judged by the quality, grade and quantity of the material. In addition, the factors like the location of the parties, availability of raw material; demand and supply equation also play pivotal role in finding out as to whether the two are really comparable or not. Thus in the Internal CUP method the local factors of AE in the other country and all the relevant factors which could have bearing on the price so charged from AE must be taken into consideration. We are dealing with a case in which the assessee has its AE in USA and rate charged is 14.66 US\$ per Kg. of Dicamba. There is no other export by the assessee to- USA. The uncontrolled transactions of export made by the assessee are to other countries such as UK, Netherlands, Newzealand. Australia, France etc. in respect of which average rate of 20.67 US\$ per Kg. of Dicamba has been determined by the TPO for computing the ALP. All other transactions of export by the assessee are to non-USA countries. The price on which a particular product

is available in one country may largely vary from the price prevailing in other countries due to host of factors. The country which is producer of a particular commodity or its raw material may have lower sale price in comparison with the country which is short of such natural resources. Similarly, the price may vary from one country to another depending upon climatic conditions and the demand and supply factors. Thus the price charged by an Indian party from UK or Australia may be at much variance with that charged from USA. In such a scenario no valid comparison can be made between the price charged by the assessee from other countries with that from USA.....”

ii) The Hon’ble Kolkata Tribunal (Jurisdictional Tribunal) in the matter of NLC Nalco (India) Ltd vs. DCIT reported in [2016] 71 taxmann.com 57 (Kolkata - Trib.), wherein it is held that:

“38. In view of the above decision, we find that apart from differences in quality, grade and quantity of materials, the difference in such factors like the geographical location of the parties, availability of raw material, demand and supply equation also play an important role in the application of the CUP Method.”

iii) The Hon’ble High Court of Bombay in the matter of Principal Commissioner of Income-tax-5, Pune vs. Amphenol Interconnect India (P.) Ltd. reported in [2018] 91 taxmann.com 441 (Bombay). The Hon’ble Bombay High Court confirmed the order of the Hon’ble Tribunal and held that:

“We note that the impugned order of the Tribunal has analyzed the differences between sales commission paid to its AEs for clients identified by them and the sales commission paid to third party agents in respect of sales goods in India. On account of the differences in respect of function and geography between the AEs transaction and third party transaction, the CUP method is not the MAM method. It, therefore, held that TNM method is the most appropriate. In these circumstances, the view of the Tribunal that the TNM method is the most appropriate method is a reasonable and possible view on application of appropriate test in the present facts.”

iv) The Hon'ble Cochin Tribunal in the matter of ACIT vs. Akay Flavours & Aromatics (P.) Ltd. reported in [2015] 64 taxmann.com 431 (Cochin - Trib.), wherein the Hon'ble Tribunal *interalia* held that:

"6.2 Thirdly, the TPO has compared the exports in different geographical locations. For instance, as rightly observed by the DRP, exports to Germany cannot be compared with exports to Italy. The TPO has not appreciated the price fluctuation/difference according to demand / supply position in different geographical locations. The adoption of non-AE export sale price as internal CUP is therefore incorrect and bad in law."

7. The Id. CIT(A) in his order stated that the, import of raw materials & components from associated enterprises (INR 96,05,434/-) constitutes a small part of the total raw materials consumed (INR 63,26,73,000/-) and voluminous purchase results in lower prices in the open market and in this scenario, the TPO has made erroneous application of the CUP Method by comparing the prices paid by the assessee to associated enterprises with the prices paid by the assessee to unrelated suppliers for identical type of raw materials & components without having regard to the volume of purchase in respective cases.

v) The Hon'ble Mumbai Tribunal in the matter of Gharda Chemicals Ltd. v. Dy. CIT (supra), wherein it is stated that:

"The essence of determining ALP under CUP method is to ensure that the price charged by the Indian Enterprise from its AE should be consistent with that charged from unrelated parties under similar circumstances. The importance of the "similar circumstances" cannot be lost sight of in this context because a round cannot be compared with a square and a rectangle with a triangle. In other words, the uncontrolled transactions which are contemplated for comparison should be alike, if not identical. Similarity between the two sets of transactions can be judged by the quality, grade and quantity of the material."

vi) The Hon'ble Kolkata Tribunal (Jurisdictional Tribunal) in the matter of NLC Nalco (India) Ltd vs. DCIT (supra) reported in [2016] 71 taxmann.com 57 (Kolkata - Trib.), wherein it is held that:

"38. In view of the above decision, we find that apart from differences in quality, grade and quantity of materials, the difference in such factors like the geographical location of the parties, availability of raw material, demand and supply equation also play an important role in the application of the CUP Method."

vii) The Hon'ble Pune Tribunal in the matter of Atlas Copco (India) Ltd vs. ACIT reported in [2019] 112 taxmann.com 120 (Pune - Trib.), wherein it is held that:

"Adverting to the facts of the instant case, we find that though description of items sold by the assessee to its AE and non-AEs is similar, but there are several differences in the two, such as, location of the parties, quantities lifted and customization of products. Such differences have significant bearing on the price charged by the assessee. No adjustment has been allowed by the TPO on account of such differences. In the same manner, the Id. DR also could point out any mechanism for giving adjustment on account of such material differences. In such circumstances, the price charged from AEs and non-AEs cannot be compared under the CUP method. The Hon'ble jurisdictional High Court in Pr. CIT v. Amphenol interconnect India (P.) Ltd. [2018] 91 taxmann.com 441/[2019] 410 ITR 373 (Bom.) considered almost a similar situation in which there were differences in volumes and locations and the TPO had applied the CUP method for benchmarking the assessee's international transaction. The Tribunal did not approve the application of the CUP method on account of such difference. When the Revenue preferred an appeal against the Tribunal order, the Hon'ble High Court held that the CUP method is not appropriate method in case of geographical difference, volume difference, timing difference, risk difference and functional difference. Reverting to facts of the extant case, we find that since there are significant differences in the sales made by the assessee to its AEs and non-AEs, the effect of which has neither been given by the TPO nor it has been shown that how it

can be given, we hold that the action of the authorities below in applying the CUP as the most appropriate method cannot be countenanced.”

7.1. In view of the above decisions, it is quite evident that the TPO has erroneously applied the CUP Method in the instant case without considering two important factors of comparability such as geographical location and volume of purchase.

7.2. The TPO, in similar circumstances for the AY 2003-04 and AY 2004-05 and AY 2006-07, has accepted that the international transaction involving purchase of raw materials by the assessee from associated enterprises is at arm's length under the TNMM and he has not directed ALP adjustment in respect of this international transaction by applying the CUP Method on transaction-by-transaction basis.

8. Hence, we uphold the order of the Id. CIT(A) on this issue and dismiss Ground No. II of the revenue.

Ground No. III

8. Ground no. III is directed against the action of the CIT(A), while computing the figure for value addition for royalty computation, in considering only the cost of standard materials without appreciating the fact that cost of non-standard materials should also be considered for the purpose of analysis as raw material means both standard and non-standard materials.

Facts

8.1. The assessee has entered into 'Technical Assistance and Licence Agreement' (TALA) with EPCOS AG for obtaining technical know-how (technical knowledge and experience, technical documentation, assistance and training) in relation to manufacture of DC capacitors and AC/DC stacked film capacitors in India. The assessee has paid royalty to EPCOS AG at the rate of 3 percent of net sales price. As per the

aforesaid agreement, the method of computation of royalty contained in TALA is as under:

Table No. 3 – Method of royalty computation

Invoiced selling price (A)	xxx
Less:	
Sales tax and customs duties (B)	(xxx)
Cost of insurance and transportation from the place of manufacture to the customer's premises or point of installation (C)	(xxx)
Cost of standard bought out components and the landed cost of imported components (including freight, insurance and customs duty) which are incorporated in final products (D)	(xxx)
Net Sales: (E)=(A)-(B)-(C)-(D)	xxx
Royalty payable by the assessee to EPCOS AG: 3% of (E)	xxx

During the relevant financial year, the assessee pays royalty to EPCOS AG for a sum of INR 93,70,670/-.

8.2. For the purpose of computation of royalty, the assessee has classified the raw materials / components used for the purpose of manufacturing the finished products to which the aforesaid agreement applies, into two categories such as 'standard items' and 'non-standard items'. The raw materials / components categorized as 'non-standard' are the ones which the assessee specifically orders and gets them manufactured as per the specifications required by it. On the other hand, the raw materials / components categorized as standard are the ones which are readily available in the market. The details of standard and non-standard items hereunder:

Table No. 4 – Standard and non-standard items of raw materials/components
(Disclosed in page no. 17 of TPO's order)

Sl. No.	Material	Standard INR	Non-Standard INR
1	Aluminium Foil		9,71,537
2	Metallised Film		6,32,68,592
3	Masking Tape		41,95,980
4	Zinc Wire	52,42,323	
5	Tin Copper Wire		2,95,96,068
6	Silicon Oil	6,19,990	
7	Martinal	13,71,278	
8	Accelerator	3,08,705	
9	Silicon as Mittel Resin	17,572	
10	Resin	1,27,70,065	
11	Hardener	6,09,387	
12	Colour – Blue	1,55,617	
13	Colour – White	2,56,179	
14	Pibiter	1,17,26,445	
15	Plastic Cans		3,59,55,944
16	Terminal Wire		76,90,231
17	Red Link	1,26,127	
18	Black Ink	3,91,372	
19	Other Consumables	12,51,029	
	Grand Total	3,48,46,089	14,16,78,352

8.3. In page no. 14 of the TPO's order, the assessee's description of the non-standard items was as under:

- Aluminium foil – This is used in winding the coil specially made as per the specifications given by EPCOS AG.

- Metallised film – Metallisation is done in-house and the film is received as per the specifications defined by EPCOS AG. Only capacitor film grade (High Temperature / Low Temperature) BOPP film is used for capacitor manufacturing and this grade of BOPP films is used for capacitor manufacturing and this grade of BOPP films is not manufactured by packing grade BOPP film manufacturers. The metallization activity is done in-house by the assessee and as such, adds value to the produce.
- Masking tape – This is used to facilitate spraying of Zinc/Tin/Copper solution on the end points of the would element on a fully automated spraying machine. The masking tape is tailor-made as per EPCOS AG's specification to suit automatic loading of the would elements.
- Tin Copper Wire – Bi-metal wire made to Tin/Copper Alloy is used for spraying operation produced to EPCOS AG's specifications.
- Plastic cans – Plastic cans are made out of injection moulds designed by EPCOS AG with appropriate polymer compound, dimensions to withstand filling of hot resin on a fully automated assembly line.
- Terminal wire – Bi-metal wire made of copper and steel gets manufactured as per EPCOS AG's specification.

8.4. While computing the royalty, the assessee has deducted *interalia* the cost of standard items of raw materials / components from the net selling price as per the formula provided in the TALA. The cost of non-standard items which are manufactured by the suppliers as per the specifications received by the assessee from EPCOS AG and communicated to the suppliers, is not deducted from the net selling price. It is the contention of the assessee that as the royalty agreement is approved by the Secretariat for Industrial Approval (SIA) and the Reserve Bank of India (RBI) and the working of the calculation of royalty is regularly submitted to the RBI (through the authorised dealer) and there have been no objections as regards the calculation of royalty [as mentioned in paragraph no. (d) contained in page no. 14 of the TPO's order], the international transaction involving payment of royalty (INR 93,70,670/-) is at arm's length. Further, the entity level TNMM analysis undertaken by the assessee covers this

international transaction. Thus, the impugned international transaction is also at arm's length under the TNMM at the entity level.

Findings of the Id. TPO

8.5. The TPO has deducted the cost of standard items as well as non-standard items of raw materials / components from FOB value of sales for arriving at the net sales and then applied the rate of 3% to the arrived figure for computing the amount of royalty. The TPO computed the royalty and ALP adjustment in the following manner:

Table No. 5 – Computation of royalty and ALP adjustment by the TPO

Particulars	Amount (INR)	Amount (INR)
FOB value of sales		318310190
Less: Cost of standard items	34846089	
Less: Cost of non-standard items	141678352	
		176524441
Net Sales		141785749
Royalty: 3% of INR 141785749/-		4253572
Less: Royalty paid by assessee to EPCOS AG		9370670
Arm's length price adjustment directed by TPO		5117098

Findings of the CIT(A)

8.6. In respect of royalty payment, the CIT(A) observes that the assessee, during the course of hearing before the TPO, has submitted detailed list of 13 standard items and 6 non-standard items of materials used for the manufacture of DC capacitors. Th CIT(A) further observes that the TPO in his order has accepted that aluminium foil, metallised films, masking tape, tin copper wire, plastic can and terminal wire are non-standard items which are specifically designed to satisfy the requirement of the assessee.

Accordingly, he has computed the royalty that would be allowed as deduction under the provision of Income-tax Act, 1961, for the previous year relevant to the assessment year 2005-06:

Table No. 6 – Computation of royalty and ALP adjustment by the CIT(A)

Particulars	Amount (INR)
FOB value of sales	318310190
Less: Cost of standard items	34846089
Net Sales	283464101
Royalty: 3% of INR 283464101/-	8503923
Less: Royalty paid by assessee to EPCOS AG	9370670
Arm's length price adjustment directed by CIT(A)	866747

8.7. We have considered rival submissions.

8.8. The assessee has classified the raw materials / components into two categories such as 'standard items' and 'non-standard items'. The raw materials / components categorized as 'non-standard' are the ones which the assessee specifically orders and gets them manufactured as per the specifications required by it. The non-standard items are aluminium foil, metalised film, masking tape, tin copper wire, plastic can and terminal wire. As explained, the assessee gets the aforesaid items manufactured by the suppliers as per the technical specification obtained by the assessee from EPCOS AG and thereafter communicated by the assessee to the suppliers. The raw materials / components categorized as standard items are the ones which are readily available in the market. The standard items are zinc wire, silicon oil, martinal, accelerator, silicon as mittel resin, resin, hardener, blue colour, white colour, pibiter, red link, black ink and other consumables. The assessee deducts the total value of standard items (INR 3,48,46,089/-) from invoiced selling price in order to arrive at net selling price to which the rate of 3% is applied in order to compute the royalty payable by the assessee to associated enterprise.

8.9. The cost of standard items has been deducted from invoiced selling price as per the method of computation contained in the TALA. The TALA (including the method of computation of royalty contained in 'Article 3 – Consideration' of the aforesaid agreement) has been approved by the Secretariat for Industrial Approval (SIA) and the Reserve Bank of India (RBI) and the working of the calculation of royalty is regularly submitted to the RBI (through the authorised dealer) and there have been no objections as regards the calculation of royalty [as mentioned in paragraph no. (d) contained in page no. 14 of the TPO's order]. It is pertinent to note that the TPO has not disputed the aforesaid facts in his order.

8.10. We now examine the case-law on this issue:-

- i) the Hon'ble Mumbai Tribunal in the matter of Cadbury India Ltd. v. Addl. CIT reported in [2013] 40 taxmann.com 529/[2014] 147 ITD 487, held that:

"Ongoing through the records and the orders of the revenue authorities, we find that in so far as the payment of royalty on technical knowhow concerned, the assessee has been paying to its parent AE right from 1993, as, other group companies are paying across the globe Besides this, the payment is made as per the approval given by the RBI and SIA, Government of India. Hence there cannot be any scope of doubt that the royalty payment on technical knowhow is not at arm's length."

- ii) the Hon'ble Kolkata Tribunal in the matter of NLC Nalco India Ltd vs. DCIT reported in [2016] 71 taxmann.com 57 (Kolkata - Trib.), held that:

"In the instant case also, we find in page no. 53 of the assessee's paper book that assessee made application dated 14th March, 2001 to the General Manager, Exchange Control Department, Reserve Bank of India. In the aforesaid application, assessee explained the scope of services receivable from Nalco Pacific under the aforesaid agreement, the benefits to be received by it from entering into the aforesaid agreement with Nalco Pacific and the maximum amounts to be remitted

as consultancy charge to Nalco Pacific under the aforesaid agreement. In reply, the RBI intimated their "in-principle" approval for remittance of consultancy charge to Nalco Pacific @ 2% of net sales for the calendar year 2001. In view of this, we are of the view that the aforesaid payment (Rs. 1,51,74,980/-) made to Nalco Pacific @ 2% of net sales, having been the rate of consultancy charge approved by the RBI, are at arm's length price. Accordingly, we delete the addition and allow this issue of assessee's appeals."

- iii) the Hon'ble Mumbai Tribunal in the case of ThyssenKrupp Industries India Private Limited v Addl. Commissioner of Income-tax bearing ITA No. 6460/Mum/2012 reported in [2013] 33 taxmann.com 107 (Mumbai – Trib.), wherein the Hon'ble Tribunal has held that the automatic approval granted by RBI would be deemed to the approval granted by RBI. The relevant extract in the present context is as under:

"14.3 After considering the rival submissions and perusing the relevant material on record, we find that the assessee entered into collaboration agreement with its AE for payment of 2% of contract value for manufacturing, drawing and engineering services and 5% of the selling price as royalty. The assessee applied to the RBI seeking approval in respect of payment of royalty and technical fee through Central Bank of India. A copy of letter addressed by the Central Bank of India to the RBI dated 26.03.2008 is available on page 240 of the paper book. Through this letter, the Central Bank of India forwarded relevant documents along with a copy of the agreement. The RBI vide its letter dated 21.04.2008 requested Central Bank of India to consider the assessee's case in accordance with its AP(DIR Series) No.76 dated 24.02.2007. It is in pursuance to the deemed approval by RBI under the automatic approval scheme that the assessee made payment of royalty and technical fee to its AE. It is relevant to note that such payment has been approved or deemed to have been approved by the RBI. When a payment is made after obtaining due approval from the RBI, how its ALP can be computed at Rs. Nil, is anybody's guess. The fact of approval of the payment by the RBI has been succinctly recorded by the TPO in his order as well. He still chose to propose adjustment in respect of full payment. In our considered opinion, when the rate of royalty

payment and fee for drawings etc. has been approved or deemed to have been approved by the RBI, then such payment has to be considered at ALP. We, therefore, direct to delete addition of Rs. 4.29 crore made by the A.O. in this regard."

- iv) the Hyderabad Tribunal in the matter of DCIT vs. Owens Corning Industries (India) (P.) Ltd. in the matter of [2014] 51 taxmann.com 276 (Hyderabad - Trib.), it is held that:

17. We find merit in this claim that once the RBI approval of royalty rate was obtained the payment was considered to be held at arm's-length. It is also noted that various Tribunals such as Air Liquide Engg. India (P.) Ltd. (supra), Dy. CIT v. Sona Okegawa Precision Forgings Ltd. [2012] 17 taxmann.com 98/49 SOT 520 (Delhi), Hero Motocorp Ltd. v. Addl. CIT (IT Appeal No. 5130/Del/2010), ThyssenKrup Industries India Ltd v. Addl. CIT [2013] 33 taxmann.com 107 (Mum. - Trib.), Abhishek Auto Industries Ltd. v. Dy. CIT [2011] 9 taxmann.com 27 (Delhi) have taken a view that RBI approval of the Royalty rates itself implies that the payments are at Arm's Length and hence no further adjustment needs to be made viewed from this angle too."

- v) the Hon'ble Pune Tribunal in the matter of Kinetic Honda Motor Limited vs. JCIT reported in 77 ITD 393 (Pune) held that when one wing of the Government approves a transaction, another wing of the Government should not treat the payment as excessive.

9. In the light of the above decisions, the royalty for a sum of INR 93,70,670/- paid by the assessee to EPCOS AG as per the TALA (including the method of computation of royalty contained in 'Article 3 – Consideration' of the aforesaid agreement) which has been approved by the SIA and the RBI and in respect of which the working of the calculation of royalty is regularly submitted to the RBI (through the authorised dealer) and there have been no objections as regards, the calculation of royalty, is at arm's length as per the Indian transfer pricing law.

10. The Id. Counsel for the assessee further submits that the impugned international transaction is at arm's length under the TNMM undertaken by the assessee at the entity level. The Id. Counsel for the assessee relied on decision of the Hon'ble High Court of Karnataka in the matter of Kaypee Electronics & Associates (P.) Ltd vs. DCIT reported in [2018] 94 taxmann.com 251 (Karnataka), wherein it is held that in the event the royalty paid already forms part of the operating cost under the TNMM, there is no necessity of separately bench marking royalty. In the instant case, the operating cost of INR 1298689 Thousand computed by the assessee under the TNMM (kindly refer to paragraph no. 5.1.6 contained in the transfer pricing study report – page no. 197 of the paperbook) includes royalty paid by the assessee to EPCOS AG (INR 9371 Thousand) under the head 'Other expenses' (INR 326,516 Thousand). The computation of 'Other Expenses' is as under:

Table no. 7 – Other expenses

Particulars	Amount (INR)
Manufacturing, selling and general expenses as per schedule 18 to the Profit & Loss Account (including royalty)	326,640
Less: Loss on disposal of fixed assets	124
Other expenses	326,516

11. In the order issued under section 92CA (3) of the Income-tax Act, 1961, the TPO has not disputed the computation of operating revenue and operating cost made by the assessee in paragraph no. 5.1.6 of its transfer pricing study report as aforesaid. As the operating cost includes royalty expenses in the instant case, we, in the light of the aforesaid decision of the Hon'ble Karnataka High Court, decide that there is no need to benchmark royalty separately in the instant case.

12. The TPO, for the immediately succeeding assessment years (AY 2006-07 and 2007-08) has accepted that the international transaction involving payment of royalty by the assessee to EPCOS AG under the TALA is at arm's length on the same facts.

13. In view of the above, we uphold the findings of the Id. CIT(A) and dismiss Ground No. 3 of the revenue.

Ground No. IV

14. Ground no. IV is directed against the action of the CIT(A) in stating that the financial indicator for the indenting activity segment of the assessee has nothing to do with the sales revenue generated by associated enterprise in the Indian market without appreciating that the indenting activity is performed for promoting sales of AE in the Indian market.

Facts

14.1. EPCOS AG has entered into 'Marketing and Service Agreement' with the assessee (kindly refer to page no. 292 of the paperbook) under which the assessee agrees to use its best effort to promote, solicit and mediate sale of specified products of EPCOS AG in India. The customers, however, import products directly from EPCOS AG. Thus, EPCOS AG has appointed the assessee as its indenting agent in India. In return for provision of indenting services, EPCOS AG paid indenting commission for a sum of INR 2,95,50,194/- to the respondent.

Findings of the Id. TPO

14.2. The TPO noted that during the year under consideration, the assessee has received an amount of INR 2,95,50,194/- for rendering indenting services to EPCOS AG. The assessee acts as an indenting agent for EPCOS AG products in India. The business is conducted as a direct business i.e. customers import directly from EPCOS AG. The marketing activities that the assessee undertakes for EPCOS AG products cannot be separated from its normal marketing activities. The sales division is involved in marketing in the local market for its own products as well as products of EPCOS AG. The assessee has earned a commission of approximately 6% on the aforesaid products of EPCOS AG during the year.

14.3. The assessee has received a commission of INR 2,95,50,194/- and for earning such commission, the cost incurred by the assessee is for INR 2,70,55,358/-. Thus, the net profit earned by the assessee for marketing the products of EPCOS AG in India stands at INR 24,94,835/- (=2,95,50,194 -2,70,55,358). Through the marketing services rendered by the assessee to EPCOS AG, EPCOS AG achieves sales for a sum of INR 50,64,18,000/-. Therefore, the profit out of the commission over sales of EPCOS AG works out to 0.492% (2494835/50,64,18,000 X 100).

14.4. As comparable uncontrolled transaction, the TPO has considered the profit attributable to marketing function performed by the assessee under the domestic manufacturing segment. The TPO referred to the details submitted by the assessee wherein the working of allocation of 'profit before depreciation, interest and tax' in the ratio of manufacturing and selling overheads has been given. The total manufacturing expenses are at Rs.1,90,821 (000) and the selling expenses are at Rs.1,69,456(000). It is accordingly seen that the selling overheads form 47.02% of the total expenses and these selling overheads are towards the marketing cost, sales margin, turnover incentives, etc. The TPO noted that when the cost incurred towards the selling expenses is 47.03% of the total expenses, the corresponding profits attributable to the marketing function undertaken by the company would be 47.03% of the total profits of the company. It is further seen in the details that the profit before interest and depreciation in the case of domestic sales of the assessee comes at 12.75% on sales and therefore 47.03% of 12.75% would work out to 5.996%. Thus, the TPO computed the arm's length price adjustment in respect of the international transaction under consideration in the following manner:

$$\text{INR } 50,64,18,000/- \times (5.996 - 0.492)/100 = \text{INR } 2,78,73,247/-$$

Findings of the CIT(A)

14.5. In respect of receipt of indenting commission, it is the observation of the CIT(A) that the TPO failed to appreciate that the profit earned by the assessee (INR 24,94,835/-) represents return from the indenting activity performed by the assessee that enables

the assessee to earn commission of INR 2,95,50,194/-. Thus, the financial indicator under this segment of activity would be 8.44% (i.e. Rs. 24,94,835 / Rs. 2,95,50,194). He held that the TPO failed to further appreciate that the aforesaid profit (Rs. 24,94,835/-) earned by the assessee has nothing to do with the sales revenue (Rs. 50,64,18,000/-) received by the associated enterprise from sale of its manufactured goods in India. Thus, the computation made by the TPO of the financial indicator for the indenting activity segment of the assessee with reference to the sales revenue generated by associated enterprise in Indian market at 0.492% has been erroneous. The CIT(A) has noted that the financial indicator of the indenting segment would be 8.44% ($=24,94,835/2,95,50,194$) which is higher than the financial indicator of the domestic sales segment (5.996%). In view of this, he has accepted the arm's length nature of the international transaction under consideration and directed the AO to delete the arm's length price adjustment of INR 2,78,73,247/-.

14.6. On consideration of arguments of both the sides, we find that the TPO has erroneously computed the financial indicator of the indenting segment of the assessee by way of dividing the profit of the assessee under this segment (INR 24,94,835/-) by the sales generated by the associated enterprise in India (INR 50,64,18,000/-). The sales generated by the associated enterprise in India (INR 50,64,18,000/-) does not pass through the books of account of the assessee in India. It has been mentioned in the TPO's order that the assessee acts as an indenting agent for EPCOS AG products in India and the customers import products directly from EPCOS AG. The sales generated by the associated enterprise in India is accounted for in the books of the associated enterprise in its country of residence. As mentioned in the TPO's order, the assessee earns profit of INR 24,94,835/- which is computed by way of deducting cost incurred by the assessee (INR 2,70,55,358/-) from the indenting commission earned by the assessee (INR 2,95,50,194/-). Hence, the financial indicator of the assessee under the indenting segment would be 8.44% ($=24,94,835/2,95,50,194$) which is higher than the financial indicator attributable to marketing function performed under the domestic sales segment of the assessee as computed by the TPO (5.996%). Hence, the international transaction under consideration is at arm's length under the TNMM applied by the TPO on transaction-by-transaction basis.

14.7. Clause (e) of sub-rule (1) of rule 10B of the Income-tax Rules, 1962 which reads as under:

(e) transactional net margin method, by which,—

- (i) the net profit margin realised by the enterprise from an international transaction [or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;*
- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;*
- (iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;*
- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);*
- (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction [or the specified domestic transaction];*

14.8. Now we consider the case-law on this issue:-

i) The Hon'ble Delhi Tribunal in the matter of DCIT vs. Agilent Technologies India (P.) Ltd reported in [2016] 67 taxmann.com 95 (Delhi - Trib.), held that:

"A cursory glance at sub-clause (i) of Rule 10B(1)(e) transpires that the net operating profit margin realized by the enterprise from an international

transaction is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base...."

ii) The Hon'ble Delhi Tribunal in the matter of DCIT vs. Haworth (India) (P.) Ltd reported in [2013] 33 taxmann.com 111 (Pune - Trib.) held as under:

"12. On the analysis of the agreement between the assessee and Associated Enterprises for the period from April, 2003 to December, 2003, the Transfer Pricing Officer observed that on the orders procured by Haworth India, a commission at 85% of the difference between the price paid by Indian customers and price at which the products are procured by Haworth Singapore from its suppliers is payable to Haworth India. Further, on the orders procured by agents of Haworth Singapore, commission at 15% of the price at which the products are procured by Haworth Singapore from its suppliers is payable to Haworth India. Regarding period from January, 2004 to March, 2004, commission at 98.5% of the price paid by the Indian customer less the price at which the products are procured by Haworth Singapore from its suppliers is payable to Haworth India. Based on this, the Transfer Pricing Officer calculated the sales of Singapore entity as Rs. 32,58,78,454/- and treated this figure as the assessee's sale figure and arrived at the Arm's Length Price of the international transaction at the rate of 8.6% based on the TP/sales of the comparable. The Profit Level Indicator was changed to OP/Sales as against OP/Cost maintained by the Transfer Pricing study. The Transfer Pricing Officer re-calculated OP/Sales of the assessee. While doing so Rs.21,46,081/- representing liability written back in P&L account was not considered as an operating profit by the Transfer Pricing Officer. In appeal, the CIT(A) held assessee as service provider and held entitled for commission as commission agent.

13. In first appeal, we find that as per the market and project management agreement dated 01.01.2002 as well as 01.01.2004 the terms and condition governing the transaction between the assessee and Associated Enterprises clearly indicate that the assessee is entitled for commission. The foreign entity directly makes the sale to Indian customers and collects the proceeds directly. It is undisputed that the sale proceeds of the foreign entity i.e. Associated Enterprises does not pass through the books of accounts of the assessee. As per the liability clause of the agreement, it is abundantly clear that the assessee is not responsible for the payment from the customers to the Associated Enterprises. The bills are not raised by the assessee on Indian customers for the sales made by Associated Enterprises. Therefore, the sales made by the Associated Enterprises cannot be treated as sales made by the assessee.....

15. As a result, the appeal filed by the Revenue is dismissed."

14.9. The TPO has erroneously considered the sales made by associated enterprise directly in India (INR 50,64,18,000/-) through the marketing service rendered by

assessee to the associated enterprise, as sales of the assessee and based on this consideration, he has taken the aforesaid sales figure as the denominator of the financial indicator of the assessee under the indenting segment (0.492% i.e. INR 2494835 / INR 50,64,18,000). That the TPO has failed to appreciate that the aforesaid sales figure does not pass through the books of account of the assessee and it is solely the commission income (INR 2,95,50,194/-) that passes through the books of account of the assessee as revenue under the indenting segment.

Therefore, the CIT(A) has correctly computed the financial indicator of the assessee under the indenting segment at 8.44% ($=24,94,835/2,95,50,194$). We uphold the same and dismiss this ground of the revenue.

15. Before parting, it is noted that the order is being pronounced after ninety (90) days of hearing. However, taking note of the extraordinary situation in the light of the COVID-19 pandemic and lockdown, the period of lockdown days need to be excluded. For coming to such a conclusion, I rely upon the decision of the Co-ordinate Bench of the Mumbai Tribunal in the case of *DCIT vs. JSW Limited* in ITA No. 6264/Mum/2018 & 6103/Mum/2018, Assessment Year 2013-14, order dt. 14th May, 2020.

16. Thus, the order of the ld. CIT(A) is upheld and appeal of the revenue is dismissed.

Kolkata, the 10th day of July, 2020.

Sd/-
[Aby T. Varkey]
Judicial Member

Dated : 10.07.2020
{SC SPS}

Sd/-
[J. Sudhakar Reddy]
Accountant Member

Copy of the order forwarded to:

1. M/s. EPCOS India Pvt. Ltd
Kulia Kanchrapara Road
Kalyani, Nadia
PIN – 741 251

2. Deputy Commissioner of Income Tax, Circle-11(1), Kolkata

3.CIT(A)-

4. CIT- ,

5. CIT(DR), Kolkata Benches, Kolkata.

True copy
By order

Assistant Registrar
ITAT, Kolkata Benches