IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Date of Decision: 10.12.2019
ITA-8535-2018 (O&M)

Principal Commissioner of Income-tax, Faridabad ... Appellant
vs.
M/s Knorr-Bremse India Pvt. Ltd. .. Respondent

ITA-105-2019 (O&M)

Principal Commissioner of Income Tax, Faridabad ... Appellant
vs.
M/s Knorr Bremse India Pvt Ltd .. Respondent

ITA-104-2019 (O&M)

Principal Commissioner of Income Tax, Faridabad ... Appellant
vs.
M/s Knorr Bremse India Pvt Ltd .. Respondent

CORAM: HON'BLE MR. JUSTICE AJAY TEWARI
HON'BLE MR. JUSTICE VIVEK PURI

Present : Mr. Tajinder Joshi, Senior Standing Counsel with
Mr. Vikram Bali, Junior Standing Counsel
for the appellant(s).

Ms. Radhika Suri, Senior Advocate with
Mr. M.S.Kanda, Advocate
for the respondent(s).

*****

<u>AJAY TEWARI, J.</u>

1. This order will dispose of above mentioned three appeals for Assessment Years 2007-08, 2009-10 and 2010-11.

2. For the sake of convenience, the facts of A.Y. 2007-08 (ITA-8535-2018) are being adverted to, to adjudicate the issue(s) in the appeals.

3. The Respondent Assessee is a private limited company and is a wholly owned subsidiary of M/s. Knorr Bremse Far East Ltd. and is engaged in the business of manufacturing air brake sets of passenger cars and wagon coaches, shock Absorbers for passenger cars and locomotives, distributor

valves, computer control brake system, tread break unit and other brake accessories. The Respondent assessee filed its return of income on 31st October, 2007 declaring total income of ₹1,71,64,832/-. The Transfer Pricing Officer while evaluating the international transactions held that the transactions of professional consultancy, management fee for support services, SAP consultancy charges Sap licence fee and software expenses were required to be separately considered under the CUP method. The transfer price officer proposed an adjustment of Rs.56,157,877/- for professional consultancy services of Rs.15,207,206/- management fee for Support Service of Rs.14,056,800/- Sap Consultancy Charges and other expenses of Rs.26,893,871/- stating that no independent enterprise would be able to pay a portion of its profits before it knows the cost incurred by the service provider and thus the assessee had failed to follow basic principle of independent behavior. However, although the CUP Method was applied by the TPO, no comparable was referred to or adverted to while making the said adjustment. The Assessing Officer passed a draft order based on the observations of the TPO to which the Assessee filed its objections before the DRP. The Assessee specifically objected to the use of the CUP method for evaluation of Intra Group Services contending that the TPO had failed to provide any instance where a service provider is sending its employees incurring travel cost and other overheads and still the third party service provider did not pay anything. The DRP brushed aside the objections filed by the Respondent Assessee holding that the assessee had not been able to substantiate that the payment for the services had increased the profits of the assessee. The Assessing Officer passed the Assessment Order on 3rd October, 2011 making an addition of ₹2,92,64,006/- on account of professional consultancy and management fee of ₹1,61,36,323/- on account of SAP charges after giving benefit of depreciation.

4. The Assessee filed an appeal before the ITAT. The Tribunal vide order dated 31st October, 2012 partly allowed the appeal of the assessee holding that the Sap license and MS Office had been purchased at lower rate as per the finding given by the DRP and hence deleted the addition to that extent all other additions were confirmed. The assessee as well as the department filed appeals bearing ITAs No. 182 of 2013 and 172 of 2013 , respectively, against the order passed by the ITAT before this Court. This Court vide order dated 6th November, 2015 restored the matter back to the Tribunal to decide the matter afresh after considering the evidence filed by the appellant. This Court while setting aside the orders passed by the TPO, DRP and ITAT also held that the approach of the Transfer Pricing Officer was incorrect as the test applied by the Transfer Pricing Officer that the assessee had to demonstrate increase in profits to justify, that the price paid was at arm's length was untenable in law. The ITAT in the 2nd round of litigation concluded as follows:-

i. The Respondent Assessee had engaged the service of the employee of A.E. M/s. George Moll and M/s. Rita Ricken who helped the assessee in material development, development of product as per European Standard, maintenance of CNG Machines and rendered Technical Support to the assessee.

ii. The Respondent Assessee paid only the salary and related cost of the employees and no mark up had been charged by the assessee on the transaction.

iii. The CUP Method applied by the Transfer Pricing Officer without any comparable to substantiate that the A.E. provided similar services to an independent enterprise in comparable circumstances or any instance where comparable services were provided to an independent enterprise in the recipient market was contrary to Income Tax Act and Rules.

iv. That the TNMM Method used by the assessee to evaluate its international transaction was the most appropriate method because it was difficult to apply the Cup Method or cost plus method, therefore, TNMM was the most appropriate method in the absence of cup which is applicable where nature of activities involved, assets used and risk assumed are comparable to those undertaken by an independent enterprise. The ITAT concluded that the assessee had divided its operation into manufacturing and distribution segment and the profit level indicator of OP/sales was disclosed at 9.26 as against five comparable companies of 8.40. Similarly in the distribution segment the assessee through TNMM had shown its OP/Sales at 15.21% as compared to six comparables who had only 3.96% profits. The tribunal thus concluded that the adjustment made by the TPO on account of professional consultancy services and management support services rendered by the employees of the A.E. was not justified.

5. It is against the 2nd order passed by the ITAT that the revenue has filed the present appeal.

6. The following questions of law have been raised in ITA No. 8535 of 2018:-

1.) Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in deleting adjustment made by the TPO on account of Infra Group Services without appreciating that the TNMN is not most appropriate method in determining the ALP of Infra Group Services?

2.) Whether on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in holding that segregation of the transaction of Infra Group Services was not correct and permissible?

3.) Whether on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in

> *ignoring the findings of the TPO/AO that services were not received by the assessee from A.E.?"*

7. It is the contention of Mr. Tajender Joshi, Ld. Counsel for the Revenue that the Tribunal had fallen in error in rejecting the Cup Method employed by the TPO and accepting the TNMM used by the assessee in its transfer pricing analysis. It was also argued that the ITAT has not passed the order as per the directions/ observations given by this Court in the order dated 06-11-2015. He relied on the observations made by this Court in above said order and contended that this court did not held that the CUP method applied by the TPO was wrong and TNM method was required to be applied. The counsel for the revenue further contended that the ITAT had fallen in error in accepting TNMM as the most appropriate method for evaluation of international transactions including Intra Group Services.

8. The Tribunal while deciding the application of method for determining the Arm's Length Price held as under:-

> *"...In the present case, the TPO although applied the CUP method but nothing was brought on record to substantiate that the AE provided the similar services to an independent enterprise in comparable circumstances. He also did not bring on record any instance where comparable services were provided to an independent enterprise in the recipient market. Therefore, in our opinion, in the assessee's case the CUP method was not the most appropriate method. On the contrary, the assessee rightly applied the TNMM method as most appropriate method because it was difficult to apply the CUP method or the cost plus method. Therefore, the TNMM was the most appropriate method in the absence of a CUP which is applicable where the nature of the activities involved, assets used, and risk assumed are comparable to those undertaken by an independent enterprise."*

9. On a pointed query by the Bench whether in terms of Rule 10C read with Section 92C of the Income Tax Act and Rules, the Transfer Pricing Officer had referred to any comparables to apply the Cup Method in the facts and circumstances of the case, the counsel could not indicate any instance where an independent entity had availed of services and had not paid any remuneration for the same.

10. In light of the above, the conclusion of the ITAT could not be faulted as the same was inconsonance with the provisions of the Act and the Rules. The contention of the Counsel for the revenue cannot be accepted as the Tribunal while upholding the TNMM Method has observed that the other methods prescribed under the Act namely the CUP or Cost Plus Method being not applicable in the facts and circumstances of the case, the Respondent Assessee could only resort to TNMM as the most appropriate method to show that its profit margin from international transactions was at arm's length.

11. Further, the Tribunal has concluded that the expenses paid to the employees of the A.E. were in the nature of reimbursement of their salaries without any mark up. Thus, the payment per se was to third party employees and not to any related party for services rendered. In light of the findings of the fact arrived at by the ITAT, the questions of law raised are answered against the revenue and in favour of the assessee.

12. Accordingly, all the three appeals stand dismissed.

(AJAY TEWARI)
JUDGE

10.12.2019
smriti

(VIVEK PURI)
JUDGE

Whether speaking/reasoned : Yes/No
Whether Reportable : Yes/No