IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 03.12.2024

+ **ITA 1242/2011**

CIT – I .....Appellant

versus

M/S. BIRLASOFT LTD ..... Respondent

Advocates who appeared in this case:

For the Appellant : Mr. Gaurav Gupta, Mr. Shivendra Singh, Mr. Yojit Pareek & Mr. Adarsh Singh, Advs.

For the Respondent : Mr. Neeraj Jain, Mr. Aniket D. Agrawal & Mr. Abhishek Singhvi, Advs.

CORAM
HON'BLE MR JUSTICE VIBHU BAKHRU
HON'BLE MS JUSTICE SWARANA KANTA SHARMA

JUDGMENT

VIBHU BAKHRU, J

1. The Revenue has filed the present appeal under Section 260A of the Income Tax Act, 1961 [hereafter *the Act*] impugning an order dated 17.06.2011 [hereafter *the impugned order*] passed by the Income Tax Appellate Tribunal [hereafter *the ITAT*] in ITA No.4001/Del/2009 captioned ***Assistant Commissioner of IT, Circle 3(1), New Delhi v. M/s Birla Soft Limited***, in respect of the assessment year (AY) 2004-05.

2. The Revenue had filed the said appeal [ITA No.4001/Del/2009] for assailing the order dated 28.07.2009 passed by the learned

Commissioner of Income Tax (Appeals) [hereafter *CIT(A)*] in respect of the AY 2004-05, essentially on three grounds. First, that the learned CIT(A) had erred in deleting the Transfer Pricing Adjustment of ₹4,95,51,723/- as directed by the Transfer Pricing Officer (TPO) under Section 92CA(3) of the Act. Second, in respect of the learned CIT(A)'s decision to delete an addition of ₹19,26,120/- on account of prior period expenses. And third, relating to allowing deduction under Section 10A of the Act in respect of the Assessee's income relating to its new undertaking. However, the learned ITAT had not found any merit in the said appeal and accordingly, dismissed the same.

QUESTIONS OF LAW

3. This Court admitted the present appeal by an order dated 29.11.2011, on the following questions of law:

> "(1) Whether the Income Tax Appellate Tribunal was right in holding that the "second unit" is entitled to deduction under Section 10A of the Income Tax Act, 1961 and was not a part or mere extension of the "first unit"?
>
> (2) Whether the directions given by the Income Tax Appellate Tribunal for computation and exemption under Section 10A of the Income Tax Act, 1961 are in accordance with law and as per the said provisions?
>
> (3) Whether the Income Tax Appellate Tribunal was right in setting aside the order of the Assessing Officer on the question of transfer pricing on the following accounts:
>
> (a) Benchmarking was to be done separately and the profits had to be determined of the entity as a whole.

(b) FAR analysis in respect of three units was not possible.

(c) There were functional differences between the three units.

(4) Whether the Income Tax Appellate Tribunal was correct in law in holding that expenditure of Rs.19,26,120/- was not prior period expenditure and was allowable in the year in question?"

FACTUAL CONTEXT

4. Before proceeding further, it would be relevant to briefly note the factual context in which the aforesaid questions of law arise.

5. The Assessee was incorporated under the Companies Act, 1956 and is engaged in the business of software development and related services. The Assessee has six units, which includes three units, that have been set up under the Software Technology Park (hereafter *STP*) Scheme. Two of its units are located overseas – one in Singapore and the other in Australia.

6. The brief description of the Units registered under the STP Scheme with Software Technology Parks of India (STPI) – (hereafter referred to as *STP Units*) – are as under:

(i) Birlasoft
Software Technology Park
Block-III, 2nd Floor
Ganga Shopping Complex,
Sector-29, NOIDA-201303
(hereafter **NOIDA-I unit**)

(ii) Birlasoft (GE-GDC)

Software Technology Park
Block-III, 3rd Floor
Ganga Shopping Complex,
Sector-29, NOIDA-201303
(hereafter **NOIDA-II unit**)

(iii) Birlasoft
36, Vijayaraghava Road, 3
T. Nagar, Chennai."
(hereafter **Chennai unit**)

7. The Assessee claimed deduction under Section 10A of the Act in respect of its STP Units including for an amount of ₹7,71,19,580/- in respect of NOIDA-II unit [Birlasoft (GE-GDC) located at Software Technology Park, Block-III, 3rd Floor, Ganga Shopping Complex, Sector-29, Noida-201303] and an amount of ₹1,16,03,823/- in respect of NOIDA-I unit [located at Software Technology Park, Block-III, 2nd Floor, Ganga Shopping Complex, Sector-29, Noida-201303]. The Assessee also furnished certificates from the Chartered Accountant in Form No. 56F as per Rule 16D of the Income Tax Rules, 1962 (hereafter *the Rules*).

8. The Assessee had entered into international transactions with its associated enterprises (hereafter *AE's*) to provide software services, which were in the nature of developing and supplying customized software and related software services during the financial year (FY) 2003-2004 relevant to the AY 2004-2005.

9. The Assessee filed its return of income for the AY 2004-05 on 01.11.2004 enclosing from – disclosing the following international transactions with its AE's.

"S.No.	Description of transaction	Method	Value (in Rs.)
1.	Software development services	TNMM	1,53,16,98,060
2.	Chargeback of expenses by AEs		3,31,30,369
3.	Chargeback of expenses by AEs		4,01,580"

ASSESSMENT ORDER

10. The return filed by the Assessee was selected for scrutiny. The Assessing Officer (hereafter *AO*) issued a notice under Section 143(2) of the Act calling upon the Assessee to furnish certain information. The Assessee also issued another notice as to why the NOIDA-II unit should not be considered as an extension of its existing STP unit. The AO also made a reference to the TPO in respect of the Assessee's international transactions for determination of the Arm's length Price (ALP).

11. During the course of the assessment proceedings, the AO found that the tax audit report furnished by the Assessee indicated that it had incurred prior period expenses of ₹19,26,120/- and, accordingly, the AO disallowed the same.

12. Insofar as the Assessee's claim that it had established a new STP unit is concerned, the AO found that the Assessee had set up NOIDA-I unit (a STP unit on the second floor of Block-III, Sector-29, Noida), and was conducting its business of software development and services from

the said unit. Subsequently in the year 2001, the Assessee had set up another unit (NOIDA-II unit) on the third floor of the same building – Block III, Sector-29, Noida for carrying on the same business. The AO held that NOIDA-II unit was a mere extension of the existing STP unit (NOIDA-I unit) and could not be considered as a new undertaking eligible under Section 10A of the Act. The AO further held that even if NOIDA-II is considered as a separate unit, deduction under Section 10A of the Act could not be allowed as the business carried on by NOIDA-II unit was identical to the business that was carried out from NOIDA-I unit that was established earlier on the second floor of Block-III, Sector-29, Noida. The STP registration of NOIDA-I unit was valid till the year 2005 and accordingly, the AO held that no deduction would be available to the Assessee under Section 10A of the Act in respect of NOIDA-I unit as well as NOIDA-II unit with effect from AY 2005-06. However, no addition was made as according to the AO, the new unit (NOIDA-II unit) was an extension of the extant second floor STP unit (NOIDA-I unit).

TRANSFER PRICING ADJUSTMENT

13. Before the TPO, the Assessee submitted its benchmark studies. The Assessee benchmarked its international transactions using Transactional Net Margin Method (TNMM) with the ratio of Operating Profit (OP) to Total Cost [OP/TC] as the profit level indicator (PLI).

14. The Assessee had selected several comparable entities (twenty-four in numbers). It had computed the mean PLI of the comparable

entities at 11.7% and its PLI at 13.86%. The TPO conducted its own studies and finalized a list of thirteen comparable entities and determined the mean PLI of the comparable entities at 14.01%.

15. The Assessee was thereafter asked to submit segmental accounts and reconcile the same with the profit and loss account. The TPO then examined the unit wise operating margins for each of the three STP units both from transactions with related entities and unrelated entities. The TPO also examined the profit margins of non-STP units. A comparison of the operating margins of the controlled transactions and uncontrolled transactions indicate the profit margin of the controlled transaction was higher than the internal comparable uncontrolled transactions. However, the TPO concluded that the segmental accounts were not credible, and therefore it was not feasible to explore the possibility of using the comparable uncontrolled price method (CUP Method) using internal comparable transactions. The TPO then proceeded to determine the transfer pricing adjustment in respect of each of the STP units. The TPO found that the profit margin of the new unit (NOIDA-II unit) was 17.11% and therefore no transfer pricing adjustments were recommended in respect of the said unit. However, in respect of the other two units [NOIDA-I unit and Chennai unit], the PLI was lower and the TPO directed the transfer pricing adjustment for amounts of ₹2,27,05,996/- and ₹2,68,45,727/- in respect of the aforesaid STP units. Thus, in aggregate an addition of ₹4,95,51,723/- was directed to be made to the Assessee's income.

16. Accordingly, the AO passed an assessment order dated 28.12.2006 computing the total income of the Assessee at ₹13,97,49,284/-.

CIT(A)'S ORDER

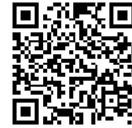
17. Aggrieved by the assessment order dated 28.12.2006, the Assessee preferred an appeal before the learned CIT(A) being Appeal No. 142/2007-08.

18. Insofar as disallowance of exemption under Section 10A of the Act with effect from AY 2005-06 is concerned, the learned CIT(A) allowed the Assessee's appeal based on the order dated 23.07.2009 passed by the learned ITAT in the Assessee's case for AY 2003-04.

19. The learned CIT(A) accepted that NOIDA-II unit was an undertaking that was eligible for deduction for the purposes of Section 10A of the Act. The learned CIT(A) held that in view of the said finding, the Assessee's claim that the income from NOIDA-II unit was eligible for deduction under Section 10A of the Act, was required to be allowed.

20. The learned CIT(A) also allowed the Assessee's claim in regard to the expense of ₹19,26,120/- on the ground that the said liability was crystallized in June, 2003 and thus was not a prior period expense.

21. Insofar as the transfer pricing adjustments are concerned, the learned CIT(A) held that the benchmarking of international transactions in respect of the provision of software development services by the



Assessee ought to be undertaken at an entity level and not unit wise. The learned CIT(A) also found that the Assesses's PLI of 10.91% fell within the acceptable range, as provided under the second proviso to Section 92C(2) of the Act, of the mean PLI of 14.01% of the comparable entities as computed by the TPO. Accordingly, the additions made by the TPO on account of transfer pricing adjustments were deleted.

22. As noted above, the learned ITAT declined to interfere with the learned CIT(A)'s order dated 28.07.2009.

QUESTIONS NOS. 1 AND 2

23. The principal issue to be addressed is whether NOIDA-II unit is not eligible for the benefit of deduction under Section 10A of the Act on account of the exclusionary clauses as stipulated under sub-section (2) of Section 10A of the Act. The relevant extract of Section 10A of the Act is set out below:

> "**10A. Special provision in respect of newly established undertakings in free trade zone, etc**.— (1) Subject to the provisions of this section, a deduction of such profits and gains as are <u>derived by an undertaking</u> from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee:
>
> *** *** ***

(2) This section applies to any undertaking which fulfils all the following conditions, namely:—

*** *** ***

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertakings as is referred to in section 33B, in the circumstances and within the period specified in that section;

(iii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation—The provisions of *Explanation* 1 and *Explanation* 2 to sub-section (2) of section 80-I shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.**”**

*** *** ***

24. The Explanation I and Explanation II to Section 80I of the Act which are equally applicable to clauses (ii) and (iii) of Section 10A (2) of the Act are set out below:

“Explanation 1.—For the purposes of clause (ii) of this sub-section, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:— (a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India; (b) such machinery or plant is imported into India from any country outside India; and (c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the

> total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.
>
> Explanation 2.—Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been complied with."

25. As noted above, the AO had observed that the Assessee was not entitled to deduction under Section 10A of the Act in respect of NOIDA-II unit on the ground that it was a mere extension of the existing unit (NOIDA-I unit) located at one floor below in the same building where NOIDA-II unit was established. The AO had also noted that both the existing units (NOIDA-I unit and NOIDA-II unit) were carrying on the same business. According to the Assessee, the new unit was catering only to one customer, namely GE-GDC, with regard to the provision of software development services. The AO reasoned that since the Assessee had claimed that NOIDA-II unit was set up to increase the client base, it was a mere extension of the existing unit (NOIDA-I unit) of the Assessee. According to the AO, an undertaking established to carry on the same business was ineligible for deduction under Section 10A of the Act.

26. Additionally, the AO had also noted that the period for which the benefit of Section 10A of the Act, was available to NOIDA-I unit would

lapse in the year 2005 and would not be available from the following assessment year.

27. NOIDA-II unit was set up in the year 2001 and it commenced its operations in April, 2001. The income from NOIDA-II unit was a subject matter of assessment of income for the FY 2001-02 relevant to AY 2002-03. During the said period deduction under Section 10A of the Act was allowed by the AO in respect of the AY 2002-03.

28. The Assessee had also explained that in the year 1999, General Electric (GE) had acquired certain equity stake in Birlasoft. In partnership with GE, Birlasoft had prepared an aggressive business plans for its growth. The seating capacity at the Assessee's NOIDA-I unit was a constraint to meet its growth plans as the same was limited to only 300 (three hundred) seats, which was found to be insufficient for the company's growth. Accordingly, the Assessee had taken the third floor of the same building (Block-III, Sector-29, Noida) on a long-term lease from NOIDA (New Okhla Industrial Development Authority) to set up a new facility. The Assessee had thereafter, applied for registration of NOIDA-II unit with STPI (Software Technology Parks of India) in November, 2000 which was granted by the STPI in December, 2000.

29. The Assessee explained that it had made an investment of ₹84,226,317/- for creation of the new facility and its gross block at the end of the FY 2001-02 had increased to ₹16,84,28,800/-. According to the Asssessee, this established that its gross block had practically

doubled in the FY 2001-02 as compared to the FY 2000-01. The Assessee had also explained that with the addition of NOIDA-II unit, the total seating capacity increased from 300 seats to 700 seats and the effect of the same was apparent from the revenue for the year 2001-02, which had also doubled as compared to the previous year 2000-01.

30. The Assessee explained that the revenue growth could be achieved only due to substantial support from its equity partner GE. The Assessee had also substantiated its claim by furnishing the figures of turnover for the previous years. However, the AO was not persuaded to accept the same.

31. The AO also relied on the findings of the learned CIT(A) in respect of the proceedings relating to the AY 2003-2004, rejecting the Assessee's contention.

32. It is important to note that the issues relating to the assessment proceedings pertaining to the AY 2003-04 had travelled to the learned ITAT (ITA Nos. 3821/Del/2006 & 3919/Del/2006) and by an order dated 27.03.2009, the learned ITAT had set aside the orders passed by the learned CIT(A) for the AY 2003-04. The learned ITAT had accepted the Assessee's claim that it had set up a new unit and income from the same was eligible for deduction under Section 10A of the Act. The learned ITAT had held that the new STP unit (NOIDA-II unit) was not an extension of existing unit (NOIDA-I unit).

33. Thus, following the earlier decision in the Assessee's own case for the AY 2003-04, the learned CIT(A) rejected the AO's findings that the Assessee's new STP unit (NOIDA-II unit) fell within the exclusionary clauses of Section 10A of the Act and thus was ineligible for deduction under the said section.

34. The learned ITAT, following its earlier decision, concurred with the view of the learned CIT(A) and rejected the Revenue's appeal [ITA 401/DEL/2009] by the impugned order.

35. The facts as set out by the Assessee for deduction under Section 10A of the Act in respect of NOIDA-II unit are not in dispute. It is apparent from the facts and figures as furnished by the Assessee that its gross block at the end of FY 2002 had practically doubled. The seating capacity had increased from 300 (three hundred) to 700 (seven hundred). The Assessee had also claimed that NOIDA-II unit was operated separately from the unit located at the second floor of the same building (NOIDA-I unit).

36. There is no dispute that the Assessee was carrying on the same business, however, it is not necessary that in order to be eligible for deduction under Section 10A of the Act, the new undertaking must be in a different field of business. There is no such stipulation under Section 10A of the Act

37. The Assessee's claim that the new unit (NOIDA-II unit) was independent and separate from NOIDA-I unit and its revenues for the

FY 2001-02 to 2003-04 were higher than the revenue from NOIDA-I remains uncontroverted.

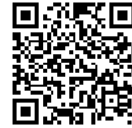
38. The turnover of NOIDA-I unit and the new unit (NOIDA-II unit) as mentioned in the assessment order is set out below:

Previous Year	NOIDA-I unit	NOIDA-II unit	Total
2001-2002	65,757,615	182,479,051	248,236,666
2002-2003	127,172,783	366,056,785	493,229,568
2003-2004	193,491,959	562,387,930	755,879,889

39. Plainly, this is not a case where a separate unit has been formed by shifting the business from an existing STP unit at the far end of the exemption period solely for the purpose of continuing to avail the benefit under the Act. Although, the AO did suggest the same. But there are no facts to support this view. The learned counsel appearing for the Revenue had also sought to canvas the same, however, was unable to refer to any factual finding that would support the said view.

40. In ***Textile Machinery Corpn. Ltd. v. CIT***[1], the Supreme Court had examined the exclusionary clause under Section 15C of the Indian Income Tax Act, 1922. Under the said Section, tax was not payable by an assessee on profits not exceeding 6% per annum on the capital employed in a new industrial undertaking. The said benefit was available to the new industrial undertaking, which was not formed by splitting up, or the reconstruction of business already in existence or by

[1] (1977) 107 ITR 195



the transfer to a new business of building, machinery, or plant, previously used in any other business[2].

41. In the aforesaid context, the Court observed as under:

> "… No hard and fast rule can be laid down. Trade and industry do not run in earmarked channels and particularly so in view of manifold scientific and technological developments. There is great scope for expansion of trade and industry. **The fact that an assessee by establishment of a new industrial undertaking expands his existing business, which he certainly does, would not, on that score, deprive him of the benefit under Section 15-C. Every new creation in business is some kind of expansion and advancement. The true test is not whether the new industrial undertaking connotes expansion of the existing business of the assessee but whether it is all the same a new and identifiable undertaking separate and distinct from the existing business.** No particular decision in one case can lay down an inexorable test to determine whether a given case comes under Section 15-C or not. In order that the new undertaking can be said to be not formed out of the already existing business, there must be a new emergence of a physically separate industrial unit which may exist on its own as a viable unit. An undertaking is formed out of the existing business if the physical identity with the old unit is preserved. This has not happened here in the case of the two undertakings which are separate and distinct."

42. In ***Bajaj Tempo Ltd., Bombay v. CIT***[3]– a decision rendered in the context of the exclusionary clause under Section 15C of the Indian Income Tax Act, 1922 which is similar in its import as the exclusionary clauses (ii) and (iii) of sub-section (2) of Section 10A of the Act – the Supreme Court referred to the earlier decision of the ***Textile Machinery***

[2] Section 15C(2)(i) of the Indian Income Tax Act, 1922
[3] 1992 (196) ITR 188

***Corpn. Ltd. v. CIT*[1]** and explained that the emphasis of the Court was on the expression "not formed" and the same was "*construed to mean that the undertaking should not be a continuation of the old but emergence of a new unit*." The Supreme Court further observed that "*the initial exercise, therefore should be to find out if the undertaking was a new one. Once this test is satisfied then clause (i) should be applied reasonably and liberally in keeping with the spirit of Section 15C(1) of the Act*".

43. We also consider it apposite to refer to the following extract from the opinion of Masud J. of the Calcutta High Court in ***Commissioner of Income Tax, West Bengal I v. Indian Aluminium Co. Ltd***.[4], which was also rendered in the context of Section 15C of the Indian Income Tax Act, 1922:

> "If the assessee's original business remains intact and retains its original character and the assessee establishes separate independent undertakings whether of the same or different nature in respect of the same or different commodity the subsequent undertakings cannot be called "reconstruction" within the meaning of section 15C(2)(i). **The newness of subsequent industrial undertaking does not necessarily exclude all cases of expansion or extension of the original business.** To illustrate, where the original business is only extended or expanded or developed by the assessee in the same building or enclosure with a proportionately smaller capital or where the transactions of the original business and the extended business are of such a nature that they are dependent on one another or where the requirements of the original business are subserved substantially by the product of subsequent undertakings, it may be said that such expansions

[4] (1973) 88 ITR 257

cannot have the benefit of exemption under section 15C. **But where the assessee invests large sums of money and establishes new production units of similar or different nature as a result of which the original business of the assessee does not intrinsically alter its original character or continues to produce, manufacture or carry on the original activity in the same way even after the establishment of subsequent undertakings, the latter may be called extensions of such a nature which may be called a kind of new industrial undertaking which is entitled to get tax relief.** Thus whether the term "reconstruction" would include the case of substantial extensions or expansions of the assessee's original business so as to invoke the benefit or mischief under section 15C would depend upon the facts of each case. Exemption under section 15C would only be available to those industrial undertakings which are not established by division or reorientation of the assessee's original business or Which has not been formed by the transfer to it of building, machinery or plant used in the assessee's original business. The emphasis should be laid on the words "is formed by" and not the form of subsequent undertaking. To obtain relief under section 15C, the subsequent undertaking must not be formed or constituted by remodelling or reconstituting the earlier business. It is significant that, apart from the head-note, the words "new business" have only been specifically mentioned in the case of transfer of building, machinery or plant used in the original business. Thus the new, separate or independent character of subsequent business is relevant but not important elements in construing the word "reconstruction". Even any enlargement or expanded unit may be called "new industrial undertaking" in the sense that the subsequent unit was not originally existing but the new undertaking must be understood in the context of the word "reconstruction". The legal meaning of the term "reconstruction" is, in my opinion, a mixed question of fact and law. It will be incorrect to say that "reconstruction" must include or exclude all kinds of expansions, irrespective of the nature constitution or character of the subsequent undertaking. All the facts relating to the original business and the subsequent undertaking, as found by the Tribunal, have to be

> examined before a decision is made on the question whether an assessee is entitled to get relief under section 15C Where, therefore, the activities or the business of the subsequent undertaking show substantial expansions they may be called industrial undertakings which are not formed by the reconstruction of the assessee's original business."

44. A.N. Sen J. penned a separate but concurring opinion in ***Commissioner of Income-Tax, West Bengal I v. Indian Aluminium Co. Ltd.***[4] It is relevant to refer to the following extract of the said decision:

> "54. I do not see any logic in the contention that the benefit under section 15C can only be granted in respect of an industrial undertaking of an assessee, if the assessee chooses to carry on a kind of a business different from the one which is being carried on by the assessee. The intention of the legislature, to my mind, is to grant tax relief to industrial undertakings, which must, of course, satisfy the requirements of the section. The object was to promote industrial development of the country by employment of fresh capital by setting up new industrial undertakings. It does not appear from the language of the section that the legislature intended that an assessee must diversify its industrial activity and must not develop its existing business by setting up new industrial undertakings. <u>An assessee, experienced and well-versed in the manufacture and trade of a particular commodity, is usually expected to develop the industry with which the assessee is familiar. He is likely to set up new industrial undertakings for further development of its existing industry and he may not be inclined to risk his capital by setting up an industrial undertaking for the manufacture and trade of a different commodity about which he has no experience. All that is required of an assessee to claim relief under section 15C is that he must satisfy the requirements of the said section and the industrial undertaking in respect of which he claims relief is not</u> formed by the splitting up, or the reconstruction of, business already in existence or by the transfer to a new

> business of building, machinery or plant used in a business which was being carried on before the 1st day of April, 1948 (now amended retrospectively by the Finance Act of 1959 as "previously used in any other business"). In the facts of the instant case the industrial undertakings in question cannot be said to have been formed by the reconstruction of business already in existence only because the newly set up units manufacture and produce the same commodity, viz., aluminium ingots. The ultimate end product of the industrial undertaking is not of any material consequence in judging whether the industrial undertaking has been formed by the reconstruction of business already in existence. The stage which is relevant and has to be considered is the stage of formation of the industrial undertaking and not the stage when the industrial undertaking goes into manufacture."
>
> [Emphasis added]

45. In the present case, the fact that NOIDA-II unit was engaged in the same business is not dispositive of the question whether the said undertaking does not fulfil the criteria as specified in Clauses (ii) and (iii) of sub-section (2) of Section 10A of the Act. The Assessee had explained that it would set up the new undertaking to cater to its growth plans. It had hired a separate space from NOIDA (New Okhla Industrial Development Authority) for establishing the said unit. It had made an investment in the additional assets for setting up the said unit and resultantly not only the Assessee's gross block but also the seating capacity had doubled. As noted before, the Assessee's claim that the sitting capacity had increased from 300 seats to 700 seats with the establishment of the new undertaking (NOIDA-II unit) has not been controverted.

46. It is also material to note that the learned ITAT had in its order dated 27.03.2009 in respect of the AY 2003-04 considered the question as to whether the new STP unit (NOIDA-II unit) was formed as a result of reconstruction of the existing business and had rejected the same. The relevant passage of the said order as set out in the written submissions filed on behalf of the Assessee – which was expressly admitted by the learned counsel for the Revenue during the course of the hearing – is reproduced below:

> "2.9 We have considered the rival submissions and also perused the relevant material on record. It is observed that the claim of assessee for deduction under section 10A in respect of profits derived from the new STP unit known as GE-GDC was disallowed by the Assessing Officer on the ground that the said unit was set-up as a result of reconstruction of the existing business of the assessee company. In his impugned order, the learned CIT(Appeals) however held that the said new unit was not set-up by theassessee company by way of reconstruction or splitting up of the unit already in existence. In its appeal by revenue against the said order of learned CIT(Appeals), the decision so rendered by learned CIT(Appeals) has not been challenged and the same, therefore, has become final. The learned CIT(Appeals), however, further held that the establishment of a new unit by the assessee company was a part of expansion of its existing unit and since both these units were entitled for deduction under section 10A, the said deduction should be computed on the combined profit of both these units treating the same as one unit. He, however, has not given any reason whatsoever or has not referred to any provisions of the Act to support his conclusion that both the units should have been treated as one unit for the purpose of computing deduction under section 10A.
>
> 2.10 At the time of hearing before us, the learned counsel for the assessee has relied on the various judicial pronouncements wherein it was held that where a new undertaking has been formed

> with fresh capital and investment with a motive to increase the production capacity and expand its business, then it cannot be said that the new undertaking was not the new industrial unit by itself. It was also held that establishment of new industrial unit as a part of already existing industrial establishment may result in an extension of the industry, but if the newly established unit itself is an integrated unit in which new plant and machinery are put up and the same itself independently of the old unit capable of production of goods, then it can be classified as a newly established industrial undertaking. This makes it abundantly clear that even if the new unit was established by the assessee company as expansion of its existing unit, a substantial fresh capital having been invested in the said unit and it was capable of doing business of its own independent of the old unit, the same was eligible to be treated as a newly established undertaking. In our opinion, the learned CIT (Appeals) thus was not correct in holding that both the units were liable to be treated as one unit for the purpose of computing deduction under section 10A."

47. Admittedly, the Revenue had accepted the aforesaid findings of the learned ITAT, which is evident from the fact that the Revenue had not appealed the said finding. Significantly, the Revenue had filed an appeal before this court (being ITA No.71/2010) but had not proposed any question of law with regard to the ineligibility of the new STP unit (NOIDA-II unit) for deduction under Section 10A of the Act. The Revenue's appeal (ITA No.71/2010) was dismissed by this court by an order dated 06.01.2011.

48. It is material to note that the benefit under Section 10A is in respect of an undertaking and not the assessee. In ***CIT v. Yokogawa India Limited***[5], the Supreme Court had held as under:

---

[5] (2017) 391 ITR 274

17. From a reading of the relevant provisions of Section 10-A it is more than clear to us that the deductions contemplated therein are qua the eligible undertaking of an assessee standing on its own and without reference to the other eligible or non-eligible units or undertakings of the assessee. The benefit of deduction is given by the Act to the individual undertaking and resultantly flows to the assessee. This is also more than clear from the contemporaneous Circular No. 794 dated 9-8-2000 which states in para 15.6 that,

> "The export turnover and the total turnover for the purposes of Sections 10-A and 10-B shall be of the undertaking located in specified zones or 100% export-oriented undertakings, as the case may be, and this shall not have any material relationship with the other business of the assessee outside these zones or units for the purposes of this provision".

18. If the specific provisions of the Act provide [first proviso to Sections 10-A(1); 10-A(1-A) and 10-A(4)] that the unit that is contemplated for grant of benefit of deduction is the eligible undertaking and that is also how the contemporaneous circular of the department (No. 794 dated 9-8-2000) understood the situation, it is only logical and natural that the stage of deduction of the profits and gains of the business of an eligible undertaking has to be made independently and, therefore, immediately after the stage of determination of its profits and gains. At that stage the aggregate of the incomes under other heads and the provisions for set off and carry forward contained in Sections 70, 72 and 74 of the Act would be premature for application. The deductions under Section 10-A therefore would be prior to the commencement of the exercise to be undertaken under Chapter VI of the Act for arriving at the total income of the assessee from the gross total income. The somewhat discordant use of the expression "total income of the assessee" in Section 10-A has already been dealt with earlier and in the overall scenario unfolded by the provisions of Section 10-A the aforesaid discord can be reconciled by understanding the expression "total income of the assessee" in Section 10-A as "total income of the undertaking".

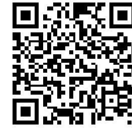
49. The question whether a new undertaking has been set up, which is eligible for deduction under Section 10A of the Act is, therefore, most relevant in the initial year of operation. In ***CIT v. Heartland Delhi Transcription Services Private Limited (2015) 228 Taxmann 326 (Del)***, this court had in the context of Section 10B of the Act – which includes similar exclusionary clauses – observed as under:

> 10. Sub-section (1) refers to deduction of profit and gains of an undertaking. The deduction is to be allowed for a period of 10 years from the year in which undertaking begins to manufacture, produce etc. articles, things or computer software. The beginning and end points for claiming the deduction are stipulated. These have reference to the eligible undertaking. Sub-clause (ii) to Section 10B(2) incorporates a negative condition and states that the undertaking must not be formed by splitting up or reconstruction of business already in existence. Clause (ii) refers to the date on which the undertaking mentioned in sub-section (1) is created or formed. On the date of formation, the undertaking should not violate the condition stipulated in clause (ii) i.e. that it should not be created by splitting up or reconstruction of a business already in existence. Clause (ii) does not have any reference to the period of 10 years stipulated in sub-section (1) to Section 10B, after an undertaking is formed or created without violation of clause (ii) to Section 10B(2). Clause (ii) to Section 10B(2) does not apply to the period, post formation of the undertaking, covered under sub- section (1), when the undertaking which at the time of formation meets the requirements of clause (ii) to Section 10B(2). The undertaking, of course meet the requirements and fulfil the condition that it manufactures or produces articles, things or computer software during the assessment year. The proviso equally supports the said interpretation as it also refers to the date of formation of the undertaking, for seeking benefit under Section 10B(1). The requirements under clauses (ii) and (iii) in this manner do not relate to the subsequent period, i.e. post or after formation.

50. Clearly, once the Revenue accepts in the initial year of operation that a new undertaking has been set up and does not fall within the exclusionary clauses – that is, it is not formed by the splitting up, or the reconstruction of an extant business or by transfer to a new business of machinery or plant previously used for any purpose – the controversy must rest for future years as well. This is of course subject to the condition that no additional material or facts, which establish otherwise are found subsequently. It would be debilitating to the rule of consistency and certainty in the matter of taxation, if the question of eligibility of a unit is permitted to be re-agitated on the same set of facts despite the Revenue having accepted the findings – which are essentially factual findings – in favour of the Assessee in the initial year(s). It is difficult to accept that the Revenue could accept a set of facts in one year and yet challenge the same in another, without any change in circumstances or any new fact coming to light.

51. The proceeding relating to each assessment year are separate and it is settled law that the principle of *res judicata* does not apply to the subsequent assessment proceedings. However, this is a fit case where it would be apposite to apply the principles enunciated by the Supreme Court in the case of ***Radhasoami Satsang Saomi Bagh, Agra v. CIT: (1992) 193 ITR 321 SC***. In the said case, the Supreme Court had observed as under:

> "**13.** One of the contentions which the learned senior counsel for the assessee-appellant raised at the hearing was that in the absence of any change in the circumstances, the

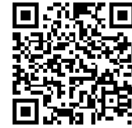


Revenue should have felt bound by the previous decisions and no attempt should have been made to reopen the question. He relied upon some authorities in support of his stand. A Full Bench of the Madras High Court considered this question in *T.M.M. Sankaralinga Nadar & Bros.* v. *CIT* [4 ITC 226 (Mad) (FB)] . After dealing with the contention the Full Bench expressed the following opinion:

> "The principle to be deduced from these two cases is that where the question relating to assessment does not vary with the income every year but depends on the nature of the property or any other question on which the rights of the parties to be taxed are based, e.g., whether a certain property is trust property or not, it has nothing to do with the fluctuations in the income; such questions if decided by a Court on a reference made to it would be res judicata in that the same question cannot be subsequently agitated."

14. One of the decisions referred to by the Full Bench was the case of *Hoystead* v. *Commissioner of Taxation* [1926 AC 155 (PC) : (1925) All ER Rep 56] . Speaking for the Judicial Committee Lord Shaw stated:

> "Parties are not permitted to begin fresh litigation because of new views they may entertain of the law of the case, or new versions which they present as to what should be a proper apprehension by the court of the legal result either of the construction of the documents or the weight of certain circumstances. If this were permitted, litigation would have no end, except when legal ingenuity is exhausted. It is a principle of law that this cannot be permitted and there is abundant authority reiterating that principle. Thirdly, the same principle, namely, that of setting to rest rights of litigants, applies to the case where a point, fundamental to the decision, taken or assumed by the plaintiff and



> traversable by the defendant, has not been traversed. In that case also a defendant is bound by the judgment, although it may be true enough that subsequent light or ingenuity might suggest some traverse which had not been taken."

These observations were made in a case where taxation was in issue.

15. This Court in *Parashuram Pottery Works Co. Ltd.* v. *ITO* (1977) 1 SCC 408 stated:

> "At the same time, we have to bear in mind that the policy of law is that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity."

Assessments are certainly quasi-judicial and these observations equally apply.

16. We are aware of the fact that strictly speaking res judicata does not apply to income tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year.

17. On these reasonings in the absence of any material change justifying the Revenue to take a different view of the matter — and if there was no change it was in support of the assessee — we do not think the question should have been reopened and contrary to what had been decided by the Commissioner of Income Tax in the earlier proceedings, a different and contradictory stand should have been taken. We are, therefore, of the view that these appeals should be allowed

> and the question should be answered in the affirmative, namely, that the Tribunal was justified in holding that the income derived by the Radhasoami Satsang was entitled to exemption under Sections 11 and 12 of the Income Tax Act of 1961.
>
> **18.** Counsel for the Revenue had told us that the facts of this case being very special nothing should be said in a manner which would have general application. To are inclined to accept this submission and would like to state in clear terms that the decision is confined to the facts of the case and may not be treated as an authority on aspects which have been decided for general application.

52. We find no infirmity with the decision of the learned ITAT in upholding the view that NOIDA-II unit was entitled to deduction under Section 10A of the Act in respect of its profits and gains derived from NOIDA-I unit.

53. In view of the above, question Nos. 1 and 2 are answered in favour of the Assessee and against the Revenue.

RE: QUESTION NO. 3

54. The Revenue, essentially, questions the decision of the learned CIT(A) to delete the additions made on account of transfer pricing adjustments as directed by the TPO in its order under Section 92CA(3) of the Act. The learned ITAT had upheld the decision of the learned CIT(A), which has led the Revenue to file an appeal before this court. It is material to note that there were certain issues, which were raised before the TPO as well as the learned CIT(A) including the issue regarding use of the current year's data of the comparable entities and

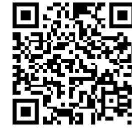
the selection of comparables. However, none of those issues have been pressed before this court. The controversy before this court is confined to the correctness of the decision to determine the ALP at an entity level instead of separately for each of the three STP units in question.

55. The TPO had determined the PLI (operating profit over total cost) in respect of each of the three STP units and had proceeded to determine the quantum of ALP adjustment as required for each of the three separate units. The TPO found that the PLI of NOIDA-II unit was higher than the mean PLI of the comparable entities. The TPO accepted that the said international transactions were on arm's length basis; therefore, concluded that no ALP adjustment in respect of the international transactions pertaining to NOIDA-II unit was necessary. However, in respect of remaining STP units (NOIDA-I unit and Chennai unit), the TPO found that the PLI was significantly lower than the mean PLI of comparable entities. Accordingly, the TPO directed that the TP adjustments be made in respect of international transactions pertaining to the said two STP units.

56. As noted hereinbefore, the learned CIT(A) faulted the TPO for conducting the benchmark analysis for each unit separately rather than at an entity level. This dispute is at the heart of the question of law as raised in the present appeal. The learned counsel for the Revenue has also confined the present appeal insofar as it relates to question no.3 to the said issue.

57. The learned CIT(A) had sustained the Assessee's challenge to the TP adjustment as directed by the TPO, *inter alia*, on the ground that there was no significant functional difference in the software development and maintenance services. The services rendered by the STP units were rendered to the same AEs of the Assessee – Birla Soft Inc. US and Birla Soft UK. The terms and conditions for rendering the services was also covered under a single agreement entered into with the AEs. There was unity of funds and management. And, the PLI's of the comparable transactions were computed at an enterprise level and not at the undertaking level. The learned ITAT accepted that the PLI was required to be computed at entity level and not at the level of the units and held that the TPO had erred in ignoring the unity of the business, administrative control and unity of funds. The learned ITAT further held that independent FAR analysis of each unit with the comparable entities was not practically possible because of the common management and interlacing of funds.

58. It was contended by Mr Gupta, the learned counsel for the Revenue that the conclusions of the learned CIT(A) and the learned ITAT were *ex facie* erroneous as it was the Assessee's case that each of its STP units was a separate undertaking. The Assessee had also claimed that the profits derived from NOIDA-I unit and NOIDA-II unit were eligible for deduction under Section 10A of the Act. This necessarily entailed that the profits and gains derived by the Assessee from those undertakings were required to be separately computed. He also submitted that computing the ALP on an entity level would enable the



Assessee to its transfer business with the higher profit margin to the new undertaking while retaining the business transaction with lower margin with other undertakings that do not enjoy the benefit of deduction under Section 10A of the Act. He also referred to the observations made by the Supreme Court in ***CIT v. Glaxo Smithkline Asia (P.) Ltd***.[6], where the Supreme Court had made observations that transfer pricing regulations should not be limited to cross border transactions and should be extended to domestic transactions as well. The court had also highlighted that in domestic transactions, under-invoicing and over-invoicing would be Revenue neutral except in the cases where there were different rates for related units. The relevant extract of the said decision, which was referred to by the learned counsel, is set out below:

> "3. However, we direct the Authorities to examine as to whether there is any loss of revenue in any of the assessment years in question. If, however, the Authorities find that the exercise is a revenue neutral exercise, then the matter may be decided, accordingly. We say no more in that regard.
>
> 4. However, a larger issue is involved in this case. The main issue which needs to be addressed is, whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions. In the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage—

[6] (2010) 195 Taxmann 35 (SC)

> (i) If one of the related Companies is loss making and the other is profit making and profit is shifted to the loss making concern; and
>
> (ii) If there are different rates for two related units (on account of different status, area based incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage. For example, sale of goods or services from non-SEZ area (taxable division) to SEZ unit (non-taxable unit) at a price below the market price so that taxable division will have less profit taxable and non-taxable division will have a higher profit exemption."

59. He submitted that under Section 92 of the Act, the benchmarking was required to be done for an international transaction and it was, therefore, not permissible to bundle the international transactions that were materially different. He also referred to Rule 10B(1)(e) of the Rules and submitted that TNMM method is required to be applied on the basis of net operating margin realised by an enterprise. He submits that the word "enterprise" was not used synonymously with the term "person", which would include a company. He referred to Clause (b) of Section 92A(2) of the Act, which uses the expression "any person or enterprise" and submitted that use of the said terms together clearly indicates that the said terms – 'enterprise' and 'person' – have different meanings. Therefore, the term "enterprise" could not be construed to mean a 'person'. He submitted that there was nothing erroneous in applying TNMM method for determining the ALP for each undertaking instead of for the Assessee.

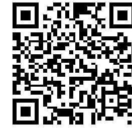
60. Before proceeding further, it would be relevant to refer to Section 92 of the Act. Section 92(1) of the Act expressly provides that "*any income arising from an international transaction shall be computed having regard to the arm's length price*".

61. Thus, the mandate of Section 92(1) of the Act is to recompute the income arising from an international transaction having regard to the arm's length price.

62. It is apparent from the above that the entire exercise of computing the ALP is to ensure that the tax base is not distorted on account of the transactions being between the related parties and thus controlled. With the insertion of sub-section (2B) of Section 92CA of the Act, by the Finance Act 2012, the ALP is also required to be determined for certain specified domestic transactions. The object for the same remains the same – to remove any distortion on account of transactions being between related entities.

63. It would be relevant to refer to the following passages from the United Nations Practical Manual on Transfer Pricing for the Developing Countries, 2021:

> "**2.4.1 Legal Basis of the Arm's Length Principle**
>
> 2.4.1.1 The UN Model Tax Convention Article 9(1) states the following:
>
> > "Where:



> (a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of these conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".

2.4.1.2 In other words, the transactions between two related parties should reflect the outcome that would have been achieved if the parties were not related i.e. if the parties were independent of each other and the outcome (price or margins) was determined by (open) market forces. This is the basis of the "arm's length principle". The principle set out above in the UN Model has also been reiterated in the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines as supplemented and amended.

2.4.1.3 The arm's length principle is thus the generally accepted guiding principle in establishing an appropriate transfer price under Article 9 of the UN Model. The arm's length principle by itself is not new; it has its origins in contract law to arrange an equitable agreement that will stand up to legal scrutiny, even though the parties involved may have shared interests.

2.4.1.4 Under the arm's length principle, transactions within a group are compared to transactions between unrelated

> entities under comparable circumstances to determine acceptable transfer prices. Thus, the marketplace comprising independent entities is the measure or benchmark for verifying the transfer prices for intragroup transactions and their acceptability for tax purposes.
>
> 2.4.1.5 The rationale for the arm's length principle itself is that because the market governs most of the transactions in an economy it is appropriate to treat intragroup transactions as equivalent to those between independent entities. Under the arm's length principle, intragroup transactions are tested and may be adjusted if the transfer prices or other terms of the transactions are found to deviate from those of comparable uncontrolled transactions. The arm's length principle is argued to be acceptable to everyone concerned as it uses the marketplace as the norm."

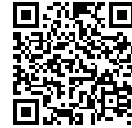
64. It is necessary to bear in mind the aforesaid principles while considering the apposite approach for determining the ALP in respect of the international transaction.

65. The expression "international transaction" has been defined in Section 92B of the Act. In terms of the said definition, an international transaction would include a transaction between two or more associated enterprises, either or both of whom are non-residents, which is in the nature of provision of services. Although, Section 92B of the Act uses the expression "an international transaction" in singular, it is now well settled that a reference to an international transaction under Section 92B of the Act would also include multiple inter-linked transactions.

66. In ***Sony Ericsson Mobile Communication India Pvt. Ltd. v. CIT***[7], this court had considered the question whether an international transaction as referred to in Section 92B of the Act would encompass multiple transactions or was required to be considered as a singular transaction. The Court also referred to the relevant Rules (Rule 10A and 10B of the Rules) and concluded that the expression "transaction" would also include the number of closely linked transactions. We consider it relevant to refer to the following passages from the said decision:

> "**79.** At this stage and before we examine the TNM method exhaustively, we deem it necessary to interpret and refer to in some detail sub-section (1) of section 92C and reference to the term "transaction" with the vowel "an", which has been interpreted by the majority judgment of the Tribunal to mean a single independent transaction and not a group or bundle of transactions. We do not think that the use of vowel "an" or the word "transaction" instead of the word "transactions" should be given undue notability and prominence. One of the primary rules of statutory construction is that singular includes plural and vice versa. This rule applies unless a contrary intention is manifest and exhibited. Merely because a statutory provision is drafted in singularity as opposed to plurality, is not enough to exclude application of the general rule that singular includes plural. The rule is not to be discarded on the ground that the relevant provision is singular or plural and the subsidiary and ancillary provision follow the same pattern. Contrary intention to exclude this generic rule is not to be lightly inferred. Contrary intention is not assumed or formed by confining attention to a specific provision but it would be apposite to consider the provision in the setting and placement of the legislation. It is a substance and tenure of the statute which would be meaningfully and critically determinative. This is the

[7] (2015) 374 ITR 118 (Del)



mandate of section 13(2) of the General Clauses Act, 1897 (see Newspapers Ltd. v. State Industrial Tribunal, AIR 1957 SC 532, Narashimaha Murthy v. Smt. Susheelabai (1996) 3 SCC 644, J. Jayalalitha v. Union of India (1999) 5 SCC 138, Blue Metal Industries Ltd. v. R. W. Dilley (1969) 3 All ER 437, Floor v. Davis (Inspector of Taxes) (1979) 2 All ER 677 (HL), Sin Poh Amalgamated (H. K.) Ltd. v. Attorney-General (1965) 1 All ER 225 (PC).

80. The use of the expression “class of transaction”, functions performed by the parties” in section 92C(1) illustrates to the contrary, that the word “transaction” can never include and would exclude bundle or group of connected transactions. More important would be reference to the meaning of the term “transaction” in section 92F, clause (v), which as per the said definition includes an arrangement or understanding or action in concert whether or not the same is formal or in writing, whether or not it is intended to be enforceable by legal proceedings. Rule 10A in clause (d) states that “for the purpose of this rule and rules 10AB and 10E”, the term “transaction” would “include a number of closely linked transactions”. This rule in positive terms declares that the legislative intent is not to deviate from the generic rule that singular includes plural. The meaning or definition of the expression “transaction” in clause (d) of rule 10A read with sub-section (1) of section 92C, therefore, does not bar or prohibit clubbing of closely connected or intertwined or continuous transactions. This is discernible also from sub-rule (2) of rule 10B quoted above. The sub-rule refers to “services provided”, “functions performed”, “contractual terms (whether or not such terms are formal or in writing) of the transactions” which lay down explicitly or impliedly the responsibilities, risks and benefits to be divided between the respective parties to the transactions. The use of plurality by way of necessity and legislative mandate is evident in the said rule.

81. Similarly, sub-rule (3) of rule 10B refers to transactions being compared or comparison of the enterprises entering into such transactions likely to affect the price or cost charged, etc.

A reading of rule 10C reassures and affirms that the general principle of plurality is not abandoned or discarded."

67. Section 92(2) of the Act, *inter alia*, expressly provides that in an international transaction between two or more AE's the cost contributed by any of the enterprise "*shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be*". Rule 10B of the Rules sets out the method for determining the arm's length price. In the present case, the Assessee had furnished the benchmarking analysis by using the TNMM. And, there is no dispute that TNMM is the most appropriate method for benchmarking the international transactions in question. There is also no dispute as to the use of OP to TC as the PLI.

68. The method for calculating the ALP by TNMM is set out in Rule 10B(1)(e) of the Rules. The same is reproduced below:

"**10B. Determination of arm's length price under section 92C.**

(1) *** *** ***

(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."

69. It is also relevant to note that the expression "enterprise" as used in Rules 10AB to 10E of the Rules is defined under Clause (aa) of Rule 10A of the Rules. The said clause is set out below:

> "(aa) "enterprise" shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a

> business of a person who undertakes such transaction;"

70. As is apparent from the above, the meaning of the term 'enterprise' for the purposes of specified domestic transactions – that is, the 'transaction' as defined under Section92F of the Act – has a wider meaning and includes an undertaking or a business of a person. However, in respect of an international transaction, the meaning of the term enterprise is the same as defined under Clause (iii) of Section 92F of the Act. Clause (iii) of Section 92F of the Act is set out below:

> "(iii) "enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;"

71. As is apparent from the above, the expression "enterprise" is defined in wide terms. However, the opening words of the said Clause

(iii) of Section 92F clearly indicate that "an enterprise" means "a person". The term "person" is defined under Section 2(31) of the Act as under:

> "2(*31*) "person" includes—
>
> (*i*) an individual,
>
> (*ii*) a Hindu undivided family,
>
> (*iii*) a company,
>
> (*iv*) a firm,
>
> (*v*) an association of persons or a body of individuals, whether incorporated or not,
>
> (*vi*) a local authority, and
>
> (*vii*) every artificial juridical person, not falling within any of the preceding sub-clauses."

72. The word "person" is expressed in expansive terms and includes "a company". Section 92F(iii) of the Act also includes a permanent establishment of a person within the meaning of "enterprise". The meaning of the word 'person' is also required to be understood in the context of Section 4 of the Act – the charging section – which provides for the total income of 'every person' is chargeable to tax as enacted. Thus, the word person must be understood as a taxable entity.

73. It is relevant to note at this stage, that in the given cases, income of a foreign entity, which is attributable to its PE in India is chargeable to tax. Thus, in one sense, although the PE may not be a separate entity, it may nonetheless for the purposes of the Act be considered as a taxable unit.

74. The meaning of the word 'enterprise' as used in the context of computation of ALP in respect of the international transactions and specified domestic transactions is clearly different. The legislative intent of ascribing separate meanings for the word 'enterprise' in respect of the international transactions and specified domestic transactions is clear from the plain language of Clause (aa) of Rule 10A of the Rules. The meaning of the word 'enterprise' in respect of the international transaction is the same as in Clause (iii) of Section 92F of the Act. However, in respect of the specified domestic transaction, the said expression would additionally encompass a unit or an enterprise or an undertaking or business of a person who undertakes such transactions. In view of the above, it is clear that the word 'enterprise' in context of the computation of ALP of an international transaction is required to be construed as a 'person' as defined under Section 2(31) of the Act and would also include a PE of such a person. But in respect of 'specified domestic transactions' it would also include a unit, enterprise, or an undertaking, or a business of a person.

75. Rule 10B of the Rules prescribes the methods that can be used for determination of the ALP under Section 92C of the Act. As noted above, Rule 19B(1)(e) of the Rules sets out TNMM for computing the ALP. In the present case, the Assessee had submitted its transfer pricing analysis using TNMM as the most appropriate method. The TPO has also used the same method for computing the ALP. Thus, there is no real dispute that TNMM is the most appropriate method for determining the ALP in case of the international transactions. TNMM is a method

which is premised on comparing the profit margin realized by an enterprise in respect of an international transaction, with profit margins from uncontrolled transactions. The expression 'net profit margin' realized by an enterprise clearly indicates that the profit margins are required to be compared with the profit margins of an enterprise and not that of any sub-unit or division of an enterprise. However, it is necessary to determine a profit margin that is realized from an international transaction. Clearly, the exercise is to determine the profit margins which are realized from an international transaction (or a specific domestic transaction). The method entails comparing the profit margin of an enterprise (in this case the Assessee) from an international transaction with the net profit margin of a comparable uncontrolled transaction.

76. The net profit margin of a tested party from an international transaction with an AE may be tested with, either by an uncontrolled internal comparable or by an external comparable. In the case of an internal comparable, the profit margin realized by a tested party from an uncontrolled transaction is compared with the profit margin realized from a controlled transaction (that is, transaction between two or more AE).

77. In the present case, the Assessee had submitted that the internal uncontrolled transactions to be used for benchmarking the international transactions. The data provided by the Assessee indicated that the profit margin realized from transactions with unrelated parties is significantly

lower than the profit margin realized from the international transactions in question. However, the AO did not accept the same on the ground that the data was not reliable.

78. The learned CIT(A) had noted that in the earlier assessment years the internal uncontrolled transactions were used for benchmarking the international transactions and thus raised doubts on the AO's conclusion to reject the internal comparables.

79. However, the controversy in the present case is in respect of the method used by the AO for benchmarking the ALP on the basis of external comparables.

80. As stated above, the expression 'an international transaction' is required to be construed in plural and would encompass a number of transactions, which are inextricably linked. However, it is necessary that the international transactions which may be bunched together are of a similar nature and character. It is not apposite to bunch the transactions of a completely different nature, which are not interlinked or subsumed in the overarching commercial transactions that are required to be tested.

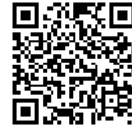
81. If the controlled international transactions are part of a particular segment, it would be relevant to ascertain the profit margin of the enterprise at a segmental level. This would obviously entail allocating entity level expenses on a reasonable basis to the relevant segment. Further when segmental data is not available, the margins necessarily

have to be determined at an enterprise level. Apart from the above, it is also necessary that the uncontrolled transactions, which are used for benchmarking the controlled transactions are comparable keeping in view that the object is to determine the ALP. Thus, in a case where uncontrolled transactions are compared with margins at segmental level, it would be necessary that the nature and character of the uncontrolled transaction so as to draw parallel with the controlled transactions on a segmental level.

82. At this stage, it would be relevant to refer to the Guidance Note[8] issued by the Institute of Chartered Accountants of India. Paragraph 6.41 of the said Guidance Note is reproduced below:

> "6.41 The steps involved in the application of this method are:
>
> (i) Identify the net profit margin realised by the enterprise from an international transaction [or the specified domestic transaction]. Where the assessee also has transactions, segments or businesses where the international transactions [or the specified domestic transaction] with AEs are not relevant, then the net profit margin to be considered for the purposes of this TNMM method should be such net profit margin as is derived only from the transactions, segments or businesses related to the international transaction [or the specified domestic transaction]. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base.
>
> For example,

[8]Guidance Note on Report under Section 92E of the Income Tax Act, 1961 (Transfer Pricing) (Revised 2022)



- In case where the assessee acts as a distributor and the transaction pertains to import, the revenue may be used as base.

- In case the transaction involves export of services/goods, costs may be taken as base provided the exporting entity acts as a contract service provider / contract manufacturer.

- Return on capital employed or Return on assets are typically used in case of a capital intensive manufacturing set-ups where the tangible operating assets have a high correlation to profitability. For example: Return on capital employed or Return on assets could be used in case of a leasing company.

(ii) Identify the net profit margin from a comparable uncontrolled transaction or a number of such transactions having regard to the same base; In practice, net profit margin is ascertained at segment level where segment data are available. The unallocated expenses are allocated on a reasonable basis and the segmental net profit is determined. Where segment data are not available, net profit is normally determined at enterprise level. Where internal CUT is available transaction level net profit may be determined.

(iii) In case internal CUT is not available, external CUT is taken. In such case, as discussed above, net profit margin should be taken at enterprise level (segmental or enterprise as a whole) of comparable companies. A search should be carried out to identify comparable companies on the basis of information and data available with the assessee. Where such information and data are not available, search may be carried out with reference to database in public domain.

(iv) The net profit margin so identified is adjusted to take into account the transaction level and enterprise level differences if any. The differences should be those that

could materially affect the net profit margin in the open market;

(v) The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction [or the specified domestic transaction]."

[Emphasis added]

83. In the present case, the TPO benchmarked each of the three STP units separately. However, the profit margin of external uncontrolled transactions was determined on entity level and not on a unit or segmental level. Whilst TNMM is tolerant to minor functional dissimilarities, it will be necessary that the comparable international transactions are of a similar nature. It would be impermissible to use uncontrolled comparable transaction with different parameters that controlled international transactions. It is also relevant that reasonably accurate and authentic data of the uncontrolled transaction is available so as to reasonably determine the profit margin arising from the said transaction. In the present case, the learned CIT(A) had faulted the TPO for comparing entity level margins with margins derived by an undertaking. In addition, the learned CIT(A) also noted that the international transactions are covered under the same agreement with the AE. Thus, splitting the transaction unit wise for the purpose of determining the ALP would not be apposite. As noted at the outset, the object of undertaking the transfer pricing analysis is to impute a real value to the transaction that would obtain in case the same was not controlled on account of being *inter se* AE. Thus, it is necessary to determine the profit margin if a similar transaction was executed by an

unrelated entity. In this regard, the facts that the agreement between the AE under which services were rendered by the Assessee through its various undertaking is the same, it would be apposite to compare the services provided by unrelated entity under a similar agreement. The singularity of an agreement would be relevant for determining the overarching transaction that is required to be benchmarked. This would not permit the overarching transactions to be split up between various undertakings for comparing the profit margin derived by an unrelated entity from a comparable uncontrolled transaction.

84. In addition to the above, the learned CIT(A) had also noticed that there was interlacing of funds and unity of management which are necessary aspects required to be factored while using TNMM for determining the ALP.

85. The contention that the Assessee may be able to manage its affairs so as to ensure that its new undertaking, which is covered under Section 10A of the Act, derives a higher profit. Therefore, it may be also apposite for making transfer pricing adjustment *inter se* domestic units to ensure that any transaction *inter se* separate units of an entity are accounted for at ALP. Mr. Aggarwal had also referred to the decision in the case of ***CIT v. Glaxo Smithkline Asia (P.) Ltd***.[6]. However, it is not necessary for this Court to address the said issue. As noted above, certain specified domestic transactions are also required to be benchmarked to impute arm's length value. If in a given case, the transactions fall within the scope of a 'domestic specified transaction'

under Section 92BA of the Act, the said exercise of determining the ALP would be required. However, if a particular transaction does not fall within the sweep of the statutory provisions, it is obvious that it will not be permissible to readjust the prices on account of a possible domestic transactions that may possibly distort the quantum of benefit available under Section 10A of the Act. The only question to be addressed is whether the decision of the learned CIT(A) and the learned ITAT to direct that the ALP be determined on the basis of TNMM by comparing the PLI at an enterprise level is erroneous or contrary to the guidelines for determining the ALP as prescribed under the Rules.

86. This question must necessarily be answered in the negative that is in favour of the Assessee and against the Revenue. Thus, question no. (3) as posed by the Revenue is answered accordingly.

RE: QUESTION NO.4

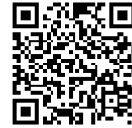
87. We find that the fourth question is centred around the fact as to the date on which the liability to pay ₹19,26,120/- had arisen. The assessment order indicates that the Assessee had explained that the liability for making the payment was crystallized in June, 2003. The expenses related to payroll taxes were paid by the Assessee in July, 2003. According to the Assessee, it was entitled to deduction of ₹19,26,120/- paid on account of payroll taxes. The Assessee explained that the liability to pay the reconciled payroll taxes had accrued and crystallized on 30.06.2003 when reconciliation of the Australian payroll taxes was done pursuant to the closure of the Australian tax year. The

Assessee's submission as noted in the order dated 28.07.2009, is reproduced below:

> "The appellant had incurred a sum of Rs 19, 26,120 in July 2003 on account of payroll taxes, in respect of contracted employees engaged in its branch in Australia. As per the facts of the case, every employer in Australia is required to pay the payroll taxes on monthly basis which is calculated as a percentage of the monthly wages. Further, at the end of the year, the employer is obligated to reconcile the annual wages and pay the differential or is entitled receive the excess paid. The accounting period for this activity is 1 July to 30 June of the following year. The provisions of payroll taxes in Australia are similar to the withholding tax provisions in India as the employer is required to deduct taxes from the salary of the employees on an estimated basis. Based on the reconciliation of the estimated payroll taxes payable for the period 1 July 2002 to 30 June 2003, the Australian branch was obligated to pay Rs.19.26, 120 at the end of the accounting period and the same was duly paid by the appellant in July 2003. Thus, as the liability in respect of the payroll taxes was actually determined in the Assessment Year 2004-05, the same is allowable as a deductible expenditure in the computation of income for AY 2004 -05."

88. The CIT(A) accepted the aforesaid contention and held as under:

> "13.3 I have gone through the above submission of the appellant and have also gone through the decision of Hon'ble Gujarat High Court in the case of Saurashtra Cement and Chemical Industries Ltd. vs. CIT (123 1 TR 669) and Hon'ble Allahabad High Court in the case of CIT vs. Ashok Iron and' Steel Rolling Mill (199 1 TR 815), 1 find that the appellant was entitled to claim a deduction of Rs 19, 26, 120, on account of payroll taxes. The actual liability to pay the reconciled payroll taxes has actually accrued and crystallized on June 30, 2003 when the reconciliation of Australian payroll taxes was done pursuant to the closure of Australian tax year. Thus, as the liability towards payroll taxes of Rs 19, 26, 120 has actually



> crystallized and accrued in the Assessment Year 2004-05, the same is allowable in A Y 2004-05;"

89. The learned ITAT had found no infirmity with the said view. We also find no fault with the said view. Strictly speaking, no substantial question of law arises in view of the undisputed finding of the fact that the reconciliation of payroll tax was conducted at the end of Australian tax year in July, 2003 and the amount in question was crystallized on such reconciliation.

90. The question no.4 is also decided in favour of the Assessee and against the Revenue.

91. In view of the above, the present appeal is dismissed.

VIBHU BAKHRU, J

SWARANA KANTA SHARMA, J

DECEMBER 03, 2024
'gsr'