IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 21.01.2025

\+ **ITA 566/2023**

PRINCIPAL COMMISSIONER OF
INCOME TAX – 1, NEW DELHI .....Appellant

Versus

DCM SHRIRAM LTD. ....Respondent

Advocates who appeared in this case:

For the Appellant: Mr Induraj Singh Rai, SSC with Mr Sanjeev Menon, Mr Rahul Singh, and Mr Anmol Jagga, Advocates.

For the Respondent: Mr S. Ganesh, Senior Advocate with Mr V.P. Gupta and Mr Anurav Kumar, Advocates.

CORAM
HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MS JUSTICE SWARANA KANTA SHARMA

JUDGMENT

VIBHU BAKHRU, ACJ

1. The Revenue has filed the present appeal under Section 260A of the Income Tax Act, 1961 (hereafter *the Act*) impugning an order dated 28.10.2021 (hereafter *the impugned order*) passed by the learned Income Tax Appellate Tribunal (hereafter *the ITAT*) in ITA

No.7362/Del/2018 captioned *DCM Shriram Ltd. v. Addl. CIT* in respect of the assessment year (AY) 2014-15.

QUESTIONS OF LAW

2. The Revenue had projected several questions of law for consideration of this court. However, this court had, by an order dated 02.05.2024, confined the present appeal to the following questions:

> "A. Whether on the facts and circumstances of the case and law, the Hon'ble ITAT has erred in law and on facts in deleting the adjustment proposed by the TPO on account of ALP adjustment of specified domestic transactions from Associated Enterprises for the A.Y 2014-15?
>
> B. Whether ITAT was right in deleting adjustments made on account of transfer of power as per the provision of section 92F r.w.s 80IA of the Act without appreciating that there was suitable selling CUP rate from the central agency in the field of power trading?

3. The learned ITAT had allowed the appeal (ITA No.7362/Del/2018) preferred by the respondent (hereafter *the Assessee*), *inter alia*, in regard to the adjustment of ₹26,52,98,490/- in respect of electric power transferred by the Assessee from its eligible unit to its non-eligible unit.

4. The Transfer Pricing Officer (TPO) had made the said addition on account of rates of electricity quoted on the Indian Energy Exchange (hereafter *IEX*). The rates of energy quoted on IEX are hereafter referred to as IEX rates. The learned ITAT accepted that the IEX rates

for electricity could not be used as an external comparable uncontrolled price (CUP) and held that the rates charged by the State Electricity Board (SEB) for supply of power to the Assessee was an appropriate external CUP for determining the market value of electricity as supplied by the Assessee's eligible unit to a non-eligible unit.

5. The said issue has arisen in the context of determining the quantum of exemption available to the Assessee under Section 80I of the Act.

THE CONTEXT

6. The relevant facts necessary to address the aforesaid questions are briefly set out below:

7. The Assessee is a company engaged in the business of manufacturing and trading of chemicals, PVC resins, PVC compounds, UPVC windows and door systems, cement, sugar, fertilizers, seeds, textile yarn, power generation and operating retail outlets.

8. The Assessee filed its return of income for AY 2014-15 on 28.11.2014 declaring its taxable income at ₹1,37,91,54,650/-. The Assessee disclosed its book profit for the purposes of Section 115JB of the Act at ₹3,16,84,96,338/-. The Assessee also paid tax of ₹66,41,32,675/- on its book profits. Subsequently, the Assessee filed a revised return claiming a higher TDS of ₹3,53,99,761/- as against ₹3,53,76,361/- claimed in the original return.

9. The Assessee's return was picked up for scrutiny. During the said proceedings, it was found that the Assessee had an international transaction with associated enterprise (AE) and accordingly, the Assessing Officer (AO) referred the Assessee's return to the Transfer Pricing Officer (TPO) for determination of the arm's length price (ALP) on the international transaction. The TPO passed an order dated 31.10.2017 accepting that the Assessee's "international transactions" were on arm's length basis. However, in respect of certain eligible domestic transaction, it was held that the profits of the power undertaking qualifying for deduction under Section 80IA of the Act needed to be reduced by ₹30,83,65,268/-. The said adjustment was determined, *inter alia*, on the basis that the transfer of electricity generated by the Assessee's eligible power units was not at the market value.

10. The Assessee had transferred power from its eligible units to non-eligible units in three regions. A tabular statement setting out the power transferred by the Assessee's eligible units to ineligible units as set out in the order dated 31.10.2017 passed by the TPO, is reproduced below:

"**UP Region**				
Transferor	Transferree	Quantity	Rate	Amount
TG-1, Loni (Eligible)	Sugar Plant (Non-Eligible)	1,86,41,986 KWH	4.29	7,99,74,118
TG-II, Loni (Eligible)	Sugar Plant (Non-Eligible)	9,23,797 KWH	4.20	38,79,947
TG-1, hariawan (Eligible)	Sugar Unit	1,93,06,294	4.29	8,28,24,001
TG-II, hariawan (Eligible)	Sugar Unit	8,51,577	4.29	36,53,265

TG-II, Ajbapur (Eligible)	Sugar Unit	34,83.722	4.24	1,47,70,983
TG-III, Ajbapur (Eligible)	Sugar Unit	1,02,52,023	4.24	4,34,68,579
Rajasthan Region				
Kota Power Plant	Fertilizer & Chemical Plant	31,21,15,871	6.30	196,63,29,987/-
Gujrat Region				
Bharuch Power Plant	Alkali & Chemical Plant	40,31,84,860 KWH	6.67	268,96,24,567/-
			Total	4884525447"

11. The Assessee had benchmarked the transactions at the rate on which electricity was transferred by its unit to Uttar Pradesh Power Corporation Limited (UPPCL) at the rate of ₹4.39 kWh; in the Gujrat Region at the rate of ₹38.56 kWh being the rate at which power was purchased from Dakshin Gujarat Vij Company Limited (DGVCL); and at the rate of ₹8.35 kWh in the Rajasthan Region being the rate at which the power was purchased from Jaipur Vidyut Vitran Nigam Limited (JVVNL).

12. The TPO found that the rates at which the transactions in Uttar Pradesh, Rajasthan and Gujarat Regions were benchmarked were significantly higher than the average rate of power traded on the IEX.

13. The TPO issued a notice dated 06.10.2017 under Section 133(6) of the Act to IEX. In response to the said notice, IEX furnished certain information according to which the average sale price of power at the IEX (IEX rates) during the financial year 2013-14 (relevant to AY 2014-15) was ascertained as under:

"(i) UP Region Rs.2.55 per KWH;

(ii) Rajasthan Region Rs.2.55 per KWH;

(iii) Gujrat Region Rs. 2.52 per KWH"

14. The TPO thereafter averaged the rates at which the Assessee had benchmarked the transactions and the average rates on which power was traded at the IEX and determined the ALP rates at ₹3.47 for the UP Region, ₹5.45 for Rajasthan Region; and ₹20.54 for the Gujarat Region. Based on the aforesaid rates, the TPO directed a transfer pricing adjustment of ₹30,83,65,268/-. A tabular statement of determination of the aforesaid adjustment as set out by the TPO in its order dated 31.10.2017, is reproduced below:

"UP Region									
Transferor	Transferee	Quantity (A)	Rate (B)	Amount (C=A*B)	Rate at which power was purchased/sold from UPPCL/DGVCL/ JVVNL(D)	Average IEX rates (E)	F=(D+E)/2	Difference in rates of power (G=F-B)	Adjustment (h=A*G)
TG-I, Loni (Eligible)	Sugar Plant (Non-Eligible)	1,86,41,986 KWH	4.29	7,99,74,118	4.39	2.55	3.47	0.82	**1,52,86,429**
TG-II, Loni (Eligible	Sugar Plant (Non-Eligible)	9,23,797 KWH	4.20	38,79,947	4.39	2.55	3.47	0.73	**6,74,372**
TG-I, haria wan (Eligible)	Sugar Unit	1,93,06,294	4.29	8,28,24,001	4.39	2.55	3.47	0.82	**1,58,31,161**
TG-II, haria wan	Sugar Unit	8,51,577	4.29	36,53,265	4.39	2.55	3.47	0.82	**6,98,293**

(Eligible)									
TG-II, Ajbapur (Eligible)	Sugar Unit	34,83,722	4.24	1,47,70,983	4.39	2.55	3.47	0.77	**26,82,466**
TG-III, Ajbapur (Eligible)	Sugar Unit	1,02,52,023	4.24	4,34,68,579	4.39	2.55	3.47	0.77	**78,94,058**
Rajasthan Region									
Kota Power Plant	Fertilizer & Chemical Plant	31,21,15,871 KWH	6.30	196,63,29,987/-	8.35	2.55	5.45	0.85	**26,52,98,490**
Gujrat Region									
Bharuch Power Plant	Alkali & Chemical Plant	40,31,84,860 KWH	6.67	268,96,24,567/-	38.56	2.52	20.54	Nil	Nil
			Total	**488,45,25,447**					**30,83,65,268"**

15. The TPO also directed a transfer pricing adjustment of ₹1,03,57,45,275/- on account of transfer of steam from power plants to manufacturing plants as according to the TPO, the said transfer was required to be made at Nil value.

16. The AO framed a draft assessment order dated 29.12.2017, *inter alia*, including an adjustment of ₹134,41,10,543/- on account of transfer pricing of power and steam (₹30,83,65,268 on transfer of power from eligible units to ineligible units and ₹103,57,45,275/- on account of transfer of steam from power plants to manufacturing plants).

17. The Assessee had claimed a deduction of ₹220,24,71,231/- under Chapter VIA (Section 80IA) of the Act, which was reduced by the aforesaid adjustment of ₹1,34,41,10,543/-. Accordingly, the Assessee's income under the normal provisions was determined at ₹267,14,55,411/-. Since the tax payable on the said amount was higher than the tax payable on book profits, the AO proposed a demand under the normal provisions of the Act.

18. The Assessee filed its objections before the Dispute Resolution Panel (DRP) against the draft assessment order dated 29.12.2017.

19. The Assessee also submitted that it had been consistently following methodology of using rates at which power was supplied and purchased by the SEBs as an internal CUP since 1997-98 and therefore, the said rates were required to be applied for AY 2014-15 as well.

20. The learned DRP did not accept that the rates at which it had purchased power from SEBs, could be considered as an internal CUP. The DRP held that only the rates at which the petitioner had sold power to SEB would be considered as an internal CUP and not the rates at which the Assessee had purchased electricity. Since the Assessee had not sold electricity to SEBs in Gujarat and Rajasthan region; the rates at which it purchased electricity from DGVCL and JVVNL could not be considered as internal CUPs. The relevant extract of the said decision is set out below:

"2.2.5 We have considered the submissions of the assessee and the TP order. We have also considered the judgments relied upon by the assessee. The various judgments referred to by the assessee have held that in terms of the provisions of sub-section (8) of s. 80IA of the Act the 'market value' referred to in the Explanation below the sub-section (8) should be taken as the rate, in this case the rate of power, to a consumer in the open market and not the rate at which power is sold to supplier. Thus, unambiguously it is held in these judgments that the rate at which the supplier sells in the open market should be considered for benchmarking the transactions. Therefore, the rate at which IEX or the Electricity Boards sells power to the consumer are para materia for determining the ALP of the impugned transactions. IEX is the central exchange which buys power from various producers of power irrespective of the sources material from which power is produced, and sells power to the consumer as per their demand. If the IEX sells power to consumers at lower price, any consumer would prefer to purchase power from IEX, or any other supplier of power and certainly not from a supplier who sells power at high cost.

2.2.6 On consideration of the facts of the case it is apparent that the assessee has sold surplus power generated from the power units at Ajbapur. Hariawan and Loni in UP to SEBs as per agreements with them for sale of surplus power and in respect of the power unit at Kota in Rajasthan the assessee has purchased power from the SEB. The assessee has taken both the power sold to the three SEBs in UP as well as power purchased from SEB in Kota as internal CUP. This is a fallacious and incorrect method since while the former are internal CUP, the latter could only be an external CUP.

2.2.7 The assessee has submitted copies of agreements with SEBs in respect of the three power units in UP for sale of surplus power to them. The assessee has entered into separate agreements with Madhyanchal Vidyut Vitran Nigam Ltd. in respect of the three units at Hariawan) (w.e.f. 01.03.2006), Loni (w.e.f. 06.12.2006 and Ajbapur w.e.f. 26.12.2006). The assessee has also submitted the invoices of power bills duly verified by the Executive Engineer & Nodal Officer of the

> respective SEB according to which the rate of sale of power by the assessee to the SEBs at Hariawans Rs. 4.39 per Kwh (March 2014), Rs. 4.39 per Kwh at Loni (March 2014 and Rs. 4.24 per Kwh at Ajbapur. In view of the fact that internal CUP is available for these three units, the AO/TPO is directed to apply internal CUP for benchmarking the transfer/sale of power (electricity) by these three units and re-compute the adjustment in respect of these three units.
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> 2.2.8 As discussed earlier herein above, in respect of the Kota unit (no adjustment was made in respect of Bharuch unit) the assessee has not applied correct internal CUP in as much as the assessee has applied the rate at which it is purchasing power from SEBs, which is an external CUP. Since the assessee has not sold power to any third party, the comparable sale rate for internal CUP is not available. In fact, had the assessee sold power to any independent third party, that could have been considered as correct internal CUP. Under CUP strict comparability is desired and adjustments for variations are not allowed, data of which in any case in respect of SEBs are not available. The TPO has applied the average price of power traded by IEX applicable for Kota, Rajasthan and the price at which the assessee has purchased power from Jaipur Vidyut Vitran Nigam Ltd. Under these facts and circumstances, the adjustment made by the TPO in respect of power transferred/sold from its power unit at Kota, Rajasthan is upheld."

21. In view of the aforesaid directions, the transfer pricing adjustment in respect of power supplied by the Assessee's eligible units to ineligible units was determined at ₹26,52,98,490/-.

22. The Assessee appealed the said decision before the learned ITAT (ITA No.7362/Del/2018). The learned ITAT upheld the decision of the DRP in holding that the rates at which the power was sold in the UP region by the Assessee's power units could be considered as an internal CUP and the rates at which power was purchased by the Assessee from

DGVCL and JVVNL in Rajasthan and Gujarat region were required to be treated as external CUPs.

23. However, the learned ITAT accepted the Assessee's contention that the rates at which electricity was traded on IEX could not be considered as external CUPs as the products (energy sold on spot rates and energy supplied/purchased by State Electricity Board) were not sufficiently comparable. Accordingly, the learned ITAT deleted the additions made on account of transfer pricing of power from the Assessee's eligible units to ineligible units.

24. The learned ITAT also accepted the Assessee's contention in regard to the other issues, which are not presently relevant as the present appeal is confined only to two questions relating to whether the IEX rates could be considered for benchmarking the market rates for the purposes of Sub-section (8) of Section 80IA of the Act.

25. The Revenue being aggrieved by the said decision has filed the present appeal.

REASONS AND CONCLUSION

26. As noted above, the controversy in the present case relates to the quantum of deduction available to the Assessee under Section 80IA of the Act. Section 80IA of the Act provides for deduction in respect of profits and gains arising from industrial undertaking or enterprises engaged in infrastructure development.

27. Sub-section (8) of Section 80IA of the Act provides that in cases where goods or services of an eligible business are transferred to any other business carried on by an assessee and the consideration for such transfer does not correspond to the market value of such goods or services, then for the purposes of deduction under Section 80IA of the Act, the profit and gains of eligible business would be computed as if the transfer had been made at market value of such goods or services.

28. Section 80IA(1) and 80IA(8) of the Act is set out below:

> "80-IA. (1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (4) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to hundred per cent of the profits and gains derived from such business for ten consecutive assessment years.
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> *** *** ***
>
> (8) Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of the deduction under this section, the profits and gains of such eligible business shall be computed as if the transfer,

in either case, had been made at the market value of such goods or services as on that date :

Provided that where, in the opinion of the Assessing Officer, the computation of the profits and gains of the eligible business in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

Explanation - For the purposes of this sub-section, "market value", in relation to any goods or services, means–

(*i*) the price that such goods or services would ordinarily fetch in the open market; or

(*ii*) the arm's length price as defined in clause (*ii*) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA."

29. The Explanation to Sub-section (8) of Section 80IA of the Act expressly provides that the expression 'market value' as used in the said sub-section would mean the price that such goods or services would ordinarily fetch in the open market or the ALP as defined in Clause (ii) of Section 92F of the Act, in case where the transfer of goods or the services is a specified domestic transaction referred to in Section 92BA of the Act.

30. Section 92BA[1] of the Act defines the expression 'specified domestic transaction' as used in Section 92 (92C, 92D and 92E) of the

[1] **92BA.** For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—
(*i*) [***]
(*ii*) any transaction referred to in section 80A;

Act. In terms of Clause (iii) of Section 92BA of the Act, the same includes any transfer of goods or services referred to in Sub-section (8) of Section 80IA of the Act.

31. Section 92C of the Act contains provisions regarding computations of ALP. By virtue of Clause (ii) of Explanation to sub-section (8) of Section 80IA of the Act, the market value in relation to goods and services as specified would mean the ALP as is defined under Clause (ii) of Section 92F of the Act. The said Clause [Clause (ii) of Section 92F of the Act], which defines the ALP, reads as under:

> "92F. In sections 92, 92A, 92B, 92C, 92D and 92E, unless the context otherwise requires,—
>
> *** *** ***
>
> (ii) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;"

32. It is apparent from the conjoint reading of Explanation to Sub-section (8) of Section 80IA, Section 92BA and Section 92F(ii) of the

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(*iii*) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
(*iv*) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
(*v*) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
(*va*) any business transacted between the persons referred to in sub-section (6) of section 115BAB;
*(*vb*) any business transacted between the assessee and other person as referred to in sub-section (4) of section 115BAE*
(*vi*) any other transaction as may be prescribed,
and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of twenty crore rupees.

Act that the market value in relation to any goods or services under Sub-section (8) of Section 80IA is required to be determined in terms of Section 92C of the Act, which contains provisions regarding computation of the ALP.

33. It is relevant to refer to Sub-sections (1) and (2) of Section 92C of the Act. The same are set out below:

> "92C. (1) The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—
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> (*a*) comparable uncontrolled price method;
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> (*b*) resale price method;
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> (*c*) cost plus method;
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> (*d*) profit split method;
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> (*e*) transactional net margin method;
>
> (*f*) such other method as may be prescribed by the Board.
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> (2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:
>
> **Provided** that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:
>
> **Provided further** that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not

exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price:

Provided also that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply.

Explanation.—For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 1st day of October, 2009."

34. It is also material to refer to Rule 10B of the Income Tax Rules, 1962 (hereafter *the Rules*) which provides for determination of an ALP under Section 92C of the Act. Rule 10B(1) of the Rules is set out below:

"10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction *or a specified domestic transaction* shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a) comparable uncontrolled price method, by which,—

(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(ii) such price is adjusted to account for 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 price in the open market;

(iii) the adjusted price arrived at under sub-clause (*ii*) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction *or the specified domestic transaction*;

(b) resale price method, by which,—

(i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, 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 gross profit margin in the open market;

(v) the adjusted price arrived at under sub-clause (*iv*) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) cost plus method, by which,—

(i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(iii) the normal gross profit mark-up referred to in subclause (ii) is adjusted to take into account the functional and other 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 such profit mark-up in the open market;

(iv) the costs referred to in sub-clause (*i*) are increased by the adjusted profit mark-up arrived at under sub-clause (*iii*);

(v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

(d) profit split method, which may be applicable mainly in international transactions or specified domestic transactions involving transfer of unique intangibles or in multiple international transactions *or specified domestic transactions* which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—

(i) the combined net profit of the associated enterprises arising from the international transaction *or the specified domestic transaction* in which they are engaged, is determined;

(ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (*ii*);

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction *or the specified domestic transaction*:

Provided that the combined net profit referred to in sub-clause (*i*) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction *or specified domestic transaction* in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative

contribution in the manner specified under sub-clauses (*ii*) and (*iii*), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction *or the specified domestic transaction*;

(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*;

(f) any other method as provided in rule 10AB."

35. In the present case, the Assessee had computed the ALP by adopting the CUP method as provided in Rule 10B(1)(a) of the Rules. The TPO had also accepted it as the most appropriate method in the facts of the present case. Thus, there is no dispute that CUP method is required to be used for determining the ALP and the market value for the purposes of Section 80IA of the Act.

36. As is apparent from Sub-clause (i) of Clause (a) of Rule 10B(1) of the Rules, it is necessary to determine the price charged or paid for the property or goods transferred or services provided in a comparable uncontrolled transaction. In the present case, the transaction relates to the sale of electricity by the Assessee's eligible unit to a non-eligible unit. Thus, a comparable uncontrolled transaction would necessarily involve determining a transaction of sale of power in a similar uncontrolled transaction.

37. It is relevant to refer to OECD Guidelines[2], which explains various methods for determining the ALP.

38. The relevant extract of the said guidelines is set out below:

"2.14. The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable

[2] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022

circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.

2.15. **Following the principles in Chapter I, an uncontrolled transaction is comparable to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for purposes of the CUP method if one of two conditions is met: a) none of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or, b) reasonably accurate adjustments can be made to eliminate the material effects of such differences.** Where it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm's length principle. Consequently, in such cases the CUP method is preferable over all other methods.

2.16. It may be difficult to find a transaction between independent enterprises that is similar enough to a controlled transaction such that no differences have a material effect on price. For example, a minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price even though the nature of the business activities undertaken may be sufficiently similar to generate the same overall profit margin. When this is the case, some adjustments will be appropriate. As discussed below in paragraph 2.17, the extent and reliability of such adjustments will affect the relative reliability of the analysis under the CUP method.

2.17. In considering whether controlled and uncontrolled transactions are comparable, regard should be had to the effect on price of broader business functions other than just product comparability (i.e. factors relevant to determining comparability under Chapter I). Where differences exist between the controlled and uncontrolled transactions or between the enterprises undertaking those transactions, it may

be difficult to determine reasonably accurate adjustments to eliminate the effect on price. The difficulties that arise in attempting to make reasonably accurate adjustments should not routinely preclude the possible application of the CUP method. Practical considerations dictate a more flexible approach to enable the CUP method to be used and to be supplemented as necessary by other appropriate methods, all of which should be evaluated according to their relative accuracy. Every effort should be made to adjust the data so that it may be used appropriately in a CUP method. As for any method, the relative reliability of the CUP method is affected by the degree of accuracy with which adjustments can be made to achieve comparability.

2.18. Subject to the guidance in paragraph 2.2 for selecting the most appropriate transfer pricing method in the circumstances of a particular case, the CUP method would generally be an appropriate transfer pricing method for establishing the arm's length price for the transfer of commodities between associated enterprises. The reference to "commodities" shall be understood to encompass physical products for which a quoted price is used as a reference by independent parties in the industry to set prices in uncontrolled transactions. The term "quoted price" refers to the price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognised and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used as a reference by unrelated parties to determine prices in transactions between them.

2.19. Under the CUP method, the arm's length price for commodity transactions may be determined by reference to comparable uncontrolled transactions and by reference to comparable uncontrolled arrangements represented by the quoted price. Quoted commodity prices generally reflect the agreement between independent buyers and sellers in the market on the price for a specific type and amount of commodity, traded under specific conditions at a certain point in time. A relevant factor in determining the appropriateness

of using the quoted price for a specific commodity is the extent to which the quoted price is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction. Accordingly, depending on the facts and circumstances of each case, quoted prices can be considered as a reference for pricing commodity transactions between associated enterprises. Taxpayers and tax administrations should be consistent in their application of the appropriately selected quoted price.

2.20. For the CUP method to be reliably applied to commodity transactions, the economically relevant characteristics of the controlled transaction and the uncontrolled transactions or the uncontrolled arrangements represented by the quoted price need to be comparable. For commodities, the economically relevant characteristics include, among others, the physical features and quality of the commodity; the contractual terms of the controlled transaction, such as volumes traded, period of the arrangements, the timing and terms of delivery, transportation, insurance, and foreign currency terms. For some commodities, certain economically relevant characteristics (e.g. prompt delivery) may lead to a premium or a discount. If the quoted price is used as a reference for determining the arm's length price or price range, the standardised contracts which stipulate specifications on the basis of which commodities are traded on the exchange and which result in a quoted price for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions of the uncontrolled transactions or the conditions determining the quoted price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are comparable. Contributions made in the form of functions performed, assets used and risks assumed by other entities in the supply chain should be compensated in accordance with the guidance provided in these Guidelines."

[emphasis added]

39. It is relevant to refer to Law & Practice of Transfer Pricing in India – A Compendium[3], the relevant extract is set out below:-

> "While applying CUP method product comparability should be examined rather than business functions. The CUP method is used in cases where an independent enterprise buys or sells products that are identical or very similar to those purchase/ sold by one AE to another AE or in situations where services are rendered that are identical or very similar to those rendered in the controlled transaction.
>
> While product comparability is the most important factor under the CUP method, the following other comparability factor also play a vital role:
>
> (i) Contractual terms; and
> (ii) Economic circumstance
>
> Where there are difference between controlled transaction and transaction with/ between unrelated parties due to other comparability factors, adjustments should be made to enhance reliability."

40. In ***Sumitomo Corporation India Pvt. Ltd. v. CIT[4],*** this court made the following observations: -

> "34. However, we find that the Tribunal erred in proceeding to determine the ALP on the basis of the rate of commission reported by the Assessee in respect of indenting transactions with Non-AEs, without further examination as to the similarity between the two transactions. The Tribunal effectively used the CUP Method for imputing the ALP of Assessee's indenting transaction with AEs. This may well be the most appropriate method to be used for determining the ALP.

[3] Chapter 12- Comparable Uncontrolled Price Method, Resale Proce Method and Cost Plus Method at Pg no. 469, Volume 1.
[4] Neutral Citation No. 2016:DHC:5154-DB

> However, if the Tribunal thought that this was the case, it was necessary for the Tribunal to conduct a further in-depth inquiry as to the relevant uncontrolled transactions. **It is well settled that in applying the CUP Method, a very high degree of similarity between the controlled and uncontrolled transactions is required.**"
>
> [emphasis added]

41. A similar view has also been expressed by the Income Tax Appellate Tribunal in various decisions[5].

42. It is clear from the above that the CUP method would be an appropriate method only if the transactions are identical inasmuch as there are no differences that would materially affect the price in an open market. And, if there is any difference which affects the price, the same can be reasonably ascertained and its effect can be eliminated by an appropriate adjustment.

43. In the present case, the question is to determine the market value or the ALP of power supplied by power plants established by the Assessee to its other units. Supplying of electricity is governed by the Electricity (Supply) Act, 1948 and Electricity Act, 2003. The transmission of electricity is also governed by the Electricity Rules, 2005.

[5] Star India Pvt. Ltd. v. ACIT-16(1), ITA No. 7872/MUM/2019 decided on 05.06.2023; M/s. Qual Core Logic Ltd. v. Dy. Commissioner of Income-tax, Circle-16(3), ITA No. 893/Hyd/2011; Aztec Software & Technology Services Ltd. v. Astt. CIT: [2007] 107 ITD 141; UCB India (P.) Ltd. v. Astt. CIT, ITA No. ITA 428/Mum/2007 decided on 06.02.2009.

44. Thus, the market for supply of electricity is regulated. Thus, to apply the CUP method, it would be necessary to ascertain the comparable transactions that are similar in material aspects and there is no difference between the transactions which has a bearing on the price of the power supplied.

45. The question whether the average IEX rate at which power is traded on IEX, is a comparable uncontrolled transaction, is required to be evaluated by determining whether there are any differences between the specified domestic transaction[6] and the uncontrolled transaction of trade on the IEX.

46. The Assessee states – and the same is not controverted – that the availability of power on IEX is unpredictable and the supply of power is unreliable.

47. It is stated that in order for a party to purchase power from IEX, the said party has to participate in the bidding process. The same entails furnishing a bid in advance for supply of fifteen minutes slots. Illustratively, it is stated that if a party requires power supply for a period of four hours, it would be required to submit sixteen bids for fifteen minutes slots. Further, the bidder cannot resile from the bids furnished by it in advance.

[6] As defined under Section 92BA of the Act.

48. In view of the above, it is contended that power traded on IEX cannot be compared with the power supplied by a SEB.

49. It is not disputed that IEX is a platform, which is used by power producing units to sell surplus power for short term requirements. IEX is not a platform for sourcing continuous power for power consuming units. It is also pointed out that there is a high level of volatility in the IEX rates as it depends on immediate availability of surplus electricity.

50. It is also contended by the Assessee that the rates quoted on IEX are in respect of power supplied and not the power that is consumed and therefore, there is a material difference between the power that is purchased from IEX and the power which is supplied by the SEBs or power distribution companies. The said submission is also not controverted. The Assessee claims that it had on occasions purchased power from IEX.

51. We find considerable merit in the Assessee's contention that the transactions of sale and purchase of power on the IEX is not comparable to the regular supply of power by the SEB or the power distribution companies. Undisputedly, IEX is not a source for uninterrupted power on the basis of which any power consumer can set up its unit. It is also not disputed that there is a wide fluctuation in the IEX rates. The Revenue has also not controverted the assertion that rates for power quoted on IEX are for power purchased and not for power consumed. Thus, if an entity bids for certain quantity of power on IEX and is successful, it is required to pay for the same. However, the electricity

supplied by power distribution companies is charged on the basis of the power consumed, which is recorded in the metering devices.

52. It is also clear that the said material differences between the electricity supplied by SEBs or power distribution companies and those secured by bidding on IEX would have a significant bearing on the price of power.

53. As noted above, the CUP method is an appropriate method only in cases where there is sufficient degree of identity between the tested transactions and comparable uncontrolled transactions. The CUP method cannot be applied where there is significant dissimilarity between the comparable transactions and it is not feasible to determine an adjustment to eliminate the impact of the said differences on the prices of comparable transactions.

54. In the present case, the Assessee had supplied excess power to UPPCL in UP region at the rate of ₹4.39 per kWh. Thus, the said transaction was accepted by the learned DRP as well as the learned ITAT as an internal uncontrolled transaction. The rate at which such electricity was supplied by the Assessee being ₹4.39 per kWh, was rightly accepted as an ALP.

55. As noted above, the learned ITAT also accepted the rates at which electricity was supplied by the SEBs/power distribution companies to the Assessee in Gujarat and Rajasthan regions as the said rates was considered as an external CUP.

56. Undoubtedly, there is a degree of similarity between the transaction of supply of electricity by SEBs to the Assessee and the supply of electricity by the Assessee's eligible units. However, there is a difference between the transactions being benchmarked, which is supply of electricity by captive units, and the transaction of supply of electricity by distribution companies/corporations. The power distribution companies enjoy a near monopoly status. The tariff charged by such companies are regulated tariffs. However, we accept that there is a sufficient degree of similarity between the said transaction for reasonably determining the ALP by using the CUP method.

57. We also consider it apposite to refer to the recent decision of the Supreme Court in ***Commissioner of Income Tax v. Jindal Steel and Power Limited***[7]. The principal issue involved in the said decision was the determination of market value of goods and services. In terms of Clause (i) of Explanation to Sub-section (8) of Section 80IA of the Act, the market value in relation to goods and services would mean the price that such goods or services would ordinarily fetch in the open market. In the aforesaid context, the Supreme Court had considered the question of what would constitute an open market in the context of determining the market value of electricity supplied by captive power units of the assessee in that case. In that case, the assessee had entered into an agreement with the SEB of State of Madhya Pradesh to supply surplus electricity at the rate of ₹2.32 per unit. However, the Assessee had

[7] (2024) 460 ITR 162

computed the revenue from supply of electricity to its own unit at the rate of ₹3.72 per unit. It was the Assessee's case that the market value of the electricity was ₹3.72 per unit as that was the rate charged by the SEB for supply of electricity to industrial consumers including the Assessee. The learned ITAT had accepted the assessee's stand and had set aside the order passed by the CIT(A) rejecting the assessee's appeal in that regard. The High Court had also rejected the Revenue's appeal by referring to its earlier decision where the question of law had been answered against the Revenue and in favour of the Assessee.

58. The Revenue had approached the Supreme Court assailing the orders passed by the learned ITAT and the High Court. In the aforesaid context, the Supreme Court had held as under:

> "23. This brings to the fore as to what do we mean by the expression "open market" which is not a defined expression.
>
> 24. Black's Law Dictionary, 10th Edition, defines the expression "open market" to mean a market in which any buyer or seller may trade and in which prices and product availability are determined by free competition. P. Ramanatha Aiyer's Advanced Law Lexicon has also defined the expression "open market" to mean a market in which goods are available to be bought and sold by anyone who cares to. Prices in an open market are determined by the laws of supply and demand.
>
> 25. Therefore, the expression "market value" in relation to any goods as defined by the Explanation below the proviso to sub-section (8) of section 80 IA would mean the price of such goods determined in an environment of

free trade or competition. "Market value" is an expression which denotes the price of a good arrived at between a buyer and a seller in the open market i.e., where the transaction takes place in the normal course of trading. Such pricing is unfettered by any control or regulation; rather, it is determined by the economics of demand and supply.

26. Under the electricity regime in force, an industrial consumer could purchase electricity from the State Electricity Board or avail electricity produced by its own captive power generating unit. No other entity could supply electricity to any consumer. A private person could set up a power generating unit having restrictions on the use of power generated and at the same time, the tariff at which the said power plant could supply surplus power to the State Electricity Board was also liable to be determined in accordance with the statutory requirements. In the present case, as the electricity from the State Electricity Board was inadequate to meet power requirements of the industrial units of the assessee, it set up captive power plants to supply electricity to its industrial units. However, the captive power plants of the assessee could sell or supply the surplus electricity (after supplying electricity to its industrial units) to the State Electricity Board only and not to any other authority or person. Therefore, the surplus electricity had to be compulsorily supplied by the assessee to the State Electricity Board and in terms of Sections 43 and 43A of the 1948 Act, a contract was entered into between the assessee and the State Electricity Board for supply of the surplus electricity by the former to the latter. The price for supply of such electricity by the assessee to the State Electricity Board was fixed at Rs. 2.32 per unit as per the contract. This price is, therefore, a contracted price. Further, there was no room or any elbow space for negotiation on the part of the assessee. Under the

statutory regime in place, the assessee had no other alternative but to sell or supply the surplus electricity to the State Electricity Board. Being in a dominant position, the State Electricity Board could fix the price to which the assessee really had little or no scope to either oppose or negotiate. Therefore, it is evident that determination of tariff between the assessee and the State Electricity Board cannot be said to be an exercise between a buyer and a seller in a competitive environment or in the ordinary course of trade and business i.e., in the open market. Such a price cannot be said to be the price which is determined in the normal course of trade and competition.

27. Another way of looking at the issue is, if the industrial units of the assessee did not have the option of obtaining power from the captive power plants of the assessee, then in that case it would have had to purchase electricity from the State Electricity Board. In such a scenario, the industrial units of the assessee would have had to purchase power from the State Electricity Board at the same rate at which the State Electricity Board supplied to the industrial consumers i.e., Rs. 3.72 per unit.

28. **Thus, market value of the power supplied by the assessee to its industrial units should be computed by considering the rate at which the State Electricity Board supplied power to the consumers in the open market and not comparing it with the rate of power when sold to a supplier i.e., sold by the assessee to the State Electricity Board as this was not the rate at which an industrial consumer could have purchased power in the open market.** It is clear that the rate at which power was supplied to a supplier could not be the market rate of electricity purchased by a consumer in the open market. On the contrary, the rate at which the State Electricity Board supplied power to the industrial

> consumers has to be taken as the market value for computing deduction under Section 80 IA of the Act."
>
> [emphasis added]

59. As is apparent from the above, the Supreme Court had accepted the rates at which electricity was supplied by the SEBs to industrial consumers as being the market value of the said supplies for the purposes of Sub-section (8) of Section 80IA of the Act.

60. In view of the above, the questions of law are answered in favour of the Assessee and against the Revenue.

61. The appeal is dismissed in the aforesaid terms.

VIBHU BAKHRU, ACJ

SWARANA KANTA SHARMA, J

JANUARY 21, 2025
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