

[2019] 10 S.C.R. 133

THE PRINCIPAL COMMISSIONER OF INCOME TAX-4, A
MUMBAI

v.

M/s. S.G. ASIA HOLDINGS (INDIA)PVT. LTD.

(Civil Appeal No. 6144 of 2019) B

AUGUST 13, 2018

[UDAY UMESH LALIT AND VINEET SARAN, JJ.]

Income Tax Act, 1961: s.92 – Transfer Pricing Adjustment – Respondent received certain amount of brokerage from its parent company – During the assessment proceedings, respondent was directed to furnish details about the parent company and the rate of brokerage that was charged – According to the Assessing Officer, the brokerage charged by the respondent was only 0.05% which was found to be at a lower rate as compared to the prevalent rates in market – Assessing Officer, therefore, while computing the assessment made an addition of Rs.2,89,82,746/- under s.92 of the Act – Appellate Authority confirmed the addition made by the Assessing Officer – Tribunal set aside the findings rendered by the first two authorities and held that Transfer Pricing Adjustment made by the Assessing Officer was contrary to the mandatory instructions issued by CBDT in its Instruction No.3/2003 dated 20.05.2003 – The view so taken by the Tribunal was affirmed by the High Court – On appeal, held: In view of the guidelines issued by the CBDT in Instruction No.3/2003 the Tribunal was right in observing that by not making reference to the Transfer Pricing Officer (TPO), the Assessing Officer had breached the mandatory instructions issued by the CBDT – Matter remitted to the Assessing Officer for making appropriate reference to the TPO – CBDT's Instruction No.3/2003.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 6144 of 2019.

From the Judgment and Order dated 27.08.2018 by the High Court of Bombay in Income Tax Appeal No. 281/2016. G

Mahabir Singh, Sr. Adv., V. Girish Chowdary, H. R. Rao, Mrs. Anil Katiyar, Advs. for the Appellant.

A Arijit Chakravarty, Arush Negi, Abhishek Tilak, Himanshu Tyagi, Advs. for the Respondent.

The Judgment of the Court was delivered by

UDAY UMESH LALIT, J.

B 1. This Appeal by Special Leave challenges the judgment and final order dated 27.08.2018 passed by the High Court of Bombay dismissing Income Tax Appeal No.281 of 2016 preferred by the appellant herein and thereby confirming the order dated 22.04.2015 passed by the Income Tax Appellate Tribunal ('the Tribunal', for short) in ITA No.2399/Mum/2009.

C 2. The facts leading to the filing of this Appeal are as under:-

A) The respondent had received certain amount of brokerage from its parent company. During the assessment proceedings the respondent was directed to furnish details about the parent company and the rate of brokerage that was charged. After the details were furnished, the respondent was asked to establish if the parent company was involved in arbitrage activity and whether the rate charged was higher. After considering the material on record, according to the Assessing Officer, the brokerage charged by the respondent was only 0.05% which was found to be at a lower rate as compared to the prevalent rates in market. The Assessing Officer, therefore, while computing the assessment under Section 143(3) of the Income Tax Act, 1961 ('the Act', for short), by his order dated 27.12.2007 made an addition of Rs.2,89,82,746/- under Section 92 of the Act.

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E) The respondent being aggrieved preferred an appeal before the CIT(A)¹, who by his order dated 16.02.2009 confirmed the addition made by the Assessing Officer and dismissed the appeal. The matter was carried further by filing ITA No.2399/Mum/2009 before the Tribunal.

G) The Tribunal by its order dated 22.04.2015 set aside the findings rendered by the first two authorities and held that

H ¹ Commissioner of Income Tax (Appeals)

transfer pricing adjustment made by the Assessing Officer was contrary to the mandatory instructions issued by CBDT² in its Instruction No.3/2003 dated 20.05.2003. While allowing the appeal, the Tribunal observed as under:-

“16.1 After considering the entire judicial discussion discussed hereinabove, in our considered opinion, the mandatory instructions issued by the Central Board of Direct Taxes cannot be brushed aside lightly. By not making reference to the Transfer Pricing Officer, the AO has breached the mandatory instructions issued by the CBDT thereby making the assessment order on this issue in violation of the provisions of the law. We, therefore, set aside the findings of the Ld. CIT(A) on this issue and hold that the Transfer Pricing Adjustments made by the AO in contradiction to the mandatory instructions of the CBDT is bad in law. Here, we would like to make it clear that the assessment order is good but the Transfer Pricing Adjustments made therein are bad in law. Ground No.11 is therefore partly allowed.

16.2 Before parting with this issue, the Ld. DR has emphasized that if the AO has not followed the mandatory directions, the case may be set aside to the file of the AO so that he may refer the matter to the TPO. We do not subscribe to this argument of the Ld. DR for the simple reason that the Tribunal is an Appellate Authority and therefore cannot interfere in the administrative matters which are mandatory as per the provisions of the Act. Reference to the TPO is an administrative matter which was supposed to be followed by the AO which he has failed to do so. The Tribunal cannot make any good to such lapse made by the AO.

17. As we have held that T.P. Adjustments are bad in law, we do not find it necessary to dwell into the merits of the case.

² Central Board of Direct Taxes

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- A 18. In the result, the appeal filed by the assessee is partly allowed.”
3. The view so taken by the Tribunal was affirmed by the High Court which is presently under Appeal. We heard Mr. Mahabir Singh, learned Senior Advocate in support of the Appeal and Mr. Arijit B Chakravarty, learned Advocate for the Respondent.
- B 4. Instruction No.3/2003 dated 20.05.2003 which weighed with the Tribunal and the High Court, is as under:-

- “Instruction No. 3/2003**
- C SECTION 92 OF THE INCOME TAX ACT, 1961 – TRANSFER PRICING – COMPUTATION OF INCOME FROM INTERNATIONAL TRANSACTION HAVING REGARD TO ARM’S LENGTH PRICE UNDER SECTION 92 – GUIDELINES TO TRANSFER PRICING OFFICERS AND ASSESSING OFFICERS TO OPERATIONALISE TRANSFER PRICING PROVISIONS AND TO HAVE PROCEDURAL UNIFORMITY.
- D INSTRUCTION NO. 3/2003, DATED 20-05-2003
(SUPERSEDED BY INSTRUCTION NO.15/2015 (F.NO.500/9/2015-APA-II), DATED 16-10-2015)
- E The provisions relating to transfer price contained in sections 92 to 92F of the Income-tax Act, have come into force with effect from assessment year 2002-03. In terms of the provisions, income from an international transaction is to be computed having regard to arm’s length price between the associated enterprises. Further, in terms of Section 92CA, a Transfer Pricing Officer, on a reference received from the Assessing Officer, is required to determine arm’s length price of an international transaction by an order and the Assessing Officer is required to compute the income having regard to the price so determined by the TPO. The notification regarding jurisdiction of TPOs and their controlling officers have been issued by the Central Board of Direct Taxes and the copies thereof are enclosed for ready reference as Annexure II. In order to maintain uniformity of procedure and to ensure that work in this important area proceeds smoothly and effectively, the following guidelines are hereby issued:
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(i) *Reference to Transfer Pricing Officer (TPO):-* The Power to determine arm's length price in an international transaction is contained in sub-section (3) of section 92C. However, section 92CA provides that where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of arm's length price in relation to an international transaction to the TPO. Sub-section (3) of section 92CA provides that the TPO after taking into account the material available with him shall, by an order in writing, determine the arm's length price in accordance with sub-section (3) of section 92C. Sub-Section (4) of section 92CA provides that on receipt of the order of the TPO, the Assessing Officer shall proceed to compute the total income of the assessee having regard to the arm's length price, determined by the TPO. Thus, whereas the determination of the arm's length price, wherever reference is made to him, is required to be done by the TPO under sub-section (3) of section 92CA, read with sub-section (3) of section 92C, the computation of total income having regard to the arm's length price so determined by the TPO is required to be done by the Assessing Officer under sub-section (4) of section 92C, read with sub-section (4) of section 92CA.

In order to make a reference to the TPO, the Assessing Officer has to satisfy himself that the taxpayer has entered into an international transaction with an associated enterprise. One of the sources from which the factual information regarding international transaction can be gathered is Form No.2CEB filed with the return which is in the nature of an accountant's report containing basic details of an international transaction entered into by the taxpayer during the year and the associated enterprise with which such transaction is entered into, the nature of documents maintained and the method followed. Thus, the primary details regarding such international transactions would normally be available in the accountant's report. The Assessing Officer can arrive at *prima facie* belief on the basis of these details whether a reference is considered necessary. No detailed enquiries are needed at this stage and the Assessing Officer should not embark upon scrutinizing the correctness or otherwise of the price of the international transaction at this stage. In the initial years of implementation of these provisions and pending development of adequate database, it would be appropriate if a small number of

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- A cases are selected for scrutiny of transfer price and these are dealt with effectively. The Central Board of Direct Taxes, therefore, have decided that wherever the aggregate value of international transaction exceeds Rs.5 crores, the case should be pricked up for scrutiny and reference under section 92CA be made to the TPO. If there are more than one transaction with an associated enterprise or there are transactions with more than one associated enterprises the aggregate value of which exceeds Rs.5 crores the transaction should be referred to TPO. Before making reference to the TPO, the Assessing Officer has to seek approval of the Commissioner/Director as contemplated under the Act. Under the provisions of section 92CA reference is in relation to the international transaction. Hence all transactions have to be explicitly mentioned in the letter of reference. Since the case will be selected for scrutiny before making reference to the TPO, the Assessing Officer may proceed to examine other aspects of the case during pendency of assessment proceedings but await the report of the TPO on the value of international transaction before making final assessment.
The threshold limit of Rs.5 crores will be reviewed depending upon the workload of the TPOs.
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- E The work relating to selection of cases for scrutiny and reference to TPO on the above basis in respect of pending returns filed for the assessment year 2002-03 should be completed by June 30, 2003.
- F *(ii) Role of Transfer Pricing Officer:-* The role of the TPO begins after a reference is received from the Assessing Officer. In terms of section 92CA this role is limited to the determination of arm's length price in relation to the international transaction(s) referred to him by the Assessing Officer. If during the course of proceedings before him it is found that there are certain other transactions; which have not been referred to him by the Assessing Officer, he will have to take up the matter with the Assessing Officer so that a fresh reference is received with regard to such transactions. It may be noted that the reference to the TPO is transaction and enterprise specific.
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- H The transfer price has to be determined by the TPO in terms of section 92C. The price has to be determined by any one of the

methods stipulated in sub-section (1) of section 92C and by applying the most appropriate method referred to in sub-section (2) thereof. There may be occasions where application of the most appropriate method provides results which are different but equally reliable. In all such cases, further scrutiny may be necessary to evaluate the appropriateness of the method, the correctness of the data, weight given to various factors and so on. The selection of the most appropriate method will depend upon the facts of the case and the factors mentioned in rules contained in rule 10C. The TPO after taking to account all relevant facts and data available to him shall determine arm's length price and pass a speaking order after obtaining the approval of the DIT (TP). The order should contain details of the data used, reasons for arriving at a certain price and the applicability of methods. It may be emphasized that the application of method including the application of the most appropriate method, the data used, factors governing the applicability of respective methods, computation of price under a given method will all be subjected to judicial scrutiny. It is, therefore, necessary that the order of the TPO contains adequate reasons on all these counts. Copies of the documents or the relevant data used in arriving at the arm's length price should be made available to the Assessing Officer for his records and use at subsequent stages of appellate or penal proceedings.

(iii) *Role of the Assessing Officer after receipt of "arm's length price"*: Under sub-section (4) of section 92C, the Assessing Officer has to compute total income of the assessee having regards to the arm's length price so determined by the TPO. While sub-section (4) of section 92CA clearly provides that such computation of income will be made having regard to the arm's length price so determined by the TPO, it is imperative that a formal opportunity is given to the taxpayer before making adjustments to the total income. The opportunity with regard to the determination of arm's length price has already been given by the TPO and, therefore, opportunity by the Assessing Officer, for final determination of income under sub-section (4) of section 92C, read with sub-section (4) of section 92CA is to be given by the Assessing Officer.

(iv) *Maintenance of database*: It is to be ensured by the DIT (Transfer Pricing) that the reference received from the Assessing

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- A Officer is dealt with expeditiously so as to leave the Assessing Officer with sufficient time to offer an opportunity of being heard of the taxpayer before computing the income and completing the assessment. In order to ensure that all the references are attended to timely and effectively, a record of all such developments should be maintained in the format enclosed as Annexure I to these guidelines. This format will also serve as an important data base for future action and also help ensure uniformity in the determination of “arm’s length price” in identical or substantially identical cases.
- B These instructions are under Section 119 of the Income-tax Act.

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ANNEXURE I
Register of record to be maintained by Transfer Pricing Officer

	1	2	3	4	5	6	7	8	9	10	11	12	13
D	Sl.No.	Date of receipt of reference from AO	Name of the AO making reference	Name and address of the tax payer and nature of business	Nature and quantum of international transaction as per section 92B and assessment year	Name and address of the associated enterprise and the country in which it is resident	Nature of association as per section 92A	Date of issue of notice to taxpayer	Transfer price as taken by the taxpayer	Arms length price as determined by the Transfer Pricing Officer under section 92CA(3)	Method applied	Reference to any database adopted by TPO	Date of despatch of the order of the AO
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ANNEXURE II
Order under section 120, read with section 92CA of the Income-tax Act, 1961, dated April, 2003

- F In exercise of the power conferred by sub-section (1) and sub-section (2) of section 120 of the Income-tax Act, 1961, the Central Board of Direct Taxes hereby directs that the Transfer Pricing Officers mentioned in column 2 having their headquarters mentioned in column 3 shall exercise such powers and perform such function of Transfer Pricing Officers as mentioned in Section 92CA for the purpose of sections 92C and 92D of the Act, in respect of persons or classes of persons mentioned in column 5.”
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5. It was submitted by Mr. Mahabir Singh, learned Senior Advocate that the expression “....*the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under Section 92C to the Transfer Pricing Officer*” occurring in Section 92CA of the Act signified that discretion was vested in the Assessing Officer and it would not be mandatory in every single case that he must refer the issue of computation of the Arm's Length Price to the TPO³.

6. However, the following expressions employed in Instruction No.3/2003 put the matter in a different perspective: -

“... ...The Assessing Officer can arrive at *prima facie* belief on the basis of these details whether a reference is considered necessary. No detailed enquiries are needed at this stage and the Assessing Officer should not embark upon scrutinizing the correctness or otherwise of the price of the international transaction at this stage... ... If there are more than one transaction with an associated enterprise or there are transactions with more than one associated enterprise the aggregate value of which exceeds Rs.5 crores, the transactions should be referred to the TPO.Since the case will be selected for scrutiny before making reference to the TPO, the Assessing Officer may proceed to examine other aspects of the case during pendency of assessment proceedings but await the report of the TPO on the value of international transaction before making final assessment.

... ...

(vi) *Role of the Assessing Officer after receipt of “arm's length price”:* Under sub-section (4) of section 92C, the Assessing Officer has to compute total income of the assessee having regard to the arm's length price so determined by the TPO.”

7. In view of the guidelines issued by the CBDT in Instruction No.3/2003 the Tribunal was right in observing that by not making reference to the TPO, the Assessing Officer had breached the mandatory instructions issued by the CBDT. We do not find the conclusion so arrived at by the Tribunal to be incorrect.

³ Transfer Pricing Officer

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A 8. However, the Tribunal ought to have accepted the submission made by the Departmental Representative as quoted in para 16.2 of its order and the matter ought to have been restored to the file of the Assessing Officer so that appropriate reference could be made to the TPO. It would therefore be upto the authorities and the Commissioner concerned to consider the matter in terms of Sub-Section (1) of Section 92CA of the Act.

B 9. We, therefore, allow this Appeal to the aforesaid extent and direct that it would now be upto the Assessing Officer to take appropriate steps in terms of Instruction No.3/2003.

C 10. The Appeal is allowed to the aforesaid extent. No costs.

Devika Gujral

Appeal allowed.