

IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH : BANGALORE

BEFORE SHRI N. BARATHVAJA SANKAR, VICE PRESIDENT  
AND SHRI N.V. VASUDEVAN, JUDICIAL MEMBER

<b>IT(TP)A Nos. 1037 &amp; 1038/Bang/2008</b>
Assessment years : 2003-04 & 2004-05

M/S.Tellabs India Private Ltd., No.53, I Floor, Empire Tower, Railway Parallel Road, Kumarapark West, Bangalore – 560 020.  <b>PAN : AA ACT 9392B</b>	Vs.	The Assistant Commissioner of Income Tax, Circle 12(5), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Padamchand Khincha, C.A.
Respondent by	:	Shri S.K. Ambastha, CIT-I (DR), ITAT

Date of hearing	:	19.03.2013
Date of Pronouncement	:	05.04.2013

**ORDER**

*Per N.V. Vasudevan, Judicial Member*

These are appeals by the assessee against two orders both dated 30.04.2008 of CIT(A)-IV, Bangalore, relating to AY 03-04 & 04-05.

2. The common issue that arises for consideration in these appeals is as to whether the addition made to the total income of the Assessee consequent to determination of Arm's Length Price (ALP) in respect of

compensation payable for rendering services to Power Grid Corporation of India Ltd. ("PGCIL") under two on-shore contracts u/s.92 of the Income-tax Act, 1961 [hereinafter referred to as "the Act" in short"] is sustainable.

3. The facts and circumstances give rise to the above issue are as follows. The Assessee was incorporated in India on 30.12.1998 as a wholly owned subsidiary of Tellabs International Inc., USA (Tellabs US). Tellabs group designs, manufactures and markets extensive line of telecom equipments and products. The Assessee was initially set up as sales and marketing office of Tellabs US and its group companies which are engaged in the business of manufacture and sale of telecommunication equipment. The Assessee also renders services in connection with installation and commissioning of telecommunication equipment, on behalf of Tellabs group of companies worldwide for their customers in India.

4. Power Grid Corporation of India Limited ("PGCIL") is a Government of India enterprise. It had invited tenders for the supply, installation and commissioning of the telecommunication equipments. The work was to be performed both outside India (manufacture and supply of telecom equipments from Denmark- offshore) and in India (customs clearance in India and installation of the equipments - onshore). The Off-shore and On-shore contracts were independent contracts. On 4th June 2001 Tellabs Denmark provided a response to the request for Tender issued by PGCIL and the tender was awarded to it. Tellabs Denmark is a subsidiary of Tellabs US and therefore an 'Associated Enterprise' (AE) of the assessee

within the meaning of the said expression as defined in the Act u/s. 92B of the Act.

5. In pursuance of the award of contract in favour of Tellabs Denmark, Tellabs Denmark entered into 4 agreements with PGCIL. A brief summary of the contracts are given below:

SL. NO.	CONTRACT	TYPE OF CONTRACT	SERVICE LINK
1	C-02405-L858-1/CA-I/1083 dated 23rd May 2003	Offshore	Telecom Equipment Package-3 for Balance Network (Excluding Delhi-Mumbai Link)
2	C-02405-L858-1/CA-I/906 dated 27th March 2002	Offshore	Telecom Equipment Package-3 for Delhi Mumbai Link
3	C-02405-L858-1/CA-II/1083 dated 23rd May 2003	Onshore	Telecom Equipment Package-3 for Balance Network (Excluding Delhi-Mumbai Link)
4	C-02405-L858-1/CA-II/907 dated 27th March 2002	Onshore	Telecom Equipment Package-3 for Delhi - Mumbai Link

Description of Services under Offshore Contract:

For planning, design, engineering, manufacture, testing and CIF supply of all offshore equipment and materials including testing equipment, documentation and mandatory spares.

Description of Services under Onshore Contract:

For handling and custom clearance of all supplies from abroad, inland transit insurance, handling and transportation to site, unloading at site, storage, insurance, erection/installation (including survey, planning, design, engineering activities and termination as required), training of employees personnel, testing and commissioning and demonstration for acceptance at site of the complete Optic Fibre system including associated hardware / equipment / civil works etc.

6. After the award of contract to Tellabs Denmark, a corporate restructuring exercise took place in 2002, wherein the entire business activities of the assessee's group were restructured to achieve efficiency, operational realignment, technological development, customer focused strategy etc. Tellabs Denmark therefore sought permission of PGCIL to assign a portion of the Onshore contract to the Assessee. PGCIL agreed to the proposal subject to the condition that Tellabs Denmark will continue to be liable for due performance of all the 4 contracts. According to the assessee, the assignment of onshore contract in favour of the assessee was as a consequence of the aforesaid restructuring exercise. The restructuring and the accompanying assignment was to make the assessee accountable for the entire risks and rewards under the assigned contract. The consideration payable by PGCIL to Tellabs Denmark in respect of On-shore contract for Delhi-Mumbai link and On-shore contract for rest of India was as follows:

Delhi-Mumbai link contract:

The Contract Price shall be the aggregate of US\$ 321,700 + Rs. 74,489,893.00 (US Dollars Three Hundred Twenty One Thousand and Seven Hundred plus Seventy Four million Four Hundred Eighty Nine Thousand Eight Hundred Ninety Three Only). The break-up of the Contract price was as under:

(i) Inland Freight & Insurance Charges	:	Rs.43,298,037.00
(ii) Expenditure towards expatriate personnel:		US \$ 282,441.00
(iii) Installation Services	:	Rs.31,191,856.00
(iii) Training Charges	:	US \$ 39,259.00
TOTAL (i + ii)	:	US \$ 321,700.00 + Rs.74,489,893.00

Rest of India Contract:

The Contract Price shall be the aggregate of US\$ 652,222 + Rs. 130,372,230.00 (US Dollars Six Hundred Fifty Two Thousand Two Hundred Twenty Two plus One Hundred Thirty million Three Hundred Seventy Two Thousand and Two Hundred Thirty Only). The break-up of the Contract price is as under:

(i) Inland Freight & Insurance Charges	:	Rs.82,189,375.00
(ii) Expenditure towards expatriate personnel:		US \$ 436,294.00
(iii) Installation Services	:	Rs.48,182,855.00
(iii) Training Charges	:	US \$ 215,928.00
TOTAL (i + ii + iii + iv)	:	US \$ 652,222.00+ Rs.130,372,230.00

The portion of the onshore contract that was assigned to the Assessee was only with regard to the rupee portion of the contract as follows:-

C-02405-L858-1/CA-I/1083 dated 23rd May 2003(Delhi-Mumbai Link)

	Assigned Contract Tellabs India	Original Contract Tellabs Denmark
Scope of Work	Assignment of Onshore contract for Freight & Insurance and Installation Services to Tellabs India	Onshore contract for <ul style="list-style-type: none"> <li>• Freight and Insurance</li> <li>• Installation Services</li> </ul>
Compensation	Freight and Insurance Charges – Rs.82,189,375  Installation Charges Rs.48,182,855	Freight and Insurance Charges – Rs.82,189,375  Installation Charges Rs.48,182,855
Other terms	Terms and conditions in both the contracts are the same	Terms and conditions in both the contracts are the same

C-02405-L858-1/CA-II/907 dated 27th March 2002 (Rest of India)

	Assigned Contract Tellabs India	Original Contract Tellabs Denmark
Scope of Work	Assignment of Onshore contract for Freight & Insurance and Installation Services to Tellabs India	Onshore contract for <ul style="list-style-type: none"> <li>• Freight and Insurance</li> <li>• Installation Services</li> </ul>
Compensation	Freight and Insurance Charges – Rs.43,298,037  Installation Charges Rs.31,191,856	Freight and Insurance Charges – Rs. 43,298,037  Installation Charges Rs. 31,191,856
Other terms	Terms and conditions in both the contracts are the same	Terms and conditions in both the contracts are the same

7. As per the provisions of Sec.92-E of the Act read with Rule 10-E of the Income Tax Rules, 1962 (the Rules) every person entering into an international transaction with an AE during the previous year has to report in Form No. 3CEB and verify in the manner indicated therein, the particulars of such international transaction. The Assessee did not report the transaction that it undertook consequent to assignment of the onshore contracts by Tellabs Denmark with PGCIL. The AO made a reference to TPO to determine the ALP of the said transaction. The TPO called upon the Assessee to file necessary report justifying the price received in respect of the said contract as at arm's length.

8. In reply, the Assessee took a stand that the off-shore contracts for supply of equipments and On-shore contract (customs clearance and insurance of equipments and installation of equipments both included in on-shore contract) were separate contracts. Further Tellabs Denmark had assigned the contract to the Assessee with the approval of PGCIL. The agreement for installation is thus between the Assessee and PGCIL and all responsibility and benefits under the contract vested with the Assessee. This agreement is independent of any other agreement between PGCIL and Tellabs Denmark. The Assessee thus submitted that the transaction in question is not an international transaction within the meaning of Sec.92B of the Act and therefore the provisions of Sec.92 of the Act are not attracted. The Assessee thus submitted that the transaction cannot be subject matter of determination of ALP.

9. The TPO did not agree with the stand so taken by the Assessee and he held as follows:

- (a) The off-shore contract and on-shore contracts were not independent and they are inseparable. In this regard the TPO referred to the letter dated 13.1.2003 approving the assignment of agreement for customs clearance and installation of equipment by Tellabs Denmark in favour of the Assessee wherein there is a reference to the fact that breach in terms of any of the contract shall be deemed to be breach of entire contract.
- (b) Tellabs has only sub-contracted the offshore contract to the Assessee.
- (c) There was no novation of the contract between PGCIL and Tellabs Denmark. In this regard the TPO made a reference to the letter dated 13.1.2003 wherein PGCIL has clearly spelt out that the assignment of the on-shore

contract shall not amount to novation of the contract in favour of Assignee.

- (d) Tellabs Denmark continues to be liable despite assignment. The TPO has again made a reference to the letter dated 13.1.2003 of PGCIL wherein this aspect was made clear by PGCIL.
- (e) The contract between PGCIL and the Assessee is not an independent contract.
- (f) The fact that the Assessee directly bills PGCIL for services is not relevant.
- (g) On services rendered for import of equipment, the Assessee took a stand that it gets reimbursement of costs incurred by it from Tellabs Denmark and therefore TP regulations will not be attracted. The TPO on the above stand held that cross charging of expenses to an AE (Tellabs Denmark) is an international transaction and had to be reported as per Form 3CEB (clause-13).

10. The TPO thereafter proceeded to determine the ALP of the transaction between the Assessee and PGCIL. He firstly held that the functions and risk in the said transaction was similar to the one which the Assessee was performing to Tellabs US. In this regard it may be recalled that the Assessee was initially set up as sales and marketing office of Tellabs US and its group companies which are engaged in the business of manufacture and sale of telecommunication equipment. The Assessee also renders services in connection with installation and commissioning of telecommunication equipment, on behalf of Tellabs group of companies worldwide for their customers in India. The TPO after coming to the conclusion that the work performed by the Assessee to PGCIL was akin to the services it performed for Tellabs US, found that the Assessee did not give any functional analysis. The Assessee had identified 9 comparable



companies in its TP study with reference to transactions with Tellabs US. The most appropriate method chosen was TNMM. The TPO took those comparable companies as comparable in respect of the transaction between the Assessee and PGCIL. The TPO excluded 2 of the companies so identified and determined the ALP and consequent addition to the Total income of the Assessee by way of TP adjustment as follows:

“For the sake of simplification PBIT/Revenue is used as Profit Level Indicator (PLI).

Company Name	PBIT (NNRT) as % of sales
Amex Information Technologies Ltd.	26.54
C M C Ltd.	9.14
Hexaware Technologies Ltd.	11.17
Intellvisions Software Ltd.	1.94
Shanthi Sales Ltd.	1.63
Spanco Telesystems & Solutions Ltd.	11.11
Arithmetic Mean	<b>9.49</b>

The PBIT/Sales ratio of 9.49% arrived at as above is taken as the arms length profit margin.

3.3 Arms Length Price of the services rendered for Tellabs Denmark is computed as under:

(in Rs.)

Project Cost debited			
Total expenses debited	10,26,59,333		
Less: Estimated Loss	1,66,11,659		
Actual expenses incurred		8,60,04,674	
Add: Depreciation attributed		3,77,293	8,64,24,967
Arms Length Profit Margin on Revenue			9.49%
Therefore Arms Length Service Margin on cost			10.49%
Arms length Service Charges receivable			9,54,86,650
Revenue recognized in respect of services			5,89,68,264
Adjustment u/s 92CA			3,65,18,386

11. Before CIT(A) the Assessee raised contentions as were put forth before the TPO besides also raising issues with regard to lack of opportunity before the TPO before passing his order and the merits of the addition made by the TPO.

12. On the issue whether the transaction in question would be international transaction so as to attract the provisions of Sec.92 of the Act, the CIT(A) held as follows:

- \* The original contracts entered into between M/s Tellabs Denmark (assignor) and PGCIL remain in full force and effect and shall be deemed to be amended only to the limited extent set forth in the Assignment Agreements.
- \* The terms and conditions of the original contracts were determined in substance by its AE, M/s Tellabs Denmark and were only subsequently subcontracted/assigned to the assessee.
- \* The assessee merely carried out the contract with PGCIL in accordance with the terms and conditions originally determined in sum and substance by its AE, Tellabs Denmark. As a result the transaction between the assessee and PGCIL is squarely covered by the deeming provisions of Sec 92B(2) of the Act.
- \* The conditions prescribed under S.92B(2) for a transaction to be deemed an international transaction between two associated enterprises have been met. There was a prior agreement between the person (PGCIL) and the associated enterprise (Tellabs Denmark). The assignment agreement and the so-called transaction between the appellant and PGCIL are only subsequent events. The terms of the transaction have been determined between the person (PGCIL) and the associated enterprise (Tellabs Denmark) and the assessee had no say or control in this regard. The assignment of the agreement to the assessee was on terms over which it had no control and was the result of a global management decision for reasons best known to it. The resultant loss from the

assignment of the contract is quite clearly not of the assessee's making. The transaction was "deemed to be a transaction entered into between two associated enterprises" in accordance with the provisions of Sec 92B(2).

13. On the other grounds raised by the Assessee, the CIT(A) confirmed the order of the TPO/AO.

14. Aggrieved by the order of the CIT(A) the Assessee has preferred the present appeals before the Tribunal.

15. We have heard the submissions of the learned counsel for the Assessee and the learned DR.

16. We will first deal with the issue whether the transaction by which the Assessee rendered services of looking after the customs clearance and handling insurance and installation of equipment imported from Tellabs Denmark would be an international transaction warranting invoking the provisions of Sec.92 of the Act.

17. The learned counsel for the Assessee on the above issue reiterated the stand of the assessee as put forth before the CIT(Appeals) that it was not an international transaction and referred to a decision of the ITAT, Hyderabad in the case of *Swarnandhra IJMII Integrated Township Development Company Pvt. Ltd. v. DCIT for AY 2007-08, ITA No. 2072/Hyd/2011 dated 31st December 2012*.

18. The learned DR reiterated the stand of the Revenue as reflected in the orders of TPO/AO/CIT(A). He also relied on the decision of the ITAT

Mumbai in the case of *Diageo India Private Ltd., Vs. DCIT ITA No.8602/mum/2010 AY 06-07 dated 5.9.2011*. He also brought to our notice that Tellabs Denmark in AY 2004-05 by an order dated 29.12.2006 was assessed on the profits arising on offshore contract as well as the portion of the onshore contract that had not been assigned to the Assessee by the ADIT, Circle 2(2), Intl. Taxation, New Delhi. In the aforesaid order the profits arising on offshore contracts have been brought to tax on the premise that the Assessee constitutes PE of Tellabs Denmark in India. The relevant observations of the AO were as follows:-

“1. The contention of the assessee that offshore supplies of equipment took place outside India, hence, the income from such supplies is not taxable is not tenable. As, a composite contract was awarded to the assessee, where the scope of activities is to supply, transportation and installation, commissioning and testing of equipment at the site of PGCIL. Therefore, the responsibility of assessee does not ceases outside India in respect of those equipments. Successful installation of equipment at the site of PGCIL was prime objective of the assessee. Although the title of equipment stated to have been transferred outside India but responsibility and risk associated in such supply does not ceases outside India and responsibility of successful installation of those equipment remains with the assessee.

2. The activities of assessee's HO and Indian Co. cannot be compartmentalized into onshore & offshore activities for supply of equipment, Though the onshore installation erection and commissioning and local transportation was assigned by the assessee to Indian co. and Indian co. directly raises bill to PGCIL for this part of assignment. But that does not make any difference as the Indian co. was working on behalf of the assessee Co. and even for the portion of job done by Indian co. the assessee co. was responsible for successful installation and acceptance testing of the equipments. Therefore the Indian Co. constitutes PE of the assessee co.

In view of above it is held that assessee co. has a permanent establishment in India.”

19. We have considered the rival submissions. Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and tax in India in the case of such multinational enterprises. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through sections 92A to 92F of the Indian Income-tax Act, 1961 (the Act) which guides computation of the transfer price and suggests detailed documentation procedures. Chapter X of the Act provides for Special Provisions relating to Avoidance of Tax. Sec.92 of the Act mandates Computation of income from international transactions having regard to arm's length price. It lays down that "*Any income arising from an international transaction shall be computed having regard to the arm's length price.*" Sec.92-B of the Act defines "international transaction" as under:-

"92B. (1) For the purposes of this section and Sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.”

20. It can be seen that for application of Sec.92B(1) of the Act there are two conditions to be fulfilled before a transaction can be said to be an “International Transaction” viz., :-

- (1) Transaction should be between two or more Associated Enterprises;
- (2) Either or both the parties to the transaction should be Non-Residents.

The transaction may relate to one or more of the following :-

- (a) Purchase, sale or lease of Tangible or Intangible Property.
- (b) Provision of services.
- (c) Lending or borrowing of money.
- (d) Any transaction having a bearing on profits, income, losses or assets.
- (e) Mutual agreement between AEs for allocation/apportionment of any cost, contribution or expense.

21. Sec.92B(2) of the Act covers cases of “deemed International transaction”. The condition for application of those provisions would be:-

- (1) There must be a transaction between the Assessee and other person who is not an “Associated enterprise”;
- (2) there must be a prior arrangement in relation to the said transaction between such other person and the associated enterprise of the Assessee, or

- (3) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

By way of an illustration of a deemed 'International Transaction', we may refer to an Assessee who is a resident enterprise exporting goods to an unrelated person abroad, and there is a separate arrangement or agreement between the unrelated person and an AE which influences the price at which the goods are exported. In such a case the transaction with the unrelated enterprise will also be subject to Trans Pricing Regulations.

22. The other requirement for application of Sec.92-B (1) of the Act is that the international transaction should be between two associated persons. For application of Sec.92-B(2) of the Act, the arrangement should be between the "other person" and an "associated enterprise". We therefore have to see the definition of "Associated Enterprise" under the Act.

23. Sec.92-A of the Act defines the meaning of "associated enterprise".

It reads thus:

**"92A.(1)** For the purposes of this section and Sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise –

- (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

- (2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,
- (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or
  - (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
  - (c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or
  - (d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or
  - (e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
  - (f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or
  - (g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of 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
  - (h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
  - (i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
  - (j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
  - (k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or
  - (l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or



(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

24. As can be seen from the above definition the basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise. The participation may be direct or indirect or through one or more intermediaries. The concept of control adopted in the legislation extends not only to control through holding shares or voting power or the power to appoint the management of an enterprise, but also through debt, blood relationships, and control over various components of the business activity performed by the taxpayer such as control over raw materials, sales and intangibles. It appears that one may go to any layer of management, control or ownership in order to find out association:-

- (a) Direct Control
- (b) Through Intermediary

For instance, if enterprise B is managed, controlled or owned either directly or through an intermediary, then Enterprise B is said to be an AE of enterprise A. Further, if Mr A and Mr B control both Enterprise A and Enterprise B, then both Enterprise A and Enterprise B are AEs.

25. We will now revert to the facts of the present case and see if the conditions mentioned in Sec.92B(1) or (2) of the Act are satisfied. As far as condition (2) for application of Sec.92B(1) of the Act referred to above is concerned, the requirement of either or both the parties to the transaction being non-resident, is to be first analyzed. As we have already seen part of

the on-shore contract in so far as it relates to customs clearance and installation thereafter is claimed to have been assigned by Tellabs Denmark to the Assessee. The claim of the Assessee is that effect of such assignment is that the portion of the said contract is between the Assessee and PGCIL both of whom are residents and therefore one of the requirement of Sec.92B(1) is not satisfied. In this regard it is seen that on 3rd May 2002, Tellabs Denmark submitted a proposal to PGCIL asking for its concurrence to the assignment of the onshore contracts in favour of the appellant. Similarly, the letter dated 23rd January 2004 addressed by Tellabs Denmark to PGCIL had requested PGCIL's consent for the assignment of onshore contract.

26. PGCIL vide letters dated 13.01.2003 and 07.05.2004 approved the assignment of the onshore contracts. In other words, PGCIL agreed and concurred for the assignment of the contracts. PGCIL also provided a format of the assignment agreement and mandated Tellabs Denmark to execute and sign the assignment agreement in the format so provided. The relevant portion of the letter reads as follows:-

“In consideration of your request, POWER GRID hereby accords approval to assign the Indian rupee portion of Onshore Services Contract on M/s Tellabs India Pvt Ltd. .... On assignment of the Indian Rupee portion of Onshore Services Contract on M/s Tellabs India Pvt Ltd, you shall sign an “Assignment Agreement” with them. The approved format for signing the “Assignment Agreement” is enclosed herewith.”

A copy of the letter according approval for assignment was also sent to M/s Tellabs India (P) Ltd.

27. Tellabs Denmark entered into assignment agreements with the assessee in the manner desired by PGCIL. In the assignment agreements it was stated as follows:-

- (i) PGCIL has granted permission to assign the contracts in favour of the assessee.
- (ii) the signing of the assignment agreement shall be at the same terms as the signing of the two contract agreements by ASSIGNOR and POWERGRID in pursuance of the Notifications of Award issued on March 2002.
- (iii) pursuant to clause no.3 of the General conditions of contract, [an integral part of the main contract], the obligations and rights under Onshore Contract were assigned to the assessee.
- (iv) Tellabs Denmark [assignor] assigned, transferred and conveyed all rights, benefits and interests over the Onshore Contract to the assessee [assignee] and the assessee assumed full responsibility for the said contract.
- (v) The assigned contract would apply between POWERGRID and the assessee [ASSIGNEE] as if the assessee had been a party to the contracts in place of the Tellabs Denmark from the date of signature of the onshore contract.
- (vi) The assessee was entitled, in the place of Tellabs Denmark to all benefits of, and was entitled to exercise all of the rights and remedies to Tellabs Denmark with regard to the Onshore contract.
- (vii) Any and all rights of Tellabs Denmark to compensation (whether due before or after the effective date) under the onshore contract devolved upon and enjoyed by the assessee, including the right to invoice directly PGCIL and receive payments directly from PGCIL for the assigned rights and obligations.
- (viii) Tellabs Denmark guaranteed that the assessee is technically and financially capable of assuming and performing all the obligations and liabilities regarding the assigned contracts.

- (ix) It was provided that the contracts concluded between PGCIL and Tellabs Denmark shall be deemed amended to the extent to give effect to the assignment agreement.

28. A copy of the assignment agreements was submitted to PGCIL as mandated by it. Performance guarantee was also given by the assessee to PGCIL.

29. It is the plea of the learned counsel for the Assessee that the effect of all the above was that the assignment of onshore contract with prior permission, consent and concurrence of PGCIL amounted to novation of the contract. PGCIL was a party to the act of assignment. In the absence of PGCIL's prior permission for assignment, it was neither possible for Tellabs Denmark to assign the onshore contract nor was it possible for the appellant to become a party to the impugned contract. The factual sequence whereunder the initial contract itself had permitted the assignment of contract; the action of Tellabs Denmark in approaching PGCIL for grant of permission to assign the onshore contract; the conduct of PGCIL in granting such permission; providing the specimen format of the assignment agreement and mandating Tellabs Denmark to enter into assignment agreement only in the prescribed format and the various clauses of the assignment agreement, as explained above, according to the learned counsel for the Assessee, would clearly establish that the assignment was in fact and in substance a novation of a contract.

30. The Revenue (TPO's order for AY 2004-05) on the other hand has proceeded on the basis that the Assessee has carried out the contract

between Tellabs Denmark and PGCIL as per the terms determined by Tellabs Denmark. Hence, the terms of the relevant transaction between the Assessee and PGCIL are determined in sum and substance by its AE. Hence, the transactions are squarely covered by Sec.92B(2) of the Act and is a deemed "International Transaction". In AY 2003-04, the TPO has expressed the view that there is no novation and that Tellabs Denmark continues to be responsible for due performance of all its obligations under the On-shore contracts.

31. We have perused the terms of the assignment of portion of onshore contract by Tellabs Denmark to the Assessee and the terms subject to which such assignment was accepted by PGCIL. PGCIL has consented to the assignment of the portion of Onshore Agreement by Tellabs Denmark to the assessee with a specific condition that the Assignment will not amount to Novation of contract between PGCIL and Tellabs Denmark. Section 62 in The Indian Contract Act, 1872 lays down the effect of novation, rescission, and alteration of contract. It lays down that if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed. Assignment involves the transfer of an interest or benefit from one person to another. However the 'burden', or obligations, under a contract cannot be transferred. If one wants to transfer the burden of a contract as well as the benefits under it, one has to novate. Like assignment, novation transfers the benefits under a contract but unlike assignment, novation transfers the burden under a contract as well. In a novation, the original contract is extinguished and is replaced by a new one in which a third party takes up rights and obligations

which duplicate those of one of the original parties to the contract. Novation is only possible with the consent of the original contracting parties as well as the new party.

32. It is clear from the various agreements that there has been only an assignment of the portion of onshore contract by Tellabs Denmark to the Assessee and there has been no novation of the portion of on shore contract between Tellabs Denmark and PGCIL. The consequences in the event of an assignment and novation are different. Since there has only been an assignment and not novation of the contract in the present case, the transaction of assignment between Assessee and Tellabs Denmark cannot be said to be a transaction between two persons either or both of them were not non-residents.

33. It is a very strange situation where had Tellabs Denmark not assigned the portion of onshore contract, the provisions of Sec.92 of the Act would not have been applicable because Tellabs Denmark and PGCIL are not Associated Enterprises. The assignment of the portion of onshore contract has taken place exactly at the same consideration for which Tellabs Denmark agreed to render services to PGCIL. Nevertheless, the assignment agreement between Tellabs Denmark and the Assessee has all the ingredients of an international transaction within the meaning of Sec.92 of the Act. It was an agreement between two or more Associated Enterprises (there is no dispute that Tellabs Denmark and the Assessee are Associated enterprises) where one of both the parties to the transaction i.e., Tellabs Denmark is a Non-Resident. The transaction relates to

provision of services or a transaction which has a bearing on profits, income, losses or assets. Therefore the price paid for such transaction had to pass the ALP test u/s. 92 of the Act.

34. However, we find that the revenue has proceeded on the basis that there is a deemed international transaction u/s.92B(2) of the Act between Assessee and Tellabs Denmark, which in our view is not correct. In this regard, we agree with the submission of the learned counsel for the Assessee that PGCIL is a Government of India entity, performing a governmental functions in a restricted sector. Its policies are directly controlled by the Central Government. It can neither be accused of entering into tainted agreements or exercising undue influence for the purpose of avoiding taxes. PGCIL is neither part of a prior agreement as stipulated in the first limb of section 92B(2) nor has in substance determined the terms of the transaction with the appellant as stipulated in the second limb of section 92B(2). It has followed all the prescribed norms for calling international bids for awarding contracts, and thus cannot be accused of acting as an intermediary between Tellabs Denmark and the appellant for such purpose.

35. Even if the contract between Tellabs Denmark and PGCIL, prior to assignment, is treated as a separate agreement, it only deals with execution of work by Tellabs Denmark in relation to both the onshore and offshore part of the work. The transaction being with a Government of India entity, it cannot be regarded as tainted with the object of avoiding taxes. Nor does it have any reference to the current transaction nor was the

current transaction contemplated at that time. Therefore it cannot be regarded as being in relation to the present transaction and does not have any reference to it. Therefore, there is no prior agreement as required under the first limb of section 92B(2).

36. As a result, the preconditions to attract section 92B(2) of the Act have not been satisfied in the instant case. It cannot be deemed that the transaction between the assessee and PGCIL is one between associated enterprises.

37. The decision of the Hyderabad Bench of ITAT in the case of *Swarnandhra IJMII Integrated Township Development Company Pvt. Ltd. v. DCIT for AY 2007-08, ITA No. 2072/Hyd/2011 dated 31st December 2012* relied upon by the learned counsel for the Assessee is not relevant in the present case because in that case the transactions were between two related parties both of whom were residents, though the two related parties had a common holding company which was non-resident. The Tribunal in the aforesaid decision held that Section 92B(2) of the Act applies to cases where two AEs intend to have an international transaction but want to avoid transfer pricing provisions by interposing a third party as an intermediary. The legal form of the transaction was ignored and the substance of the transaction was given effect by deeming the transaction with the intermediary itself to be one with an AE. This deeming provision needs at least one of the parties to the transaction to be non-resident. In that case, both the taxpayer and IJMII are residents the provisions would not be applicable. Further the



transaction in question does not involve transfer of goods or services either directly or indirectly from the taxpayer to its AE or any other non-resident using IJMII as an intermediary. The factual background in the present case, as we have already seen, is different. In fact, it is quite the opposite in the sense that the original contract was not with an AE and therefore the provisions of section 92 were not attracted. The assignment agreement however attracted the provisions of section 92 of the Act.

38. For the reasons given above, we uphold the orders of the revenue authorities holding that provisions of Sec.92 were applicable to the assignment of the portion of the onshore contract by Tellabs Denmark to the Assessee.

39. We will now deal with the merits of the addition made by the TPO which was confirmed by the DRP. The first aspect which was highlighted by the learned counsel for the Assessee was that there was no opportunity of being heard by the TPO before proposing the adjustment.

40. The proceedings before the Additional Director (Transfer Pricing)-II, Bangalore commenced with a letter dated 1<sup>st</sup> June, 2006. The first and final date of hearing was 17-11-2006. Various details relevant to the said proceedings were filed by the assessee as under:-

- (i) Vide letter dated 15.06.2006 : Audited accounts , Copy of Form 3AB with the Transfer Pricing report and the agreements entered with associate enterprises was submitted.
- (ii) Vide letter dated 09.08.2006: Brief background of the company with details of the revenue streams were

provided along with the cost break up and the FAR analysis on the Project Income was submitted.

- (iii) Vide letter dated 17.08.2006 : Income and expenses split based on the nature of revenue, objection to why the PGCIL Contract will be outside the purview of transfer pricing with the comparable details was provided.
- (iv) Vide letter dated 31.08.2006 : Copy of the contracts entered with PGCIL was submitted.
- (v) Vide letter dated 20.11.20.06 : objection against the proposed order u/s 92CA and the basis on which the objections were raised was submitted. In this letter the assessee also gave a working of the net margin of the comparable companies.

41. The assessee had, in the letter, broadly stated the following:

- (i) the transaction under consideration was not an international transaction;
- (ii) comparables chosen by the TPO were inappropriate.

42. A personal hearing was afforded to the assessee on 17-11-2006. During the personal hearing, it was stated that in view of the findings drawn in the earlier years, the same would be sustained for the present year also. The personal hearing lasted for a very minimal time of less than 15 minutes. Without affording a further opportunity of being heard, an order of 20-12-2006 has been passed under section 92CA of the income-tax Act. In the order under section 92CA of the Income-tax Act, the adjustment as proposed originally in the letter dated 03.11.2006 has been sustained in its entirety. It was submitted that the letter dated 03.11.2006 was drafted even without an opportunity of being heard personally being given to the assessee and even without the requisite details being on record. In other

words, the letter was drafted merely on the basis of the preliminary details submitted by the assessee. All the objections through assessee's various letters have been disregarded. The order as ultimately passed is a reproduction of the letter dated 03.11.2006 with some cosmetic changes. The same comparables as originally chosen have been broadly retained. The reason why the transaction was not an international transaction has been only briefly addressed. No reference was made to the workings of net margin submitted by the assessee.

43. Thus the assessee has not been afforded a proper opportunity of presenting its case. Thus the assessee was not afforded any opportunity to substantiate its case or rebut the proposals of the Additional Director (Transfer Pricing)-II, Bangalore. The dragging of the proceedings to the fag end of the limitation period is in no way attributable to the assessee.

44. The CIT(A) however did not deal with this objection specifically but went on to uphold the order of the TPO. We find that the Assessee has been pursuing its ground that the transaction in question cannot be regard as one falling within the ambit of Sec.92 of the Act and has not been addressed on the merits of the adjustment to the ALP. The Assessee had reported two transactions in Form 3CEB viz., Transaction of rendering Marketing, sales and customer services support to Tellabs International Inc. USA and transaction of loan with Tellabs Enterprises B.V. In respect of the first transaction the Assessee adopted TNMM. In respect of the second transaction the Assessee adopted CUP method. Those transactions were accepted as at Arm's Length by the TPO. The TPO

thereafter proceed to hold that the Transaction which was assigned by Tellabs Denmark to the Assessee was of the same nature as that of rendering marketing, sales and customer services support of Tellabs International Inc. USA and thereafter took the very same comparables.

45. As we have already seen, the ALP adjustments are counter measures to ensure that the prices at which international transactions are entered into by the associated enterprises are not arranged so that the taxes legitimately attributable to income accruing in India are not adversely affected. This basic principle should not be lost sight of. The Transactional profit methods (i.e. Transactional Net Margin Method and Profit Split Method) are treated as methods of last resort which are pressed into service only when the standard methods, which are also termed as 'traditional methods', ( i.e. Comparable Uncontrolled Price Method, Resale Price Method and Cost Plus Method) cannot be reasonably applied. The CIT(A) despite plea of the Assessee that the TPO did not afford proper opportunity of being heard, did not seek any fresh TP study from the Assessee, but however proceeded to confirm the order of the TPO. We deem it appropriate to afford opportunity to the Assessee to explain its stand on the ALP of the assignment agreement. The analysis done by the TPO and CIT(A) in our view is on the basis that the agreement for rendering onshore services was between the Assessee and PGCIL. This is not the international transaction in dispute but the assignment agreement. This difference, in our view, will have consequences in as much as the FAR analysis would be different. We therefore set aside the orders of CIT(A) and remand the issue of determination of ALP afresh to the Assessing

Officer, who will make a reference to the TPO, who will after affording opportunity of being heard to the Assessee with liberty to file a fresh TP analysis and justify the price as at Arm's Length. The TPO will keep in mind that the assignment of the portion of onshore contract had taken place due to business restricting of the Tellabs group worldwide and also the fact that the assignment had taken place on the same terms agreed between Tellabs Denmark and PGCIL. As to whether this transaction itself would constitute a comparable uncontrolled transaction is also a question which will need consideration by the TPO. With the aforesaid observations, the order of AO is set aside and the appeal of the Assessee is treated as allowed for statistical purposes.

46. For statistical purposes the appeals are treated as allowed.

Pronounced in the open court on this 5<sup>th</sup> day of April, 2013.

Sd/-

( N. BARATHVAJA SANKAR )  
Vice President

Sd/-

( N.V. VASUDEVAN )  
Judicial Member

Bangalore,  
Dated, the 5<sup>th</sup> April, 2013.  
Ds/-

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Senior Private Secretary  
ITAT, Bangalore.