



IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA 504 OF 2008

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Judgment Reserved on:10.10.2011

Judgment Pronounced on :18.11.2011

RANBAXY LABORATORIES LTD.

. . . APPELLANT

THROUGH: Mr. M.S. Syali, Sr. Advocate
with Mr. Satyen Sethi, Ms.
Mahua Kalra, Mr. Sumit K.
Singh and Ms. Tunsal Syali,
Advocates.

VERSUS

THE COMMISSIONER OF INCOME TAX

. . . RESPONDENT

THROUGH: Mr. Sanjeev Sabharwal,
Sr.Standing Counsel.

CORAM:-

**THE HON'BLE THE ACTING CHIEF JUSTICE
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL**

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, ACTING CHIEF JUSTICE

1. This appeal was admitted on the following two substantial questions of law:-



"1. Whether on the facts and circumstances of the case, the Tribunal erred in law in holding that CIT had validly assumed jurisdiction under Section 263 of the Act?

2. Whether on facts and circumstances of the case, the Tribunal erred in not holding that in terms of Section 92C (3) read with Section 92CA (1) of the Act, the Assessing Officer was fully competent to determine the arm's length price of international transactions even if the aggregate value thereof exceeded Rs. 5 crores, without making reference to TPO?"

2. The aforesaid questions have cropped for consideration under the following circumstances.

The appellant is a company incorporated under the Companies Act, 1956 engaged in the business of manufacture and sale of pharmaceutical products, such as, patented and/or generic drugs and medicines. For the relevant previous year, the return of income of the appellant was filed on 29th October, 2004 declaring an income of Rs. 330,64,05,014/-. The appellant entered into certain international transactions with its Associated Enterprises (AEs) in the various overseas foreign jurisdictions, viz., (a) Sale of Active Pharmaceutical Ingredients (API) and spare parts;(b) Sale of dosage formulations: (c) Provision of technical assistance and know-how, etc. The transfer pricing in respect of the said international transactions was carried out by M/s RSM Advisory Services Pvt. Ltd,



Chartered Accountants, who issued the certificate in Form 3CEB on the basis of Transfer Pricing study of documentation maintained as per section 92D of the Act read with rule 10D of the Income-Tax Rules, 1962. The international transactions were certified to be at arm's length, based on the study carried out. A certificate from a Chartered Accountant in Form 3CEB was appended alongwith the return of income. It is the case of the appellant that the Assessing Officer in the course of scrutiny assessment required the appellant to, inter alia, explain as to whether, in terms of provisions of Section 92 of the Act, transfer price of the various 'international transaction', entered into by the appellant during the relevant previous year, were at arm's length. In response thereto, the appellant vide letter dated 24th March, 2005 submitted before the Assessing Officer complete transfer pricing documentation alongwith the details and an elaborate note justifying that the 'international transactions' were at arm's length having regard to the Transfer Pricing provisions. The Assessing Officer, accepted the transfer price of the 'international transactions' entered into by the appellant as being at arm's length. The Assessing officer in the assessment completed under Section 143(3) of the Act recorded his finding, in this regard, as follows:-



“in response to the above, the assessee has filed a note alongwith its letter dated 24th March, 2005 and has also produced a copy of transfer pricing document prepared by M/s RSM Advisory Services Pt. Ltd. The assessee has also produced copies of audited accounts of the above AEs for the year 2003 as well as documents/information maintained in support of the Transfer Pricing. After going through the report filed in for No. 3CEB, transfer pricing documents and other details/information furnished, it is observed that M/s RSM Advisory Services Pte. Ltd. after analyzing the comparable data compiled from EXTL & Hoovers Online and doing functional, assets and risks analysis, have reached to the conclusion that as compared to the other prescribed methods, in case of the assessee, TNMM is the Most Appropriate Method. The net margins realized by the uncontrolled comparable companies were identified on similar type of transactions applying the TNMM method. On comparison of the transfer prices charged by the assessee from its Associated Enterprises and net margins thereon, in respect of these international transactions, it is observed that the prices charged by the assessee on international transactions with its Associated Enterprises (AE) were at arm’s length. I have also observed that the declared margins/profits as per the books, are higher than the profits/margins computed as per the Most Appropriate Method and, therefore, I hold that the assessee was in compliance of the Transfer Pricing Provisions and the prices charged during the previous year relevant to the assessment year 2004-05 from its AE in respect of goods and services were at arm’s length and, therefore, no further adjustment is required”.



The assessment was completed on 30th March, 2005 under Section 143(3) of the Act at book profit of Rs.398,48,42,660/- under section 115JB of the Act and at an income of Rs.363,45,44,931/- under regular provisions of the Act as against income of Rs.330,64,05,614/- returned by the appellant, i.e. after making additions/disallowances amounting to Rs.32.81 crores. Thereafter, notice dated 9th March, 2007 was issued by the Commissioner of Income-Tax, Delhi-V, New Delhi (CIT) under Section 263 asking to show cause why the assessment completed under Section 143(3) of the Act be not revised on the grounds that the same was erroneous and prejudicial to the interests of Revenue with regard to determination of arm's length price of international transactions with AEs. It was stated in the show cause notice that the assessment was erroneous and prejudicial to the interests of the Revenue on the following grounds:-

- (i) No referring the matter to the TPO as required by instruction no. 3 of 2003 dated 20th May, 2003.
- (ii) Taking overseas AEs as tested parties.
- (iii) The operating profit/sales in the case of the assessee company worked out to 20.16% as opposed to 26.57% calculated for 4 comparable Indian Companies.
- (iv) Non-consideration of findings of audit of the Central Excise department.



In response to the said notice, the appellant vide letter dated 23rd March, 2007 made elaborate submissions before the CIT explaining the various issues raised in the show cause notice. More specifically, the assessee submitted that-

- (i) The Assessing Officer was competent to determine the arm's length price without reference to the TPO. CBDT instruction no.3 of 2003 was not mandatory and did not take away the jurisdiction of the assessing Officer to himself determine the arm's length price;
- (ii) The assessee company being a complex entity carrying on multiple functions and owing intangibles, was not taken as the tested party. The foreign AEs being least complex were, therefore, adopted as the tested party. There is no bar in law on taking the foreign AEs as the tested party;
- (iii) The comparison made by the CIT of the results of the assessee company with 4 comparable Indian companies suffered from arithmetical inaccuracies. On a proper analysis, on uniform basis, it was seen that the operating profit/sales of the assessee company worked out at 19.45% as against 14.55% for the very same comparable Indian companies taken by the CIT. No adjustment was, therefore, required to be made to the arm's length price in respect of international transactions;



- (iv) Although the Central Excise Department had carried out the audit, no audit report was issued to the assessee company. No adverse findings were recorded or communicated to the assessee company which is further reinforced by the fact that till date the assessee has not received any show cause notice for the said period from the Central Excise authorities.
3. The CIT (A) however did not countenance the aforesaid submissions of the appellant and passed orders dated 29th March, 2007 holding that assessment completed under Section 143(3) of the Act was erroneous and prejudicial to the interests of the Revenue on account of (i) non-reference of the case to TPO,(ii) taking overseas AEs of assessee as tested party and (iii) non consideration of findings of audit of Central Excise Department. The assessment was set aside on the three grounds as aforesaid. The assessing officer was directed to refer the case to the TOP for determination of arm's length price. Being aggrieved by the aforesaid order, the appellant filed an appeal before the Tribunal. The Tribunal vide order dated 22nd January, 2008 upheld assumption



of jurisdiction under Section 263 of the Act by the Commissioner
Income-Tax, Delhi-V, New Delhi.

4. Challenging the aforesaid order of the Tribunal, present appeal is preferred in which aforesaid two questions of law have been formulated for determination. With this background, we take up these questions for our answer.

5. We find from the perusal of the judgment of the Tribunal that the Tribunal has affirmed the invocation of powers by the CIT (A) under Section 263 of the Act on the ground that the Assessing Officer had made the assessment without considering the relevant question without application of mind. It is settled position in law that powers under Section 263 of the Act can be invoked only when assessment is established to be erroneous and prejudicial to the interest of the Revenue. It cannot be invoked merely for making a finding inquiry. Further the order of the Assessing Officer cannot be reviewed merely because any reasonable view of the matter is possible in the case. Thus, when it is found that the Assessing Officer had held an appropriate inquiry and made necessary investigation, on the relevant facts where after he arrived at a



particular conclusion, such a conclusion was not to be interfered with by the Commissioner in exercise of his revisionary jurisdiction under Section 263 of the Act. If the view of the Assessing Officer was plausible and taken after due consideration of the entire material that would be the end of the matter. However, the interference with the assessment order was permissible if it is found that the assessment was made without conducting proper inquiry and investigation as enjoyed by law and warranted in the facts of the case. Then such an order can be termed as erroneous and prejudicial to the interest of the Revenue. This principle of law is supported by the judgment of Supreme Court in **Malabar Industrial Co. Ltd. Vs. CIT** 243 ITR 83, wherein it was held:-

“An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind.”

In that case the Court found justification in the order of the Commissioner passed under Section 263 of the Act on the following basis:-

“In the instant case, the Commissioner noted that the Income-tax Officer passed the order of nil assessment without application of mind. Indeed,



the High Court recorded the finding that the Income-tax Officer failed to apply his mind to the case in all perspective and the order passed by him was erroneous. It appears that the resolution passed by the board of the appellant company was not placed before the Assessing Officer. Thus, there was no material to support the claim of the appellant that the said amount represented compensation for loss of agricultural income. He accepted the entry in the statement of the account filed by the appellant in the absence of any supporting material and without making any inquiry. On these facts the conclusion that the order of the income-tax Officer was erroneous is irresistible. We are, therefore, of the opinion that the High Court has rightly held that the exercise of the jurisdiction by the Commissioner under Section 263(1) was justified."

6. The Tribunal also took note of the following observation contained in **Jagdish Kumar Gulati Vs. CIT**, 269 ITR 71:-

"It is well settled that if the Assessing Officer fails to make a proper enquiry this is erroneous and prejudicial to the interest of the Revenue vide K.A .Ramaswamy Chettiar Vs. CIT (1996) 220 ITR 657 (Mad); Addl. CIT Vs. Mukur Corporation (1997) 111 ITR 312 (Guj); Gee Vee Enterprises Vs. Addl. CIT (1975) 99 ITR 375 (Del); Malabar Industrial Co. Ltd. Vs. CIT [2000] 243 ITR 83 (SC); CIT Vs. Active Traders 9P) Ltd. [1995] 214 ITR 583 (Cal); Swarup Vegetable Products Industries Ltd. (No.1) Vs. CIT [1991] 187 ITR 412 (All.); CIT Vs. Rampiyari Khemka [1967] 63 ITR 367 (Cal.); Bagsu Devi Bafna Vs. CIT [1967] 63 ITR 333 (Cal); CIT Vs. Kiran Debi Singhee [1967] 65 ITR 167 (MP); CIT Vs. Everest Cold Storage [1996] 220 ITR 241 (MP) and Duggal and Co. Vs. CIT [1996] 220 ITR 456 (Delhi), etc. "



7. This position of law was not disputed by the learned counsel for the appellant before the Tribunal or before us. The entire case, therefore rests on the issue as to whether the Assessing Officer had made the assessment without application of mind or without making proper inquiry into the facts and without considering the statutory provision applicable thereof whereas the Tribunal has held it to be so while affirming the order of the CIT (A), the appellant feels otherwise.

8. In this behalf, the submission of Mr. Syali, learned Senior Counsel appearing for the appellant was that the only basis of interference with the order of the Assessing Officer was that the Assessing Officer took the view himself that the price determined was arm's length price without referring the matter to the Transfer Pricing Officer. It was submitted that the CIT (A) or for that matter the Tribunal was wrong in holding that without referring the question of determination of arm's length price to the TPO, the Assessing Officer could not have determined the same. The submission was that the Assessing Officer had ample power and discretion to carry out this exercise. In any case, failure to make reference was only "procedural irregularity" which could not be the basis of treating the



assessment as erroneous and prejudicial to the interest of t Revenue. In support of this submission, Mr. Syali referred to the provisions of Rule 10B of the Income-tax Rules as well as Section 92C of the Act. Predicated on these provisions, the submission was that Section 92C of the Act provides for computation of arm's length price in relation to an 'international transaction'. Sub-Section (3) thereof empowers the Assessing Officer to determine the arm's length price and computation of total income of the assessee subject to conditions provided in clauses (a),(b),(c) and (d) thereof. It was argued that Section 92CA (1) of the Act provides that, where the Assessing Officer considers it "necessary or expedient" so to do, he may refer computation of arm's length price in relation to an international transaction to the TPO with the previous approval of the CIT. Even in a case where reference is made to the TPO, the Assessing Officer is the final adjudicating authority for determining the arm's length price of international transactions; the Assessing officer is not bound by the determination made by the TPO (prior to the amendment in Section 92CA(4) w.e.f. 1.6.2007). Thus, it was argued that when the ultimate authority was the Assessing officer himself, it did not make any difference if he chose not to make the



reference to TPO as according to him it was not "necessary expedient" so to do.

9. Mr. Syali further submitted that while holding that such a reference was compulsory in case the aggregate value of transaction exceeds ₹ 5 crores, the CIT (A) and the Tribunal had relied upon the CBDT instruction no.3 dated 20th May, 2003 by CBDT. According to Mr. Syali, this was misreading of the said instruction which was only in the nature of a guideline as held by this Court in ***Sony India Pvt. Ltd. Vs. Central Board of Direct Taxes and Another*** 288 ITR 52.

Relevant portion of this instruction reads as under:-

"...wherever the aggregate value of international transactions exceeds ₹ 5 crores, the cases should be picked up for scrutiny and reference under Section 92CA be made to the TPO. If there are more than one transaction with the associated enterprise or there are transaction with more than one associate enterprise, the aggregate value of which exceeded ₹ 5 crores, the transaction should be referred to the TPO."

He submitted that judgment in ***Sony India*** (supra) would bring forth the following principle qua the aforesaid instruction viz-a-viz powers of the Assessing Officer under Section 92C of the Act:-

"a. The assessing officer may refer the case for determination of the arm's length price to the TPO where the assessing officer



- considers it necessary and expedient to do so.
- b. Prior approval of the CIT is required before making the reference.
 - c. Instruction No.3 of 2003 is in the nature of guideline to the AO.
 - d. Even pursuant to issue of the said Instruction, the powers of the assessing Officer are not usurped by the TPO or any other authority, contrary to the scheme of the Act.
 - e. The Instruction supplements the discretion of the assessing officer and does not supplant the same.
 - f. The exercise of discretion by the assessing officer in referring the case to the TPO is subject to judicial review by the appellate authority
 - g. The assessing officer may even refer cases to the TPO where the aggregate value of international transactions is below ₹ 5 crores, where the assessing officer considers it necessary or expedient to do so
 - h. The assessing officer is not bound to accept the arm's length price as determined by the TPO."

10. He argued that CBDT instructions did not seek to supplant the discretion of the Assessing Officer by making it mandatory for the Assessing Officer to refer the case to the TPO. Relying upon the judgment of the Apex Court in the case of ***Kerala Financial Corporation Vs. CIT 201 ITR 129***, Mr. Syali argued that a circular in any case could not control the quasi judicial discretion of the Assessing Officer. He also referred to another judgment of this Court



in **Maruti Suzuki India Ltd. Vs. Addl. CIT**, 328 ITR 210 a

particularly the following observations therein:-

“Section 92CA of the Income-tax Act 1961 (hereinafter referred to as the Act) provides that where the assessee has entered into an international transaction and the Assessing Officer considers it necessary or expedient to do so he may, with the previous approval of the Commissioner, refer computation of the arm’s length price, in relation to the said international transaction, under Section 92CA, to the TPO. Since the reference to the TPO is not mandatory, ordinarily the assessing Officer would make reference to TPO in those cases, where he is not in agreement with the price disclosed by the assessee or where, on account of the complex nature of the transaction, he feels that the arm’s length price needs to be determined by the TPO.”

Mr. Sabharwal, on the other hand argued that all these submissions of the appellant which were advanced before the Tribunal as well were duly taken note of and after due consideration by a well reasoned order, the Tribunal has repelled these contentions. He read out those portions of the order of the Tribunal and submitted that the reasons given by the Tribunal were valid.

11. It is not in dispute that under Section 92CA of the Act enables the Assessing Officer to refer computer of arm’s length price in



relation the an international transaction, under Section 92C of t Act, when the Assessing Officer considers it 'necessary or expedient' to do so. Thus, discretion lies with the Assessing Officer. Having regard to the circumstances of a particular case and reference to the TPO is not mandatory. In **Maruti Suzuki** (supra) this Court observed that ordinarily the Assessing Officer would make reference to the TPOs in those cases where he is not in agreement with the particular price disclosed by the assessee or where, on account of complex nature of the transaction, he feels that the arm's length price needs to be determined by the TPO. So far so good. However, further question that has arisen for consideration is as to whether it becomes mandatory on the part of the Assessing Officer to make reference wherever the aggregate value of international transaction exceeds ₹ 5 crores? Instruction no.3 of the CBDT dated 25th May, 2003 makes a stipulation to this effect. The Central Board of Direct Taxes, therefore, have decided that wherever the aggregate value of international transaction exceeds ₹ 5 crores, the case should be picked up for scrutiny and reference under Section 92CA be made to the TPO.



12. It was a common case that the CBDT has issued this Circular in exercise of its powers under Section 119 of the Act. Special Bench of the Tribunal in the case of ***Aztec Software & Technology Vs. ACIT***, 2009 TIOL 170 has upheld the validity of this circular. While doing so, the Special Bench has relied upon the judgment of this Court in ***Sony India*** (supra). The contention of the appellant before the Tribunal, which was repeated before us was that the aforesaid view of the Special Bench is erroneous and rather contrary to the decision of this Court in ***Sony India*** (supra). Dismissing this contention of the appellant, the Tribunal had stated as under:-

“on careful consideration of decision of Sony India P. Ltd.(supra) and that of Special Bench I the case of Aztec Software (supra), we do not find any good reason to accept the argument of Shri Vohra and interpretation he has put on the decision in the case of Sony India P. Ltd. leading to his inference that it is not necessary for Assessing officer to make a reference to TPO even the value of international transaction exceeds ₹ 5 crores. The constitutional validity of above instructions dated May 20, 2003 was challenged under Article 226/227 of the constitution and contentions of the petitioner are recorded at page 59 of the report. It was claimed that classification of international transaction into two categories, those of value exceeding ₹ 5 crore and others less than ₹ 5 crores was not based on any intelligible differentia and, therefore, such instructions were violative of Article 14 of the Constitution. Instructions issued u/s 119 of the I.T. Act were ultra vires of the



statutory provision. The quasi-judicial discretion of the Assessing Officer has been taken away.

69. Their Lordships considered relevant scheme of the Act relating to transfer pricing under Indian regulation, its purposes and the legal validity of above instructions. The matter for consideration was taken in two parts: Firstly, statutory provisions were considered in detail without going into the question of validity of the instruction; and secondly, the question of validity of instructions was considered in the light of Article 14 of the Constitution. It is quite clear from what is stated above in paras 12,29 and 31 of the judgment. Shri Vohra has referred to that part of the decision where discretion of Assessing Officer to determine Arm's Length Price in respect of transaction of value of less than ₹ 5 crore remaining unaffected is discussed. While maintaining the validity of the instructions, their lordships made pertinent observations in para 32 and 37. Para 37 has already been quoted. Para 32 is as under:-

32. Applying the above test, the impugned instruction cannot be held to violate article 14. The classification brought about by the impugned instruction is based on a straightforward recognizable basis giving no room for confusion. Transactions of a high value require a careful examination to determine if the declared price is in fact an acceptable ALP. It may not be expedient for the Assessing Officer to efficiently deal with the assessment involving such an exercise. In that sense it achieves the expeditious disposal of the assessment by the Assessing Officer if the exercise is referred for a specialized determination by the Transfer Pricing Officer. The classification certainly bears a nexus to this objective. We are of the considered view that the challenge to the impugned instruction on the ground of "suspect classification" must fail.



13. On the basis of aforesaid reasoning, the Tribunal concluded that once validity of CBDT Circular was upheld, as per the said circular the Assessing Officer was duty bound to refer the matter to the TPO having regard to the purpose of Specialized Cell created by the Revenue Department to deal with complicated and complex issues and since this channel was not resorted to by the Assessing Officer in the instant case, the Commissioner was right in passing the order under Section 263 of the Act.

14. No doubt, the validity of the said instruction was upheld on the touch stone of Article 14 of the Constitution holding that it was based on reasonable classification and there was rationale nexus with the objectives sought to be achieved. At the same time, we feel that while doing so this Court had also laid down the rigors of the said Circular. No doubt, this Court observed, in the process that the said Circular acted as a guideline to the Assessing officer. However, much mileage cannot be drawn by the appellant from those observations as these observations were made while dealing with the contention of the petitioner in the said petition. That



instruction completely takes away the discretion of the Assessing Officer in relation to an international transaction if the aggregate value thereof exceeded Rs. 5 crores. This contention was turned down in the following words:-

"37. The other ground on which the instruction is challenged is that it completely takes away the discretion of the AO in relation to an international transaction of the value exceeding Rs. 5 crores. A reading of the impugned instruction indicates that it acts as a guideline to the AO in the exercise of the discretion conferred under Section [92CA\(1\)](#). This instruction is in fact helpful in ensuring that the discretion of the AO will not be abused. It correctly interprets the law as requiring only a formation of a prima facie opinion by the AO at the stage of the reference. Therefore, the question of the CBDT supplanting the judicial discretion of the AO does not arise. It is perfectly possible that, independent of the circular, the AO might still "consider it necessary or expedient" to refer an international transaction of such value to the TPO for determination of the ALP. At the same time it is not as if the transactions of the value of less than Rs. 5 crores cannot be referred to the TPO by the AO. Ultimately, any exercise of discretion by the AO is bound to be judicially reviewed by the statutory appellate authorities as well as by courts. Therefore, it is not as if there is no check on the exercise of discretion by the AO.

39. For these reasons, we hold that the impugned Instruction No. 3 dated 20.5.2003 issued by the CBDT is consistent with the statutory objective underlying Section [92CA\(1\)](#) and acts as a guidance to the AO in the exercise of discretion in referring an international transaction to the TPO for determination of its ALP. It is neither arbitrary nor unreasonable, and is not ultra virus the Act.



15. It is clear from the above that this Court held that referring of the matter to the TPO for determination of arm's length price acts as a guide to the AO and is, in fact helpful in ensuring that the discretion of the Assessing Officer will not be abused.

16. We thus agree with the view taken by the Tribunal that the judgment of Special Bench in **Aztec Software** (*supra*) is not in conflict with **Sony India** (*supra*) once the validity of said instruction is upheld by this Court. The followup thereof is that the Assessing Officer was supposed to refer the matter to the TPO having regard to the fact that Specialized Cell was created by the Revenue Department to deal with the complicated and complex issues arising out of the transfer mechanism. The Tribunal was right in holding that even the instant case itself provides a good example for need to refer the matter to TPO in such cases. When circular is issued under Section 119 of the Act and its validity is upheld it is binding on the Assessing Officer. Not taking recourse thereto and passing the order amounted to making assessment without conducting proper inquiry and investigation as enjoyed by law which was also warranted in the facts of this case and, therefore, the Commissioner



was right in holding that such assessment was erroneous a prejudicial to the interest of the Revenue in the light of law laid down by the Apex Court in ***Malabar Industrial Co. Ltd.*** (*supra*).

17. We thus answer both the questions in favour of the Revenue and against the assessee. As a result, this appeal is dismissed.

18. No order as to costs.

ACTING CHIEF JUSTICE

**(SIDDHARTH MRIDUL)
JUDGE**

NOVEMBER 18,2011
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