THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 04.04.2013

+ ITA No. 1114/2008

COMMISSIONER OF INCOME TAX ... Appellant

versus

MENTOR GRAPHICS (NOIDA) PVT.LTD. ... Respondent

Advocates who appeared in this case:
For the Appellant : Ms Suruchii Aggarwal
For the Respondent : Mr M.S. Syali, Sr. Adv. with Ms Husnal Syali, Mr Mayank Nagi.

CORAM:-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE R.V.EASWAR

JUDGMENT

BADAR DURREZ AHMED, J (ORAL)

1. In this appeal, the revenue has challenged the order of the Income Tax Appellate Tribunal, dated 02.11.2007, passed in ITA No. 1969/Del/2006, relating to the assessment year 2002-03. By virtue of an order dated 13.01.2011, a Division Bench of this court, while admitting the appeal, had framed the following substantial question of law:-

> "(i) Whether the finding of the Tribunal that if any one margin of a comparable, in a given set of comparables is lower than the margin of the taxpayer,

then the transactions are at arm's length, is correct in view of the express provisions contained in proviso to Section 92C(2) of the Income-tax Act, 1961?"

2. The counsel for the parties agreed that the above question needs to be re-framed in the following manner:-

"(i) Whether, in view of the first proviso to section 92C(2) of the Income-tax Act, 1961, the Tribunal was correct in holding that if one profit level indicator of a comparable, out of a set of comparables, is lower than the profit level indicator of the taxpayer, then the transactions reported by the taxpayer is at an arm's length price as contemplated in sections 92, 92C and other related provisions of the said Act?"

3. This question has specifically arisen because of the observation of the Tribunal in paragraph 46.2 of the impugned order which reads as under:-

" 46.2 While holding so, we have not adopted mean profit of several comparable found by respective parties because in spite of our repeated requests, the parties before us, were unable to show us any rule or decision under which average or mean margin (OP/TC) of different companies is to be taken. Tax administration and parties can work different Arm's length price i.e. a range by the application of different methods. In such a situation, mean of Arm's Length Price as provided in proviso to Section 92C(2) of the Act can be taken. But above Arm's length range is not the same thing as average operating profits of different entities with different FAR worked through the same method as done in this case by adopting TNMM. The assessee has satisfied not one but several points of arms's length range worked out on record. In our considered view, it is not necessary for the taxpayer to satisfy all points in the range. Even if one point is satisfied, the assessee can be taken to

have established its case and in that situation, the onus is shifted to the department to show why taxpayer's case be not accepted. Arm's length price does not mean maximum price or maximum profit in the range. A willing buyer in an open market shall pay minimum and not maximum price for goods or services. Of course, quality and brand name are important but considered not so by T.P.O. as TNMM method was applied by him. Project profile and other factors were, therefore, not erroneously considered. As noted earlier, the case of integrated Hitech has been specifically accepted as comparable by both the parties. On other four cases noted above, the T.P.O. or other revenue authorities have not made any adverse comment at any stage of proceeding. It was open to them in proceedings before the learned CIT(A) or the Appellate Tribunal to show that PIL figure of integrated Hitech or other four companies were wrong or on account of their FAR analysis, these entities could not be taken as "reliable" comparables for computation of the Arm's Length Price. But no material was brought on record, no arguments advanced to reject the above transaction. Therefore, having regard to facts of the case and material on record, we accept them as comparable and accept the price disclosed by the taxpayer as Arm's Length Price. Consequently, the addition of ₹. 1,45,73,857 is directed to be deleted. The view taken by us finds support from para 1.4 of OECD guideline which we quote below:-

> "1.48 If the relevant conditions of the controlled transactions (e.g. price or margin) are within the arm's length range, no adjustment should be made. If the relevant conditions of the controlled transaction (e.g. price or margin) fall outside the arm's length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the transaction satisfy the arm's length principle, and that the arm's length range includes their results. If the taxpayer is unable to establish this fact, the tax administration must

> determine how to adjust the conditions of the controlled transaction taking into account the arm's length rante. It could be argued that any point in the range nevertheless satisfies the arm's length principle."

4. Insofar as the above observations are concerned, we may straightway refer to the relevant provisions of the Income-tax Act, 1961 (hereinafter referred to as 'the said Act'). Chapter X deals with special provisions relating to avoidance of tax. Section 92, which is the first section in that chapter, stipulates that any income arising from an international transaction is to be computed having regard to the arm's length price. "Arm's length price" is defined in section 92F to mean a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. It may be pointed out at this juncture that the respondent/assessee is an Indian company which was incorporated in 1998. It is a wholly owned subsidiary of IKOS System Inc., a company incorporated in USA and engaged in the business of software development and also in rendering marketing systems services to the parent company. The present case, as pointed out above relates to the assessment year 2002-03 pertaining to the

financial year 2001-02 in respect of which the respondent/assessee filed its return of income on 31.10.2002.

5. The respondent/assessee develops software but does so only upon the instructions of its parent associated enterprise, that is, IKOS Systems Inc. It does not create/develop/sell separate software products or packages and the entire software developed by the respondent/assessee is used by the parent associated enterprise captively for integrating the same with other software components developed by IKOS Systems Inc. The integrated software in turn supports the hardware manufactured by IKOS Systems Inc. and is sold as a separate package in the open market by the latter company. It is, therefore, clear that the respondent/assessee's business is limited to providing services of software development support entirely to its parent company, that is, IKOS System Inc.

6. From the accounts and the auditors report it appears that the respondent/assessee carried on two sets of transactions with its parent company. One set related to the export of software development services and the other set pertained to the export of marketing support service. In the present appeal we are not concerned with the latter set but are only concerned with the export of software development service, being the

international transaction for which the arm's length price is to be determined.

7. Upon the filing of the return by the respondent/assessee, the assessing officer referred the matter to the Transfer Pricing Officer under section 92CA of the said Act for determination of the arm's length price. At this juncture it would be relevant to note the provisions of section 92C, to the extent relevant, which reads as under:-

> "92C. (1) The arm's length price in relation to an international transaction [or specified domestic transaction] shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—
>
> (a) comparable uncontrolled price method;
> (b) resale price method;
> (c) cost plus method;
> (d) profit split method;
> (e) transactional net margin method;
> (f) such other method as may be prescribed by the Board.
>
> (2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:
>
> Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

xxx xxx xxx xxx

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

(a) the price charged or paid in an international transaction [or specified domestic transaction] has not been determined in accordance with sub-sections (1) and (2); or

(b) any information and document relating to an international transaction [or specified domestic transaction] have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(c) the information or data used in computation of the arm's length price is not reliable or correct; or

(d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction [or specified domestic transaction] in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer."

In view of the above provisions, it is apparent that the arm's length price in relation to an international transaction has to be determined by following one of the methods prescribed in sub-section (1) of section 92C. In the present case there is no dispute that it is the transactional net margin method (TNMM) which is the most appropriate method and which had been adopted both by the respondent/assessee as well as by the Transfer Pricing Officer. The proviso to sub-section (2) of section 92C makes it clear that where more than one price is determined by employing the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. There is no dispute that the prices which are to be considered while computing the arithmetical mean as indicated in the said proviso are all prices determined by following any one of the methods stipulated in section 92C(1). It does not have any reference to prices being determined by more than one method. This is so because the reference is to the price determined by the most appropriate method and that can be only one method. We have already indicated above that in the present case the most appropriate method, as accepted both by the respondent/assessee and by the revenue,

was the transactional net margin method. The dispute that has arisen in the present case is with regard to the observation of the Tribunal to the effect that where one of the prices determined by the most appropriate method is less than the price as indicated by the respondent/assessee, that may be selected and there would be no need to adopt the process of taking the arithmetical mean of all the prices arrived at through the employment of the most appropriate method. That observation of the Tribunal, we may say straightway, is incorrect. When more prices than one are thrown up by the most appropriate method, the statute requires that the arm's length price shall be taken to be the arithmetical mean of such prices. This is the plain and simple meaning of the proviso to section 92C(2) of the said Act.

8. Having said so, we may now notice the provisions of sub-section (3) of section 92C which we have already extracted above. A reading of the said provision makes it clear that if the assessing officer in the course of any proceeding of assessment, on the basis of material or information or documents in his possession, is of the opinion that any of the 4 conditions (a) to (d) stipulated in sub-section (3) are satisfied then, the assessing officer may proceed to determine the arm's length price in

relation to the international transaction in accordance with the provisions of sub-section (1) and sub-section (2) of section 92C on the basis of such material or information or documents available with him. Provided, of course, that an opportunity is given by the assessing officer to the assessee to show cause as to why the arm's length price should not be so determined on the basis of material or information or document in the possession of the assessing officer. In other words, in the aforesaid circumstances the assessing officer may himself embark upon the determination of the arm's length price. However, where the assessing officer considers it necessary to do so, he may with the previous approval of the commissioner, refer the computation of the arm's length price to the Transfer Pricing Officer. This is provided in section 92CA of the said Act which, to the extent relevant, reads as under:-

> **"92CA.** (1) Where any person, being the assessee, has entered into an international transaction **[***or specified domestic transaction***]** in any previous year, and 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.
>
> xxx xxx xxx xxx xxx

> (3) On the date specified in the notice under sub-section (2), or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction **[***or specified domestic transaction***]** in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee."

9. Coming back to the facts of the present case, the assessing officer while considering the assessment of income of the respondent/assessee had, in terms of section 92CA(1) of the said Act referred the computation of arm's length price to the Transfer Pricing Officer. That being the position, it is clear that the Transfer Pricing Officer, in view of the provisions of section 92CA(3), was also required to follow the same methodology and approach as was incumbent upon the assessing officer under section 92C(3) of the said Act. In other words, the Transfer Pricing Officer would have to, first, form an opinion that any of the four conditions (a) to (d) set out in sub-section (3) of section 92C existed and then he could proceed to determine the arm's length price in relation to the international transactions in question in accordance with sub-sections

(1) and (2) of section 92C on the basis of such material or information or document available with him. After the Transfer Pricing Officer determines the arm's length price, it is incumbent upon him to send a copy of the order to the assessing officer and to the assessee. In the present case what has happened is that the Transfer Pricing Officer has generally rejected the comparables submitted by the respondent/assessee in his transfer pricing report and has rejected the suggested arm's length price based on a profit level indicator of 6.99% as determined by the respondent/assessee and, in place thereof, the Transfer Pricing Officer adopted a profit level indicator of 24.53% and determined the arm's length price of the international transactions at ₹. 10,34,40,177/- as against ₹. 8,88,66,320/- returned by the respondent/assessee. This resulted in an adjustment of ₹. 1,45,73,857/- in the income of the assessee being the difference between the arm's length price and the price charged by the assessee from its associated enterprise (IKOS System Inc.) for rendering services to them. Thereafter, the assessing officer passed the assessment order on 28.03.2005, inter alia, after making the aforesaid addition. We are not concerned with the other aspects of the assessment order.

10. The CIT (Appeals) confirmed the said addition by virtue of an order dated 30.03.2006. Being aggrieved by the said order, the respondent/assessee preferred an appeal before the Income Tax Appellate Tribunal which has been allowed by the said Tribunal. The revenue is in appeal before us. While allowing the respondent/assessee's appeal, the Tribunal made the observations in paragraph 46.2, which we have already extracted above, to which serious exception was taken by the revenue. We have already indicated that the question that has been framed, has to be decided in favour of the revenue and against the respondent/assessee. But, the matter does not end there inasmuch as we have to also examine as to what is the effect of such an answer.

11. It may be pointed out that the Transfer Pricing Officer had rejected the comparables submitted by the respondent/assessee. However, that rejection was of all comparables, generally. None of the 16 comparables submitted by the respondent/assessee were specifically rejected. The manner in which the comparables were rejected is indicated in Para 7.2 of the Transfer Pricing Officer's order, which reads as under:-

> "7.2 An analysis of the comparables used by the assessee and the search criteria used by it was carried out and it was observed that :

- The assessee has not eliminated the companies which are not comparable in terms of their size i.e. their turnover. It has included all the companies without giving any consideration to the fact that certain comparable companies are new in the business and their profits are more likely to be low in initial years.
- The assessee has not used the data for the year 2002, which is not in line with the provisions of Transfer pricing.
- The assessee has rejected certain companies stating that they have different product profile, which cannot be considered as valid reason since while adopting TNMM, the base has to be a larger one so as to eliminate various functional differences. Further, had the product profile to be matched, then even all those comparables which were finally selected should not have been there since none of them is into development of chip design software, which is the main business of the assessee.
- Companies having high ratio of trading, activity were not excluded."

12. It may be clarified that while six companies have been specifically mentioned in the Transfer Pricing Officer's order, there is no such specific elimination in respect of the other ten comparables. Insofar as the aforesaid six comparable companies are concerned, the observations of the Transfer Pricing Officer were as under:-

"7.5 On 20.01.2005 the assessee was again asked to explain as to why the companies having substantially low turnover as compared to that of the assessee, companies engaged primarily in manufacturing activity and companies with low employee cost (as software development companies typically have high wages/salaries to total sales ratio), may not be eliminated. The list of such companies is as under :

Name of the company	Reason for elimination
Kushagra Software Ltd.	Manufacturing concern
lntergrated Hitech Ltd.	Low turnover
Fare C Software Ltd.	Low employee cost
Luminaire technologies Ltd.	Low turnover
Pentagon globalSolutions Ltd.	Low employee cost. Engaged in manufacturing activity
O C L Informatics Ltd.	Low turnover"

13. On an examination of paragraph 7.2 of the Transfer Pricing Officer's order, it is apparent that the general grounds for rejection of the comparables submitted by the respondent/assessee were as under:-

(a) The companies suggested by the respondent/assessee were actually not comparable inasmuch as their turnovers were widely different;

(b) The respondent/assessee had not used the data of the financial year ending 31.03.2002 which was the relevant year for the purposes of determination of the arm's length price;

(c) The respondent/assessee did not include companies in its list of comparables which had a different product profile. According to the Transfer Pricing Officer, companies having different product profiles also ought to have been included inasmuch as the TNMM method for arriving at the arm's length price allowed for functional differences, which included differences in product profiles;

(d) The comparable companies suggested by the assessee were not companies involved in chip design software; and

(e) The companies having a high ratio of trading activity had not been excluded by the respondent/assessee from its list of comparables."

14. We find that while these were the general reasons cited by the Transfer Pricing Officer for rejecting the comparables suggested by the respondent/assessee, the Transfer Pricing Officer had not indicated as to how each of the comparables suggested by the respondent/assessee did not fulfil the criteria which was adopted by him. The Transfer Pricing Officer suggested that the following filters should have been employed while searching out the comparables:-

(1) Companies engaged in software development having annual turnovers between ₹.50 lakhs and ₹.100 crores;

(2) Companies whose employees' cost is more than 10% of the turnover;

(3) Companies whose sales from manufacturing and trading does not exceed 10% of the total sales; and

(4) Companies which do not have any related party transactions.

15. Based upon the said filters, the Transfer Pricing Officer conducted his own search from the 'Prowess' and 'Capitaline' databases and the Nasscom directory and short listed seven companies as under:-

"Name of the company	**OP/TC (F.Y.2001-02)**
Blue Star Infotech Ltd.	27.18%
Ideaspace Solutions Ltd.	20.69%
Integrate Hitech Ltd.	3.16%
NIIT Gis Ltd.	28.80%
Quintegra Solutions Ltd.	37.89%
Sark Systems India Ltd.	27.91%
Teledata Informatics Ltd.	32.99%
Average OP/TC	**26.94%"**

16. The respondent/assessee submitted that all the companies other than Quintegra Solutions Ltd and Sark Systems India Ltd had either a foreign parent or subsidiary company and therefore might be involved in related party transactions and therefore could not be considered to be comparables. The respondent/assessee also submitted that insofar as

Quintegra Solutions Ltd was concerned it ought to be eliminated because it had a different product profile. The Transfer Pricing Officer accepted the contentions of the respondent/assessee with regard to Blue Star Infotech Ltd. and NIIT Gis Ltd. and excluded those companies from the list of comparables. However, the Transfer Pricing Officer rejected the objections of the respondent/assessee with regard to the other suggested comparables. As a result, the Transfer Pricing Officer finalised his list of comparable companies as under:-

> "7.8 In view of the above discussions, the following list of comparable companies are finally chosen for analysis.

Name of the company	**OP/TC (F.Y.2001-02)**
Ideaspace Solutions Ltd.	20.69%
Integrated Hitech Ltd.	3.16%
Quintegra Solutions Ltd.	37.89%
Sark Systems India Ltd.	27.91%
Teledata Informatics Ltd.	32.99%
Average OP/TC	**24.53%**

> Hence, the arithmetic mean of operating profit over the total cost margins of the comparable companies for the financial year 2001-02 works out to 24.53%. The arm's length price of the international transactions entered into by the assessee with its AE is worked out as under.
>
> Total cost of provision of services by the assessee ₹. 8,30,64,464/-
>
> Margin @ 24.53% of the above ₹. 2,03,75,713/-
>
> Arms length price to be charged

From the AE ₹. 10,34,40,177/-”

17. While rejecting the objections of the respondent/assessee with regard to difference in the product profile insofar as Quintegra Solutions Ltd. was concerned, the Transfer Pricing Officer, inter alia, observed that the transactional net margin method was more tolerant to minor functional differences and was less effected by the transactional differences and in doing so the Tranfer Pricing Officer referred to paragraph 3.27 of the OECD Report on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 1995.

18. We may also note that while rejecting the objections of the respondent/assessee with regard to the comparables which were taken by the Transfer Pricing Officer, the data for the relevant year, that is, financial year ending 31.03.2002 was not available in the database. However, the Transfer Pricing Officer took the data of the subsequent year namely the financial year 2003-04 as an indication of the quantum of related party transactions that might have taken place in the relevant year, that is, financial year ending 31.03.2002. This, as will be pointed out subsequently, was found to be erroneous by the Tribunal inasmuch as the Transfer Pricing Officer could only examine the data for the relevant

year and, if at all, of two years prior to the relevant year in terms of rule 10B(4) of the Income-tax Rules, 1962 (hereinafter referred to as 'the said Rules').

19. The Tribunal while allowing the appeal of the respondent/assessee noted that the comparables furnished by the Transfer Pricing Officer ought to be rejected because, first of all, the Transfer Pricing Officer used data of 2003-04 which could not be used in view of the specific provisions of rule 10B(4) of the said Rules. Secondly, the Transfer Pricing Officer did not do any functional asset risk (FAR) analysis and was of the view that insofar as the TNMM method was concerned it was more tolerant to functional differences and was less effected by transactional differences and for this, the Transfer Pricing Officer relied on para 7.2 of the OECD guidelines referred to above. According to the Tribunal this was contrary to the provisions of rule 10B(2)(3) as well as rule 10B(1)(e). The Tribunal also found that the range of turnovers which was employed by the Transfer Pricing Officer for filtering in comparables was far too wide inasmuch as the Transfer Pricing Officer had considered the range of ₹.50 lakhs to ₹.100 crores whereas the turnover of the respondent/assessee was only ₹.8.8 crores. It may be

pointed out that the respondent/assessee, while selecting its comparables in its Transfer Pricing Report, had taken the range of ₹.47 lakhs to ₹.25.71 crores. Thirdly, the Tribunal returned the finding that the Transfer Pricing Officer should not have rejected the comparables selected by the respondent/assessee. Apart from this, the Tribunal also held that the Transfer Pricing Officer had wrongly adopted the criteria of low employee cost as a percentage of turnover and that such a criteria ought not to have been employed in selecting comparables. It is also observed by the Tribunal that a fresh search for comparables could be done by the Transfer Pricing Officer only if comparables drawn by the respondent/assessee were insufficient or had other deficiencies. According to the learned counsel for the appellant/revenue this observation is contrary to law.

20. The Tribunal then set out the respondent/assessee's comparables after applying all of the Transfer Pricing Officer rejection criteria and came to the conclusion that seven companies fulfilled the criteria of being comparables. Those seven companies are indicated herein below:-

"S. No.	Company	OP/TC (FY 2001-02 Data)
1.	C S Software Enterprise Ltd.	-25.12%

2.	Integrated Hitech Ltd.	3.16%
3.	Reynolds Software Solutions Ltd. (formerly Known as 'Shine Computech Ltd.')	0.47%
4.	Sark Systems India Ltd.	27.91%
5.	V J I L Consulting Ltd.	5.24%
6.	Visu International Ltd.	-2.76%
7.	Zigma Software Ltd.	16.38%
	Arithmetic Mean	3.61%"

It will be observed that the arithmatic mean of the profit level indicator (Operating Profit/Total Cost) came to 3.61% as against 6.99% of the respondent/assessee. The Tribunal also noted that the Transfer Pricing Officer had not made any adverse comment against eight companies which had been suggested as comparables by the respondent/assessee. Those eight companies were as under:-

"S.No.	Company	OP/TC
1.	MYM Technologies	4.81%
3.	VJIL Consulting	5.24%
5.	Zigna Software	16.38%
6.	Sark Systems	30.00%
8.	Shine Computech	0.47%
10.	Visu Cybertech	-2.76%
11.	CS Software	-25.12%
15.	VGL Softech	6.74%

16.	Top Media Entertainment	No data available
	Mean	4.47%"

From the aforesaid table it is apparent that although there are nine companies listed, only eight are relevant inasmuch as there is no data for Top Media Entertaintment. The arithimatical mean of the PLI in the cases of these eight companies also comes to 4.47% which is again lower than the PLI of the respondent/assessee which was 6.99% for the relevant year.

21. The sum and substance of the Tribunal's order is that the criteria adopted by the Transfer Pricing Officer for searching comparables was not correct. Secondly, the Transfer Pricing Officer had not specifically rejected any of the comparables of the respondent/assessee. The Tribunal was of the view that the comparables of the respondent/assesse ought to have been accepted and, had that been the case, there would have been no need for the Transfer Pricing Officer to search for comparables. Of course, in passing the order, the Tribunal made certain general observations that unless and until the comparables drawn by the tax payer were rejected, a fresh search by the Transfer Pricing Officer could not be conducted. However, this has to be tempered with the relevant statutory

provisions which are clearly set out in sub-section (3) of section 92C of the said Act which stipulates four situations whereunder the assessing officer/ Transfer Pricing Officer may proceed to determine the arm's length price in relation to an international transaction. If any one of those four conditions are satisfied, it would be open to the assessing officer/Transfer Pricing Officer to proceed to determine the arm's length price. This clarification of the observation of the Tribunal was necessary and that is why we have done so.

22. We also note that the Tribunal had gone further and reduced the list of comparables to merely four as indicated in paragraph 46 of the impugned order. We do not think that it was the right approach to be adopted by the Tribunal. The Tribunal should have stopped at the point where it decided on facts that the comparables given by the respondent/assessee were to be accepted and those searched by the Transfer Pricing Officer were to be rejected. The only option then left to the Tribunal was to derive the arithmetical mean of the profit level indicators of the comparables which were accepted by it. In this case such comparables happen to be those of the respondent/assessee. The Tribunal, in selecting only one profit level indicator out of a set of profit

level indicators had clearly erred in law. However, in the facts of the present case that would not make any difference to the respondent/assessee's case inasmuch as even if the arithmetical mean of the comparables as accepted by the Tribunal are taken into account, the profit level indicator would, whether the seven companies are taken into consideration or all eight companies are taken into consideration, be less than 6.99 % which is the profit level indicator of the respondent/assessee for the relevant year, that is, financial year ending 31.03.2002. We may also make it clear that the reference to the OECD guidelines by the Tribunal in the impugned order are in the context of the reliance placed by the Transfer Pricing Officer on the very same guidelines, in particular, to paragraph 3.27 thereof. In the present case, there are specific provisions of sub-rules (2) and (3) of Rule 10B of the said Rules as also of the first proviso to section 92C(2) of the said Act which apply. Therefore, the question of applying OECD guidelines does not arise at all.

23. From the foregoing discussion, it is clear that the Tribunal was wrong in holding that if one profit level indicator of a comparable, out of a set of comparables, is lower than the profit level indicator of the

taxpayer, then the transaction reported by the taxpayer is at an arm's length price. The proviso to section 92C(2) is explicit that where more than one price is determined by most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. To this extent the appeal is allowed. However, as pointed out above, if this principle is applied to the comparables suggested by the assessee (which have not been rejected by the Transfer Pricing Officer), the arm's length price suggested by the assessee would yet be acceptable in law. There shall be no orders as to costs.

BADAR DURREZ AHMED, J

R.V.EASWAR, J

APRIL 04, 2013
kb