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Article on Most appropriate method for computing Arm's Length Price (ALP) of International Transaction:-

What method is to be applied or what method not to be applied is always a point of dispute in transfer pricing matters. The undersigned has tried to analyse this issue in the light of relevant provisions of law and recent development of case laws. It is my humble request to the readers of this note that if they think that I have missed certain things or case laws then they please update me so that I can improve my note.

Recently the AP high Court in the case of *Alumeco India Extrusion Ltd reported at TIOL = [2014-TII-33-HC-AP-TP](#)* has held that TPO cannot reject the method applied by assessee for computing the ALP without assigning any cogent reasons. Earlier also so many courts have time and again has held that TPO is a quasi-judicial authority and hence he has to act in a judicious manner, he cannot act on his whims and fancies. Therefore, what method would be appropriate for computing the Arm Length price of an International Transaction is an issue which requires deep study as it plays important role in the TP matters. The basic law on which the TP provisions are propounded is that a Country would get its legitimate taxes and the Taxpayer would also not be taxed in an unreasonable manner. That is why so many methods are prescribed under the provisions of Income Tax law (Act+ Rules).

Selection of the most appropriate method for determining arm's length price under the transfer pricing provisions, in a particular fact and situation, is not an academic exercise which can be decided de hors the peculiar facts of that situation, and, therefore, there cannot be any straight-jacket formula holding application of a particular method in case of a particular type of product or service.

In fact the OECD guidelines and US regulations has introduced the Best Method rule and gave freedom to a taxpayer as well as to the revenue authorities to employ any of the method as Most Appropriate method, which is commonly used in Judicial orders in abbreviated form as (MAM). It is also not necessary for a taxpayer to go through all the methods to find out the most appropriate methods, the trained brains who have been entrusted with the task of taxation, depending on the facts of case, apply one of the methods to justify the Arm's Length Price(ALP) of international transactions.

The Special Bench of ITAT in the case of Aztec Software **reported in 107 ITD 141(SB)** has held that the selection of the most appropriate method (MAM) is based on the nature

of transaction, the availability of relevant data and the possibility of making appropriate adjustments.

Methods under the Indian Provisions-

Section 92C of the Indian Income Tax provides about the methodology of computing the arm's length price. It reads as under:-

(1) The arm's length price in relation to an international transaction ⁸⁶[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 prescribe⁸⁸, 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 prescribed⁸⁹ 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 prescribed⁹⁰ :

⁹¹[Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

***Provided further** that if the variation between the arm's length price so determined and price at which the international transaction ⁹²[or specified domestic transaction] has actually been undertaken does not exceed ⁹³[such percentage ⁹⁴[not exceeding three per cent] of the latter, as may be notified⁹⁵ by the Central Government in the Official Gazette in this behalf], the price at which the international transaction ⁹²[or specified domestic transaction] has actually been undertaken shall be deemed to be the arm's length price.]*

The following third proviso shall be inserted after the second proviso to sub-section (2) of section 92C by the Finance (No. 2) Act, 2014, w.e.f. 1-4-2015 :

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

⁹⁶[Explanation.—For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 1st day of October, 2009.]

⁹⁷[(2A) Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No. 2) Act, 2009 (33 of 2009), is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds five per cent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso.]

⁹⁸[(2B) Nothing contained in sub-section (2A) shall empower the Assessing Officer either to assess or reassess under [section 147](#) or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under [section 154](#) for any assessment year the proceedings of which have been completed before the 1st day of October, 2009.]

(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 ⁹⁹[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 ⁹⁹[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 ⁹⁹[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.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined :

Provided that no deduction under [section 10A](#) ¹[or [section 10AA](#)] or [section 10B](#) or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section :

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted²[or was deductible] under the provisions of Chapter XVIIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Relevant Rule applicable in this regard is as under-

While rule 10B(1) of the Income Tax Rules 1962, provides that arm's length price in relation to an international transaction shall be determined by any of the methods, **"being the most appropriate method", set out therein,**

Rule 10 C(1) provides the mechanism for selecting the most appropriate method **"which is best suited to the facts and circumstances of each particular transaction" and "which provides the most reliable measure of arm's length price of the international transaction".**

Rule 10C (2) further provides that in selecting the most appropriate method as specified in rule 10C(1), certain factors are to be taken into account:

- (a) the nature and class of the international transaction;*
- (b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;*
- (c) the availability, coverage and reliability of data necessary for application of the method;*
- (d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;*
- (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions; (f) the nature, extent and reliability of assumptions required to be made in application of a method [Emphasis, by underlining, supplied by us]*

Interpretation-

What is clear from the above analysis is that a method for determining arm's length price, to be held as a 'most appropriate method' (MAM), should be, **as provided in rule 10C(1).**

A method "which is best suited to the facts and circumstances of each particular transaction" and a method and "which provides the most reliable measure of arm's length price of the international transaction"

Under rule 10C(2)(c), "the availability, coverage and reliability of data necessary for application of the method" is one of the crucial factors determining suitability of a method of determination of arm's length price in a particular fact situation. Similarly, it is also important to determine whether accurate adjustments can be made for the

differences between the international transactions and the comparable uncontrolled transactions, and unless such adjustments can be made the related method cannot be said to be most appropriate method.

Types of Method prescribed under Income Tax Act

CUP-Comparable Uncontrolled Price Method(CUP):- Rule 10B(a) lays down provisions about the CUP method.

This method is a direct method and always applicable where the facts and circumstances of two transactions are similar in all aspects. Generally speaking CUP is applied when a price charged for a product or service. Under this method prices charged in a controlled transaction is compared with the price charged for same or similar property or services transferred in a comparable uncontrolled transaction. Being a direct method CUP is give preference over the other methods. However, that does not mean that it will always prevail over the other methods, the applicability of the same requires high degree of comparability in terms of products sold & services provided

In the OECD Guidelines for Multinational Enterprises and Tax Administrators, it is clearly stated that application of CUP method *"requires high degree of comparability not only in the products sold and services provided but also in the economic circumstances in which the respective AE and non AE transactions take place"*.

In the UN Transfer Pricing Manual, it is observed that *"degree of comparability between controlled and uncontrolled transactions is typically determined on the basis of a number of attributes of the transactions or parties that could materially affect prices or profits and the adjustment that can be made to account for differences"* and then it is observed that *"these attributes, which are usually referred to as the five comparability factors, include: (i) Characteristics of the property or service transferred; (ii) Functions performed by the parties taking into account assets employed and risks assumed, in short referred to as the "functional analysis" (iii) Contractual terms; (iv) Economic circumstances; and (v) Business strategies pursued"*. Clearly, therefore, the significant variations in economic circumstances and contractual terms can take seemingly comparable transactions outside the ambit of comparability.

U.S.Regulations 1.482-3(b)(5) provide that when CUP method is to be applied on the basis of Public data, the following requirements must be met

- a) The data is widely and routinely used in ordinary course of business in the industry to negotiate prices for uncontrolled sales.
- b) The data used to set prices in the controlled transaction in the same way that is used by uncontrolled transactions
- c) The amount charged in controlled transactions is adjusted appropriately

U.S. regulations further warn that the data from public exchange, quotation media should not be used in extraordinary situations such as war period, economic recession and other natural calamities. Indian Income Tax Rule 10B(a)(ii) takes cares of these situations

Rule10 B(1)(a)(ii) of the Income Tax Rules also provides that ALP determined by applying a particular method further to be adjusted the exact phrase of rule 10B is like this *"such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises*

entering into such transactions, which could materially affect the price in the open market

Therefore it is clear that a direct method would not always prevail over indirect method and what would be the most appropriate method is depend upon the facts of each case. And the TPO cannot forcefully inject his method as MAM for computing the ALP of International Transactions.

The CUP is most reliable method and usually applicable when the transfer is of Tangible Property & the comparable commodity is identical or nearly similar to the controlled transaction. However, there are certain limitations to this method for example internal CUP is not suitable where the volume of transactions with AE and Non AE is at huge variation.

Whether a Direct Method would always prevail over the other methods, is a issue which is debatable as per the provisions of Ruel 10B :-

Recent case laws in this regards are as under:-

Case laws wherein it has been held that a direct method would always prevail over the indirect method are as under:-

ACIT Vs MSS India Ltd [(2009) 32 SOT 132 (Pune) = [2009-TII-07-ITAT- PUNE-TP](#)

Serdia Pharmaceuticals India Pvt Ltd VS ACIT [(2011) 44 SOT 391 (Mum)] = [2011-TII-02-ITAT-MUM-TP](#)

Recently Hon'ble Ahmadabad of the ITAT in the case of GULBRANDSEN CHEMICALS PVT LTD has held that it is not always necessary that a direct method would prevail over the indirect method for computing the ALP Hon'ble Bench has referred to umpteen numbers of case laws in this regard

RPM (Resale Price Method):- Rule-10B(1)(b):- of the Income Tax Rules provides about the RPM method. As per this rule RPM method is to be applied when a property purchased or services obtained from an AE is resold to non- AE. One more aspect is to be kept in mind while applying this method is that property purchased is resold without there being any value addition, means property purchased is just passed on as it is. It is suitable when a distributor is selling the goods without having any operating expenses. For Example, an Indian Entity brought Laptop from its AE and sold them as it is without any further modification. Then RPM is the best method in such situation. However like other methods this method has also its limitation, it not applicable where there are so many intermediary involved, it is not applicable where there is any value additions made by the importer of products

Case laws where RPM is approved:-

Celio Future Fashion P Ltd (ITA No.1928/Mum/2016) = [2019-TII-146-ITAT-MUM-TP](#)

Delhi bench of Tribunal in the case of Burberry India P Ltd (ITA No.758 & 7684/Del/2017 dated 22.06.2018)= [2018-TII-359-ITAT-DEL-TP](#).

Applicability of RPM has been considered by the Bangalore bench of Tribunal in the case of M/s A.O.Smith India Water Heating P Ltd(ITA No.176/Bang/2015), wherein the

Tribunal, after considering various case laws on the matter, held that the RPM is the most appropriate method in case of a distributor of products.

For the sake of clarity, the relevant observations made by the Tribunal in the case of A.O Smith India Water Heating P Ltd(*ITA No.176/Bang/2015*) are as under:-

14. Now the assessee is before us with the submission that it is an accepted principle that the computation of ALP based on a direct method like RPM, which tests the results at gross level unlike the TNMM which tests the results at net level, extinguishes the requirement of making adjustment in relation to the difference in operating expenses, which could be different from enterprise to enterprise. It was further contended that as provided in Rule 10B, under RPM price of international transaction needs to be computed on the basis of gross profit margin earned in uncontrolled transactions, while under TNMM price of international transaction is computed on the basis of net profit margin of uncontrolled transactions. As per Rule 100(1), the most appropriate method for determining the ALP depends upon the facts and circumstances of each case. Similarly, the operating expenses incurred by the assessee is different from the operating expenses incurred by comparable companies. The learned counsel for the assessee has highlighted that I incurs certain expenses which does not affect sale/purchase price of the goods sold. Therefore, in a situation where incurrance of item expenses affects only the net profit of the entity without corresponding effect of gross profit or price of transactions, the TNMM will not provide the most reliable arms length results. The selection of TNMM would require making reliable adjustment to arrive at the operating profit i.e., adjustment for expenditure incurred in the current year, the benefit of which will be received in the future year. In the absence of reliable adjustment, the selection of TNMM will not result in arriving at the ALP of the international transaction. In transactions method like RPM or Cost Plus method, the effect of these factors may be eliminated as natural consequences of insisting upon greater product of Junction similarity. Depending upon the facts and circumstances of the case and particular on the effect of functional differences on the cost structure and the revenue of the potential comparables, the net profit indicators can be less sensitive than the gross margin to the difference in the extent of complexity of function and difference in the level of risk.

15. It was further contended that comparability should not be interpreted in isolation because of the conditions and circumstances of the controlled transactions should be taken into consideration while comparing the net margin. Under the facts and circumstances of the assessee, the net margin comparability is more volatile than the gross margin comparable. In the light of the facts, it was contended that if the cost structure is such that costs are effecting in net profit directly without affecting the price or gross margin, then there can be no two opinions that RPM should be preferred over the TNMM method. In support of these contentions, he placed reliance upon the following judgments-.-

(1) *Horiba India Pvt. Ltd., v. OCIT, 81 taxmann.com 209*

(2) *Bose Corporation Pvt. Ltd., v. ACIT, Circle 3(1), New Delhi, 77 taxmann.com 194*

(3) *ITO v. L'Oreal India Pvt. Ltd., (2015) 24 taxmann.com 192 (Born)*

(4) *Mattel Toys India Pvt. Ltd., v. DOIT in ITA No.2476/Mum/2008 = [2013-TII-139-ITAT-MUM-TP](#)*

Cost plus Method (CPM):- Rule 10(1)(c) of the Income Tax Act lays down provisions about CPM method. As per this rule the method is ordinarily used where some semi-finished goods are sold between related parties or such similar situations or in respect of joint facility agreements, etc. This method is adopted in situations where comparable transactions are of functional similarity with that of controlled transactions, important thing to be kept in mind is that 100% resemblances is alien to this method, only thing is that there should be functional similarity. In simple words Products which are functional comparable, are good enough for benchmarking under cost plus method. For example an Indian Entity is manufacturing some product for its AE, this Indian Entity is 100% captive unit of its AE and hence no selling the product to any other party anywhere in the world. On the other hand the AE is also using the product for its own consumption, and not reselling the same. Therefore in such a scenario neither CUP no RPM would be applicable. In Such a case CPM is applicable and MAM. And to find out the ALP the assessee or revenue has to find out parties who are manufacturing same product and exporting the same to unrelated parties. Therefore, FAR is to be applied in such cases along with the terms of agreement etc.

In simple words this method is generally employed in the cases of captive units, when the captive unit is a contract manufacturer or service provider, in Indian context, generally the BPO/IT enabled service Industries fit for the applicability of this method. The captive units are low risk entities and work on fix profit agreement with the parent for a certain period; these units usually enjoy smaller margins as compared to uncontrolled entrepreneurs, who bear most of the fundamental risk.

Famous case laws where CPM has been held to be MAM having regard to the facts and law are as under:-

The land mark case of Aztec Software reported in 107 ITD 141(Bang) of Special Bench of the ITAT has explained CPM in a detailed manner. The special Bench has observed as under :-

Rule 10B(1)(c) describes CPM as follows:

(c) cost plus method, by which,

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

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

(iii) the normal gross profit mark-up referred to in Sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(vi) the costs referred to in Sub-clause (1) are increased by the adjusted profit mark-up arrived at under Sub-clause (iii)

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

This method is ordinarily used where some semi-finished goods are sold between related parties or similar situations or in respect of joint facility agreements, long-term buy and supply arrangements of provisions of services etc. This is a method, which uses the costs incurred by the supplier of the property or services in a controlled transaction. Here also as in the case of RPM benchmarking of normal gross profit margins is necessary. The cost plus mark up of the supplier in a controlled transaction should ideally be established by reference to the cost plus mark up with the supplies of functional similarity earned in a comparable uncontrolled transaction.

Cost Plus Method is adopted in situations where comparable transactions are of functional similarity with that of controlled transactions. In other words, under Cost Plus Method, there is no necessity to benchmark with such product, which is 100% identical. Products, which are functionally comparable, are good enough for benchmarking under Cost Plus Method. Even in this regard FAR analysis is critical in identifying functionally similar comparable transactions.

As in other methods, the assets employed, the functions performed, the risk assumed, the contractual terms and other differences have to be taken into account. The mark up must be measured consistently between the associated enterprises and independent enterprises.

In the case of Essar Shipping Vs DCIT reported in 27 SOT 409(Mum) it is held that as per cost plus method, sum of direct & indirect cost along with gross profit mark-up, etc is taken as ALP in relation to supply of property and hence what is relevant is to include gross profit mark-up and TPO is not correct in reducing anything from cost. In this case the TPO has reduced some amount from the cost on the ground that the amount reduced is attributable to future dividend to be distributed by Company, in other words the TPO has reduced certain sum by taking it as provision for dividend instead of normal gross profit.

Some other case laws wherein the method has been approved are as under:-

- a) ACIT Vs MSS India Pvt Ltd- 32 SOT 132(Pune) **2009-TII-07-ITAT-PUNE-TP**
- b) Diamond Dye Chem Ltd Vs DCIT – ITA No-6873 of 2006
- c) Altair Engineering India Pvt Ltd- Vs DCIT 11 Taxman.com287(Bang)

Profit Split Method:-PSM-The Special Bench of the ITAT in the case of Aztech Software reported in 107 ITD has observed as under:-

Profit Split Method (PSM):

Rule 10B(1)(e) prescribes PSM as follows:

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

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

evaluated by unrelated enterprises performing comparable functions in the similar circumstances;

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

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an ALP in relation to the international transaction.

This method may be applicable in cases where transactions involved transfer of unique, intangible or any multiple interrelated international transactions, which cannot be evaluated separately for determining the ALP of any one transaction.

Methodology:- The profit split method first identifies the profit to be split for the associated enterprise from the controlled transactions in which the associated enterprises are engaged. It then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. The combined profit may be the total profit from the transactions or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties, such as the profit arising from high value, sometimes unique, intangibles.

The contribution of each enterprise is based upon a functional analysis and valued to the extent possible by any available reliable external market data.

The functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by each enterprise. The external market criteria may include, for example, profit split percentages or returns observed among independent enterprises with comparable functions.

Hence the PSM can be applied in two ways either as Residual Profit Split Method or as Transactional Profit Split Method.

Recently the Bangalore Bench of the ITAT has discussed the applicability of this method in the case of Toyota Kriloskar-[2020-TII-140-ITAT-BANG-TP](#) and has observed as under:-

"+ it is clear from the above OECD guidelines that in 'order to determine the profits to be split, the crux is to understand the functional profile of the entities under consideration. Although the comparability analysis is at the "heart of the application of the arm's length principle", likewise, a functional analysis has always been a cornerstone of the comparability analysis. In the present case the Assessee leverages on the use of technology from the AE and does not contribute any unique intangibles to the transaction. It may be true that the Assessee aggregated payment of royalty with the transaction of manufacturing as it was closely linked and adopted TNMM but that does not mean that the transactions are so interrelated that they cannot be evaluated separately for applying PSM. Further, the Assessee does not make any unique contribution to the transaction; hence PSM in this case cannot be applied".

Transaction Net Margin Method(TNMM):- It is the most widely applied method in the determination of ALP. It can also be termed as residuary method which can be applied anywhere in such cases where no direct method seems to be applicable.

Special Bench of Aztec vis-a-vis this method has observed as under:-

Rule 10B(1)(e) describes TNMM as under:

(i) the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in Sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realized by the enterprise and referred to in Sub-clause (i) is established to be the same as the net profit margin referred to in Sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

The TNMM requires establishing comparability at a broad functional level. It requires comparison between net margins derived from the operation of the uncontrolled parties and net margin derived by an associated enterprise on similar operation.

Under this method, the net profit margin realized by an associated enterprise from an international transaction is computed in relation to a particular factor such as costs incurred, sales, assets utilized, etc. The net profit margin realized by an associated enterprise is compared with net profit margin of the uncontrolled transactions to arrive at the ALP. The TNMM is similar to RPM and CPM to the extent that it involves comparison of margin earned in a controlled situation with margins earned from comparable uncontrolled situation. **The only difference is that, in the RPM and CPM methods, comparison is of margins of gross profits and whereas in TNMM the comparison is on margins of net profit.**

TNMM requires comparison between net margins derived from the operations of the uncontrolled parties and net margins derived by an associated enterprise from similar operations. Net margin is indicated by the rate of return on sales or cost or operating assets, and this forms the basis for TNMM. A functional analysis of the tested party or the independent enterprise, as the case may be, is required to determine whether the transactions are comparable and the adjustments that are required to be made to obtain reliable results. The tested party would have to consider other factors, like cost of assets of comparable companies, etc., while applying the return on assets measure. Ordinarily, the tested party has to be the party providing services because it is on the basis of rate of return on sales or cost or operating assets that transactional margin is computed. These parameters generally available in the case of a party providing services.

In simple terms TNMM requires comparison of net profit margins realised by an enterprise from an International Transaction or an aggregate of international transactions and not comparisons of operating margins of Enterprises.

The Mumbai Bench of the Tribunal in the case of UCB India Pvt Ltd Vs ACIT reported in 30 SOT 95 has held that under TNMM one has to see only net profit margin realised by

an enterprise from an international transaction or a class of such transactions but not operational margins of enterprise as a whole(Emphasis Supplied)

Other relevant case laws are as under:-

Add CIT Vs Tej Diamond- 37 SOT Vs 341(Mum)

DCIT Vs Startlite 40 SOT 421(Mum)

Chiron Behring Vs ACIT 10 taxman.com 125(Mum)

CIT Vs Givanudan Flavours India Pvt Ltd 44 SOT 1(Mum)(URO)

GIMPEX Pvt Ltd Vs ACIT- ITA No 57/Chennai/2018

AT& T- ITA No-5535 of 2016 dated 27.05.2019

Some other relevant points- **When TNMM is applied FAR analysis of controlled and uncontrolled are to be done while screening comparable**

Most Appropriate Method- As per the discussions made in various case laws and rules of the Income Tax Rules:- In selecting most appropriate method the following factors shall be taken into account

- a) **The nature of the international transaction**
- b) **The class of international transaction**
- c) **The class or classes of AE**
- d) **The availability of data**
- e) **The Coverage of data**
- f) **The reliability of data**

Further, the special Bench of the ITAT in the case of Aztec has held that burden is on assessee to select the most appropriate method for determination of ALP. Some of the pertinent observations of the Special Bench are as under:-

"21. The burden is on the assessee to select the most appropriate method (MAM). This decision of selecting MAM is to be substantiated by the assessee by an appropriate documentation as well as by substantiating why a particular method is considered best suited to the facts and circumstances of the international transaction and as to how it provides the most reliable result of the ALP. Rule 10C(2) of the I.T. Rules lays down the factors to be considered in selection of MAM. These have been extracted in the previous paragraphs.

122. Hence, while making the selection of the transfer pricing method, one would be required to evaluate each method vis--vis the a factors / parameters prescribed in Rule 10C(2).

123. Once MAM, i.e. most appropriate method, is selected, the next step is to collect the inputs for computing arms length price under that method. The question arises as to who has the onus of collecting and furnishing the requisite inputs for determining the ALP.....

127 Having regard to above statutory provisions, it is clear that burden to establish that international transaction was carried at ALP is on the taxpayer. He has also to furnish comparable transactions, apply appropriate method for determination of ALP and justify the same by producing relevant material and documents before the revenue authorities.

In case revenue authorities are not satisfied with the ALP and the supporting documents / information furnished by the taxpayer, the authorities have ample power to determine the same and make suitable adjustments. In such a situation, as rightly admitted in the ground of appeal by the revenue, this responsibility of determination of ALP is shifted to the revenue authorities who are to determine the same in accordance with statutory regulations."

The above note is dedicated to my Seniors- Shri C.S. Aggarwal jee, Shri S.D.Kapila and all others who guided me in ITAT with a very clean heart.

Thanks

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