[2016] 75 taxmann.com 81 (Pune - Trib.)[16-09-2016]

IT/ILT : Company providing off-site services to its associate enterprises stand by on a different footing from company rendering on-site services to its clients

IT/ILT : Where on reference to TPO, he determined ALP of international transaction and proposed T.P. adjustment pursuant to challenge by assessee to validity of assessment proceedings, said proceedings were dropped by Assessing Officer thereafter, Assessing Officer sought to reopen assessment to give effect to adjustment proposed by TPO, since no assessment proceedings were pending in relation to relevant assessment year, Assessing Officer was precluded from making a reference to TPO under section 92CA(1)

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[2016] 75 taxmann.com 81 (Pune - Trib.)

IN THE ITAT PUNE BENCH 'A'

Deputy Commissioner of Income-tax, Circle-6, Pune

v.

SAS Research & Development (India) (P.) Ltd.*

MS. SUSHMA CHOWLA, JUDICIAL MEMBER
AND R.K. PANDA, ACCOUNTANT MEMBER
IT APPEAL NOS. 810, 1850 & 1927 (PN) OF 2013
CO NOS. 3 & 4 (PN.) OF 2015
[ASSESSMENT YEARS 2004-05 TO 2006-07]
SEPTEMBER 16, 2016

I. Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price (Comparables and adjustments/Comparables - Illustration) - Assessment years 2004-05 to 2005-06 - Assessee-company was engaged in providing software development support services to SAS group entities - Whether company providing off site services to its associate enterprises stand on a different footing from company rendering on-site services to its clients - Held, yes - Whether where assessee had declared turnover of Rs. 10.08 crores, companies whose turnover was more than Rs. 200 crores should be excluded from comparable list - Held, yes [Para 14] [Partly in favour of assessee]

II. Section 92CA, read with sections 144C and 148, of the Income-tax Act, 1961 - Transfer pricing - Reference to TPO (Reassessment) - Assessment year 2006-07 - On reference to TPO, he determined ALP of international transaction and proposed T.P. adjustment - Pursuant to challenge by assessee to validity of assessment proceedings, said proceedings were dropped by Assessing Officer - Thereafter, Assessing Officer sought to reopen assessment to give effect to adjustment proposed by TPO - Whether since no assessment proceedings were pending in relation to relevant assessment year, Assessing Officer was precluded from making a reference to TPO under section 92CA(1) - Held, yes - Whether, consequently, order passed by TPO under section 92CA(3) was a nullity in law and void ab initio and such an order passed by TPO was not a valid material for Assessing Officer to entertain a belief that certain income chargeable to tax had escaped assessment within meaning of section 147 - Held, yes [Para 29] [In favour of assessee]

FACTS-I

- The assessee-company was engaged in providing software development support and software consultancy services to SAS group entities. Various transactions, *i.e.* on site services were entered into by the assessee with its associated enterprises during the year under consideration. The assessee had benchmarked the two services *i.e.*, provision of software development services to SAS and provision of on-site services to overseas SAS group companies separately by using OP/OC as PLI, in its TP study report.
- The TPO re-worked the arithmetic mean of margins of comparable companies and, because of abnormal results shown by certain companies, the list of companies to be compared with the results shown by the assessee were revised and for the provision of software development services, the arithmetic mean of said comparables by applying single year's data worked out to 14.18 per cent. Consequently, the TPO proposed an adjustment to the arm's length price of provision of software services by the assessee to its associate enterprises.
- The Commissioner (Appeals) while deciding the appeal of assessee had directed the Assessing Officer/TPO to apply turnover filter of Rs. 1 to 200 crores while finally selecting the list of comparables.

HELD-I

- ***Turnover Filter***
- There is merit in the orders of the Commissioner (Appeals) that while benchmarking international transactions entered into by the assessee with its associate enterprises, the comparison should be made with such companies by applying FAR analysis, *i.e.*, Functions, Assets & Risk analysis. While applying the said analysis, recourse should be made to comparing the margins declared by the tested party with such comparables who are falling within turnover criteria. The assessee has declared turnover of Rs. 10.08 crores in segment of provision of software development services the order of Commissioner (Appeals) in applying the turnover filter of Rs. 1 to 200 crores is upheld. [Para 14]
- ***Onsite Services***
- The case of assessee is that margins of both the services should be clubbed in order to benchmark the arm's length price of international transactions with its associate enterprises *vis-à-vis* the mean margin shown by the comparables. There is no merit in the claim of assessee in this regard. The law has developed in the field of transfer pricing provisions. The issue as to whether an activity being provided by a concern on account of off-site services and on-site services have been compared and it has been held that the company engaged in providing on-site services is in-comparable to the company engaged in providing off-site services. [Para 15]
- In view of the proposition, that the company providing off-site services to its associate enterprises stand on a different footing from the company rendering on-site services to its clients, even in a case where one company itself is providing both the said services, the same have to be considered separately while benchmarking the international transactions. The basis on which the assessee is being reimbursed on account of its off-site services is cost plus 7.5 per cent and for on-site services, it is being reimbursed at cost plus 15.04 per cent, which itself establishes that the two services provided by the assessee are different and the same cannot be clubbed for the purpose of benchmarking the international transactions. The order of Commissioner (Appeals) in this regard is reversed and the Assessing Officer is directed to re-compute the same. [Para 16]

FACTS-II

- The original return of income was filed by the assessee and notice under section 143(2) in the case of assessee was issued on 31-12-2007, whereas it had to be served upon the assessee on or before 30-11-2007.
- In such assessment proceedings, reference was made to the TPO for determining the arm's length price of international transactions and the TPO had passed the order under section 92CA(3).
- The assessee filed objections to the draft assessment order and the DRP directed the Assessing Officer to examine the plea of assessee *vis-à-vis* validity of assessment proceedings. Thereafter, the assessment

proceedings under section 143(3) were dropped by the Assessing Officer in the case of assessee on 28-09-2010.

- Thereafter, notice under section 148 was issued by the Assessing Officer and the reasons for reopening the assessment was the TPO's order passed under section 92CA(3) during the pendency of original assessment proceedings, which were held to be invalid, was not given effect to.
- On appeal:

HELD-II

- The question which arises is the validity of re-assessment proceedings on the surmise that an adjustment has to be made on account of arm's length price of international transactions in the hands of assessee on the basis of such reference, during the course of assessment proceedings, which were held to be invalid. [Para 26]
- In view thereof, when no assessment proceedings were pending in relation to the relevant assessment year, the Assessing Officer was precluded from making a reference to the TPO under section 92CA(1) for the purposes of computing the arm's length price in relation to the international transaction. Consequently, order passed by the TPO under section 92CA(3) proposing an adjustment to the arm's length price of the international transaction is a nullity in law and *void ab initio*, and such an order passed by the TPO was not a valid material for the Assessing Officer to entertain a belief that certain income chargeable to tax had escaped assessment within the meaning of section 147 of the Act. Consequently, the reasons recorded for reopening the assessment under section 147 do not meet the requirements of the section and hence the Assessing Officer had no jurisdiction to issue notice under section 148. Consequently, the subsequent order passed by the Assessing Officer under section 143(3) read with sections 147 and 144C is liable to be quashed. [Para 29]

CASE REVIEW-I

Genisys Integrating System (India) (P.) Ltd. v. *Dy. CIT* [2013] 31 taxmann.com 235/[2014] 62 SOT 4 (Bang. - Trib.) (para 14) and *CIT* v. *Pentair Water India (P.) Ltd.* [2016] 69 taxmann.com 180 (Bom.) (para 14) *followed*.

CASE REVIEW-II

Maximize Learning (P.) Ltd. v. *Asstt. CIT* [2015] 54 taxmann.com 234/68 SOT 62 (Pune - Trib.) (para 29) *followed*.

CASES REFERRED TO

Genisys Integrating System (India) (P.) Ltd. v. *Dy. CIT* [2013] 31 taxmann.com 235/[2014] 62 SOT 4 (Bang. - Trib.) (para 8), *TIBCO Software India (P.) Ltd.* v. *Dy. CIT* [2015] 56 taxmann.com 91 (Pune. - Trib.) (para 10), *TIBCO Software (India) (P.) Ltd.* v. *Dy. CIT* [2015] 58 taxmann.com 215/69 SOT 65 (Pune - Trib.) (URO) (para 10), *CIT* v. *Pentair Water India (P.) Ltd.* [2016] 69 taxmann.com 180 (Bom.) (para 14), *Coco Cola India Inc.* v. *Asstt. CIT* [2009] 309 ITR 194/177 Taxman 103 (Punj. & Har.) (para 23), *Maximize Learning (P.) Ltd.* v. *Asstt. CIT* [2015] 54 taxmann.com 234/68 SOT 62 (Pune - Trib.) (para 24) and *Vijay Television (P.) Ltd.* v. *Dispute Resolution Penal* [2014] 369 ITR 113/225 Taxman 35/46 taxmann.com 100 (Mad.) (para 24).

S.K. Rastogi, CIT and **Sushil Kulkarni** *for the Appellant.* **M.P. Lohia** *for the Respondent.*

ORDER

Ms. Sushma Chowla, Judicial Member - Out of this bunch of appeals, one appeal filed by the Revenue and two cross objections filed by the assessee are against consolidated order of CIT(A)-IT/TP, Pune, dated 21.01.2013 relating to assessment years 2004-05 and 2005-06 against respective orders passed under section 143(3) of the Income-tax Act, 1961 (in short 'the Act'). Further, the cross appeal filed by the assessee and the Revenue are against the order of CIT(A)-IT/TP, Pune, dated 12.08.2013 relating to assessment year 2006-07 against order passed under section 143(3) r.w.s. 147 of the Income-tax Act, 1961 (in short 'the Act').

2. All the appeals and cross objections relating to the same assessee were heard together and are being disposed of by this consolidated order for the sake of convenience.

3. The learned Authorized Representative for the assessee in the first instance withdrew cross objections filed by the assessee both in assessment years 2004-05 and 2005-06, hence, the same are dismissed as withdrawn. The assessee has also filed an application under Rule 27 for assessment years 2004-05 and 2005-06.

4. First, we shall take up the appeal in ITA No.810/PN/2013 relating to assessment year 2004-05. The grounds of appeal raised by the Revenue are as under:—

"1. The order of the Commissioner of Income-tax (Appeals) is contrary to law and to the facts and circumstances of the case.

2. The Commissioner of Income Tax (Appeals) erred on facts and in law in directing the AO to apply the Turnover filter when there is no correlation between turnover and profitability of companies in I.T. Sector.

3. On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in directing the AO to consider the aggregate margin of the assessee from onsite as well as offshore services for computing the ALP despite the fact that the mark up for onsite and offshore services were different form each other.

4. The Commissioner of Income-tax (Appeals) erred on facts and in law in not appreciating the fact that different markups for onsite and offshore services indicate towards functional and risk profile being different for onsite & offshore segments.

5. For this and such other reasons as may be urged at the time of hearing the order of the Commissioner of Income-tax (Appeals) may be vacated and that of the AO be restored."

5. The ground of appeal No.1 raised by the Revenue is general in nature and hence, the same is dismissed.

6. The issue in grounds of appeal No.2 to 4 is against the order of CIT(A) in adjudicating the issue of transfer pricing adjustment.

7. Briefly, in the facts of the case, the assessee was engaged in providing software development services to SAS group entities. The assessee was wholly owned subsidiary of SAS Institute Inc, USA. The assessee during the year under consideration had unit registered under Software Technology Park Scheme of Government of India. For the year under consideration, the assessee had filed return of income declaring total income of Rs. 2,04,740/-. The assessee was providing software development services to the SAS group companies overseas. During the year, it had two undertakings; one in Pune and the other in Mumbai. The undertaking in Mumbai was shut down in February, 2004 and was not registered under Software Technology Park Scheme. However, Pune unit was registered under Software Technology Park Scheme. Though the assessee had two separate units, the assessee had not maintained separate books of account. The assessee was entitled to claim the deduction under section 10A of the Act in respect of Pune unit. Reference under section 92CA(1) of the Act was made by the Assessing Officer to the Transfer Pricing Officer (in short 'the TPO') for computation of arm's length price in relation to international transaction. The TPO noted that the assessee had provided several services to its associate enterprises as tabulated at page 2 of the order of TPO. The assessee was providing both on-site and off-site services. The TPO also noted that the assessee in its transfer pricing report had prepared segmental profitability for software development and software consultancy services. The TNMM method was applied using operating margin over operating cost as the Profit Level Indicator (PLI), in order to test the arm's length nature of its international transactions. The assessee in the TP study report had reported that it had earned mark-up of 7.50% of cost for the software development activity during the year. The mark-up earned by the comparable companies selected by the assessee were 2.20%. However, the TPO rejected many of the said companies selected as comparable by the assessee on account of abnormal results shown by the said companies and the arithmetic mean of margins of balance companies worked out to 14.18%. The assessee was confronted with the said details and was asked to explain as to why an adjustment should not be made to arm's length price of transactions by taking the revised margins of comparables. The assessee in turn, explained its case which is not accepted by the TPO. The TPO noted that it was not that loss making companies had been removed from the list of comparables. However, only those companies which had reported huge losses in 2004 or which had very good profits in 2003 and had become loss making companies in 2004, had been rejected since they were not demonstrating consistent results. The TPO also

pointed out that all the abnormalities whether on profit or loss side had been eliminated by even excluding the companies which were showing very high profit margins. The contention of assessee to reject the companies having margin of 40% was also brushed aside holding that where two companies out of set of companies had shown 40% of mark-up, it cannot be said to be abnormal. The next contention of assessee was that the software development services and the software consultancy services should be clubbed and then the margins of comparables would fall +/- 5% of arm's length range. The TPO noted that both these services were shown as separate segments in TP study report of the year and were benchmarked separately. The assessee's contention of aggregating the software development and software consultancy was not accepted by the TPO as the mark-up in software activities was 7.5% and the mark-up in software consultancy was 15.04%. The TPO in this regard observed that the mark-up demonstrated that the activities undertaken by the assessee were different from functional and risk perspective and hence, the assessee was being remunerated at separate mark-up under the said segment, therefore, the same had to be considered separately. The TPO proposed an adjustment of Rs. 62,83,059/- in the software development transactions. The assessee had also declared transactions of provision of software consultancy services, against which separate segmental profits were shown. However, the assessee had earned mark-up of 15.04% of cost in respect of such international transactions, the margins of comparable companies selected for benchmarking the first transaction of software development services were applied in benchmarking the provision of software consultancy services also. Where the assessee had earned cost plus mark-up of 15.04% and as the margin of comparable companies as earlier worked out was 14.18% and since the assessee had earned higher mark-up at 15.04%, the value of said international transaction was accepted to be at arm's length. The third set of transactions of reimbursement of expenses by the assessee to overseas group and to the assessee by the overseas was accepted to be at arm's length. The TPO proposed an adjustment of Rs. 62,83,059/- on account of arm's length price of international transactions. The Assessing Officer in the order passed under section 143(3) of the Act made an addition of Rs. 62,83,059/- on account of adjustment as proposed by the TPO. The Assessing Officer also re-computed the deduction under section 10A of the Act by re-computing the profits for computing deduction under section 10A of the Act.

8. In appeal before the CIT(A), the assessee filed written submissions which are incorporated in the appellate order at pages 3 to 7 of the appellate order. Various issues were raised by the assessee before the CIT(A) in respect of TP adjustment made by the Assessing Officer by not allowing the risk adjustment, rejection of loss making companies, applying the turnover filter and also as to whether the margins from entire software development services were to be considered. The CIT(A) did not allow the claim of assessee to grant risk adjustment. Further, the CIT(A) also confirmed the order of TPO in excluding the loss making companies from list of comparables on the ground that the assessee was a captive service provider and operated in cost protective environment and the business module followed by the assessee did not envisage incurring of losses. With regard to turnover filter, the CIT(A) noted that before the TPO the assessee had requested for applying filter of Rs. 1 to 50 crores. However, the CIT(A) noted that the TPO had not applied any turnover filter. The CIT(A) took note of the decision of Bangalore Bench of Tribunal in *Genisys Integrating System (India) (P.) Ltd.* v. *Dy. CIT* [2013] 31 taxmann.com 235/[2014] 62 SOT 4, wherein the Tribunal had approved and applied the turnover filter of Rs. 1 to 200 crores where Genisys's turnover was Rs. 8.15 crores. The CIT(A) noted that the assessee's turnover was Rs. 10.08 crores and he directed the Assessing Officer to apply turnover filter of Rs. 1 to 200 crores and to exclude the comparables which had turnover of more than Rs. 200 crores from the list of comparables. The Assessing Officer was thus, directed to exclude iGate Global Solution Ltd., Infosys Technologies Ltd., Larsen & Toubro InfoTech Ltd. and Satyam Computer Services Ltd. from the set of comparable companies. The next plea raised by the assessee was against the order of TPO in only considering the operating margins derived from off-shore software development services and not from the entire software development services. The contention of the assessee in this regard was that the software development services rendered from India and on-site software development services were of similar nature comprising of software development activity. It was further stressed that the set of comparable companies considered for both these activities were same. Moreover, the comparable companies which were engaged in the software development activities had both off-shore and on-site delivery models and separate margins were not reported as both the activities were complementary to each other. The assessee thus, stressed that there was no reason to adopt financial results of only of off-shore development model. The CIT(A) held that he was in agreement with the contention of assessee that on-site software services and off-shore services should not be treated differently especially when comparable companies' results reflected combined margin from both the services of on-site and off-shore software services. The CIT(A) further held that if the TPO had compared the combined margins of both the segments, then there was no justification to adopt the assessee's margin

only from on-site software services. Accordingly, the Assessing Officer was directed to adopt the aggregate margins from the entire software development services of the assessee.

9. The Revenue is in appeal against the order of CIT(A), wherein by way of ground of appeal No.2, the issue raised is against the direction of CIT(A) to apply turnover filter as there was no correlation between turnover and profitability of companies in IT sectors. The Revenue is also in appeal against the directions of CIT(A) in considering the aggregate margins of assessee from on-site as well as off-shore services for computing the arm's length price despite the fact that the mark-up for on-site and off-shore were different from each other. The said issue has been raised by way of ground of appeal No.3. By way of ground of appeal No.4, the Revenue has agitated that the CIT(A) has erred in not appreciating the fact that there were different mark-ups for on-site and off-shore services, which indicate towards functional and risk profile being different for on-site and off-shore segments.

10. The ground of appeal No.1 raised by the Revenue is general in nature and hence, the same is dismissed. The learned Departmental Representative for the Revenue referred to the TP study report filed by the assessee and pointed out that the assessee itself has reported provision of software development services to its associate enterprises at Rs. 10.08 crores and the provision of on-site services to its associate enterprises at Rs. 1.70 crores separately in the said report. He further pointed out that the assessee in TP study report had separately benchmarked two transactions and had prepared its report. In respect of provision of software development services, the assessee had selected 24 companies whose arithmetic mean of margin worked out to 2.20% as against the PLI of assessee at 7.5%, which was found to be at arm's length by the assessee. However, the TPO rejected the companies where the data was not available or where the companies were having losses or the companies were having abnormal losses. The TPO thus, revised the list of comparables whose mean worked out to 14.18%. He further pointed out that in respect of second transaction of provision of on-site services, same comparables were taken and since the assessee had shown its margins higher than the mean margins of said companies, no adjustment was proposed. Before the CIT(A), the assessee had taken one objection that filter Rs. 1 to 50 crores be applied, however, the CIT(A) directed that filter of Rs. 1 to 200 crores be applied. In this regard, the learned Departmental Representative for the Revenue placed reliance on the order of TPO, in respect of second part of order of CIT(A), wherein he had directed that both the services provided by the assessee should be considered cumulatively. The learned Departmental Representative for the Revenue pointed out that in respect of aforesaid services, the assessee was reimbursed at cost plus 7.5% and in respect of on-site services, which was reimbursed at cost plus 15.04%. Our attention was further drawn to the TP study report, wherein at page 23, the analysis of transactions of provisions of software development services was carried out and at page 34, the analysis of provision of on-site services was carried out and both were separately analyzed. Even in the summary of consequences at page 38, the assessee had concluded that as against its net profit margins of 7.5% on operating cost, the same was within range of its comparables. In respect of provision for on-site services, wherein net profit margins from on-site services by the assessee was 15.04% and operating cost found to be within range of its comparables. Further reference was made to the computation of margin analysis of software services comparables at pages 68 and 69 for provision of off-shore services and at page 70 for provision of on-site services. The learned Departmental Representative for the Revenue stressed that the assessee itself had benchmarked the two transactions separately and the CIT(A) in sketchy situation had directed the merging of two. However, the order of CIT(A) was totally silent on that. The learned Departmental Representative for the Revenue further stressed that as far as FAR of two services are concerned, the same were separate. Reliance in this regard was placed on the ratio laid down by Pune Bench of Tribunal in *TIBCO Software India (P.) Ltd.* v. *Dy. CIT* [2015] 56 taxmann.com 91 , relating to assessment year 2008-09 and *TIBCO Software (India) (P.) Ltd.* v. *Dy. CIT* [2015] 58 taxmann.com 215/69 SOT 65 (URO)(Pune - Trib.), relating to assessment year 2009-10. Just because the comparables picked up by the assessee were same and results of two i.e. provision of off-shore and on-site services should be clubbed, as per the learned Departmental Representative for the Revenue was wrong and submissions of the assessee before the CIT(A) in this regard, especially in the case of assessee where separate working was available, was incorrect.

11. The learned Authorized Representative for the assessee in reply, pointed out that the CIT(A) in the first instance had excluded the big turnover companies by applying the turnover filter and in this regard four companies were excluded. Our attention as drawn to the computation at page 152 of the Paper Book, wherein before the CIT(A) the assessee had provided operating revenue of several companies. Coming to the second aspect of the issue decided by the CIT(A), the learned Authorized Representative for the assessee pointed out that Goldstone Technologies Ltd. had made segmental reporting of its earnings. However, in respect of others, no separate figures were available to show whether they have on-site and off-shore or only off-site

services provided to its associate enterprises. The learned Authorized Representative for the assessee further pointed out that while benchmarking the international transactions in assessment year 2006-07, the TPO himself has merged the results of provision of off-site and on-site services as cumulatively provided by the assessee. The learned Authorized Representative for the assessee further stressed that in the TP study report itself, it was pointed out that these two services were functionally similar and same set of comparables were picked up to benchmark the international transactions. The learned Authorized Representative for the assessee further pointed out that if the issue of turnover is decided in favour of the assessee, then the application moved under Rule 27 would become academic.

12. The learned Departmental Representative for the Revenue in rejoinder pointed out that some handicaps as with the assessee were with TPO and where the assessee says that Infosys is comparable in its TP study report, then turnover filter fails. He further stressed that the assessee was shifting his stand which should not be allowed. In respect of Genisys, it was pointed out that it was engaged in both the activities of provision of on-site and off-shore services and in the TP analysis while benchmarking international transactions, the results of two activities are separate.

13. We have heard the rival contentions and perused the record. The present appeal is filed by the Revenue against the order of CIT(A) in allowing reliefs to the assessee on certain issues while benchmarking the international transactions entered into by the assessee with its associate enterprises. The assessee was engaged in providing software development support and software consultancy services to SAS group entities. Various transactions were entered into by the assessee with its associate enterprises during the year under consideration. However, the issue which arises for adjudication is in respect of provision of software development support services to SAS Inc by the assessee to the extent of Rs. 10.08 crores. The international transaction which is the subject matter of appeal is the provision of on-site services to SAS group companies at Rs. 1.70 crores. The assessee had applied TNMM method using OP/OC as PLI in its TP study report while benchmarking the international transaction. Admittedly, the assessee had benchmarked the two services i.e. provision of software development services to the SAS and provision of on-site services to overseas SAS group companies separately by using OP/OC as PLI, in its TP study report. In respect of provision of software development services, the assessee was being reimbursed at cost plus 7.5%, whereas in respect of on-site services provided to overseas groups, the assessee was being reimbursed at cost plus 15.04%. However, in the TP study report, the assessee picked up same set of comparables whose arithmetic mean worked out to 11.75% and the same was held to be arm's length price in respect of both the transactions separately. The TPO re-worked the arithmetic mean of margins of comparable companies by applying the financial data for the financial year 2003-04 and in this regard, because of abnormal results shown by certain companies, the list of companies to be compared with the results shown by the assessee were revised and for the provision of software development services, the arithmetic mean of said comparables by applying single year's data worked out to 14.18%. Consequently, the TPO proposed an adjustment to the arm's length price of provision of software services by the assessee to its associate enterprises. However, the assessee in respect of provision of on-site services had shown its margin at 15.04%, the same was held to be at arm's length price and no adjustment was proposed on account of said services provided by the assessee to its associate enterprises. The CIT(A) while deciding the appeal of assessee had directed the Assessing Officer/TPO to apply turnover filter of Rs. 1 to 200 crores while finally selecting the list of comparables. The Revenue is in appeal against the directions of CIT(A) and pointed out that there is no merit in such directions.

14. However, we find merit in the orders of CIT(A) that while benchmarking international transactions entered into by the assessee with its associate enterprises, the comparison should be made with such companies by applying FAR analysis i.e. Functions, Assets & Risk analysis. While applying the said analysis, recourse should be made to comparing the margins declared by the tested party with such comparables who are falling within turnover criteria. The Bangalore Bench of Tribunal in Bench of Tribunal in *Genisys Integrating System (India) (P.) Ltd's* case (*supra*) had applied turnover filter of Rs. 1 to 200 crores in the case of concern which was showing turnover of Rs. 8.15 crores. The assessee before us has declared turnover of Rs. 10.08 crores in segment of provision of software development services and in view of filter applied by the Bangalore Bench of Tribunal in Bench of Tribunal in *Genisys Integrating System (India) (P.) Ltd's* case (*supra*), we uphold the order of CIT(A) in applying the turnover filter of Rs. 1 to 200 crores. The Hon'ble Bombay High Court in *CIT* v. *Pentair Water India (P.) Ltd.* [2016] 69 taxmann.com 180 have held that turnover is relevant factor to consider the comparability. In the facts of the case before the Hon'ble High Court, the question was with regard to exclusion of three companies i.e. (i) HCL Comnet Systems & Services Ltd., (ii) Infosys BPO Ltd. and (iii) Wipro Ltd. on the ground that the turnover of the said companies was high as compared to the turnover of assessee in that case at Rs. 11 crores. The turnover of HCL Comnet

Systems & Services Ltd. was Rs. 260.18 crores, of Infosys BPO Ltd., was Rs. 649.56 crores and of Wipro Ltd. was Rs. 939.78 crores. The said companies were excluded by the Tribunal on the basis of turnover filter, which was approved by the Hon'ble High Court. The Hon'ble High Court held that the said companies are no doubt large and distinct companies where the area of development of subject services are different and as such the profit earned therefrom cannot be benchmarked or equated with the Respondent-Company. Applying the said ratio to the facts before us, we uphold the order of CIT(A) in excluding the companies whose turnover was more than Rs. 200 crores. Thus, ground of appeal No.2 raised by the Revenue is dismissed.

15. Now, coming to the next direction of the CIT(A) in holding that the margins of provision of software development services and provision of on-site services by the assessee to its associate enterprises have to be computed cumulatively. The first aspect to be noted in the case is that while the assessee is providing several services to its associate enterprises and it has recognized that it is providing two kinds of services i.e. provision of software development services and provision of software consultancy services. In respect of software development activity, the assessee was reimbursed at cost plus 7.5% mark-up and in respect of software consultancy services, it was reimbursed at cost plus 15.04%. The software consultancy services were off-site and the software consultancy services were provided on-site to the associate enterprises. The financials of the assessee provides segmental details in respect of both these services i.e. off-site and on-site services, the margins at which the assessee is reimbursed by its associate enterprises in respect of off-site services is lower at cost plus 7.5% and in respect of on-site services is higher at cost plus 15.04%. In its TP study report, the assessee had benchmarked two transactions separately and had held them to be at arm's length price by taking the mean of list of comparables. However, since this was the start of transfer pricing study provisions, the complete details were not looked into by both the assessee and the Revenue. The following pattern applied by the assessee. The TPO also applied the margins of same set of comparables both for off-site and on-site services. In view thereof, the case of assessee before us is that margins of both the services should be clubbed in order to benchmark the arm's length price of international transactions with its associate enterprises vis-à-vis the mean margin shown by the comparables. We find no merit in the claim of assessee in this regard and we are at variance with the order of CIT(A) in this regard. The law has developed in the field of transfer pricing provisions. The issue as to whether an activity being provided by a concern on account of off-site services and on-site services have been compared and it has been held that the company engaged in providing on-site services is un-comparable to the company engaged in providing off-shore services. The said ratio has been laid down by the Pune Bench of Tribunal in *TIBCO Software India (P.) Ltd's* case (*supra*) relating to assessment year 2008-09 (*supra*) and *TIBCO Software India (P.) Ltd's* case (*supra*).

16. In view of the said proposition, wherein it has been held that the company providing off-shore services to its associate enterprises stand on a different footing from the company rendering on-site services to its clients, then even in a case where one company itself providing both the said services, the same have to be considered separately while benchmarking the international transactions. The basis on which the assessee before us is being reimbursed on account of its off-site services is cost plus 7.5% and for on-site services, it is being reimbursed at cost plus 15.04%, which itself establish that the two services provided by the assessee are different and the same cannot be clubbed for the purpose of benchmarking the international transactions. We reverse the order of CIT(A) in this regard and direct the Assessing Officer to re-compute the same. Where the mark-up earned by the assessee is different from two activities carried on by it that established that the activities undertaken were different on account of functional and risk perspective. Since the assessee in the present case was being remunerated at separate mark-up for each of the activity, then both the activities have to be considered separately while benchmarking arm's length price of transactions *perse.* Merely because the same set of comparables have been utilized does not justify the case of assessee. The Assessing Officer is directed to benchmark the international transactions of provision of software development services i.e. off-site services independently from on-site services provided by way of consultancy services provided by the assessee. The Assessing Officer is also directed to adopt the segmental details of comparables, if available for benchmarking the international transactions of assessee. Accordingly, this aspect of transfer pricing adjustment, if any, is remitted back to the file of Assessing Officer, who is directed to adopt only the margins of software consultancy services i.e. off-site services in order to compute the addition, if any, on account of transfer pricing adjustment. Accordingly, the grounds of appeal No.3 and 4 raised by the Revenue are thus, allowed. The grounds of appeal raised by the Revenue are thus, partly allowed.

17. The learned Authorized Representative for the assessee has pointed out that in case the turnover filter is applied as directed by the CIT(A), then the application moved under Rule 27 of Income Tax Rules, 1962 (in short 'the Rules') would become academic. Since we have upheld the turnover filter applied by the CIT(A), the application under Rule 27 of the Rules is dismissed as academic.

18. The assessee had also filed application under Rule 27 of the Rules for assessment year 2005-06. But no plea has been raised by the learned Authorized Representative for the assessee and the same is dismissed.

19. The assessee in ITA No.1850/PN/2013 relating to assessment year 2006-07 has raised the following grounds of appeal:—

> "On the facts and in the circumstances of the case and in law, the CIT(A) and the AO/Transfer Pricing Officer (hereinafter referred to as 'TPO') have:
>
> *Validity of reassessment proceedings:*
>
> 1. Erred in upholding the validity of reassessment proceedings conducted by AO under section 147 of the Act.
>
> *Non reference to the TPO during reassessment proceedings*
>
> 2. Assuming but without admitting that the reassessment proceedings are valid and without prejudice to the above ground, erred in upholding that there was no need to make fresh reference to the TPO for determination of arm's length price of international transactions, after initiating proceedings under section 147 of the Act.
>
> *Deprivation of opportunity of appeal before the DRP*
>
> 3. Without prejudice to the above grounds regarding validity of reassessment proceedings under section 147 of the Act, erred in upholding the issuance of the order under section 143(3) read with section 147 of the Act along with the notice of demand instead of issuing order under section 144C of the Act, objection against which would have been filed before DRP."

20. The assessee has challenged the re-assessment proceedings conducted by the Assessing Officer under section 147 of the Act and has further challenged the re-assessment proceedings order passed by making transfer pricing adjustment to the international transaction without making fresh reference to the TPO.

21. Briefly, in the facts of the present case, the assessee is in appeal against the order of Assessing Officer passed under section 143(3) r.w.s. 147 of the Act. The original return of income was filed by the assessee declaring total income of Rs. 14,06,487/- after claiming deduction of Rs. 3,53,65,382/- under section 10A of the Act on 24.11.2006. In order to understand the issue, it is necessary to go through chronological events in respect of assessment/appellate/re assessment proceedings initiated in the case of the assessee. The assessee has furnished tabulated details in this regard. The perusal of events reflects that consequent to the assessee filing the return of income, notice under section 143(2) of the Act was issued on 31.12.2007 and the Assessing Officer made reference to the Transfer Pricing Officer (in short 'the TPO'), who in turn, passed an order under section 92CA(3) of the Act on 29.10.2009. The assessee contested the validity of notice issued by the Assessing Officer under section 143(2) of the Act vide letter dated 11.11.2009, after which the Assessing Officer had passed draft assessment order under section 144C of the Act on 27.11.2009. The assessee filed objections before the Dispute Resolution Panel (in short 'the DRP') on 24.12.2009, who in turn, issued directions and upheld the order of Assessing Officer with respect to transfer pricing additions under section 143(3) r.w.s. 92CA(4) of the Act and section 144C of the Act. However, the DRP directed the Assessing Officer to ascertain the date of service of notice under section 143(2) of the Act to decide about the validity of assessment proceedings, vide order dated 30.08.2010. Pursuant thereto, the Assessing Officer vide order dated 28.09.2010 dropped the assessment proceedings as per order placed at page 264 of the Paper Book. Thereafter, the Assessing Officer recorded reasons for reopening the assessment under section 147 of the Act and issued notice under section 148 of the Act on 13.01.2011. The reasons recorded for reopening the assessment and issue of notice under section 148 of the Act are reproduced in the assessment order under para 2 at page 1 of the assessment order. The perusal of reasons reflects that the reference is made to the international transactions entered into by the assessee with its associate enterprises and the adjustments sought to be made by the TPO at Rs. 2.60 crores and in view thereof, the Assessing Officer was of the view that the income of assessee to the tune of Rs. 2.60 crores had escaped assessment on account of arm's length price of international transactions and notice under section 148 of the Act was issued. Consequent thereto, the assessee filed latter stating that the original return of income filed by it should be treated as filed under section 148 of the Act. The letter is dated 02.02.2011, which is placed at pages 266 to 269 of the Paper Book. The assessee thereafter, sought the reasons for reopening the assessment and also challenged the validity of assessment proceedings initiated under section 147 of the Act vide letter dated 02.02.2011 placed at page 267 of the Paper Book. The Assessing Officer in return, furnished reasons on 07.02.2011, copy of which is placed

at pages 270 and 271 of the Paper Book. The assessee challenged the validity of proceedings initiated under section 147 of the Act and also objected to the reasons furnished by the Assessing Officer for initiating re-assessment proceedings vide letter dated 11.03.2011, which are placed at pages 272 to 278 of the Paper Book. However, the Assessing Officer rejected the same and passed an order dated 23.12.2011, which is placed at pages 280 to 291 of the Paper Book. The assessee thereafter, filed another submission in response to the order disposing of objections vide letter dated 29.12.2011, which is placed at pages 292 to 298 of the Paper Book. Thereafter, the Assessing Officer completed the re-assessment proceedings and passed the order under section 143(3) r.w.s. 147 of the Act dated 28.12.2011, against which the assessee filed an appeal before the CIT(A), who in turn, upheld the re-assessment order passed.

22. The assessee is in appeal against the re-assessment order passed by the Assessing Officer which has been upheld by the CIT(A).

23. The plea of the assessee before us was that when originally the case of the assessee was selected for assessment, under which reference was made to the TPO for determining the arm's length price of international transactions, no valid proceedings were pending before the Assessing Officer. The Assessing Officer himself has admitted that no notice was issued under section 143(2) of the Act to initiate assessment proceedings and consequently, reference made to the TPO was invalid and such order passed by the TPO under section 92CA(3) of the Act could not be the basis for initiating re-assessment proceedings. The assessee further pointed out that while initiating re-assessment proceedings, there was no reason to believe that income had escaped assessment. Since the Assessing Officer was merely making reference to the order of TPO, there was no independent application of mind by the Assessing Officer. In the absence of any independent application of mind on the part of Assessing Officer, it is alleged that re-assessment proceedings initiated in the case were in-valid. With regard to the order of CIT(A), it is pointed out that the reliance placed upon by the CIT(A) on the order of Hon'ble High Court of Punjab & Haryana in *Coco Cola India Inc.* v. *Asstt. CIT* [2009] 309 ITR 194/177 Taxman 103 to conclude that the order passed by the TPO can form the material or basis for reopening the assessment, was not correct reliance in the facts of the present case.

24. The learned Authorized Representative for the assessee pointed out that the issue arising in the present appeal filed by the assessee is squarely covered by the order of Co-ordinate Bench of Pune Tribunal in the case of *Maximize Learning (P.) Ltd.* v. *Asstt. CIT* [2015] 54 taxmann.com 234/68 SOT 62, relating to assessment year 2007-08, order dated 02.02.2015 and the facts and issue were pointed out to be identical. The assessee in this regard has filed a comparative chart between the facts and issue arising in the case of *Maximize Learning (P.) Ltd.* (*supra*) and in the present case and has stressed that since the re-assessment proceedings have been quashed in the case of *Maximize Learning (P.) Ltd.* (*supra*), the same needs to be quashed in the facts of the assessee also. He pointed out that the assessee has challenged the reopening *perse* where the original assessment proceedings were dropped even though the report was received from the TPO under section 92CA(3) of the Act since no notice under section 143(2) of the Act was served upon the assessee in time. As no assessment order was passed after reference to the TPO, then the same order of TPO could not be the basis for reopening the assessment under section 147/148 of the Act and the assessment order passed by the Assessing Officer in this regard was a nullity and was not curable defect. The learned Authorized Representative for the assessee placed reliance on the order of Hon'ble High Court of Madras in *Vijay Television (P.) Ltd.* v. *Dispute Resolution Penal* [2014] 369 ITR 113/225 Taxman 35/46 taxmann.com 100. He further pointed out that once the re-assessment order passed by the Assessing Officer is said to be nullity, then no addition is warranted in the hands of assessee and hence, no merit in the appeal filed by the Revenue.

25. The learned Departmental Representative for the Revenue on the other hand, placed reliance on the orders of authorities below.

26. We have heard the rival contentions and perused the record. The issue which arises in the present appeal is against the validity of re-assessment proceedings initiated under section 147/148 of the Act. The issue arising in the present appeal is similar to the issue before the Tribunal in *Maximize Learning (P.) Ltd.* (*supra*). It was pointed out by the learned Authorized Representative for the assessee that re-assessment proceedings under section 147/148 of the Act were initiated in both the cases, wherein the original return of income was filed in time, however, the assessment proceedings in the case of assessee before us relate to assessment year 2006-07 and in the case of *Maximize Learning (P.) Ltd.* (*supra*) relate to assessment year 2007-08. Admittedly, in both the cases, time limit for service of notice under section 143(2) of the Act had expired and the said notice was issued beyond time. The notice under section 143(2) of the Act in the case of assessee was issued on 31.12.2007, whereas it had to be served upon the assessee on or before 30.11.2007 i.e. the end of 12

months from the end of month in which return of income was furnished. In the case of *Maximize Learning (P.) Ltd.* (*supra*), the said notice under section 143(2) of the Act was also served late. In both the cases, in such assessment proceedings, reference was made to the TPO for determining the arm's length price of international transactions and the TPO had passed the order under section 92CA(3) of the Act. However, in both the cases, the assessee filed objections to the draft assessment order and the DRP directed the Assessing Officer to examine the plea of assessee vis-à-vis validity of assessment proceedings. Thereafter, the assessment proceedings under section 143(3) of the Act were dropped by the Assessing Officer in the case of assessee on 28.09.2010 and similarly in the case of *Maximize Learning (P.) Ltd.* (*supra*). Thereafter, in both the cases notice under section 148 of the Act was issued by the Assessing Officer and the issue which arises before us is against the validity of such re-assessment proceedings. In both the cases, the reasons for reopening the assessment was the TPO's order passed under section 92CA(3) of the Act during the pendency of original assessment proceedings, which were held to be invalid. The question which arises is the validity of re-assessment proceedings on the surmise that an adjustment has to be made on account of arm's length price of international transactions in the hands of assessee on the basis of such reference, during the course of assessment proceedings, which were held to be invalid. After going through the factual and legal aspects of the case, the Tribunal vide order dated 02.02.2015 (*supra*) had firstly held that the Assessing Officer was precluded for making a reference to the TPO under section 92CA(1) of the Act for the purpose of computing arm's length price in relation to the international transaction, when no assessment proceedings were pending in relation to the relevant assessment year. The relevant observations of the Tribunal (*supra*) are in paras 10 to 23, which read as under :—

> '10. The crux of the controversy revolves around the provisions of section 147/148 of the Act which empower an Assessing Officer to assess or re-assess such income which has escaped assessment. Section 147 of the Act postulates that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may subject to the provisions of sections 148 to 153 of the Act, assess or re-assess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of proceedings under this section. A significant expression contained in section 147 of the Act is "reason to believe". It is judicially well-settled that such belief of the Assessing Officer must be based on some material on record. In other words, there must be some material on record to enable the Assessing Officer to entertain a belief that certain income chargeable to tax has escaped assessment for the relevant assessment year.
>
> 11. In the present case, the pertinent point setup by the assessee is that the Assessing Officer has entertained the belief for escapement of income based on an order of the TPO dated 29.10.2010 u/s 92CA(3) of the Act which is nonest and void ab initio. The fundamental point canvassed by the appellant is that the reference u/s 92CA made by the Assessing Officer to the TPO for computing the arm's length price was invalid because when the reference was made on 14.09.2009, no assessment proceedings were pending in relation to the instant assessment year.
>
> 12. At this stage, it would be appropriate to consider whether the reference made by the Assessing Officer to the TPO on 14.09.2009 for determination of arm's length price is valid or not ? For the said purpose, we may briefly touch-upon the relevant provisions relating to the transfer pricing assessment which are contained in sections 92 to 92F of the Act under Chapter - X relating to the "Special Provisions Relating To Avoidance Of Tax". Sections 92 to 92F of the Act were introduced by the Finance Act, 2001 and are effective from the assessment year 2002-03. Section 92(1) of the Act provides that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. Sections 92A and 92B of the Act contain provisions relating to the meaning of the expressions "associated enterprise" and "international transaction" respectively. Section 92C of the Act contains the powers of the Assessing Officer and the manner of determination of arm's length price in relation to an international transaction. Section 92CA of the Act provides that where the Assessing Officer considers it necessary or expedient to do so, he may refer to the Transfer Pricing Officer the determination of the arm's length price. Section 92CB of the Act relates to the power of the Board to make safe harbour rules. Section 92D of the Act relates to Maintenance and keeping of information and document by persons entering into an international transaction. Section 92E of the Act prescribes that the person entering into international transaction shall furnish a report from a chartered accountant in Form No.3CEB. Section 92F of the Act contains definitions of certain terms which are relevant to compute arm's length price, etc. in terms of sections 92 to 92F of the Act.

13. Notably, the entire scheme and mechanism to compute any income arising from an international transaction entered between associated enterprises is contained in sections 92 to 92F of the Act. Now, we may deal in slight detail the provisions of transfer pricing assessment which are relevant in the context of controversy before us. Section 92(1) of the Act mandates that any income arising from an international transaction shall be computed having regard to the arm's length price. Section 92C, inter-alia, prescribes the methods for computation of arm's length price in relation to an international transaction. Sub-section (3) of section 92C of the Act empowers the Assessing Officer to determine the arm's length price in relation to an international transaction in accordance with the methods prescribed in sub-section (1), on the basis of material or information or documents available with him, after allowing the assessee an opportunity in this regard; and, sub-section (4) of section 92C provides that where the Assessing Officer so determines the arm's length price, he may compute the total income of the assessee having regard to the arm's length price so determined. However, section 92CA of the Act provides that where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of arm's length price in relation to an international transaction to the TPO. In such a situation, the TPO, after taking into account the material before him, pass an order in writing u/s 92CA(3) of the Act determining the arm's length price in relation to an international transaction. On receipt of this order, sub-section (4) of section 92CA of the Act requires the Assessing Officer to compute the total income of the assessee in conformity with the arm's length price so determined by the TPO. In other words, the determination of the arm's length price, wherever a reference is made to him, is done by the TPO under sub-section (3) of section 92CA but the computation of total income having regard to the arm's length price so determined by the TPO is required to be done by the Assessing Officer under sub-section (4) of section 92C, read with sub-section (4) of section 92CA.

14. In sum and substance, the scheme of the Act postulates that arm's length price in relation to an international transaction is determined either by the Assessing Officer as provided in sub-section (3) of section 92C or by the TPO u/s 92CA(3) of the Act where a reference is made to him by the Assessing Officer. In both situations, the Assessing Officer is required to compute the total income of the assessee having regard to the arm's length price of the international transaction so determined, either in terms of sub-section (4) of section 92C or sub-section (4) of section 92CA. Notably, sub-section (4) of section 92C comes into play where an arm's length price in relation to the international transaction is determined by the Assessing Officer and sub-section (4) of section 92CA comes into play where the arm's length price in relation to an international transaction is determined by the TPO, on a reference by the Assessing Officer. In the case before us, the total income of the assessee has been computed having regard to the arm's length price determined by the TPO under section 92CA(3) of the Act and therefore the Assessing Officer has taken recourse to section 92CA(4) of the Act.

15. It is quite clear that the process of determination of arm's length price is to be carried out during the course of assessment proceedings, may it be, under sub-section (3) of section 92C where the Assessing Officer determines the arm's length price or under sub-sections (1) to (3) of section 92CA, where the Assessing Officer refers the determination of arm's length price to the TPO. We may also refer to the provisions of section 143(3) of the Act dealing with assessment of income. In terms of clause (ii) of sub-section (3) of section 143, it is prescribed that the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund on any amount due to him on the basis of such assessment. It is only in the course of such assessment of total income, that the Assessing Officer is obligated to compute any income arising from an international transaction of an assessee with associated enterprises, having regard to the arm's length price. In this background, is it not appropriate to infer that the provisions of section 92 to 92F of the Act get triggered only during the pendency of the process of assessment of total income before the Assessing Officer, which culminates in an order under section 143(3) or section 144 of the Act, as the case may be ?

16. In-fact, the occasion which requires the Assessing Officer to compute income from an international transaction arises only during the assessment proceedings, wherein he is determining the total income of the assessee. The appellant has canvassed the aforesaid position before us and in this context reference has also been made to the CBDT Instruction No.3 dated 20th May, 2003 the relevant portion of which read as under :-

"The Central Board of Direct Taxes, therefore, have decided that wherever the aggregate value of international transaction exceeds Rs. 5 crores, the case should be picked up for scrutiny and reference

under section 92CA be made to the TPO. If there are more than one transaction with an associated enterprise or there are transactions with more than one associated enterprises the aggregate value of which exceeds Rs. 5 crores, the transactions should be referred to the TPO. Before making reference to the TPO, the Assessing Officer has to seek approval of the Commissioner/Director as contemplated under the Act. Under the provisions of section 92CA reference is in relation to the international transaction. Hence all transactions have to be explicitly mentioned in the letter of reference. Since the case will be selected for scrutiny before making reference to the TPO, the Assessing Officer may proceed to examine other aspects of the case during pendency of assessment proceedings but await the report of the TPO on the value of international transaction before making final assessment."

[*Underlined for Emphasis by us*]

17. It is emphasized on the basis of the *CBDT Instruction* (*supra*) that even as per the understanding of the CBDT, a case is to be selected for scrutiny assessment before the Assessing Officer may refer the computation of arm's length price in relation to an international transaction to the TPO u/s 92CA of the Act. Therefore, we are inclined to uphold the position sought to be canvassed by the assessee that an Assessing Officer can make reference to the TPO u/s 92CA of the Act only after selecting the case for scrutiny assessment. In-fact, the aforesaid underlined observations of the *CBDT Instruction* (*supra*) is a pointer to the legislative import that the reference to the TPO for determining the arm's length price in relation to an international transaction is envisaged only in the course of the assessment proceedings, which is the only process known to the Act, whereby the assessment of total income is done. As per the *CBDT* (*supra*), the Assessing Officer may proceed to examine other aspects of the case during pendency of assessment proceedings but await the report of the TPO on the value of the international transactions before making assessment since the case would be selected for scrutiny before making reference to the TPO.

18. In the context of the aforesaid controversy, we may refer to the arguments raised by the Ld. CIT-DR whereby it is contended that it was open for the Assessing Officer to make a reference to the TPO for determination of arm's length price without issuing notice u/s 143(2) of the Act; in other words, as per the Revenue, reference to the TPO u/s 92CA of the Act can be made even if no assessment proceeding is pending before the Assessing Officer. In this context, it is submitted that the annual norms for selection of cases for scrutiny prescribed by the CBDT for assessment year 2007-08, inter-alia, prescribed compulsory scrutiny in all cases where the total value of international transactions as defined in section 92B exceeded Rs. 15 crores. According to her, in such a case, the Assessing Officer can very well issue the notice u/s 143(2) of the Act and then make a reference to the TPO. However, it is submitted that the CBDT norms also provide that a case which is not directly covered under the aforesaid compulsory scrutiny norm, can also be selected for scrutiny if the Assessing Officer records a satisfaction and seeks the approval of the CCIT/DGIT (International Taxation)/DGIT (Exemption). The aforesaid norm has been pointed out to say that in order to pick-up a case for scrutiny, some satisfaction is required to be recorded before the notice u/s 143(2) of the Act is to be issued. This exercise, according to the Ld. CIT-DR, could very well be the reference of the matter of the TPO, therefore, the stipulated period laid down by the CBDT does not pre-suppose that the issue of notice u/s 143(2) of the Act has to be necessarily and without fail precede the reference to TPO.

19. We have carefully considered the plea of the Ld. CIT-DR, that it is open to the Department to make a reference to the TPO without issuing notice u/s 143(2) of the Act, but in our view, it is not supported by a schematic reading of the relevant Provisions relating to the transfer pricing assessment contained in sections 92 to 92F. The entire purpose of computation of arm's length price in relation to an international transaction is found in sub-section (1) of section 92 of the Act. Section 92(1) mandates that any income arising from an international transaction shall be computed having regard to the arm's length price. Therefore, the sole aim of computing the arm's length price in relation to any international transaction is to compute the income arising therefrom. Thus, the computation of income and the determination of arm's length price in relation to the international transaction have to go hand-in-hand and without there being an occasion to compute income arising from an international transaction, it is difficult to comprehend the process for computation of arm's length price in relation to the relevant international transaction. Therefore, it would not be open for the Department to say that the process of computing arm's length price of an international transaction or a reference to the TPO to determine arm's length price can be initiated in the absence of any proceeding for computing total income of the assessee.

20. Further, in our view, the Ld. CIT-DR has relied on one of the norms prescribed for picking a return for scrutiny assessment to say that certain exercise is required to be done on the part of the Assessing Officer to record his satisfaction before the matter is put-up to the CCIT/DGIT who shall approve the selection of case for scrutiny. According to her, the recording of such satisfaction contemplated in the CBDT Instruction, would, inter-alia, envisage a reference to the TPO also. In our considered opinion, the reliance placed by the Ld. CIT-DR on the aforesaid CBDT Procedure for selection of cases for scrutiny, cannot distract from the relevant statutory provisions relating to the controversy before us. In-fact, the scheme of the Act which we have dealt earlier, establishes that the work of computing the arm's length price in relation to international transaction arises only and only when the income from such international transaction is being assessed. Certainly, the reference to the TPO for the computation of arm's length price cannot precede the initiation of the assessment proceedings by the Assessing Officer by issuance of notice u/s 143(2) of the Act.

21. As per the Ld. CIT-DR, section 92C(3) or 92CA of the Act do not enjoin the Assessing Officer to have any assessment proceedings pending before a reference to the TPO can be made for computation of arm's length price in relation to an international transaction. In this context, reference has been made to the phraseology of section 92CA(1) of the Act to say that only two conditions are prescribed therein which are to be fulfilled by the Assessing Officer before referring the matter to the TPO. Firstly, assessee should have entered into international transaction; and, that if the Assessing Officer considers it necessary and expedient to do so, he may refer the matter to the TPO under approval of the Commissioner. If both the conditions are satisfied there is no bar or requirement of any assessment proceedings being pending, before the reference is made to the TPO.

22. The aforesaid plea of the Ld. CIT-DR also, in our view, fails to take into consideration the entire scheme envisaged for the transfer pricing assessment in sections 92 to 92F of the Act. The provisions of sections 92 to 92F of the relate to computation of income from the international transaction having regard to the arm's length price, meaning of associated enterprises, meaning of international transaction, determination of arm's length price, keeping and maintaining of information and documents by persons entering into international transactions, furnishing of a report from an accountant by persons entering into such transaction and the definition of certain expressions occurring in such sections. The aforesaid provisions do not operate in individual spheres but the same operate with a singular purpose of computing income arising from an international transaction. The process of computation of income is necessarily a part and parcel of the assessment proceedings envisaged under the Act. Section 92CA of the Act is not an independent provision, but it is triggered only when the occasion arises for application of section 92(1) of the Act, whereby income from an international transaction is to be computed having regard to its arm's length price; and, the occasion to compute the income would arise only when there is an on-going assessment proceeding. Therefore, reference made by the Ld. CIT-DR to the phraseology of section 92CA(1) without considering the entire schematic arrangement of sections 92 to 92F would be incorrect.

23. Therefore, we conclude this aspect by holding that the Assessing Officer is precluded from making a reference to the TPO u/s 92CA(1) of the Act for the purposes of computing arm's length price in relation to the international transaction when no assessment proceedings are pending in relation to the relevant assessment year.'

27. The Tribunal further held that when reference was made to the TPO by the Assessing Officer for determination of arm's length price in relation to the international transaction, no assessment proceedings were pending and hence it was an invalid reference. Consequently, the subsequent order passed by the TPO determining the adjustment to the international transaction was a nullity in law and void *ab initio*. The relevant findings of the Tribunal vide paras 24 to 27 read as under :—

"24. Now, we may come back to the facts of the present case. In this case, return of income was filed on 05.11.2007, which was processed u/s 143(1) of the Act. On 14.09.2009, the Assessing Officer made a reference to the TPO for computation of arm's length price in relation to an international transaction entered by assessee with its associated enterprise. The TPO, after allowing the assessee opportunity of being heard and after taking into account the material available with him, passed an order dated 29.10.2010 determining the arm's length price in accordance with sub-section (3) of section 92CA of the Act.

25. In the background of the above facts, it needs to be established as to whether on 14.09.2009 when the Assessing Officer made a reference to the TPO u/s 92CA(1) of the Act, was there an assessment proceedings u/s 143 of the Act pending for the year under consideration. In the present case, we are dealing with assessment year 2007-08 and assessee filed its return of income on 05.11.2007. In terms of clause (ii) to sub-section (2) of section 143 of the Act, as it stood at the relevant point of time, notice u/s 143(2) of the Act in order to subject the return of income to scrutiny assessment, should have been issued within this six months from the end of the relevant assessment year i.e. upto 30.09.2008. There is no dispute that no such notice has been issued within the above stipulated period. A consequence of the aforesaid situation is that the return of income filed by the assessee on 05.11.2007 became final as no scrutiny proceedings were started within the period stipulated in law. The aforesaid position is also reinforced by the CBDT Circular No.549 dated 31.10.1989. As per the CBDT, if, after furnishing return of income, an assessee does not receive a notice u/s 143(2) of the Act from the Department within period stipulated in the proviso to section 143(2) of the Act, it follows that the return filed by the assessee has become final and no scrutiny proceedings should be started in respect of that return. In other words, in the present case, assessment proceedings u/s 143 of the Act came to end and the matter became final on 30.09.2008 i.e. the date within which a notice u/s 143(2) of the Act was required to be issued, which was not done. The judgement of the Hon'ble Punjab & Haryana High Court in the case of *Vipan Khanna* v. *CIT* and Others, 255 ITR 220 (P&H) is also to the same effect. In-fact, as per the Hon'ble Punjab & Haryana High Court, in case where a return is filed and is processed and no notice under sub-section (2) of section 143 thereafter is served on the assessee within the stipulated period, the assessment proceedings u/s 143 come to an end and matter becomes final. As per the Hon'ble High Court, although technically no assessment is framed in such a case, yet the proceedings for assessment stand terminated. To the similar effect is the ratio of the judgements of the Hon'ble Madras High Court in the case of (i) *CIT* v. *M. Chellappan* and Another, 281 ITR 444 (Madras); and, (ii) *CIT* v. *Deep Baruah*, 329 ITR 362 (madras).

26. In this background, if on the date of making of reference to the TPO, the assessment proceedings u/s 143 of the Act had come to an end and the proceedings for assessment stood terminated, there was no occasion for the Assessing Officer to have made a reference to the TPO for determination of arm's length price of the international transactions in terms of section 92CA of the Act. We have already inferred in the earlier paras that under the provisions of section 92CA of the Act, a reference to the TPO for computation of arm's length price in relation to international transactions is permissible only in the course of the assessment proceedings.

27. In view of the aforesaid discussion, it has to be inferred that when the Assessing Officer made reference to the TPO on 14.09.2009 for determination of arm's length price in relation to an international transaction, there was no assessment proceedings pending, and therefore it was an invalid reference. Consequently, the subsequent order passed by the TPO on 29.10.2010 (*supra*) determining the adjustment of Rs. 2,49,48,811/- to the international transaction is a nullity in law and void ab initio."

28. Another aspect noted by the Tribunal was whether in the above said circumstances the order of the TPO could be valid material for the Assessing Officer to entertain a belief that certain income chargeable to tax has escaped assessment within the meaning of section 147 of the Act. It was held by the Tribunal that the reasons recorded by the Assessing Officer in the present case do not meet the requirement of section 147 of the Act and therefore the Assessing Officer had no jurisdiction to issue notice under section 148 of the Act dated 14.01.2011 and as a consequence, the subsequent assessment order passed under section 143(3) r.w.s. 147 and 144C(3) of the Act was liable to be quashed. The relevant observations of the Tribunal (*supra*) are in paras 28 to 35, which are as under :—

'28. The next aspect is as to whether, in the above circumstances, the order of the TPO dated 29.10.2010 (*supra*) can be a valid material for the Assessing Officer to entertain a belief that certain income chargeable to tax has escaped assessment within the meaning of section 147 of the Act.

29. In this context, the Ld. CID-DR has vehemently pointed out that the return of income filed by the assessee included international transactions entered with the associated enterprise and such return of income was required to be taken-up for compulsory scrutiny, as per the norms of the CBDT relating to assessment year 2007-08. Therefore, when such a return of income was not picked up for a scrutiny assessment within the stipulated period, the only course for the Revenue was to issue notice u/s 148 of the Act on the ground that certain income chargeable to tax has escaped assessment. Secondly, it is pointed out that the return of income was filed by the assessee on 05.11.2007 with Circle 11(2), Pune

whereas Form No.3CEB for the same assessment year was filed in Circle 1(1), Pune on 31.10.2007. It is only on 28.07.2009, Form No.3CE B was received by the present Assessing Officer i.e. Circle 1(1) wherein it was seen that assessee had entered into international transactions with associated enterprises. For this reason, the case of the assessee had escaped from compulsory selection for scrutiny. On this basis, it is sought to be pointed out that the re-opening of assessment by issuance of notice u/s 147/148 of the Act is justified.

30. Apart from the aforesaid, it was also vehemently argued that any illegality or irregularity in making of a reference to the TPO u/s 92CA of the Act cannot render the subsequent order passed by the TPO u/s 92CA(3) of the Act as a nullity qua the belief entertained by the Assessing Officer that certain income chargeable to tax had escaped assessment on account of determination of arm's length price of the international transaction with the associated enterprise. The Ld. CIT-DR submitted that in the case of the *Pooran Mal* v. *DIT*, (1974) 93 ITR 505 (SC), the Court had refused to exclude from the purview of assessment even the material and evidence which was obtained by the Department even through a illegal search and seizure action. Drawing a similar analogy to the facts of the present case, it is contended that an illegal or incorrect reference to the TPO would not invalidate the arm's length price determined by him u/s 92CA(3) of the Act, which showed that an adjustment of Rs. 2,49,43,811/- was required to be made to the stated values of the international transaction. Therefore, the aforesaid material provided a good ground for the Assessing officer to formulate a belief that certain income chargeable to tax had escaped assessment.

31. At the outset, we may notice that the validity of the notice reopening the assessment u/s 148 of the Act has to be determined on the basis of the reasons which are disclosed to the assessee. Those reasons constitute the foundation of the action initiated by the Assessing Officer of reopening the assessment. The averments made by the Ld. CIT-DR regarding the compulsory scrutiny of returns which involved international transactions and/or that the Form No.3CEB was not filed with the Assessing Officer, are reasons which are not finding a place in the reasons recorded by the Assessing Officer for re-assessment. The reasons recorded by the Assessing Officer for re-assessment, have already been reproduced by us in the earlier part of this order. It's a trite law that the reasons recorded by the Assessing Officer are alone to be examined so as to test their validity. In this context, a reference can be made to the judgement of the Hon'ble Delhi High Court in the case of *Northern Exim (P.) Ltd.* v. *DCIT*, (2012) 20 taxmann.com 466 (Delhi) wherein it has been held that a Court is to be guided only by the reasons recorded for re-assessment and not by the reasons or explanation given by the Revenue at a later stage in respect of the notice of re-assessment. The Hon'ble Delhi High Court after making a reference to the following judgements :-

(*i*) *Jamna Lal Kobra* v. *ITO* (1968) 69 ITR 461 (All.);

(*ii*) *CIT* v. *Agarwalla Bros.* (1991) 189 ITR 786 (Pat.);

(*iii*) *G.M. Rajgharia* v. *ITO,* (1975) 98 ITR 486 (Pat.);

(*iv*) *Asa John Devinathan* v. *Addl. CIT,* (1980) 126 ITR 270 (Mad.);

(*v*) *East Coast Commercial Co. Ltd.* v. *ITO,* (1981) 128 ITR 326 (Cal.);

(*vi*) *Equitable Investment Co. (P.) Ltd.* v. *ITO,*(1988) 174 ITR 714 (Cal.); and,

(*vii*) *S. Sreeramachandra Murthy* v. *DCIT,*(2000) 243 ITR 427 (AP).

held as under :-

"The ratio laid down in all these cases is that, having regard to the entire scheme and purpose of the Act, the validity of the assumption of jurisdiction under Section 147 can be tested only by reference to the reasons recorded under Section 148(2) of the Act and the Assessing Officer is not authorized to refer to any other reason even if it can be otherwise inferred and/or gathered from the records. He is confined to the recorded reasons to support the assumption of jurisdiction. He cannot record only some of the reasons and keep the others up his sleeves to be disclosed before the Court if his action is ever challenged in a Court of law."

32. To the similar effect is the judgement of the Hon'ble Bombay High Court in the case of *31 Infotech Ltd.* v. *ACIT,*(2010) 329 ITR 257 (Bom.) wherein it has been held that the validity of the reopening of

assessment has to be determined with reference to the reasons which had weighed with the Assessing Officer and those cannot be added to or supported on a basis which was not present to the mind of the Assessing Officer when he issued the notice to reopen the assessment. As a consequence of our aforesaid discussion, we are unable to consider the validity of the issuance of notice of re-assessment based on the explanation/reasons now sought to be supplemented by the Ld. CIT-DR, which otherwise do not find a place in the reasons recorded by the Assessing Officer.

33. We have also carefully considered the other plea raised by the Ld. CIT-DR based on the judgement of the Hon'ble Supreme Court in the case of *Pooran Mal* (*supra*). It is quite well-settled that any illegality or irregularity in obtaining material or evidence would not preclude the Revenue authorities from utilizing the same in assessment of income unless the genuineness and correctness of the material or evidence is in doubt. So however, in the present case, we are not dealing with the power of the Assessing Officer to compute income of the assessee arising from an international transaction based on the arm's length price determined by the TPO. Indeed, as we had seen earlier the computation of total income from an international transaction has to be done by the Assessing Officer under sub-section (4) of section 92C read with sub-section (4) of section 92CA of the Act having regard to the arm's length price determined by the TPO. There is no dispute on the said aspect. In the present case, the point made out by the assessee is that a nonest and void ab initio order passed by the TPO on 29.10.2010 determining the arm's length price u/s 92CA(3) of the Act cannot form a basis to formulate a belief that certain income chargeable to tax has escaped assessment within the meaning of section 147 of the Act. The controversy in the present case has to be adjudicated in the light of the parameters of section 147/148 of the Act. In a somewhat similar situation, the Hon'ble Rajasthan High Court in the case of *Brig B. Lal* v. *WTO,* 127 ITR 308 (Raj.) was dealing with a situation where the reopening of assessment was based on a report submitted by the Valuation Officer in an invalid reference. As per the Hon'ble High Court, a report submitted by the Valuation Officer in an invalid reference must be treated as a nullity in the eyes of law, nonest and void ab initio. According to the Hon'ble High Court, where the reopening of assessment was based on such illegal, null and void report, the entire fabric for reopening of the assessment proceedings falls flat. In our considered opinion, the ratio of the judgement of the Hon'ble Rajasthan High Court in the case of *Brig B. Lal* (*supra*) is squarely applicable in the present case. Therefore, having regard to the peculiar facts of the present case, the proposition sought to be canvassed by the Ld. CIT-DR based on the decision in the case of *Pooran Mal* (*supra*) does not validate the issuance of notice u/s 148 of the Act to reopen the assessment in the present case.

34. The Ld. CIT-DR also relied upon the judgement of the Punjab & Haryana High Court in the case of *Coca Cola India Inc* v. *Asstt. CIT* [2009] 177 Taxman 103 to say that an order passed by the TPO can be a reason for re-assessment of income u/s 147/148 of the Act. The above proposition canvassed by the Ld. CIT-DR is not an absolute proposition, and the judgement of the Hon'ble Punjab & Haryana High Court in the case of M/s *Coca Cola India Inc* (*supra*) has to be appreciated in the light of the fact-situation therein. In the case of M/s *Coca Cola India Inc* (*supra*), the stand of the Revenue was that assessee was suppressing its profit in its transactions with its associated enterprises in the period prior to the assessment year 2002-03. The Revenue contended the suppression of profits on the ground of an order passed by the TPO under Chapter X after 01.04.2002 in relation to an assessment year after 01.04.2002. Such order of the TPO formed the basis for the Assessing Officer to formulate a belief that there was an escapement of income within the meaning of section 147 of the Act for the period prior to assessment year 2002-03. Pertinently, in the period prior to assessment year 2002-03, the un-amended provisions of section 92 of the Act did not provide for an order by the TPO determining arm's length price. The assessee attacked the initiation of proceedings u/s 147/148 of the Act for a period prior to assessment year 2002-03 contending that the order of the TPO passed under Chapter X subsequent to the amendment made with effect from 01.04.2002 in respect of a subsequent assessment year was irrelevant. In other words, assessee canvassed that the order of the TPO in respect of a subsequent assessment year could not be a ground to reopen the assessment of a year which was prior to the amendment of section 92 of the Act with effect from 01.04.2002. The Hon'ble High Court disagreed with the assessee's defense and upheld the action of the Assessing Officer in taking into account the subsequent order of the TPO for forming a belief that certain income liable to tax had escaped assessment even in relation to an assessment year prior to the insertion of 92CA of the Act with effect from 01.04.2002. As per the Hon'ble High Court, the order of the TPO could certainly have nexus for reaching a conclusion that income has been incorrectly assessed or has escaped assessment within the meaning of section 147 of the Act. The proposition laid down by the Hon'ble High Court is to the effect that the order of the TPO

passed u/s 92CA of the Act after 01.04.2002 i.e. under the amended Provisions, can be one of the reasons for re-assessment for a period prior to the introduction of the amended Chapter X with effect from 01.04.2002. Clearly, the dispute in the case of M/s *Coca Cola India Inc* (*supra*) stood on a different footing than the dispute before us. In the case of M/s *Coca Cola India Inc* (*supra*), it was nobody's case that there was any illegality in the reference made to the TPO or that the order of the TPO was void ab initio with respect to the assessment year for which the TPO passed the order u/s 92CA(3) of the Act. The only point was whether order of the TPO passed u/s 92CA(3) of the Act for a subsequent assessment year could form a basis for the Assessing Officer to formulate a belief about the escapement of income in a preceding assessment year when the amended regime of Chapter X was not on the statute. The facts and circumstances in the present case are entirely different and therefore the judgement of the Punjab & Haryana High Court in the case of M/s *Coca Cola India Inc* (*supra*) does not help the case of the Revenue.

35. As a consequence, we conclude by holding that the reasons recorded by the Assessing Officer in the present case do not meet with the requirements of section 147 of the Act and therefore the Assessing Officer had no jurisdiction to issue notice u/s 148 of the Act dated 14.01.2011. As a consequence, the subsequent assessment order passed u/s 143(3) r.w.s. 147 and 144C(13) of the Act is liable to be quashed. We hold so.'

29. As referred to by us in the paras hereinabove the factual aspects of the present case before us are identical to the facts before the Tribunal in *Maximize Learning (P.) Ltd.* (*supra*) and hence the ratio laid down by the Co ordinate Bench of the Tribunal is squarely applicable to the facts of the case. In view thereof, we hold that when no assessment proceedings were pending in relation to the relevant assessment year, the Assessing Officer was precluded from making a reference to the TPO under section 92CA(1) of the Act for the purposes of computing the arm's length price in relation to the international transaction. Consequently, order passed by the TPO under section 92CA(3) proposing an adjustment of Rs. 2,60,00,882/- to the arm's length price of the international transaction was a nullity in law and void *ab initio*. In view of the above-said facts and circumstances, such an order passed by the TPO was not a valid material for the Assessing Officer to entertain a belief that certain income chargeable to tax had escaped assessment within the meaning of section 147 of the Act. Consequently, we hold that the reasons recorded for reopening the assessment under section 147 of the Act do not meet the requirements of the section and hence the Assessing Officer had no jurisdiction to issue notice under section 148 of the Act. Consequently, the subsequent order passed by the Assessing Officer under section 143(3) r.w.s. 147 an d 144C of the Act is liable to be quashed. Accordingly, we hold so. The ground of the appeal No.1 raised by the assessee is allowed.

30. As the preliminary issue raised by the assessee regarding the assumption of jurisdiction by the Assessing Officer has been decided in favour of the assessee and the impugned assessment has been quashed, the remaining grounds of appeal raised by the assessee regarding the merits of the addition become academic and hence the same are not adjudicated for the present.

31. Since the assessment completed under section 143(3) r.w.s. 147 of the Act has been held to be invalid, there is no merit in grounds of appeal raised by the Revenue, hence, the appeal of Revenue in ITA No.1927/PN/2013 is dismissed. The grounds of appeal raised by the Revenue are thus, dismissed.

32. In the result, the appeal of Revenue in ITA No.810/PN/2013 is partly allowed, appeal of assessee in ITA No.1850/PN/2013 is allowed, appeal of Revenue in ITA No.1927/PN/2013 is dismissed and Cross Objections of assessee are dismissed.

POOJA

*In favour of assessee.