IN THE INCOME TAX APPELLATE TRIBUNAL "C", BENCH KOLKATA

BEFORE SHRI S. S. GODARA, JM &DR. A.L.SAINI, AM

आयकरअपीलसं./ITA Nos.2563 & 2564/Kol/2017

(निर्धारणवर्ष / Assessment Years: 2007-08 & 2008-09)

Dongfang Electric Corporation Project Office, CK-189, Sector-II, Salt Lake City, Kolkata – 700 091.	**Vs.**	**ACIT(International Taxation), Circle-1(1), Kolkata**
स्थायीलेखासं./जीआइआरसं./PAN/GIR No.: **AACCD0559L**		
(Appellant)	**..**	**(Respondent)**

Appellant by :ShriNageshwar Rao, Advocate & Amit Sharma, ACA
Respondent by : Dr. P.K. Srihari, CIT(DR)

सुनवाईकीतारीख/ **Date of Hearing : 14/03/2019**

घोषणाकीतारीख/**Date of Pronouncement : 17/05/2019**

आदेश / O R D E R

Per Dr. A. L. Saini:

The captioned two appeals filed by theAssessee, pertaining to Assessment Years 2007-08 and 2008-09, are directed against fair assessment orders passed by the Assessing Officer u/s 143(3)/144C(13) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'), which incorporate the findings of the ld. Dispute Resolution Panel under section 144C (5) of the Act.

2.Since, the issues involved in these two appeals are common and identical; therefore, these appeals have been heard together and are being disposed of by this consolidated order. For the sake of convenience, the grounds as well as the facts narrated in assessee`s appeal in ITA No.2563/Kol/2017,for Assessment Year 2007-08, have been taken into consideration for deciding the above appeals *en masse*.

3. The solitary grievance of the assessee in this appeal is that the ld. Assessing Officer/DRP erred in law and on facts and circumstances in making a transfer pricing adjustment of Rs.90,31,04,234/- by applying Transactional Net Margin Method(TNMM), whereas as per assessee only Comparable Uncontrolled Price Method(internal-CUP) is applicable.

Note: In this appeal, the assessee has also raised a technical ground stating that impugned assessment order is time barred, as there is no valid reference of International Transactions to Ld TPO in terms of section 92CA(1) of the Act, consequent to which extended period for passing assessment order is not available. The ld Counsel informs the Bench that the assessee reserves his right to challenge the validity of reference made by AO to Ld TPO in terms of section 92CA(1) of the Act. However, the ld Counsel for the assessee did not press this technical ground before the Bench therefore, we do not djudicate the same.

4. The facts of the case which can be stated quite shortly are as follows: In the assessee`s case, vide decree of Hon'ble Supreme court of India in the case of Director of Income Tax (In l. Taxation) versus Dongfang Electric Corp. in Civil Nos. 11006-1007 of 2013, dated 09.12.2013, the Assessing Office has been directed by the Hon'ble Supreme Court to consider the assessment afresh. Accordingly, a reference under section 92CA(1) of the IT Act, 1961 was made by the Assessing Officer, to Ld. Transfer Pricing Officer (TPO). The assessee had not filed Form 3CEB along with its return of income for AY 2007-08.The assessee is a company incorporated in the People's Republic of China. It is engaged mainly in turnkey contracting and sub-contracting for power projects, development and consultation for power equipment technology etc. During the Financial Year 2006-07, relevant to A.Y. 2007-08, it was carrying out work on two contracts for erection and commissioning of turnkey projects for thermal power plants. These contracts had been awarded by the West Bengal Power Development Corporation Limited for the project at Sagardighi and by Durgapur Projects Limited at Durgapur, both in the State of West Bengal. It is claimed that the assessee is a

Permanent Establishment (PE) in India during the relevant assessment year within the meaning of Article 5 of the Double Taxation Avoidance Agreement (DTAA) between India and the People's Republic of China. lt filed its return of income for AY 2007-08 with the office of DDIT(IT)-1(1), Kolkata. On the basis the Profit andLoss account submitted by the assessee for Assessment Year 2007-08, it was observed that the assessee had disclosed a loss to the tune of Rs.67,11,07,016/- (before FBT) for its PE in India. This loss had basically arisen on account of expenses incurred to the tune of Rs.332,80,55,124/- (inclusive of depreciation of Rs.4,54,98,363/-). During the relevant assessment year, the assessee had shown revenues to the tune of Rs.265,69,48,108/- for its PE in India from West Bengal Power Development Corporation Limited and Durgapur Projects Limited.

5. The contracts entered into by the assessee with the Indian parties suggest the scope of the contract, which is as follows:

(a).**Offshore supply:** Procurement and supply (overseas) of equipment (including spare parts, tools and tackles) for thermal power plant; and

(b).**Onshore Supplies and Services:** Local supply, design and engineering, construction, fabrication erection, installation, testing and commissioning of thermal power plant in India, transportation of the overseas supply of equipments from the Indian port of destination to the site or place of business of the buyer and inland insurance charges.

The activities mentioned above i.e. **(a) offshore supply and** (b) **onshore supply & services**, were being rendered by the assessee on the basis of two separate contracts entered into between it and the respective contracting parties in India. Thus, each activity as mentioned above was guided by a separate contract. Simpliciter, the supply of the plant & machinery and equipments for erection and commissioning of the power projects was undertaken through a separate contract between the assessee and the individual parties concerned. As this supply of plant & machinery was to take place outside the territorial waters of India, it was termed

as "offshore supply". On the other hand, once the plant & machinery was brought to the port of unloading in India, the remaining activities i.e. transportation of the plant & machinery from the Indian port to the site of installation and all activities related to the construction, fabrication, erection, installation, testing and commissioning was guided by another separate contract. This contract was referred to as "onshore supplies & services" contract. ln other words, the turn-key projects awarded to the assessee are being executed by splitting up the projects into two parts, namely, a) supply of plant & machinery, and b) installation of the plant & machinery and its commissioning and all other related activities.

6. As the assessee entered into two separate contracts, the consideration to be paid along with the detailed duties and responsibilities with regard to each set of activities were defined separately on the basis of these contracts. For execution of the contract pertaining to onshore supplies and services (i.e. local supply, design and engineering, construction, fabrication, erection, installation, testing and commissioning of the Power Project), the assessee established a project office named Dongfang Electric Corporation, Project Office, Kolkata on October 1, 2004 in Kolkata, India. As has already been mentioned, this Project Office was treated and claimed by assessee, as a permanent establishment (PE) of the assessee in India for tax purposes. The assessee did not dispute this fact. Thus, the PE of the assessee is an 'enterprise' under the provisions of Sections 92F(iii) and 92F(iiia) of the Act. As per ld TPO, as the assessee managed and controlled its PE in India, the PE constituted an 'Associated Enterprise' (AE) of the assessee under Section 92A of the Act. Thus, any transaction between the PE and the assessee would constitute an 'international transaction' under Section 92B of the Act and come under the purview of Section 92 of the Act. In other words, the 'arm's length principle would have to be applied to the transactions between the assessee and its PE in India. Accordingly, even though the assessee had not filed any Form 3CEB, with its return of income for A.Y. 2007-08, a reference was made by the Assessing Officer u/s 92CA(1) of the Act to the Transfer Pricing officer for determination of Arm's Length Price of the international transactions entered into between the assessee and its PE in India. On receiving the reference u/s 92CA(1) of the Act, notice u/s

92CA(2) was issued by the TPO on 16.09.2016 for initiating proceedings for determination of Arm's Length Price in respect of international Transactions entered by the PE with the assessee. ln response to the notice u/s 92CA(2), the assessee submitted reply to the ld TPO. The ld TPO, examined the submissions of the assessee and then asked the following further details:

(i).Why your permanent establishment in India during F.Y. 2006-07 should not be considered Your 'associated enterprise' within the meaning of section 92A of the IT Act, 1961;
(ii). Why the transactions between you and your permanent establishment in India during F.Y. 2006-07 should not be construed as 'international transactions' within the meaning of section 92B read with section 92F(v) of the Act;
(iii). As you have not furnished any Form 3CEB for AY 2007-08, why the arm's length price of the international transactions should not be computed by adopting the most appropriate method and by selecting comparables/appropriate profit level indicator of comparables, which are carrying out similar activities/functions.

7. In response, the assessee submitted the following written submissions before the Transfer Pricing officer (TPO), which is reproduced as under:

"In this regard we respectfully draw your kind reference to our earlier letter dated 26 September 2016 filed before your goodself and with utmost respect, we once again request your Honor to provide guidance on all issues raised therein especially as the same are preliminary before further proceedings.

Without prejudice to above, in present case it is necessary to appreciate that as reference to your goodself (i.e. Transfer Pricing Officer) (as expressly defined in Act and notified by Central Board of Direct Taxes) is not made, further proceedings, beyond normal (not extended) period prescribed in Act, become time barred and invalid in law. We, therefore, in the interest of justice respectfully pray consideration of this and allow us a copy of valid reference by Learned Assessing Officer to designated Transfer Pricing Officer before any further proceedings.

Without prejudice to above, it is pertinent to consider that no international transactions that can fall within the scope of Chapter X of the Act have been undertaken during assessment year under question. Without prejudice to issues relating to validity of reference being made to Learned TPO as part of exercise of profit attribution to Permanent establishment, any such reference would not be

covered as reference under section 92CA entitling extension of normal period for completion of assessment. Some of these very issues/clarifications have been sought both from Learned Assessing Officer and Your Honor (under above cited letter). Proceeding further by ignoring this very fundamental aspects would cause serious prejudice, injustice to assessee in addition to being invalid in law.

Without prejudice to above and without appearing to acquiesce/ waive any of legitimate rights in any way in proposed proceedings the validity of such proceedings is clarified, it appears that some of the details requisitioned vide notice dated 05 October 2016 is already part of records as the same was provided during initial assessment proceedings vide our earlier submissions dated 22 April 2010.

1. ***Why your permanent establishment in India during FY 2006-07 should not be considered your 'associated enterprises' within the meaning of section 92A of the Act***

Without prejudice to the legal position that courts have interpreted the provisions of assessment and Chapter X harmoniously and broadly determined the roles of Learned Assessing Officer vis-a-vis Learned Transfer Pricing Officer. Validity of reference (without prejudice to contentions as above relating to non-existence of any such reference in the first place) can be considered approval sought and in present case it can be seen that no particular international transaction has been indicated in such note seeking approval. It is for kind consideration that Act does not permit finding of international transaction by Transfer Pricing Officer in circumstances such as present case. Exercise for determination of profits attributable to permanent establishment cannot be referred as international transaction under Chapter X of the Act.

Dongfang Electric Corporation China, ('DEC' or the company') is an enterprise engaged mainly in development and consultation for power equipment technology, manufacturing and sale of power equipment, turnkey contracting for power projects, turnkey contracting for machinery, electrical machinery, electronic equipment and related projects, etc. During FY 2004-05, the company was awarded two power projects in West Bengal by following entities:

(a) The West Bengal Power Development Corporation Limited (WBPDCL) for Sagardighi and;

(b) The Durgapur Projects Limited ('DPL') for Durgapur.

Under the terms of the contracts, the scope of activities to be undertaken is as follows:

- *Offshore Supply - Procurement and supply (overseas) of equipment (including spare parts, tools and tackles) for thermal power plant; and*
- *Onshore Supplies and Services - Local supply, design and engineering, construction, fabrication, erection, installation, testing and commissioning*

of thermal power plant in India, transportation of the overseas supply of equipment from the Indian port of destination to the site or place of business of the buyer and inland insurance charges.

For execution of the demarcated on-shore activities, [on shore supplies and services-local supply, design and engineering, construction, fabrication, erection, installation, testing and commissioning of Power Project] a Project Office named Dongfang Electric Corporation, Kolkata Project Office was established in October 2004 in Kolkata, India. The payment for on-shore supplies and services was received from WBPDCL and DPL and accounted for in the books of DEC-PO in India. Since these services were rendered by DEC-PO, revenue from the same was offered to tax in India during AY 2007-08 as per the provisions of the Act.
ln this regard, your goodself has asked us to show cause as to why DEC-PO should not be considered as associated enterprises ('AE') of DEC, China within the definition of section 92A of the Act.
Reference is made to section 92A of the Act which provides that, "associated enterprise", in relation to another enterprise, means an enterprise:

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

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

ln this context, according to section 92F(iii) of the Act, "enterprise" means a "person (including a permanent establishment of such person) who is, or has been, or is proposed to be engaged in any activity, relating to the production....."

Section 92F(iiia) of the Act clarifies that a Permanent Establishment ('PE') is a fixed place of business through which the business of an enterprise is wholly or partly carried on. Thus, we submit that under the Act, the PE is a fixed place of business through which the business of Head Office is being carried out. Thus, we submit that DEC-PO and DEC, China are the same enterprises and the Project Office (i.e. DEC-PO) in the instant case cannot be regarded as "another" enterprise.

Further, as per section 2(31) of the Act person includes a company. On perusal of the said definitions, it can be said that the definition of enterprise considers a company and its PE as the same enterprise. Since an enterprise is said to mean a person including a PE of such person, hence the PE of a company cannot be considered as distinct from the company for the purpose of the definition of enterprise. Hence, the PE of a company and the company itself are not associated enterprise.

Further, as your goodself is aware that a foreign company can have its existence in India only by way of its Branch Office or Project Office or Liaison Office in India.

Hence, DEC-PO is to be considered as presence of DEC, China in India and hence, DEC, China & DEC-PO cannot be treated as two separate entities for tax purposes and should not be regarded as associated enterprises. Further, all the revenue earned by DEC-PO from the onshore activities was offered to tax in India as per the provisions of the Act.

Also, reference is made to section 2(7) of the Act which defines assessee. ln this regard, it is submitted that the word 'assessee' in section 2(7) of the Act read with the definition of 'person' in section 2(31) of the Act would mean that a Project Office of a company not being an artificial juridical person should not be taken as separate assessee/entity for the purpose of taxation.

Therefore, it is submitted that PE being an extension of enterprise, should also be treated as the same person i.e. enterprise who is or has been, or is proposed to be engaged in any activity.

ln this regard, even for the sake of argument if we assume but not accept that DEC, China and its PE (i.e. DEC-PO) are two separate enterprises, then both will be considered as associated enterprise when they satisfy the condition prescribed under section 92A of the Act.

Section 92A(1) of the Act states as follows:

"For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise -

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

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

Further sub-section 2 of section 92A states that "for the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,-

(a).....

(m)....."

On perusal of the aforesaid definition, it could be seen that as per sub-section (1) of section 92A of the Act, two enterprise are said to be 'associated enterprise' in relation to one another when one enterprise (a) participates directly or indirectly or through one of more intermediaries, in the management or control or capital of the other enterprise; or (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly

or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Further, we submit that when two enterprises falls under sub-section (1) of section 92A of the Act, then such enterprises have to further fall under one of the clauses given in sub-section (2) of section 92A of the Act to be considered as associated enterprises for the purpose of transfer pricing provisions of the Act.

In the instant case, on assuming that DEC, China participates in the control and management of its PE (i.e. DEC-PO) and hence falls under one of the clauses of sub-section (1) of section 92A of the Act. However, it is submitted that on going through the clauses as provided in sub-section (2) of section 92A of the Act, it could be seen that the DEC, China and its PE/ Project Office (i.e. DEC-PO) would not fall under any of the said clauses.

Considering the same, it is submitted that even if DEC, China and DEC-PO are considered as separate enterprises, then also they would not fall within any of the clauses given in sub-section (2) of section 92A of the Act for considering the same as associated enterprises.

Further, it is submitted that the PE is not a different person/different enterprise is also in consistent with Article 5 read with Article 7 of Double Taxation Avoidance Agreement ('tax treaty') entered between India with China.

Reference is made to Article 5 of the tax treaty which provides that, "For the purpose of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on."

As per Article 3(g), the term "enterprise of a Contracting State" & 'enterprise of the other Contracting State "has been defined to mean respectively, an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State.

The term enterprise has not been defined in the tax treaty. Hence an enterprise means carrying on of business and a fixed place of business in another contracting state as a PE of the enterprise and not an enterprise itself.

Further, Article 7(1) of the tax treaty states that profits of an enterprise of China shall be taxable only in China unless the enterprise carries business in India through a PE situated therein. lf the enterprise carries on business in India as aforesaid, the profits of the enterprise may be taxed in India, but only so much of profit as is directly or indirectly attributable to that PE. Accordingly, the profits attributed to DEC-PO has been attributed and offered to tax in respect of the onshore supply and services.

Further, reference is also made to Article 9 of the tax treaty which defines associated enterprises as under:-

"Where,

(a) An Enterprise of China participates directly or indirectly in the management, control or capital of an Enterprise of India, or

(b) The same persons participate directly or indirectly in the management, control or capital of an Enterprise of China and an Enterprise of India,and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not accrued, may be included in the profits of that enterprise and taxed accordingly."

ln the instant case, we submit that there is only a Chinese enterprise (i.e. DEC, China) and it's PE (i.e. DEC-PO), which is the same enterprise and they cannot be termed as associated enterprises under the tax treaty. The assessee is a resident of China and is governed by tax treaty between India and China. In view of the aforesaid, we submit that considering both the Act as well as fax treaty between India and China, DEC, China and DEC-PO cannot be treated as 'associated enterprises'.

2. ***Why the transactions between you and your permanent establishment in India during FY 2006-07 should not be construed as 'international transactions' within the meaning of section 92B read with section 92F(v) of the Act***

ln this regard, we would like to have your kind attention to the Transfer Pricing provisions in the Act pertaining to the reference made by the Assessing Officer to the Transfer Pricing Officer. The provisions of section 92CA(1) of the Act states as under:

"Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under section 92C to the Transfer Pricing Officer."

The term 'International transaction" has been defined to mean a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

During FY 2006-07 relevant to the subject AY 2007-08, we wish to submit that there was no international transaction entered into by the assessee with its associated enterprises. We are also enclosing the audited financial statement of

DEC-PO for the captioned financial year as Annexure 4 from which it will be apparent that there has not been any international transaction with the associated enterprises whatsoever. Further, we have also enclosed the certified (by Indian Embassy of China) consolidated financial statements in respect of the two power projects undertaken by DEC, China in India (incorporating both offshore and onshore portion) for FY 2006-07 as Annexure 5. The said statement reflects that DEC, China has incurred losses on the overall power project (both offshore and onshore supply & services,) undertaken by it in India during FY 2006-07.

The assessee also humbly submits that during the course of initial assessment proceedings vide submission dated 22 April 2010, the assessee has already made a detailed submission that the transfer pricing provisions under the Act are not applicable in the case of the company for the AY 2007-08 since no international transactions were undertaken by the company during the year.

We wish to submit that in the present case, DEC, China has earned income from two unrelated entities in India i.e. WBPDCL and DPL and the tax accounts of DEC-PO have been drawn to determine the income attributed in a manner which are reflective of appropriate profits for the activities of DEC, China in India. Hence, it is submitted that there has been no international transaction between the assessee and any of its associated enterprises in pursuance of the contracts entered into with WBPDCL and DPL which could be deemed as an international transaction within the ambit of transfer pricing provisions under the Act. Therefore, we submit that the transfer pricing provisions under the Act are not applicable in the case of the company for AY 2007-08.

3. ***As you have not furnished any Form 3CEB for AY 2007-08, why the arm's length price of the international transactions should not be computed by adopting the most appropriate method and by selecting comparables/ appropriate profit level indicator of comparables, which are carrying out similar activities/ functions***

We submit that section 92(1) of the Act provides that the income from international transactions should be computed having regard to the arm's length price. Further, section 92(2) of the Act states that, "Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be".

ln this regard, we wish to submit that the arm's length price is to be computed in case of an international transaction between two or more associated enterprises. However, as stated aforesaid in para 1 & 2 above that the PE of DEC;, China in India is not an 'associated enterprise' of DEC and further no international transaction has been entered with its associated enterprises during FY 2006-07 in pursuance of the aforesaid contracts with WBPDCL and DPL which could be

deemed as an international transaction. ln view of the same, we submit that the question of determination of arm's length price does not arise.

Without prejudice to the aforesaid, we wish to submit that the losses were suffered on the overall project (both onshore and offshore supply). The same is evidenced by the consolidated financial statements duly certified by the Indian embassy of China in respect of the two power projects undertaken in India for FY 2006-07 (Copy of the same is already enclosed as Annexure 5)

On perusal of the said financial statements, it would be noted that loss was incurred on the overall power project (both offshore supply and onshore supply & services) undertaken during FY 2006-07. Hence, it is pertinent to note here that losses were suffered not only on onshore supply and services undertaken in India but also on offshore supply executed from China in respect of the contracts entered into with DPL and WBPDCL in India for FY 2006-07. Accordingly, we submit that the issue of applicability of transfer pricing provisions does not arise between DEC, China and DEC-PO.

ln this regard, it is respectfully submitted that losses were suffered on the projects due to the reason that a fair estimate of the value/ consideration in respect of the projects could not be made. Further, during the bid process due care and diligence was exercised along with the expertise in quoting such price for the projects. However, due to unavoidable circumstances and drastic increase in prices of the raw material & other necessary cost, huge losses were suffered from the projects. In spite of reasonable care & diligence in quoting the price for the projects, it was not possible to overcome such huge losses or to reduce the cost. Further, on perusal of the expenses incurred by DEC-PO, it is very clear that all the expenses are necessary and genuine fo the project and could not be escaped by the assessee during the course of business operations. Also all the major expenses, such as expenses on civil, erection, transportation, insurance, etc., are in the nature of obligatory and/ or contractual payments. As a result of the same, losses were incurred both on "offshore supply contract" and 'onshore supply & services contract".

The overall project (both onshore and offshore portion) was awarded to DEC, China and for execution of the onshore supply and services the Project Office was opened in India. Accordingly, the revenue for onshore supply and services has been accounted for in the books of accounts of the Project Office and was offered to tax in India.

ln view of the aforesaid facts and circumstances of the case, we submit that if at all any attribution is to be made to the Project Office of DEC, China, the attribution of loss has to be made since there is an overall loss on the project undertaken by DEC, China.

Further, reference is made to Rule 10B(1)(d) of the Rule which states that Profit Split Method ('PSM') 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 arm's length price of any one transaction.

This method involves determination of overall profit of the associated enterprises arising out of the international transactions undertaken. ln this regard, for the application of PSM, the contribution of both the associated enterprise is determined and the overall profits of the international transaction are attributed to the respective associated enterprise.

ln the instant case, it is respectfully submitted that loss was suffered by DEC, China on the overall projects (including both offshore supply and onshore supply & services). Hence, for determining the profits of the DEC-PO, the contribution made by DEC-PO in execution of the onshore supply and service portion of the whole contract has to be determined. Irrespective of the ratio determined on the basis of contribution made by both DEC, China and DEC-PO, as there has been overall loss on the project, hence there will be attribution of loss to DEC, Kolkata and the question of attribution of profits does not apply n any circumstances.

Without prejudice to the aforesaid submission, we further submit that even if your good self proceeds to consider DEC, China and DEC-PO as the associated enterprises within the meaning of section 92A of the Act, then for computing the arm's length price of the impugned international transactions your goodself should only consider the foreign companies as comparables who are engaged in activities/ project in India similar to DEC, China through their PE's in India.

We therefore submit that the assessee has not undertaken any international transaction during the FY 2006-07 with its associated enterprises and hence the issue of applicability of transfer pricing provisions does not arise under the provisions of the Act. Accordingly, we submit that since the transfer pricing provisions of the Act are not applicable to the company, Form 3CEB is not required to be maintained by the company.

Without prejudice to above, for the purpose of our understanding we again request your goodself to provide us the details of international transaction which as per your goodself has been entered into by the assessee company during the AY 2007-08 and which falls within the ambit of transfer pricing provisions under the Act along with the value of transactions which require comparison with tested parties for determining the arm's length price.

It will kindly be appreciated that clarity on validity of proceedings relating to AY 2007-08 at this point of time is preliminary and foundational to any possible proceedings. Once we receive the clarification/ guidance from your Honors on under which provision current proceedings are being undertaken, we may kindly be allowed to make such further submissions (both on preliminary issues as also merits) as we are advised to before concluding the proceedings. We would be most obliged for this act of kindness."

8. Then after the ld. TPO discussed in his order about the position under India vs. China Treaty, International Tax Practice and Domestic Tax Law. The TPO also discussed in his order vide para 40 about the theory which is mentioned in the book written by Joseph A. Huse, "Understanding and Negotiating Turnkey and EPC Contracts". The ld. TPO then again discussed the theory of another book written by another author FIDIC Silver Book with respect to contract and sufficiency of the contract price.

9. Having discussed the theory about the contract price and the negotiating of Turnkey and EPC contracts, the ld. TPO concluded that in the assessee`s case the 'Transactional Net Margin Method(TNMM method)' would be applicable to compute the arm`s length price adjustment (ALP). The ld TPO also held that the Comparable Uncontrolled Price method(CUP method) is not applicable to the assessee. The Ld TPO eventually follow d TNMM method and took the comparables of M/s. Thermax Instrumentation Ltd. and worked out the ratio of operating margin (i.e. PBT/Total Cost) @6.97%, and computed the Transfer pricing adjustment.

The ld TPO observed that in the assessee`s case, the TNMM is being applied to arrive at the arm's length price. Since the terms and the conditions of the contract and the risk allocated to the PE vis-a-vis the offshore contract were not in the control of the PE, the mark-up over cost is considered as the appropriate profit-level indicator, as an independent sub-contractor for the onshore contract would have considered the same while negotiating the contract as an independent party.

The ld TPO noted that so far as benchmarking the transactions and applying the transfer pricing methods enumerated in section 92C of the Act are concerned, it can be construed that as an independent entity, the PE of the assessee in India would have charged an appropriate amount for the services rendered. ln lieu of the services that the PE has rendered in implementing the "services and supplies contract" on behalf of M/s. Dongfang Electric Corporation, China, and the risks

undertaken by it, it is to be seen whether the international transaction is at arm's length price or not.

The ld TPO noticed that From the Profit & Loss account submitted by the PE for the assessment year 2007-08, that it had disclosed a loss of Rs.67,11,07,016/-. This loss has arisen on account of expenses incurred amounting to Rs.332,80,55,124/- (inclusive of depreciation of Rs.4,54,98,363/-) while the revenues have been reported at Rs.265,69,48,108/- from West Bengal Power Development Corporation Limited and Durgapur Projects Limited on behalf of DEC, china on account of the execution of the onshore services contract.

The ld TPO, in order to arrive at an arm's length price, a benchmark has to be found out. For this purpose, a search was made in the Prowess database based on the following commands:

i. Civil works & erection & commissioning of co-generation plants
ii. Erection & commissioning
iii. Erection & commissioning service charges
iv. Erection & commissioning services
v. Erection & installation
vi. Erection & installations
vii. Erection & other services
viii. Erection and commissioning
ix. Erection and commissioning charges
x. Erection service, civil works & other services
xi. Erection, installation & other services
xii. Erection/commissioning/drawing/supervision
xii. Election/supervision charges

The search resulted in companies which had supply of machinery or other complex functions, only M/s Thermax Instrumentation Limited, qualified out of the companies thrown up by the database. It is a subsidiary of M/s Thermax Ltd and the Annual Report mentions that it focuses its operations on installation and

commissioning of power and cogeneration plants including civil construction. In F.Y. 2006-07, it had operating revenue of Rs.42.37 crores and an operating revenue of Rs. 2.76 crores. Its operating margin over total costs of Rs. 39.61 crores is presented below:

Company name	Operating margin (PBT/Total Cost) (FY 2006-07)
Thermax Instrumentation Limited	6.97%

From the above chart it is seen that the margin on the cost incurred by the comparable under consideration is 6.97%. The cost incurred by the assessee company during the year is Rs.332,80,55,124/-. Hence, the assessee is entitled to be remunerated @6.97% of Rs.332,80,55,124/- which comes to Rs.23,19,97,218/-. Hence, in view of the concept of arm's length pricing, the assessee company should have earned a profit of Rs 23,19,97,218/- instead of the book loss of Rs.67,11,07,016/-.

Therefore, TPO made upw rd adjustment to the total income of the assessee at Rs.90,31,04,234/-(Rs. 23,19,97,218 + Rs. 67,11,07,016).

10. Aggrieved by the order of the ld. TPO, the assessee filed objections before the Ld Dispute Resolution Panel who has confirmed the TP adjustment made by the ld TPO observing the following:

"DRP's Directions

2.4.1 In this case no Form-3 CEB had been filed along with its return of income. The TPO had, during the initial/original assessment proceedings, carried out appropriate analysis for application of MAM in respect of the above discussed international transactions and after due FAR analysis he selected 08 comparables following CUP for making the adjustment, which had been upheld by the DRP as well as the Hon'ble ITAT(supra) though the Hon'ble ITAT had set aside the assessment order for consideration of the assessee's contention regarding overall loss. During the original TP proceedings, the assessee had contended before the TPO for applying PSM instead of CUP. ln the set aside fresh assessment

proceedings the TPO applied TNMM and selected one comparable after applying necessary filters, However, before DRP, by giving general arguments, the assessee objected to the application of TNMM and has given alternate arguments for applying CUP and PSM.ln respect of the CUP it has been argued that agreement entered between DEC China and the third party contractees (DPL and WBPDCL) constitute a perfect internal CUP for the activities carried out by DEC-PO in lndia and the value agreed between DEC China and DPL and WBPDCL in relation to the onshore contract can be considered to be value for the services rendered by DEC-PO in India since the Project Office is carrying out the same activities and the Project Office is being remunerated at the amount agreed between DEC China and DPL and WBPDCL. As regards PSM, it has been argued that the TPO rejected this method in absence of profitability data of AEs based in Bahamas and USA but that DEC China has no AEs based out of Bahamas and USA and therefore the TPO was not justified in rejecting the PSM method on the basis of incorrect fact.

2.4.2 The Ld. AR has also submitted that the comparable, Thermax instrumentation Limited (THERMAX INSTRUMENTATION LIMITED), selected by the TPO applying TNMM is not comparable arguing that,

- *THERMAX INSTRUMENTATION LIMITED could not be said to be a Project Office of a foreign entity,*
- *THERMAX INSTRUMENTATION LIMITED is anlndian entity incorporated in lndia since 1996 and engaged in various uThermax Instrumentation Limitedity projects such as waste water treatment services and undertakes turnkey projects*
- *THERMAX INSTRUMENTATION LIMITED is engaged in the business from a long period of time, having huge resources and manpower for executing the proj cts;*
- *during the FY 2006-07 THERMAX INSTRUMENTATION LIMITED group restructured expanding activities such as supply of electronic and instrumentation systems, electrical installations, erection and commissioning of power plants, congeneration plants including civil construction work;*
- *Further no segmental information of the company is available relating its income from various sources and activities;*
- *after the completion of the projects the assessee would have to shut its Project Office and hence, the aforesaid comparison is unrealistic;*

The assessee has submitted the annual accounts of THERMAX INSTRUMENTATION LIMITED for FY 2006-07 in a CD. On perusal of the activities of THERMAX INSTRUMENTATION LIMITED it is observed that THERMAX INSTRUMENTATION LIMITED is engaged in carrying out contracts itself in the Power and Engineering sector. As per note-16 to the accounts there is only one segment and the expanded activities are related to the main business of THERMAX INSTRUMENTATION LIMITED as has also been mentioned in the

Directors' report wherein it has been mentioned that "the economy is booming, especially the Power and Engineering sector. With a view to use this opportunity to good advantage the parent company Thermax Limited had undertaken a restructuring exercise for the group companies". The FAR is broadly similar as if required under TNMM. Hence, there is no infirmity in the approach of the TPO.

2.4.3 However, we find that the TPO has not given cogent reasons for not applying CUP, which was applied in the original TP/assessment proceedings. ln the current impugned proceedings only 01 comparable was selected under TNMM the FAR of which, according to the assessee, is not comparable to the DEC-PO considering that DEC-PO was engaged in the single project of DPL/WBPDCL the scope and activities of which have been discussed above. The TPO has rejected CUP on the ground that the authentic gross level information is not available. Since the assessee itself has argued for application of CUP, and has not presented any argument against the 08 comparables selected by the TPO during the original assessment/TP proceedings, the Panel is of the view that if the authentic gross level information is available he should apply CUP and consider the same 08 comparables selected during the original assessment/TP proceedings, otherwise, as held in para-2.4.2 above, TNMM should be applied with THERMAX INSTRUMENTATION LIMITED as the comparable."

11. Aggrieved by the order of the Hon'ble DRP/A.O, the assessee is in appeal before us.

12. The ld. Counsel for the assessee, Shri Nageshwar Rao, begins by pointing out that in assessee`s ca e under consideration only Comparable Uncontrol Price Method, (internal CUP-method) is suitable to compute the arm`s length price adjustment. By applying CUP-method, no any transfer pricing adjustment is justified, as in assessee`s case there is a perfect CUP. ln present case, even if, it is possible (for argument sake only)for one to refer profit attribution exercise to TPO under section 92CA of the Act, it does not alter the conclusion that for onshore contract a CUP is available in terms of section 92C read with Rule 10C(2). ln present case, it cannot be denied that even in terms of Rule 10B(2) all details for application of CUP are available, including details like terms of contract (which are normally not available in any external comparison). There is no justification for rejecting CUP and upholding TNMM as TPO has sought to apply on vague and speculative notions. The Counsel also submitted before the Bench that in assessee`s case there is no 'international transaction" it is just reimbursement of

expenses to the assesssee company ' Dongfang Electric Corporation-Project office Kolkata" by the Government of West Bengal (WBPDCL) at the instance of the "Dongfang Electric Corporation, China"

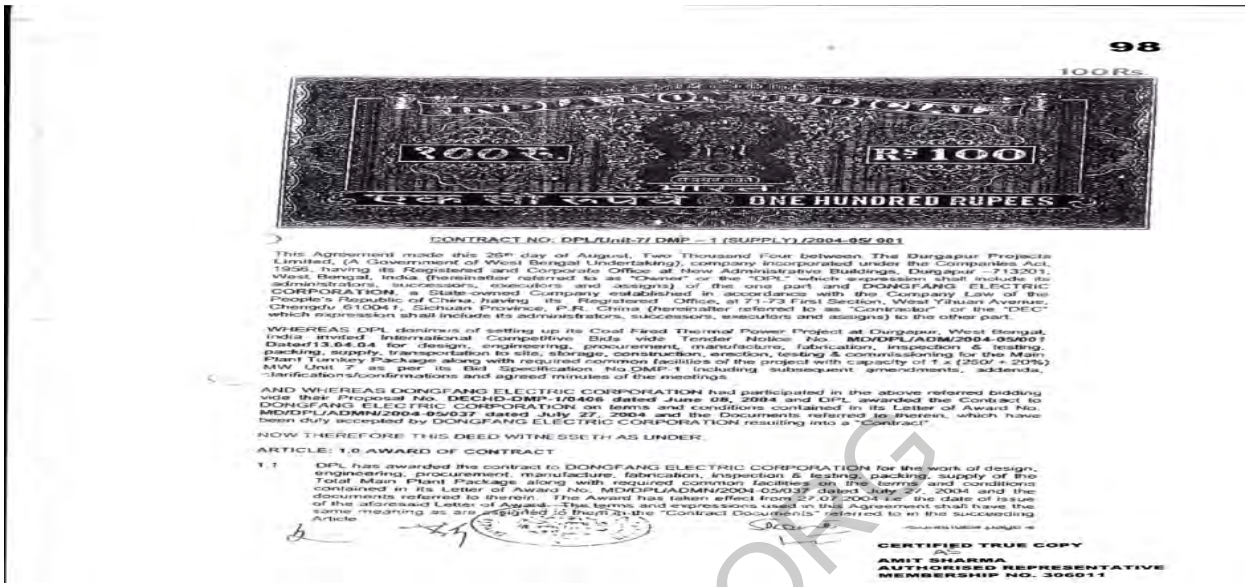
The ld Counsel pointed out that there is no FAR analysis for selection of 'most appropriate method' (MAM) for TNMM and selection of comparable are discussed in cryptic way by ld TPO. Reference to ld TPO order in second round (which are impugned in present appeals) would show that except *ipse dixit* of TPO no other reasons are cited on how TNMM is most appropriate method in terms of section 92C r.w. Rules 10B and 10C of the Rules. Further no search process is indicated the basis which Thermax is selected as comparable. It is clear, that the whole exercise is predetermined and vitiated. LdDRP has routinely upheld TPO actions perpetuating such injustice. Having found that TPO's action in rejecting CUP is without cogent reasons, DRP ought to have clearly directed application of CUP. Further vague observations to apply TNMM etc., by looking 8 comparable companies selected in original proceedings is impermissible in law as earlier proceedings in which such 8 companies were considered as comparable by TPO have been quashed and in fresh proceedings TPO has only cryptically (without citing any reasons and underlying search process) concluded that Thermax is the only comparable for TNMM method. Hence, ld Counsel prayed the Bench that by applying the internal CUP method, no any arm`s length price adjustment is required, therefore the upward adjustment done by ld TPO at Rs.90,31,04,234/- needs to be deleted.

13. On the other hand, ld DR for the Revenue submitted before us that Project Office "Dongfang Electric Corporation- Project Office" was treated as a permanent establishment (PE) of the assessee in India for tax purposes. The assessee did not dispute this fact. Thus, the PE of the assessee is an 'enterprise' under the provisions of Sections 92F(iii) and 92F(iiia) of the Act. As the assessee managed and controlled its PE in India, the PE constituted an 'Associated Enterprise' (AE) of the assessee under Section 92A of the Act. Thus, any transaction between the PE and the assessee would constitute an 'international transaction' under Section 92B of the Act and come under the purview of Section

92 of the Act. The 'arm's length principle would have to be applied to the transactions between the assessee and its PE in India. Accordingly, even though the assessee had not filed any Form 3CEB, with its return of income for A.Y. 2007-08, a reference was made by the Assessing Officer u/s 92CA(1) of the Act to the Transfer Pricing officer for determination of Arm's Length Price of the international transactions entered into between the assessee and its PE in India. In the assessee`s case, the TNMM is being applied to arrive at the arm's length price. Since the terms and the conditions of the contract and the risk allocated to the PE vis-a-vis the offshore contract were not in the control of the PE, the mark-up over cost is considered as the appropriate profit-level indicator, as an independent sub-contractor for the onshore contract would have considered the same while negotiating the contract as an independent party. The ld TPO noted that so far as benchmarking the transactions and applying he transfer pricing methods enumerated in section 92C of the Act are concerned, it can be construed that as an independent entity, the PE of the assessee in India would have charged an appropriate amount for the services rendered. Therefore, ld TPO has rightly applied the TNMM method to compute the arm`s length price adjustment at Rs.90,31,04,234/- and hence, the TPO`s order should be upheld.

14. We have heard both the parties and perused the materials available on record. We note that the core controversy in this appeal is whether Transactional Net Margin Method (TNMM) or Comparable Uncontrol Price Method(CUP) is applicable to compute the arm`s length price (ALP)? The ld Counsel for the assessee submitted before us that only CUP method is applicable whereas ld DR for the Revenue reiterated before us the stand taken by the ld TPO to apply the TNMM method. We note that ld. TPO applied TNMM method to make the TP adjustment to the tune of Rs.90,31,04,234/-. To adjudicate this issue, let us, first of all, we should analyze the contract between the assessee company and the contractee. We note that the assessee has entered into an agreement to execute the Durgapur Project Limited. The agreement between the Dongfang Electric

Corporation, China and the Durgapur Project Limited is given below for ready reference:



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100Rs.

₹100 ONE HUNDRED RUPEES

CONTRACT NO: DPL/Unit-7/ DMP – 1 (SUPPLY) /2004-05/ 001

This Agreement made this 25th day of August, Two Thousand Four between The Durgapur Projects Limited, (A Government of West Bengal Undertaking), company incorporated under the Companies Act, 1956, having its Registered and Corporate Office at New Administrative Buildings, Durgapur – 713201, West Bengal, India (hereinafter referred to as "Owner" or the "DPL" which expression shall include its administrators, successors, executors and assigns) of the one part and DONGFANG ELECTRIC CORPORATION, a State-owned Company established in accordance with the Company Law of the People's Republic of China, having its Registered Office, at 71-73 First Section, West Yiluan Avenue, Chengdu 610041, Sichuan Province, P.R. China (hereinafter referred to as "Contractor" or the "DEC" which expression shall include its administrators, successors, executors and assigns) to the other part.

WHEREAS DPL desirous of setting up its Coal Fired Thermal Power Project at Durgapur, West Bengal, India invited International Competitive Bids vide Tender Notice No. **MD/DPL/ADM/2004-05/001 Dated13.04.04** for design, engineering, procurement, manufacture, fabrication, inspection & testing, packing, supply, transportation to site, storage, construction, erection, testing & commissioning for the Main Plant Turnkey Package along with required common facilities of the project with capacity of 1 x (250/ + 20%) MW Unit 7 as per its Bid Specification No.DMP-1 including subsequent amendments, addenda, clarification/confirmations and agreed minutes of the meetings.

AND WHEREAS DONGFANG ELECTRIC CORPORATION had participated in the above referred bidding vide their Proposal No. **DECHD-DMP-1/0405 dated June 08, 2004** and DPL awarded the Contract to DONGFANG ELECTRIC CORPORATION on terms and conditions contained in its Letter of Award No. **MD/DPL/ADMN/2004-05/037 dated July 27, 2004** and the Documents referred to therein, which have been duly accepted by DONGFANG ELECTRIC CORPORATION resulting into a "Contract".

NOW THEREFORE THIS DEED WITNESSETH AS UNDER:

ARTICLE: 1.0 AWARD OF CONTRACT

1.1 DPL has awarded the contract to DONGFANG ELECTRIC CORPORATION for the work of design, engineering, procurement, manufacture, fabrication, inspection & testing, packing, supply of the Total Main Plant Package along with required common facilities on the terms and conditions contained in its Letter of Award No. MD/DPL/ADMN/2004-05/037 dated July 27, 2004 and the documents referred to therein. The Award has taken effect from 27.07.2004 i.e. the date of issue of the aforesaid Letter of Award. The terms and expressions used in this Agreement shall have the same meaning as are assigned to them in the "Contract Documents" referred to in the succeeding Article

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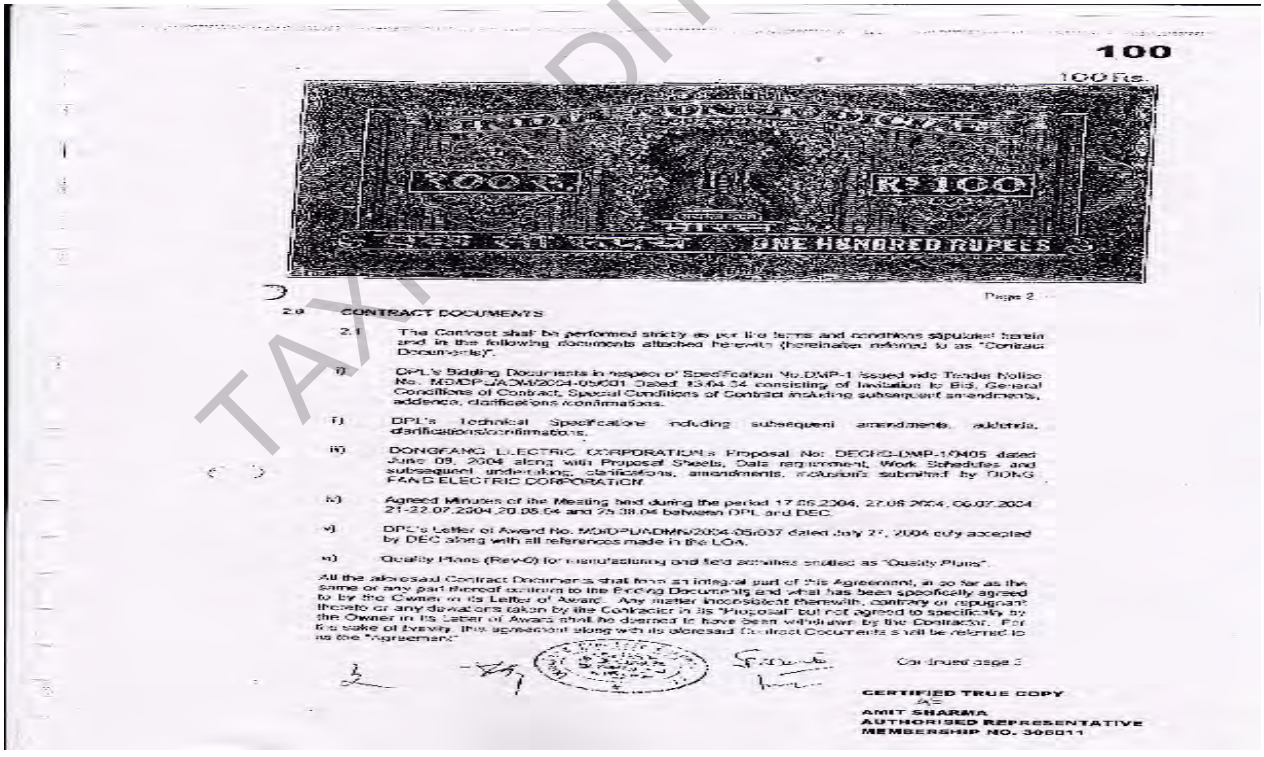
AS
AMIT SHARMA
AUTHORISED REPRESENTATIVE
MEMBERSHIP NO. 306011



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100Rs.

₹100 ONE HUNDRED RUPEES

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2.0 CONTRACT DOCUMENTS

2.1 The Contract shall be performed strictly as per the terms and conditions stipulated herein and in the following documents attached hereto (hereinafter referred to as "Contract Documents"):

i) DPL's Bidding Documents in respect of Specification No.DMP-1 issued vide Tender Notice No. MD/DPL/ADM/2004-05/001 Dated 13.04.04 consisting of Invitation to Bid, General Conditions of Contract, Special Conditions of Contract including subsequent amendments, addenda, clarifications/confirmations.

ii) DPL's Technical Specifications including subsequent amendments, addenda, clarifications/confirmations.

iii) DONGFANG ELECTRIC CORPORATION's Proposal No: DECHD-DMP-1/0405 dated June 08, 2004 along with Proposal Sheets, Data requirement, Work Schedules and subsequent undertaking, clarifications, amendments, exclusions submitted by DONGFANG ELECTRIC CORPORATION

iv) Agreed Minutes of the Meeting held during the period 17.06.2004, 27.06.2004, 06.07.2004 21-22.07.2004, 29.05.04 and 7th 30.04 between DPL and DEC.

v) DPL's Letter of Award No. MD/DPL/ADMN/2004-05/037 dated July 27, 2004 duly accepted by DEC along with all references made in the LOA.

vi) Quality Plans (Rev-0) for manufacturing and field activities shall be as "Quality Plans".

All the aforesaid Contract Documents shall form an integral part of this Agreement, in so far as the same or any part thereof conform to the Bidding Documents and what has been specifically agreed to by the Owner in its Letter of Award. Any matter inconsistent therewith, contrary or repugnant thereto or any deviations taken by the Contractor in its "Proposal" but not agreed to specifically by the Owner in its Letter of Award shall be deemed to have been withdrawn by the Contractor. For the sake of brevity, this agreement along with its aforesaid Contract Documents shall be referred to as the "Agreement".

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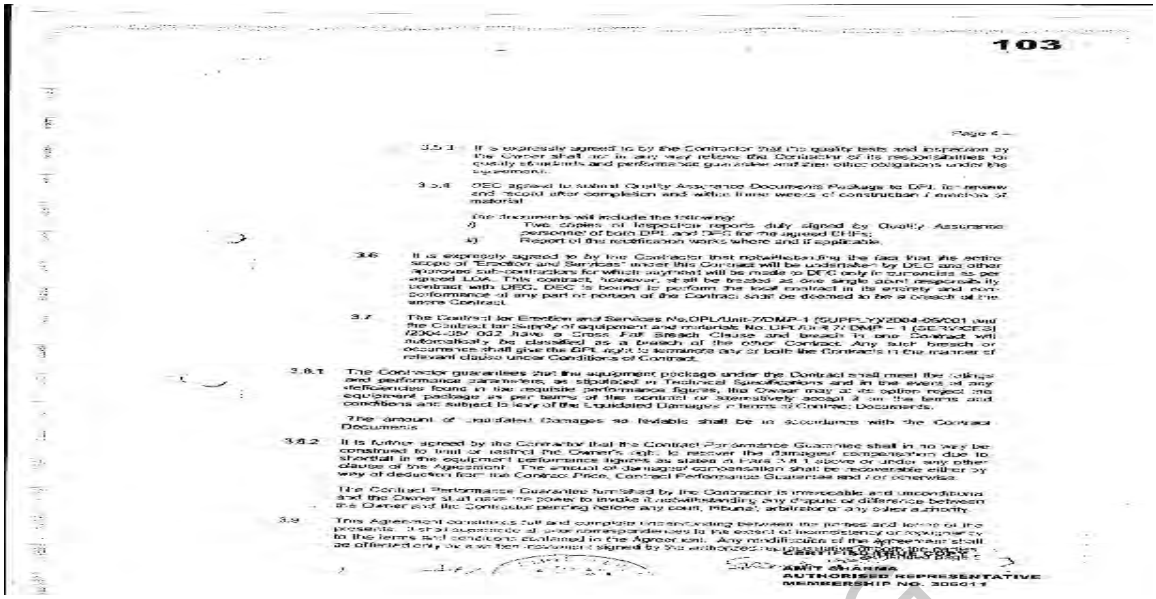
MEMBERSHIP NO. 306011



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3.5.3 It is expressly agreed to by the Contractor that no quality tests and inspection by the Owner shall be in any way relieve the Contractor of his responsibilities to qualify as per limits and perform as per guarantee and other obligations under the agreement.

3.5.4 DEC agreed to submit Quality Assurance Documents Package to DPL for review and record after completion and within three weeks of construction / erection of material.

The documents will include the following:

a) Two copies of inspection reports duly signed by Quality Assurance personnel of both DPL and DEC for the agreed QAPs;

b) Report of the rectification works where and if applicable.

3.6 It is expressly agreed to by the Contractor that notwithstanding the fact that the entire scope of "Erection and Services" under this Contract will be undertaken by DEC and other approved sub-contractors for which payment will be made to DEC only in currencies as per agreed LOA. This contract, however, shall be treated as one single agent responsible by contract with DPSL. DEC is bound to perform the total contract in its entirety and non-performance of any part or portion of the Contract shall be deemed to be a breach of the whole Contract.

3.7 The Contract for Erection and Services No.DPL/Unit-7/DMP-1 (SUPPLY)/2004-05/001 and the Contract for Supply of equipment and materials No.DPL/Unit-7/DMP – 1 (SERVICES) /2004-05/ 002 have a Cross Full Breach Clause and breach in one Contract will automatically be classified as a breach of the other Contract. Any such breach or occurrence shall give the DPL right to terminate any or both the Contracts in the manner of relevant clause under Conditions of Contract.

3.8.1 The Contractor guarantees that the equipment package under the Contract shall meet the ratings and performance parameters, as stipulated in Technical Specifications and in the event of any deficiencies found in the requisite performance figures, the Owner may at its option reject the equipment package as per terms of the contract or alternatively accept it on the terms and conditions and subject to levy of the Liquidated Damages in terms of Contract Documents.

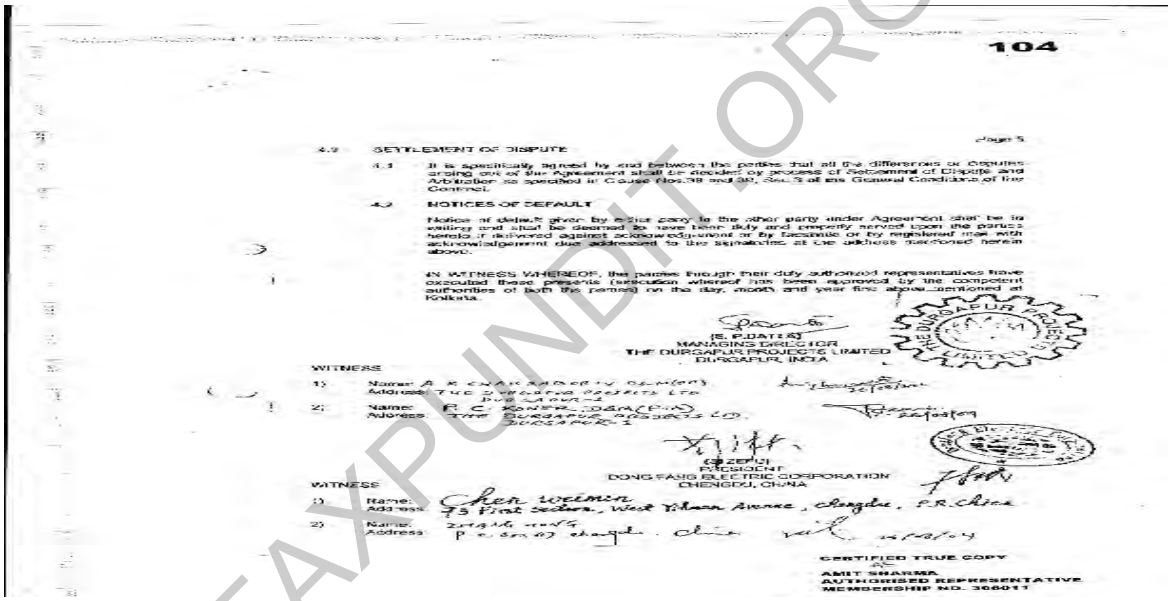
The amount of Liquidated Damages so leviable shall be in accordance with the Contract Documents.

3.8.2 It is further agreed by the Contractor that the Contract Performance Guarantee shall in no way be construed to limit or restrict the Owner's right to recover the damages/ compensation due to shortfall in the equipment performance figures as stated in Para 3.8.1 above or under any other clause of the Agreement. The amount of damages/ compensation shall be recoverable either by way of deduction from the Contract Price, Contract Performance Guarantee and / or otherwise.

The Contract Performance Guarantee furnished by the Contractor is irrevocable and unconditional and the Owner shall have the power to invoke it notwithstanding any dispute or difference between the Owner and the Contractor pending before any court, tribunal, arbitrator or any other authority.

3.9 This Agreement constitutes full and complete understanding between the parties and terms of its provisions. It supersedes all prior correspondences to the extent of inconsistency or repugnancy to the terms and conditions contained in the Agreement. Any modification of the Agreement shall be effective only as a written instrument signed by the authorized representatives of both the parties.

AMIT SHARMA
AUTHORISED REPRESENTATIVE
MEMBERSHIP NO. 306011



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4.0 SETTLEMENT OF DISPUTE

4.1 It is specifically agreed by and between the parties that all the differences or disputes arising out of the Agreement shall be decided by process of Settlement of Dispute and Arbitration as specified in Clause Nos.38 and 39, Sec. 3 of the General Conditions of the Contract.

4.2 NOTICES OF DEFAULT

Notice of default given by either party to the other party under Agreement shall be in writing and shall be deemed to have been duly and properly served upon the parties hereto if delivered against acknowledgement or by facsimile or by registered mail with acknowledgement due addressed to the signatories at the address mentioned herein above.

IN WITNESS WHEREOF, the parties through their duly authorized representatives have executed these presents (execution whereof has been approved by the competent authorities of both the parties) on the day, month and year first above mentioned at Kolkata.

[S. P.DATTA]
MANAGING DIRECTOR
THE DURGAPUR PROJECTS LIMITED
DURGAPUR, INDIA

WITNESS

1) Name: A. K. CHAKRABORTY (CHAUDHURI)
Address: The Durgapur Projects Ltd.
Durgapur-4

2) Name: P. C. BANERJEE
Address: The Durgapur Projects Ltd.
Durgapur-4

[SPECIMEN]
PRESIDENT
DONG FANG ELECTRIC CORPORATION
CHENGDU, CHINA

WITNESS

1) Name: Chen Weimin
Address: 15 Flat Section, West Yihuan Avenue, Chengdu, P.R.China

2) Name:
Address:

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AUTHORISED REPRESENTATIVE
MEMBERSHIP NO. 306011

We note that it is a single contract between the assessee's holding company, 'Dongfang Electric Corporation, China' (in short 'DEC-China') and Durgapur Projects Ltd. For this single project, the ld. TPO has applied TNMM by taking into account the profit level indicators of company "M/s Thermax Instrumentation Limited". ln respect of the CUP it has been argued that agreement entered between DEC China and the third party contractees (DPL and WBPDCL) constitute a perfect internal CUP for the activities carried out by "Dongfang Electric Corporation-Project office Kolkata" (in short "DEC-PO") in India and the value agreed between DEC China and DPL and WBPDCL in relation to the onshore

contract can be considered to be value for the services rendered by DEC-PO in lndia since the Project Office is carrying out the same activities and the Project Office is being remunerated at the amount agreed between DEC China and DPL and WBPDCL. Therefore, the DEC-PO in India is being remunerated by third party contractees (DPL and WBPDCL) and as per ld Counsel, which may constitute a perfect internal CUP. Therefore, TNMM method fails in the assessee`s case.

We note that the comparable, 'Thermax instrumentation Limited', selected by the TPO applying TNMM is not comparable because of the following reasons:

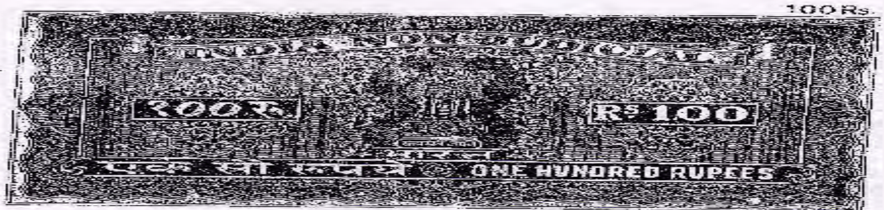
- Thermax Instrumentation Limited could not be said to be a Project Office of a foreign entity.
- Thermax Instrumentation Limited is an Indian entity incorporated in India since 1996 and engaged in various projects such as waste water treatment services and undertakes turnkey projects Its activities are different from the assessee.
- Thermax Instrumentation Limited is engaged in the business from a long period of time, having huge resources and manpower for executing the projects;
- During the FY 2006-07 Thermax Instrumentation Limited group restructured expanding activities such as supply of electronic and instrumentation systems, electrical installations, erection and commissioning of power plants, congeneration plants including civil construction work;
- Further no segmental information of the company is available relating its income from various sources and activities;
- After the completion of the projects the assessee would have to shut its Project Office and hence, the aforesaid comparison is unrealistic.

Therefore, we are of the view that TNMM method applied by the ld TPO is not a most appropriate method (MAM) for the assessee company under consideration.

15. Now, we analyze the second project which also relates to Govt. of West Bengal in respect of setting up of a project of thermal power project at Durgapur, West Bengal. The contract between the assessee and the Govt. of West Bengal is given below for ready reference:

110

100 Rs.



CONTRACT NO: DPL/Unit-7/ DMP - 1 (SERVICES) /2004-05/ 002

This Agreement made this 25th day of August, Two Thousand Four between The Durgapur Projects Limited, (A Government of West Bengal Undertaking), company incorporated under the Companies Act, 1956, having its Registered and Corporate Office at New Administrative Buildings, Durgapur – 713201, West Bengal, India (hereinafter referred to as "Owner" or the "DPL" which expression shall include its administrators, successors, executors and assigns) of the one part and DONGFANG ELECTRIC CORPORATION, a State-owned Company established in accordance with the Company Law of the People's Republic of China, having its Registered Office at 71-73 First Section, West Yihuan Avenue, Chengdu 610041, Sichuan Province, P.R. China (hereinafter referred to as "Contractor" or the "DEC" which expression shall include its administrators, successors, executors and assigns) to the other part.

WHEREAS DPL desirous of setting up its Coal Fired Thermal Power Project at Durgapur, West Bengal, India invited International Competitive Bids vide Tender Notice No. MD/DPL/ADM/2004-05/001 Dated:3.04.04 for design, engineering, procurement, manufacture, fabrication, inspection & testing, packing, supply, transportation to site, storage, construction, erection, testing & commissioning for the Main Plant Turnkey Package along with required common facilities of the project with capacity of 1 x (250 + 20%) MW Unit - 7 as per its Bid Specification No.DMP-1 including subsequent amendments, addenda, clarifications/confirmations and agreed minutes of the meetings.

AND WHEREAS DONGFANG ELECTRIC CORPORATION China has participated in the above referred bidding vide their Proposal No. DECHD-DMP-1/0406 dated June 09, 2004 and DPL awarded the Contract to DONGFANG ELECTRIC CORPORATION on terms and conditions contained in its Letter of Award No. MD/DPL/ADM/2004-05/037 dated July 27, 2004 and the Documents referred to therein, which have been duly accepted by DONGFANG ELECTRIC CORPORATION resulting into a "Contract".

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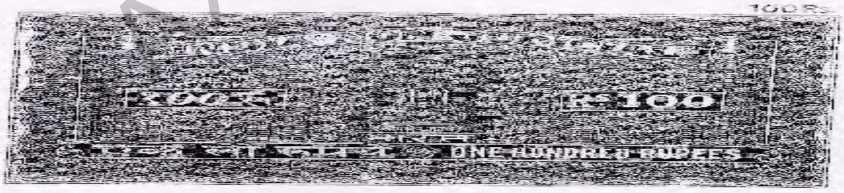
100 Rs.



Page 2

NOW THEREFORE THIS DEED WITNESSETH AS UNDER:

ARTICLE: 1.0 AWARD OF CONTRACT

1.1 DPL has awarded the contract to DONGFANG ELECTRIC CORPORATION for the work of Port Handling & Port Clearance, Transportation to Site, Storage, Construction, Erection, Testing & Commissioning of the Main Plant Package along with required common facilities on the terms and conditions contained in its Letter of Award No. MD/DPL/ADM/2004-05/037 dated July 27, 2004 and the documents referred to therein. The Award has taken effect from 27.07.2004 i.e. the date of issue of the aforesaid Letter of Award. The terms and expressions used in this Agreement shall have the same meaning as are assigned to them in the "Contract Documents" referred to in the succeeding Article.

2.0 CONTRACT DOCUMENTS

2.1 The Contract shall be performed strictly as per the terms and conditions stipulated herein and in the following documents attached herewith (hereinafter referred to as "Contract Documents")"

i) DPL's Bidding Documents in respect of Specification No DMP-1 issued vide Tender Notice No. MD/DPL/ADM/2004-05/[illegible] Dated 13.04.04 consisting of Invitation to Bid, General Conditions of Contract, Special Conditions of Contract including subsequent amendments, addenda, clarifications /confirmations.

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ii) DPL's Technical Specifications including subsequent amendments, addenda, clarifications/confirmations.

iii) DONGFANG ELECTRIC CORPORATION's Proposal No. DEC/IO-DMP-1/0406 dated June 05, 2004 along with Proposal Sheets, Data requirement, Work Schedules and subsequent undertaking, clarifications, amendments, inclusions submitted by DONG FANG ELECTRIC CORPORATION.

iv) Agreed Minutes of the Meeting held during the period 17.06.2004, 27.06.2004, 06.07.2004, 21-22.07.2004, 25.06.04 and 26.08.04 between DPL, DCPL and DEC.

v) DPL's Letter of Award No MD/DPL/ADMN/2004-05/037 dated July 27, 2004 duly accepted by DEC along with all references made in the LOA.

vi) Quality Plans for manufacturing and field activities entitled as "Quality Plans".

vii) PERT Network

All the aforesaid Contract Documents shall form an integral part of this Agreement, in so far as the same or any part thereof conform to the Bidding Documents and what has been specifically agreed to by the Owner in its Letter of Award. Any matter inconsistent therewith, contrary or repugnant thereto or any deviations taken by the Contractor in its "Proposal" but not agreed to specifically by the Owner in its Letter of Award shall be deemed to have been withdrawn by the Contractor. For the sake of brevity, this agreement along with its aforesaid Contract Documents shall be referred to as the "Agreement".

3.0 CONDITIONS AND COVENANTS

3.1 The Scope of Contract, Consideration, Terms of Payment, wherever applicable, insurance, Liquidated Damages, Performance Guarantee and all other terms and conditions are contained in DPL's Letter of Award No. MD/DPL/ADMN/2004-05/037 dated July 27, 2004 read in conjunction with other aforesaid Contract Documents. The contract shall be duly performed by the contractor strictly and faithfully in accordance with the terms of the Agreement.

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3.2 The Scope of Work shall also include supply of all such items, which are not specifically mentioned in the Contract Documents, but required for safe and reliable operation of the equipment/systems/sub-systems unless otherwise specifically excluded in the specifications.

3.3 It is agreed that the Contractor will be paid only in currencies as per agreed LOA.

3.4 TIME SCHEDULE

3.4.1 Time is the essence of the Contract. Erection & Completion Schedules shall be adhered to. DEC shall perform the work strictly in accordance with the agreed Time Schedule.

3.5 QUALITY PLANS

3.5.1 The Contractor is responsible for the proper execution of the Quality Plans. The work beyond the Customer's Hold Points (CHP) will progress only with the Owner's consent. The Owner will also undertake quality surveillance and quality audit of the systems and procedures and quality control activities. The Contractor further agrees that any change in the Quality Plans will be made only with Owner's approval. The Contractor shall also perform all quality control activities, inspection and test agreed with the Owner to demonstrate full compliance with the Contract requirements.

3.5.2 The Contractor also agrees to provide the Owner with the necessary facilities for carrying out inspection, quality audit and quality surveillance at Contractor's and its sub-contractor's Quality Assurance Systems.

These shall include but not limited to the following:

i) Relevant plant standards, drawing and procedures.
ii) Detailed Quality Assurance System manuals for manufacturing activities;
iii) Storage procedures and instructions, weld, NDT, Heat Treatment prior to commencement of manufacture;
iv) Compliance to the requirements of IBR, TAC, Explosive Department and other statutory government agencies.
v) Complete set of log sheets (blank) mentioned in the Quality Plan.

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3.5.3 It is expressly agreed to by the Contractor that the quality audit and inspection by the Owner shall not in any way relieve the Contractor of its responsibilities to quality standards and performance guarantees and their other obligations under the Agreement.

3.5.4 DEC agrees to submit Quality Assurance Documents Package to DPL for review and record after completion and within three weeks of construction / erection of material.

The documents will include the following:

i) Two copies of inspection reports duly signed by Quality Assurance personnel of both DPL and DEC for the agreed CHPs;

ii) Report of the rectification works where and if applicable.

3.6 It is expressly agreed to by the Contractor that notwithstanding the fact that the entire scope of "Erection and Services" under this Contract will be undertaken by DEC and other approved sub-contractors for which payment will be made to DEC only in currencies as per agreed LOA. This contract, however, shall be treated as one single point responsibility contract with DEC. DEC is bound to perform the total contract in its entirety and non performance of any part or portion of the Contract shall be deemed to be a breach of the entire Contract.

3.7 The Contract for Erection and Services No.DPL/Unit-7/OMP-1 (SERVICES)/2004-05/082 and the Contract for Supply of equipment and materials No. DPL/Unit-7/OMP-1 (SUPPLY)/2004 (USD) have a Cross Fall Breach Clause and breach in one Contract will automatically be classified as a breach of the other Contract. Any such breach or occurrence shall give the DPL right to terminate any or both the Contracts in the manner of relevant clause under Conditions of Contract.

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3.8.1 The Contractor guarantees that the equipment package under the Contract shall meet the ratings and performance parameters, as stipulated in Technical Specifications and in the event of any deficiencies found in the requisite performance figures, the Owner may at its option reject the equipment package as per terms of the contract or alternatively accept it on the terms and conditions and subject to levy of the Liquidated Damages in terms of Contract Documents.

The amount of Liquidated Damages so leviable shall be in accordance with the Contract Documents.

3.8.2 It is further agreed by the Contractor that the Contract Performance Guarantee shall in no way be construed to limit or restrict the Owner's right to recover the damages/ compensation due to shortfall in the equipment performance figures as stated in Para 3.8.1 above or under any other clause of the Agreement. The amount of damages/ compensation shall be recoverable either by way of deduction from the Contract Price, Contract Performance Guarantee and / or otherwise.

The Contract Performance Guarantee furnished by the Contractor is irrevocable and unconditional and the Owners shall have the power to invoke it notwithstanding any dispute or difference between the Owner and the Contractor pending before any court, tribunal, arbitrator or any other authority.

3.9 This Agreement constitutes full and complete understanding between the parties and terms of the presents. It shall supersede all prior correspondences to the extent of inconsistency or repugnancy to the terms and conditions contained in the Agreement. Any modification of the Agreement shall be effected only by a written instrument signed by the authorized representative of both the parties.

4.0 SETTLEMENT OF DISPUTE

4.1 It is specifically agreed by and between the parties that all the differences or disputes arising out of the Agreement shall be decided by process of Settlement of Dispute and Arbitration as specified in Clause Nos.38 and 39, Sec-3 of the General Conditions of the Contract.

4.2 NOTICES OF DEFAULT

Notice of default given by either party to the other party under Agreement shall be in writing and shall be deemed to have been duly and properly served upon the parties hereto if delivered against acknowledgement or by facsimile or by registered mail with acknowledgement due addressed to the signatories at the address mentioned herein above.

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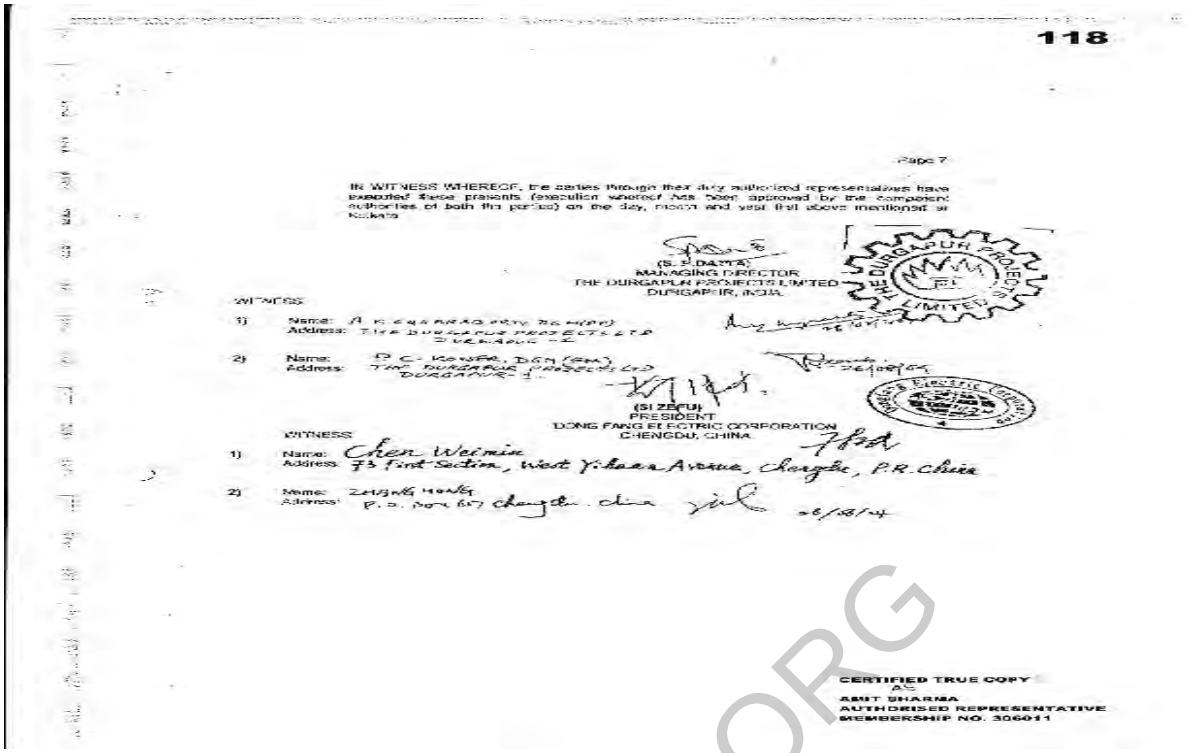

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IN WITNESS WHEREOF, the parties through their duly authorized representatives have executed these presents (execution whereof has been approved by the competent authorities of both the parties) on the day, month and year first above mentioned at Kolkata

(S. P. DATTA)
MANAGING DIRECTOR
THE DURGAPUR PROJECTS LIMITED
DURGAPUR, INDIA

WITNESS:

1) Name: A. K. CHAKRABORTY
Address: THE DURGAPUR PROJECTS LTD
DURGAPUR-1

2) Name: P. C. KOWAR, DGM (C&M)
Address: THE DURGAPUR PROJECTS LTD
DURGAPUR-1

(SI ZEFU)
PRESIDENT
DONG FANG ELECTRIC CORPORATION
CHENGDU, CHINA

WITNESS:

1) Name: Chen Weimin
Address: 73 First Section, West Yihuan Avenue, Chengdu, P.R. China

2) Name: ZHANG HONG
Address: P. R. China

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AS
ABIT SHARMA
AUTHORISED REPRESENTATIVE
MEMBERSHIP NO. 306011

After going through the agreement between the West Bengal Thermal Power Project and the assessee company, we note that this is a unique project where it is difficult to apply TNMMmethod. We have given detailed reasoning in para No.14 of our order, which are applicable to this agreement also, therefore, for the sake of brevity, we do not repeat them.

16.We note that the cornerstone of Transfer Pricing principle is the comparability analysis of a controlled transaction with an uncontrolled transaction which is substratum of arriving at Arm's length price. The controlled and uncontrolled transactions are comparable if none of the differences between the transactions materially affect the factor being examined in a given methodology, whether determination of prices or for profit margin and for such determination a reasonable accurate adjustment can be made to eliminate the material effects of any such differences. Rule 10B(2) of Income Tax Rules, provides the comparability of the transaction with uncontrolled transaction which has to be judged with reference to specific characteristics of the property transferred or services provided; FAR analysis; contractual terms; conditions prevailing in the markets,

that is, economic conditions in which respective parties transact or operate including geographical locations, size etc. Thus, comparison of attributes of the transaction is carried which would affect conditions in Arm's length dealing. Rule 10B (3) specifically provides as under:-

> *"An uncontrolled transaction shall be comparable to an international transaction or a specified domestic transaction if-*
> *(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or*
> *(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences".*

This, Rule specifically recognizes that reasonably accurate adjustment should be made to eliminate the material effects of differences, if any. Sub-rule (2) lays down the factors for determining comparability whereas; sub-rule (3) lays down the standard of comparability. The standard comparability not necessarily entails complete identity between the two transactions but sufficient similarity. It can be held to be sufficient similar if the differences between them is not material so as to effect price or profit in the open market and if there is one such thing, then such a material difference needs to be eliminated through adjustments. The factors governing the price or profit in a transaction may depend upon business strategies, market conditions, competitions, market penetration schemes, geographical locations, climatic conditions, etc. Guidelines issued by OECD also recognized the business strategies adopted by the companies which have a bearing on profitability levels. Para 1.60 and 1.62 of OECD guidelines for the sake of ready reference are reproduced hereunder:

> *"Para 1.60 of the Guidelines states as under:*
> *"Business strategies also could include market penetrate schemes. A taxpayer seeking to penetrate a market or to increase its market share might temporarily charge a price for its product that is lower than the price charged for otherwise comparable products in the same market. Furthermore, a taxpayer seeking to enter a new market or expand (or defend) its market share might temporarily incur higher costs (e.g. due to start-up costs or increased marketing efforts) and hence achieve lower profit levels than other taxpayers operating in the same market".*

Further, para 1.62 of the OECD Guidelines states as under:

> *"When evaluating a taxpayer's claim that it was following a business strategy that temporarily decreased profits in return for higher long-run profits, several factors should be considered. Tax administrations should examine the conduct of the parties to determine if it is consistent with the professed business strategy …. Another factor to consider is whether the nature of the relationship between the parties to the controlled transaction would be consistent with the taxpayer bearing the costs of the business strategy. For example, in arm's length dealings a company acting solely as a sales agent with little or no responsibility for long-term market development would generally not bear the costs of a market penetration strategy …."*

Thus, business strategies, market penetration, increase or save its market share are relevant and material factors determining prices and profit. All these factors have to be taken into consideration while eliminating the material effects which warrants some kind of reasonable accurate adjustments. Therefore, after going through the facts of the assessee s case under consideration, it seems to us that TNMM method adopted by the ld TPO for computation of arm`s length price is ad hoc, and without any cogent basis, hence the entire approach followed by the Ld. TPO is unjustified.

We note that the search resulted in companies which had supply of machinery or other complex functions, only **M/s Thermax Instrumentation Limited**, qualified out of the companies thrown up by the database. It is a subsidiary of M/s Thermax Ltd and the Annual Report mentions that it focuses its operations on installation and commissioning of power and cogeneration plants including civil construction. We note that comparable selected by the TPO, namely **M/s Thermax Instrumentation Limited** is in Civil construction also and for that ld TPO did not make any reasonable accurate adjustments. Besides, **M/s Thermax Instrumentation Limited,** is functioning in different environment, location, geography with product differentiation for which ld TPO did not make any adjustment. The turnover difference has also not considered by the ld TPO.

In respect of the CUP it has been argued that agreement entered between DEC China and the third party contractees (DPL and WBPDCL) constitute a perfect internal CUP for the activities carried out by DEC-PO in lndia and the value agreed between DEC China and DPL and WBPDCL in relation to the onshore contract can be considered to be value for the services rendered by DEC-PO in lndia since the Project Office is carrying out the same activities and the Project Office is being remunerated at the amount agreed between DEC China and DPL and WBPDCL. To constitute internal CUP there should be third party to whom the assessee is executing the same work, in this case, assessee (DEC-PO) is executing the work for Durgapur Project Limited, and the same work is being executed by the assessee (DEC-PO) for WBPDCL which is a third party to constitute the internal CUP. We note that Reference to ld TPO order in second round (which are impugned in present appeals) would show that except *ipse dixit* of TPO no other reasons are cited on how TNMM is most appropriate method in terms of section 92C r.w. Rules 10B and 10C of the Rules.

We note that business strategies, market penetration, increase or save its market share are relevant and material factors determining prices and profit, which has not been considered by the ld TPO while selecting **M/s Thermax Instrumentation Limited,** as a comparable company for application of TNMM method. All these factors have to be taken into consideration while eliminating the material effects which warrants some kind of reasonable accurate adjustments and the ld TPO has failed to do so, hence TNMM method does not apply to the assessee under consideration. For the reasons set out above, we find infirmity in the order passed by the ld TPO therefore, the TP Adjustment made by the TPO by following the TNMM method, is not justified. Hence, we delete the addition of Rs.90,31,04,234/-.

17.Since, the facts and circumstances in the case of assessment year 2007-08 are identical to those considered in the assessment year 2008-09, therefore our decision in the case of assessee for A.Y.2007-08 shall apply *mutatis mutandis* in

the assessment year 2008-09 also. Accordingly, both appeals of the assessee are allowed.

18. In the result, both appeals filed by the assessee are allowed.

Order is pronounced in the open court on 17.05.2019.

Sd/-	**Sd/-**
(S.S.GODARA)	**(A.L.SAINI)**
न्यायिकसदस्य / JUDICIAL MEMBER	**लेखासदस्य / ACCOUNTANT MEMBER**

कोलकाता /Kolkata;
दिनांक/ Date: 17/05/2019
(*RS, Sr.PS*)

आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/The Appellant- Dongfang Electric Corporation
2. प्रत्यर्थी/ The Respondent- ACIT(International Taxation), Circle-1(1), Kolkata
3. आयकरआयुक्त(अपील) / The CIT(A),
4. आयकरआयुक्त/ CIT
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, **कोलकाता**/ DR, ITAT, Kolkata
6. गार्डफाईल / Guard file.

सत्यापितप्रति

True Copy

By Order

Assistant Registrar,
I.T.A.T, Kolkata Benches,
Kolkata.