

Assessee can opt for any method under sec. 92C for computing ALP if it proves to be the most appropriate method.

Summary – The Chennai ITAT in a recent case of SCM Microsystems (India) (P.) Ltd., (the Assessee) held that assessee is at liberty to adopt any of appropriate methods specified in section 92C, as long as it can show it to be most appropriate method for determining arm's length price.

Facts

- The assessee was a wholly owned subsidiary company of a foreign company and was engaged in prototype design development and related supported activities based on technical specifications and product ideas obtained from affiliates. The assessee entered into a service agreement with associated enterprises in Singapore. As per the agreement compensation for the services rendered by the assessee-company was to be calculated by adopting cost plus an appropriate mark-up. An addendum to service agreement was signed between the parties specifying appropriate mark-up at 17 per cent. The assessee, however, arrived at operating profit/total cost of 15.5 per cent to benchmark the international transaction by following transactional net margin method.
- The TPO did not accept TNM method adopted by the assessee and, accordingly, made TP adjustment.
- The Commissioner (Appeals) however accepted computation of ALP by the assessee and deleted addition made by the TPO/Assessing Officer.
- On second appeal:

Held

- The most appropriate method has to be applied for determining arm's length price in the manner as may be prescribed in rule 10C of the Income-tax Rules. In the instant case, the assessee followed the transactional net margin method over the cost plus method for the reason: Cost plus method requires comparison of gross margins earned by the company with that of the comparable companies and to determine the gross margins of the comparable companies in a reliable manner is difficult as the accounting policies adopted by the comparable companies are not consistent and the details are not available in the public domain. An agreement between the parties cannot exclude the other approved method of determining the arm's length price as provided under the law, for the reason that the margins mentioned therein are between related parties. Thus, the assessee has shown reasonable cause for adopting the transactional net margin method as the most appropriate method. The method mentioned in the agreement cannot be followed for comparison being a related party transaction. The assessee is at liberty to adopt any of the appropriate methods specified in section 92C, as long as it can show it to be the most appropriate method for determining

the arm's length price. Therefore, the contention of the departmental representative that the assessee has deviated from the method specified in the agreement, i.e., the cost plus method to the transactional net margin method has to force.

- Further, the Transfer Pricing Officer has not conducted the pricing study as required under the statute. The Transfer Pricing Officer has not independently determined the arm's length price by taking candid transactions of unrelated parties. The Transfer Pricing Officer has erred in simply accepting the percentage of profit indicated in the service agreement between the assessee and the permanent establishment. The Transfer Pricing Officer ought to have conducted detailed study for determining the arm's length price between unrelated enterprises by applying the most appropriate method as provided under section 92C.
- In view of the above, this issue is remitted back to the Transfer Pricing Officer with a direction to pass a speaking order after conducting detailed transfer pricing study to selected comparables and to determine arm's length price as per the provisions of law.