

**IN THE INCOME TAX APPELLATE TRIBUNAL  
(DELHI BENCH 'I-1', NEW DELHI  
BEFORE SHRI R.S.SYAL, ACCOUNTANT MEMBER SHRI  
KULDIP SINGH, JUDICIAL MEMBER**

I.T.A. Nos.5202 /Del/2012  
(Assessment Years 2004-05)

DCIT  Circle 2(1), New Delhi  Appellant)	Vs.	Phillip Morris Services India (S.A.) India Branch Office 28, Barakhamba Road, New Delhi PAN : AACCP 2770K (Respondent)
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Assessee by: Sh. Neeraj Jain, Adv.  
Sh. Raonit Kotjal, CA  
Sh. Puneet Chugn, C.A.  
Revenue by : Sh. Amrendra , CIT, DR  
Sh. Rahul Cyors, Sr. DR

Date of hearing: 16.02.2016  
Date of Pronouncement: 21.03.2016

**ORDER**

**PER KULDIP SINGH, JM:**

Appellant Dy. Director of Income Tax, Circle-2(1), New Delhi hereinafter referred to as the revenue by filing the present appeal sought to set aside the impugned order dated 16.7.2012 passed by CIT(A), New Delhi on the grounds inter alia that :

*“1. Whether on facts and circumstances of the case, the CIT(A) has failed to appreciate that the AO had correctly applied the operating profit percentage on sales of assessee’s group company [ M/s Altira*

*Group Inc.] as under a unique market situations brand royalty of a product played a vital role in the sale.*

*2. Whether on the facts and circumstances of the case the CIT(A) has failed to appreciate that the AO was correct in determining the income of the assessee on the basis of the operating profit percentage on sales of its group company since it was not possible to correctly determine the taxable profits on the basis of profit and loss account prepared by it which inter-alia included expenses of capital nature and were not admissible.*

*3. Whether on the facts and circumstances of the case the CIT(A) has erred in not appreciating that the AO has correctly rejected the transfer pricing analysis submitted by the assessee company which has only two comparables and the AO was not given the opportunity to examine the fresh comparables submitted during the appellate proceedings.*

*4. Whether on the facts and circumstances of the case the CIT(A) has erred in holding that interest u/s 234B was not chargeable in this case by relying upon the decision in the case of DIT vs. Jacobs Civil Incorporated/ Mitsubishi by ignoring that the said decision has not been accepted by the Department and against which a SLP has been filed before the Hon'ble Supreme Court involving similar issue."*

2. Briefly stated facts of this case are : during the processing of return of income filed by the assessee for assessment year 2004-05, the case was selected for scrutiny and consequent to the notice issued u/s 143(2) Shri Arun Sawara, C.A. attend the precedence from time to time, filed submissions and replies to the clarifications / questions raised.

3. Assessee company is a wholly owned subsidiary of FTR Holding S.A. (Swiss Holding Company) and is one of the group companies of Phillip Morris U.S.A. and is into the business of manufacturing and trading of cigarettes and other tobacco products main operation of the assessee company is

- *“Import and distribution of the Marlboro brand of cigarettes in India as well as export of tobacco leaves ; and*
- *Provides services to its Associated Enterprises i.e. marketing support services.”*

4. During the assessment year under consideration the assessee has shown loss of Rs. 1,28,45,971/- as operating loss from total turnover of Rs. 7,10,50,023/- and entertain to following international transactions with its associated enterprises (A.E.)

S.No.	Particulars	Transaction Value (Rs.)	Benchmarking Method	Assessee's Margins	Comparables Margins	Conclusion
1	Purchase of cigarettes for resale	1,54,26,346	Resale Price Method ("RPM")	Gross Profit / Sales (GP/Sales) : 14.43%	6.81% (on Average Data)	At Arm's Length
2	Provision of Services	2,45,83,466	Transactional Net Margin Method ("TNMM")	OP / TC : 5.00%	7.33% (on Average Data)	At Arm's Length

5. On the basis of TP study adopted by the assessee company for the purposes of transfer pricing analysis the assessee considered the aforesaid international transactions to be at an arm's length. In the earlier years assessee has shown profit for rendering services to the group companies at cost plus method but during the year under consideration, it has shown loss amounting to Rs. 1,28,45,971/- marked as operating loss out of total trading turnover of Rs. 7,10,50,023/-. Assessee in its transfer pricing study chosen two comparables and taken the basis for comparison of profit on the basis of so-called "alternative practical approach" based on Resale Price Method. AO rejected the comparables taken by the assessee as not correct one as none of the comparable has actually incurred net loss in its trading transactions. Assessee explained the reason for net loss as huge expenditure incurred without comparable receipts. TPO noticed that the assessee has sold his entire purchases during the year leaving closing stock at nil.

6. From the result of business segment it has come on record that the assessee's group is earning operating profit at 16.60% for the year 2004 and 18.82% for the year 2003. TPO taking the role of Brand royalties as important feature with regard to the sales of a particular brand came to the conclusion that the price of brand is not dependent upon any other brand of cigarettes and thus AO made the comparability of assessee company with its own group companies who are dealing with the same brand and thereby rejected the TP report. AO has not examined the issue of allow ability of expenditure for determination of the taxable profit. AO has taken weighted average of the operating profit rate of the group at 16.57 and hold the 50% of the profit to be attributable to the activities of the assessee in India and computed the taxable income of the assessee in India at 70% of Rs. 1,11,84,340/- i.e. 78,29,038/-.

7. Assessee carried the matter before the Ld. CIT(A) who has allowed the appeal. Feeling aggrieved the revenue has come up before the Tribunal by way of filing the present appeal.

8. Assessee company is one of the group companies of Phillip Morris U.S.A. engaged in the business of manufacturing and trading of cigarettes and other tobacco products and operates through its Indian Branch authorised to carry out activities inter alia that :

- Import and distribution of the Marlboro brand of cigarettes in India as well as export of tobacco leaves; and
- Provides services to its Associated Enterprises i.e. marketing support services.

9. Undisputedly assessee company is a part of group namely Altria group and Indian branch office is PE of the Assessee Company. AO after rejecting the TP study adopted by the assessee company on the basis of which it has

considered its international transactions to be at an arm's length adopted the GP rate of its group which is at 16.57% as against GP rate of 14.44% on gross turnover of Rs. 7,10,50,023/- adopted by the assessee company. AO after applying the GP rate of 16.57% and after allowing 5% reduction u/s 44C of the Act ear-marked 70% of the income to PE in India and thereby assessed the income at Rs. 78,29,038/-. The AO after rejecting the TP study relied upon by the assessee company for transfer pricing adjustment has returned the following findings :-

*“As is reflected from the above statement, the assessee’s group is earning operating profit of 16.60% for the year 2004 and 18.82% for the year 2003. The brand is a very important feature of Cigarette market. Brand loyalty plays a vital role with regard to sales of a particular brand. The price of a brand is not dependent upon any other brand of cigarette, so it the sales margin. Therefore in such a unique market situation, it would be imprudent to compare the margin of the assessee with any other entity trading in other brands. The only prudent comparability will be with the assessee’s group only, who are dealing in the same brand. Therefore the T.P. study and the T.P. Report are not reliable in the unique environment of tobacco business. Therefore as stated above, the profit margin of the group would be the relevant benchmark for arriving at the profit of the assessee.*

*The assessee has filed its audited accounts in respect of the branch. It is however pointed out that the present assessment is on the assessee who is operating in India through a branch. Therefore, though the audited account of branch is relevant for determination of the profit of the assessee in India, yet it is not the only criteria for determining the profit, considering the arrangement under which the assessee operates.*

*Even if we consider the audit report, there are various expenditures claimed in the profit and loss account, which are not allowable for the purpose of computation of taxable Income of the assessee in India as per the provisions of Income Tax Act. For instance, trade offer expenses amounting to Rs. 88,43,852/-, professional & consultancy services and various other expenses. Some of the expenses charged are capital in nature. Since, for determination of taxable profit, the operating profit of the group is being resorted to, the aspect of allowability of expenditure is not considered as of now in this rder.*

*In view of the income of the assessee is recomputed as under :-*

*The weighted average of the operating profit rate of the group is 16.57. Since this operating margin accounts for both manufacturing and selling, 50% of the profit is held to be attributable to the activities of the assessee in India.*

<i>Total turn over of the assessee in India</i>	<i>Rs. 7,10,50,023/-</i>
<i>Operating Profit of the assessee (Applying the rate of 16.57%)</i>	<i>Rs. 1,17,72,989/-</i>
<i>Less 5% u/s 44C</i>	<i><u>Rs. 5,88,649/-</u></i>
<i>Total Income</i>	<i>Rs. 1,11,84,340/-</i>

*As the manufacturing and other related activities have been undertaken outside India and sales have been made in India, it is found proper to attribute income of the assessee in India on reasonable basis. Considering the unique market*

*situation in which the assessee operates; processes involved in manufacturing of cigarettes; value attached to the brand "Marlboro"; and other relevant facets of selling cigarettes-it is held reasonable to attribute 30% of the profit outside India and remaining 70% to India where the sales have taken place. Therefore, the taxable income in India is 70% of Rs. 1,11,84,340/- which comes out to be Rs. 78,29,038/-."*

The Ld. DR also emphasised that since the assessee is a group company of Altria group having been specifically incorporated for groups operation in India, it is a case of brand intensive sale of the world known Marlboro Cigarettes brand, the AO has rightly adopted the GP rate of group company instead of transfer pricing study adopted by the assessee company for TP adjustment.

10. But this contention of the ld. DR is not tenable on the grounds inter alia that no cogent reasons have been recorded for rejecting the TP study adopted by the assessee company nor disclosed the methodology adopted by him by affording an opportunity of being heard to the assessee to consider the international transaction at an arm's length; that the DR has failed to explain as to which method has been adopted by the AO to determine the international transaction at arm's length; that when the AO has himself not justified the segregation made by the assessee company he was not empowered to reject the TP study adopted by the assessee company summarily.

11. Bare perusal of aforesaid findings returned by the Assessing Officer goes to prove that he has proceeded on the basis of assumptions and guesswork that brand loyalty plays a vital role with regard to sales of a particular brand which cannot be compared with any other entity trading in other brands by losing sight of the fact and reasons that the assessment year under consideration is the first

year of operation, in which assessee company incurred huge expenses without comparable receipt. Thus, assessee company cannot be compared with the assessee's group company only without analysing the functional and risk disparities between the two company. Assessing Officer merely decided on the basis of profit margin of the group for bench marking without analysing the economic and marketing conditions of both the companies.

12. Assessing Officer again proceeded to recompute the income of the assessee on the basis guesswork by taking operating margin accounts for both manufacturing and selling at 50% of the profit attributable to the activities of the assessee in India, that too without providing opportunity of being heard to the assessee. AO also proceeded on the basis of reasonableness by attributing 30% of the profit outside India and remaining 70% to India where sales have taken place by ignoring law applicable to the facts and circumstances of this case.

13. At the very outset, it is fairly conceded by Ld. D.R. that there is no dispute regarding the extended marketing supports services rendered by the assessee company and the only dispute is regarding the aspect of distribution. Ld. A.R. for the assessee by relying upon the impugned order passed by Ld. CIT(A) contended inter alia that the Assessing Officer has applied the operating profit rate of the group arbitrarily without any basis and without considering the assessee's duly audited accounts; that profits and losses offered for taxation by the assessee are in line with the principles of attribution of profits as per Article 7 of India-Switzerland Tax Treaty and as per the Arm's Length Principles; that assessee carried out a detailed FAR analysis (Functions performed, assets employed and risk assumed) and its operation in India and then determined the Arm's Length Margin, which is required to be attributed to a Permanent Establishment (PE) using the third party industry benchmark; that Assessing

Officer has also erroneously presumed that assessee is the main performing arm of the company through which all the activities of the company are carried out by ignoring the fact of Altria Group (of which assessee company is a wholly owned subsidiary) is engaged in a wide area of functions, own significant tangible and intangible assets and operates vast geographical spread; that if the gross margin is determined based on margin computed by Assessing Officer, it results into gross margin of approximately 49%, which is much higher than the average gross margin earned by the independent distributor; that assessee also adopted fresh search comparables during appellate proceedings by taking three comparable company apart from the two comparables already adopted in the TP study and has shown the more gross margin of the comparable company @ 15.70% or 18.31% as against the gross margin earned by the assessee @ 14.43% and by applying  $\pm 5\%$  ranged the assessee's international transaction at arm's length. Ld. CIT(A) has reproduced the fresh search of comparables undertaken by the assessee during appellate proceedings in para 5.3.2 and 5.3.3 of the impugned order.

14. Keeping in view the facts and circumstances of the case; findings returned by the Assessing Officer and the fact that Ld. CIT(A) is not bound by the TP study undertaken by the Assessing Officer for T P adjustment, we are of the considered view that the contentions raised by the Ld. D.R. are not sustainable and no ground is made out to interfere into the findings returned by Ld. CIT(A) for the following reasons:

- i) that when the Assessing Officer has lost sight of the fact that trading activities have been carried out by the assessee company for a period of five months only during the year under consideration and in such a short period it is not feasible for expenses of Indian Branch Offices to be set off by income generated out of trading activities because

during the initial years of operation, expense of a company ought to be at higher side;

ii) that the Assessing Officer has merely taken GP rate @ 16.57% of assessee's group companies by rejecting TP study adopted by the assessee company as against GP rate claimed by the assessee @ 14.44% by comparing it with the group as a whole without discussing the total number of functions being carried out by the Altria group;

iii) that the Assessing Officer has also lost sight of the fact that assessee company having branch offices in India, is a distributor having responsibility for its business operation in India including market risk, price risk etc. So, keeping in view the facts, Ld. CIT(A) has rightly applied the resale price method (RPM) for benchmarking, which is the most appropriate method in this case;;

iv) that gross margin of the assessee company cannot be compared with the group company as the assessee company is an importer and distributor of cigarettes in India without any value addition;

v) that when the assessee company is not maintaining any warehouse nor it has any R&D activities and trade mark is also owned by the group company, manufacturing is also done by the group company and as such FAR of the assessee is not comparable with the FAR of its group company;

vi) that Ld. CIT(A) after considering all these facts, TP study undertaken by the assessee company initially on the basis of two comparables showing GP @ 6.81% as against GP rate of assessee company @ 14.44% and during the appellate proceedings, the appellant filed fresh search on the basis of three comparables showing average GP @ 18.31% has rightly held the international transaction at arms length;

vii) that Ld. CIT(A) has also rightly considered the detailed comparison of assessee's distribution agreement with another company namely God Fray Phillips India showing GP rate of 4.42% and this comparison is showing distribution segment of the appellant at Arm's Length Principle;

viii) that Arm's Length nature of distribution segment of assessee company has otherwise not been disputed by TPO during Assessment Year 2005-06;

ix) that a bare perusal of the distribution agreement dated 01.09.2013 entered into between the assessee company with Fillet Morris Products SA shows that assessee company was appointed as non exclusive distributor of the product manufactured by the assessee in the territory of India making it ineligible to compare with its group company;

x) that it is further agreed in the agreement (supra) that the assessee company shall sell the products of its parent company at prices agreed by the parties from time to time and in these circumstances, it was not feasible to acquire the operating profit rates of the group arbitrarily for benchmarking without considering the assessee's duly audited account;

xi) that Ld. CIT has rightly come to the conclusion on the basis of TP study adopted by the assessee company during appellate proceedings vide which three comparable companies have been taken showing GP rate of three new comparables @ 18.31% as against GP rate of assessee company shown @ 14.44% and by applying the safe harbour rule having benefit of  $\pm 5\%$ , the TP study adopted by the assessee company is at arm's length;

xii) that fresh search brought out on record by the assessee company for TP study goes to prove that the assessee company has brought out on

record detailed comparison of its distribution agreement with the comparable company namely God fray Phillips India showing GP rate of 4.42% which is much lower than the assessee company;

xiii) that the contention of Ld. D.R. that fresh TP study adopted by the assessee during appellate proceedings, cannot be relied upon without providing opportunity of being heard to the A.O. /TPO, is not tenable because the fresh TP study adopted by the assessee apparently goes in favour of the Revenue showings distribution segment of the assessee at arm's length principle;

xv) that the A.O. has also arbitrarily disallowed various expenses claimed by the assessee without specifying how and which of the expenses are not allowable.

15. In view of what has been discussed above we find no ground to interfere into the impugned order passed by Ld. CIT(A), consequently present appeal of the Revenue is hereby dismissed.

16. Order pronounced in the open court on 21<sup>st</sup> March., 2016.

Sd./-  
(R.S.SYAL)  
ACCOUNTANT MEMBER

Sd./-  
(KULDIP SINGH)  
JUDICIAL MEMBER

Date: 21.03.2016

Binita/Sp

Copy forwarded to:-

1. The appellant
2. The respondent
3. The CIT
4. The CIT (A)-, New Delhi.
5. The DR, ITAT, Loknaya Bhawan, Khan Market, New Delhi.

True copy.

By Order

No.	Details	Date	Initials	Designation
1	Draft dictated on	16.02.2016		Sr. PS/PS
2	Draft placed before author	16.02.2016		Sr. PS/PS
3	Draft proposed & placed before the Second Member			JM/AM
4	Draft discussed/approved by Second Member			AM/AM
5	Approved Draft comes to the Sr. PS/PS	21/3/16		Sr. PS/PS
6	Kept for pronouncement	21/3		Sr. PS/PS
7	File sent to Bench Clerk	21/3		Sr. PS/PS
8	Date on which the file goes to Head Clerk			
9	Date on which file goes to A.R.			
10	Date of Dispatch of order			