

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH '1-2', NEW DELHI**

Before Sh. N. K. Saini, AM and Sh. Kuldip Singh, JM

ITA No. 2847/Del/2014 : Asstt. Year : 2009-10

Deputy Commissioner of Income Tax, Circle-16(1), New Delhi	Vs	M/sTianjin Tianshi India Pvt. Ltd., 10, Community Centre, Basant Lok, Vasant Vihar, New Delhi-110057
(APPELLANT)		(RESPONDENT)
PAN No. AABCT5611J		

CO No. 70/Del/2015 : Asstt. Year : 2009-10

M/sTianjin Tianshi India Pvt. Ltd., 10, Community Centre, Basant Lok, Vasant Vihar, New Delhi-110057	Vs	Deputy Commissioner of Income Tax, Circle-16(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. AABCT5611J		

Assessee by : Sh. B. Prathap, CA

Revenue by : Sh. H. K. Chaudhary, CIT DR

Date of Hearing : 05.10.2017	Date of Pronouncement : 13.10.2017
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ORDER

Per N. K. Saini, AM:

The appeal by the department and the Cross Objection of the assessee are directed against the order dated 28.02.2014 passed by the TPO on the directions given by the ld. DRP vide order dated 26.12.2013.

2. The only effective ground raised in this appeal of the department reads as under:

“1. On the facts and circumstances of the case and in law, TPO-II(7), New Delhi erred in deleting the addition of Rs.32,28,16,031/- by applying RPM instead of TNMM.”

4. Facts of the case in brief are that the assessee filed the return of income on 30.09.2009 declaring carried forward loss of Rs.5,96,09,802/- . Later on, the case was selected for scrutiny. During the course of assessment proceedings, the AO noticed that the assessee had entered into international transaction with its associated enterprises. He, therefore, made the reference to the TPO to determine the arm’s length price u/s 92CA(3) of the Income Tax Act, 1961 (hereinafter referred to as the Act) in respect of international transaction entered into by the assessee. The TPO noticed that the assessee had undertaken the following international transactions:

<i>S. No.</i>	<i>Description of Transaction</i>	<i>Method</i>	<i>Value</i>
1.	<i>Purchase of Food Supplements and Health Equipments</i>	<i>RPM</i>	<i>31,10,33,139/-</i>
2.	<i>Sale of Food Supplements and Health Equipments</i>	<i>RPM</i>	<i>9,25,485/-</i>

5. The TPO observed that the assessee had purchased food supplements and healthcare instruments from Tianjin Tianshi Biological Development Company Ltd. [India Branch Office-Permanent Establishment (PE)], whose head office is in China. The assessee had

stated in the TP study report that the transactions between the assessee and the PE falls within the ambit of definition of international transaction in Section 92B of the Act. The TPO observed that the assessee relied upon Resale Price Method (RPM) taking Gross Profit/Sales as Profit Level Indicator (PLI) and that its margin in food supplement and health equipment was 55.48% on entity wide basis as compared to 39.68% of 15 comparable relied upon by the assessee. The TPO held that RPM was not appropriate method and that the TNMM with OP/Sales as PLI was the most appropriate method by observing in paras 3 to 4 of the order dated 22.01.2013:

“3. Transfer Pricing Approach of the assessee:

3.1 The assessee has purchased food supplements and health care instruments from Tianjin Tianshi Biological Development Company Ltd. [India Branch Office-Permanent Establishment (PE)], whose head office is in China. The assessee has stated in the TP report that the transaction between the assessee and the PE falls within the ambit of the definition of "international transaction" in section 92B. The assessee has relied upon Resale Price Method (RPM) taking GP/Sales as the PLI. Its margin in the food supplement and health equipment is 55.84% on entity wide basis compared to 39.68% of 15 comparable relied upon by the assessee.

3.2 In the transfer pricing report filed by the assessee before the department the assessee he had used TNMM to benchmark the international transaction in relation to purchase of goods from his AE and taking OP/Sales as the PU taking only the current year operating margin of the companies cited by assessee as comparable be used for comparability analysts. No substantive reason for change in adoption of methodology from TNMM in the A.Y. 2006-07 to RPM in the year under consideration has been

given by the assessee. In view of these facts and in the absence of any cogent reason for change in methodology, I am of the considered view that TNMM with OP/Sales as the PLI is the most appropriate method for benchmarking the international transaction undertaken by the assessee during the year.

3.3 The resale price method (RPM) is primarily intended to measure the value of the services performed by a buyer/reseller of goods acting as a distributor. Under the RPM comparability is dependent upon the similarity of functions performed and the risk assumed by the controlled and uncontrolled distributors. RPM focuses on the gross profit margin, which are heavily influenced by the scope and intensity of the functions performed, which may vary widely among uncontrolled parties. Therefore, RPM is not appropriate method.

3.4 In the case of the assessee it is a multi level marketing company and through reply dated 07.12.2012 it has explained its multilevel marketing model. "The marketing model followed by Tianshi group is a Multi Level Marketing ("MLM") model, whereby numerous networks of franchises and distributors get together and they are involved directly in retail selling. The Group does not undertake retail setting on its own. Also, there are no retail outlets, shops or showrooms for the sale of TIENS products by the company.

3.5 The marketing of the products in this company is done by a "Network Marketing" Plan. In Network Marketing, all the intermediaries in the Retail Sales Distribution Line up to the end user or consumer are replaced by Distributor Networks. Network marketing is based on "word of mouth" and independent canvassing by the Distributors in the Network and also ability to enroll more Distributors in the Network. This marketing strategy is typically that of a relationship marketing, wherein the marketing person approaches the customers, educates them about the utility, quality and functionally of the products.

3.6 Under the MLM model franchises and distributors purchases the products from the company and resells to the direct consumers. This model saves on heavy advertisement expenditure, showroom costs, sales staffing costs and other related direct selling expenses. Hence, there is only a small margin on this purchase and sale.

3.7 The franchises and distributors are entitled to commissions not only on the sales made by them, but also commission for the sales made by others in the network. This company has a specific marketing plan designed to encourage and build a strong, stable and successful network with maximum Reward Potential comprising of i) Retail Sales Margin ii) Commission for Direct/Own Sales iii) Commission on account of Sales made by others down the line in the Network iv) Commission for Total Sales in a Network, v) Enhanced commission for Target Achievements and vi) Award of Luxury Gifts for higher level of Sales Achievements. There is also Royalty Commission based on Global Sales Achievement of the Group.

3.8 The Tianshi Marketing plan was submitted by the assessee through letter dated 07.12.2012 clearly shows that selling commission and awards are an integral part of the pricing policy of the company and therefore in this case are direct expenses. The GP/sales of the tested party is computed as under:

Operating Income (sale of goods)	72,64,04,610/-
Purchases	34,01,12,402/-
Direct Selling and Distribution expenses	35,34,60,542/-
Gross Profit	3,28,31,666/-
Other Indirect Expenses	9,24,41,468/-
Net Loss	(5,96,09,802)
OP/Sales (Gross Level)	4.50%
OP/Sales (Net Level)	(8.20%)

4. From the above it can be seen that even while taking RPM as the method to benchmark international transaction relating to purchase of goods from its AE the transaction is not at Arm's

Length. But following the past precedence we will use TNMM as TNMM tests the Arm's Length character of Transfer Prices in the control transaction by comparing the operating profits earned by uncontrolled parties engaged in similar business activities. This method measures the total return derived from the control taxpayer's most narrowly defined business activity for which reliable data incorporating the controlled transaction under review is available. The strength of this method is that Net margins are less affected by transactional differences and also some functional diversity between the controlled and uncontrolled parties is acceptable. Therefore, I have considered TNMM with OP/Sales as PLI the most appropriate method in this case."

6. The TPO accepted only 4 comparables out of the 15 selected by the assessee and worked out the TP adjustment of Rs.18,58,14,299/- in the following manner:

"6. TP Adjustment:

6.1 In view of the observations above, the OP/Sales margin of comparables considered as functionally similar to the assessee are as below:

<i>S. No</i>	<i>Name of the company</i>	<i>OP/Sales</i>
<i>1.</i>	<i>Emami Ltd.</i>	<i>15.31%</i>
<i>2.</i>	<i>Dabur India Ltd.</i>	<i>15.50%</i>
<i>3.</i>	<i>Fern Care Pharma Ltd.</i>	<i>15.10%</i>
<i>4.</i>	<i>ZanduPharma Ltd.</i>	<i>23.60%</i>
	<i>Arithmetic Mean</i>	<i>17.38%</i>

6.2 The Operating Profit of the assessee as per the P&L account is (5.96 crores) and the turnover during the year is 72.64 crores. The OP/Sales margin of the assessee is (8.20%). As the average OP/Sales of the comparables taken above after detailed analysis is 17.38%, the OP/Sales margin of the assessee falls outside the

+/-5% range and therefore, TP adjustment is made in the case as below:

<i>Total Sales</i>	<i>72,64,04,610/-</i>
<i>OP/Sales @ (8.20%)</i>	<i>(5,95,65,178)</i>
<i>Arm's Length Price, of Operating Profit @17.38</i>	<i>12,62,49,121/-</i>
<i>Adjustment</i>	<i>18,58,14,299/-</i>

6.3 In order to benchmarked the above international transaction, I propose to use the OP/Sales margin for financial year 2008-09 of the comparables at 17.38% and reduce the purchase price of Food Supplements and Health Equipments by Rs. 18,58,14,299/-."

7. The TPO asked the comments of the assessee. In response, the assessee submitted the reply vide letter dated 08.09.2010 raising certain objection which are summarized by the TPO in para 6.1 of his order which read as under:

- "1. Use of RPM as the most appropriate method has been reiterated.*
- 2. The assessee acts has a reseller for the products manufacturer by its AE.*
- 3. The assessee has determined the gross profit margin on its import and resale activity in its own case and that of comparable during the same guidance.*
- 4. The comparable chosen by the assessee in the transfer pricing study sell processed and semi processed foods, drug formulation and cosmetics."*

8. The TPO did not find merit in the submission of the assessee and rejected the RPM applied by the assessee. The TPO considered the TNMM as the most appropriate method, however, he accepted the contention of the assessee for inclusion of Cravatex Ltd. as comparable

and worked out the addition of Rs.16,73,35,606/- on account of arm's length price by observing in paras 11 to 11.2 of the order dated 22.01.2013 which reads as under:

“11. Given the discussions in the preceding paragraphs, the comparables that shall be used in the Software Development Services are as below:

<i>S. No</i>	<i>Name of the company</i>	<i>OP/Sales</i>
<i>1.</i>	<i>Cravatex Ltd.</i>	<i>6.83%</i>
<i>2.</i>	<i>Emami Ltd.</i>	<i>16.31%</i>
<i>3.</i>	<i>Dabur India Ltd.</i>	<i>17.26%</i>
<i>4.</i>	<i>Fern Care Pharma Ltd.</i>	<i>13.79%</i>
<i>5.</i>	<i>ZanduPharma Ltd.</i>	<i>19.88%</i>
	<i>Arithmetic Mean</i>	<i>14.83%</i>

11.1 The Operating Profit of the assessee as per the P&L account is (5.96 crores) and the turnover during the year is 72.64 crores. The OP/Sales margin of the assessee is (8.20%). As the average OP/Sales of the comparables taken above after detailed analysis is 14.83%, the OP/Sales margin of the assessee falls outside the +/-5% range and therefore, TP adjustment is made in the case as below:

<i>Total Sales</i>	<i>72,64,04,610/-</i>
<i>OP/Sales @ (8.20%)</i>	<i>(5,96,09,802)</i>
<i>Arm's Length Price, of Operating Profit @14.83%</i>	<i>10,77,25,804/-</i>
<i>Adjustment</i>	<i>16,73,35,606/-</i>

11.2 Accordingly, the Arm's Length Price OP/Sales of the International Transaction entity wide for the year is computed at Rs.16,73,35,606/-. The Assessing Officer shall reduce Rs.16,73,35,606/- from the purchase price paid by the assessee to its related party.”

Thereafter, the AO passed the draft assessment order dated 22.03.2013 u/s 144C of the Act and made the addition of Rs.16,73,35,606/-.

9. Against the said draft assessment order, the assessee raised objection before the Id. DRP on the issue relating to rejection of the Resale Price Method by the TPO for benchmarking the international transaction.

10. The Id. DRP directed the TPO to use RPM as the MAM by observing in para 6.1 of the order dated 26.12.2013 which read as under:

"6.1. The TPO has rejected RPM based on the reason given in the order. However, DRP is not convinced because of the following factors:

1) There is no dispute on the fact that assessee is a retailer of health food supplements. RPM is the MAM when the function performed by the assessee is reselling.

2) There is no evidence brought on the record by the TPO to show that the assessee has done any value addition to the goods being sold in India.

3) In the case of the assessee itself for AY 2007-08, the Hon'ble ITAT in its order dated 21.05.2013 has set the case back to the AO/TPO to decide the application of the RPM.

4) Six methods are mandated in Section 92C of the IT Act so that these methods can be appropriately used in the facts and circumstances of each case. Rule 10B(l)(b) gives the RPM, in a circumstance when the property is purchased for resale.

This is the fit case for employing the RPM and therefore TPO is directed to use RPM as the MAM and using Gross Profit/ Sales as the Profit Level Indicator (PLI).”

11. Now the assessee is in appeal. The ld. DR strongly supported the orders of the TPO and the AO and reiterated the observations made in the said orders.

12. In his rival submissions, the ld. Counsel for the assessee submitted that this issue is covered vide order dated 21.05.2013 of the ITAT Delhi Bench -I, New Delhi in ITA No. 2299/Del/2011 for the assessment year 2007-08 in assessee's own case wherein the additional ground was raised and the issue was set aside to the file of the AO. It was further submitted that the TPO on the direction of the ITAT passed the order dated 30.01.2016 and accepted the RPM as the most appropriate method and thereafter no TP adjustment was made (copy of the said order was furnished which is placed on record).

13. We have considered the submissions of both the parties and carefully gone through the material available on the record. It is noticed that the ITAT Delhi Bench -I, New Delhi in ITA No. 2299/Del/2011 for the assessment year 2007-08 remitted the issue relating to the rejection of RPM as the most appropriate method vide order dated 21.05.2013. The relevant findings have been given in para 4 of the said order which read as under:

“4. As regards the additional grounds of appeal, we have heard both the counsel and perused the records. Upon careful consideration, we admit the additional grounds of appeal. We find that these grounds were not before the authorities below. In the interest of justice, we remit the additional ground of appeal to the files of the Assessing Officer. The Assessing Officer shall consider the same after giving the assessee proper opportunity of being heard in this regard and accordingly decide the grounds of appeal.”

14. On the direction of the ITAT, the TPO passed the order dated 30.01.2016 u/s 92CA(3) of the Act and accepted the RPM as the most appropriate method by observing in para 4.4 of the said order which read as under:

“4.4 The assessee buys goods from its AE and resells to a network of distributors through Franchisees. There is no value addition or repacking to the products. There are no other complex activities in the business of this company. Further, it can be noted that in Transfer Pricing proceedings u/s 92CA for AY 2010-11, AY 2011-12 and AY 2012-13 RPM as the MAM has been accepted by the department in case of the assessee for similar kind of transactions. The facts and circumstances of the transactions and business are same in AY 2007-08 vis-à-vis all these subsequent years. Hence, applying the principles of common symmetry of approach as has been accepted by the department in the AY's discussed above, RPM can be accepted as the most appropriate method.”

15. We, therefore, considering the totality of the facts as discussed hereinabove, are of the view that the Id. DRP rightly directed the AO/TPO to consider the RPM as the most appropriate method instead of

TNMM proposed by the TPO. Accordingly, we do not see any merit in this appeal of the department.

16. As regards to the Cross Objection, the Id. Counsel for the assessee submitted that he has the instruction not to press the Cross Objection and gave in writing as under:

“CO withdrawn”

*Sd/-
(B. Prathap)
Adv.*

17. In view of the above, the Cross Objection filed by the assessee is dismissed as withdrawn.

18. In the result, the appeal of the department and Cross Objection of the assessee are dismissed.

(Order Pronounced in the Court on 13/10/2017)

**Sd/-
(Kuldip Singh)
JUDICIAL MEMBER**

**Sd/-
(N. K. Saini)
ACCOUNTANT MEMBER**

Dated: 13/10/2017

Subodh

Copy forwarded to:

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2. Respondent
3. CIT
4. CIT(Appeals)
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ASSISTANT REGISTRAR