

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH: BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER  
AND  
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

|                          |
|--------------------------|
| IT(TP)A No.351/Bang/2016 |
| Assessment Year: 2011-12 |

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|--|------------|---|
| M/s. Element 14 India Pvt. Ltd.<br>#15, 2 <sup>nd</sup> Floor, Theme House<br>Krishna Nagar Industrial Area<br>Off Hosur Main Road<br>Bangalore-560 029.<br><br><b>PAN NO : AABCF1609A</b> | <b>Vs.</b> | Deputy Commissioner of<br>Income-tax<br>Circle-2(1)(2)<br>Bangalore |
| <b>APPELLANT</b>   |            | <b>RESPONDENT</b>   |

|                      |   |                              |
|----------------------|---|------------------------------|
| <b>Appellant by</b>  | : | Shri Ajit Tolani, A.R.       |
| <b>Respondent by</b> | : | Shri Sunil Kumar Singh, D.R. |

|                       |   |            |
|-----------------------|---|------------|
| Date of Hearing       | : | 08.09.2020 |
| Date of Pronouncement | : | 16.09.2020 |

**ORDER**

**PER B.R. BASKARAN, ACCOUNTANT MEMBER:**

The assessee has filed this appeal challenging the assessment order dated 30-12-2015 passed by the assessing officer for assessment year 2011-12 u/s 143(3) r.w.s 144C of the Income-tax Act,1961 [‘the Act’ for short] in pursuance of directions given by Ld Dispute Resolution Panel (DRP).

2. The grounds urged by the assessee relate to the Transfer Pricing Adjustment made in respect of “Distribution Segment” and “ITES segment”.

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3. The assessee is a subsidiary of Element 14 Holdings BV Netherlands and is engaged in the business of distribution of electronic, electrical, industrial and maintenance, repair and operations products. In addition to it, the assessee is also providing technical support services akin to IT enables services to its Associated Enterprises. Thus the assessee has got two segments, viz., Distribution segment and ITES segment.

4. The first issue relates to the Transfer pricing adjustment made in respect of distribution segment. The assessee adopted "Resale Price Method" (RPM) as most appropriate method for the distribution segment. The TPO noticed that the assessee is required to perform certain additional functions with regard to the distribution segment. Further the assessee has declared loss in the distribution segment. Accordingly, he took the view that the TNM method is the most appropriate method for the distribution segment. The relevant observations made by the TPO are extracted below:-

*"7.4 Some of the functions that the taxpayer is required to perform as per the Agreements with its AEs are as under:*

- The distributor (read taxpayer) shall use its best efforts to promote the sale of goods in the territory.*
- The distributor shall keep the supplier informed on a regular basis as to the market conditions, laws and regulations which may affect the goods, the Distributor's own activities and those of the competition within the territory.*
- The distributor shall inform immediately of any faults with or lack of suitability of the goods for the purposes for which they are required in the territory and co-operate with the supplier in seeking to resolve any such problems.*
- The Distributor shall use the Trade Marks or Trade names of the supplier during the period of the agreement and the distributor shall protect such Trade Marks from any infringement in the territory etc. The result of these added functions are expenditures incurred by the taxpayer, which have been distributed, all over the profit and loss account, resulting in a huge loss in the Distribution Segment. The taxpayer has also made payment of Royalty to its AE. A routine trader would have earned a profit out of its trading activity and not*

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*incurred such a huge loss. Therefore, the TPO does not consider the RPM to be the most appropriate method for determining ALP of the international transaction of the taxpayer in the Distribution segment. The TPO is of the view that, the TNMM is the most appropriate method for determining the ALP of the international transaction of the taxpayer, in the distribution segment. A discussion on the advantages of TNMM over RPM is made below.”*

Accordingly, the TPO adopted TNM method as most appropriate method and made transfer pricing adjustment of Rs.2.38 crores. The Ld DRP also confirmed the same.

5. The Ld A.R submitted that the assessee is pure distributor and does not carry out any value addition to the products traded by it. Accordingly, he submitted that the RPM is the most appropriate method for the distribution segment. He submitted that, under RPM method, the Gross profit margin has to be compared with the comparable companies. The assessee has incurred net loss due to huge expenses involved in marketing the products. While marketing the products, the assessee usually carry out certain functions relating to marketing activities. They are not per se, result in value addition to the products traded by the assessee. Accordingly he submitted that the TPO was not justified in giving importance to those routine marketing functions. He further submitted that the co-ordinate bench of Tribunal has held in the case of Acer India Pvt Ltd (IT(TP)A No.2837/Bang/2017 & IT(TP)A No.3391/Bang/2018 dated 05-03-2020) that the RPM is the most appropriate method in case of distributor of products.

6. The Ld D.R, on the contrary, submitted that the assessee has incurred huge loss by incurring huge advertisement expenses. Normally a trader would not incur loss in trading segment of reputed products. Hence the TPO has adopted TNM method as most

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appropriate method, since ALP could be best determined under that method.

7. In the rejoinder, the Ld A.R submitted that the assessee is involved in mere trading activity and it does not carry out any value addition functions on the products. Hence RPM is the appropriate method.

8. We heard the parties and perused the record. We notice that the co-ordinate bench has examined the issue of “most appropriate method” for a distributor of products in the case of Acer India Pvt Ltd (supra). The relevant observations made by the co-ordinate bench are extracted below:-

*“10. In our considered view, the view so entertained by TPO is based on surmises and conjectures. He has merely relied upon the fact that the assessee was making losses in its trading segment. We notice that the AO has not brought any material on record to support his view. **There is no dispute with regard to the fact that the assessee does not make any value addition to the products imported by it from its AE. When there is no value addition and the imported products are sold as it is, then "Resale Price method" is held to be most appropriate method in the cases relied upon by Ld A.R.** In the case of M/s Celio Future Fashion P Ltd (supra), the Mumbai bench of Tribunal held so by following the decision rendered by Delhi bench of Tribunal in the case of Burberry India P Ltd (ITA No.758 & 7684/Del/2017 dated 22.06.2018). Identical issue was considered by the Bangalore bench of Tribunal in the case of M/s A.O. Smith India Water Heating P Ltd (ITA No.176/Bang/2015), wherein the Tribunal, after considering various case laws on the matter, held that the RPM is the most appropriate method in case of a distributor of products. For the sake of convenience, we extract below the relevant observations made by the Tribunal in the case of A.O Smith India Water Heating P Ltd (supra):-*

*14. Now the assessee is before us with the submission that it is an accepted principle that the computation of ALP based on a direct method like RPM, which tests the results at gross level unlike the TNMM which tests the results at net level, extinguishes the requirement of making adjustment in relation to the difference in operating expenses, which could be different from enterprise to enterprise. It was further contended that as provided in Rule 10B, under RPM price of international transaction needs to be computed on the basis of gross profit margin earned in uncontrolled*

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*transactions, while under TNMM price of international transaction is computed on the basis of net profit margin of uncontrolled transactions. As per Rule 100(1), the most appropriate method for determining the ALP depends upon the facts and circumstances of each case. Similarly, the operating expenses incurred by the assessee is different from the operating expenses incurred by comparable companies. The learned counsel for the assessee has highlighted that incurs certain expenses which does not affect sale/purchase price of the goods sold. Therefore, in a situation where incurrence of item expenses affects only the net profit of the entity without corresponding effect of gross profit or price of transactions, the TNMM will not provide the most reliable arms length results. The selection of TNMM would require making reliable adjustment to arrive at the operating profit i.e., adjustment for expenditure incurred in the current year, the benefit of which will be received in the future year. In the absence of reliable adjustment, the selection of TNMM will not result in arriving at the ALP of the international transaction. In transactions method like RPM or Cost Plus method, the effect of these factors may be eliminated as natural consequences of insisting upon greater product of function similarity. Depending upon the facts and circumstances of the case and particular on the effect of functional differences on the cost structure and the revenue of the potential comparables, the net profit indicators can be less sensitive than the gross margin to the difference in the extent of complexity of function and difference in the level of risk.*

*15. It was further contended that comparability should not be interpreted in isolation because of the conditions and circumstances of the controlled transactions should be taken into consideration while comparing the net margin. Under the facts and circumstances of the assessee, the net margin comparability is more volatile than the gross margin comparable. In the light of the facts, it was contended that if the cost structure is such that costs are effecting in net profit directly without affecting the price or gross margin, then there can be no two opinions that RPM should be preferred over the TNMM method. In support of these contentions, he placed reliance upon the following judgments:-*

*(1) Horiba India Pvt. Ltd., v. OCIT, 81 taxmann.com 209*

*(2) Bose Corporation Pvt. Ltd., v. ACIT, Circle 3(1), New Delhi, 77 taxmann.com 194*

*(3) ITO v. L'Oreal India Pvt. Ltd., (2015) 24 taxmann.com 192 (Born)*

*(4) Mattel Toys India Pvt. Ltd., v. DOIT in ITA No.2476/Mum/2008.*

*The Id. DR placed reliance upon the order of the AO and the DRP.*

*16. Having heard the rival submissions and from a careful perusal of the record, we find that undisputedly the assessee is a trading company and carries out distribution and marketing of products of AOS group in India. It imports water filters from AO Smith China and sells them in India. AO Smith India is, according to the TP document, a distributor of AOS Water Heaters in India. **The Tribunal has examined the most appropriate method in the case of distributor to determine the ALP for the international transactions. In the case of Horiba India Pvt. Ltd. (supra), the Tribunal has held that in the case of a distributor where the goods are purchased from the AE and resold to other independent entities without any value addition, then the resale price method should be reckoned as most appropriate method.** One of the main reason given by the TPO as well as the DRP is that the assessee is full fledged/full risk distributor and performing host of functions, therefore RPM should not be taken as the most appropriate method, because all these functions require huge cost which may not represent the gross profit margin. This contention of the revenue was rejected by the Tribunal and it was held that in comparable controlled transaction scenario, a normal distributor will undertake all kinds of functions which are related to sales of the product. The things like market research, sales & marketing, warehousing, controlled quality and also risks like market risk, credit risk, etc. are undertaken by any distributor for the sale of the products. The Tribunal further held that **what is important to see is whether there is any value addition or not on the cost purchased for resale.** If there is no value addition to the finished goods purchased from the AE are sold in the market as it is, then gross profit margin earned on such transactions become determining factor to analyse the gross compensation after the cost of sales. Accordingly the Tribunal held that the RPM is the most appropriate method.*

*17. Similarly, in the case of Bose Corporation Pvt. Ltd. v ACIT (supra), the assessee company was engaged in the business of distribution of sound and audio assistant for individual customers and public places. It was a wholly owned subsidiary of Bose Corporation, USA. During the relevant year, assessee purchased furnished goods from its AE and resold the same in India to unconnected parties. The assessee adopted resale price method (RPM) as most appropriate method (MAM) for determining the ALP of the said international transactions. The profit level indication (PLI) adopted by the assessee was gross profit/sale and the assessee has made itself tested party for the purpose of international transactions. The TPO rejected the transfer pricing study of the assessee and opined that transactional net margin method was to be applied for determining ALP of international transactions under question. While determining the issue as to which is the most*

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*appropriate method in case of distributor, the Tribunal has held that the resale price method (RPM) is the most appropriate method and directed the TPO to calculate margin of the comparables by using RMP. The relevant observation of the Tribunal is extracted hereunder for the sake of reference:*

*"8.1 At this juncture, we note the mandate of Rule 10C which defines the 'Most appropriate method'. Sub-rule (1) of Rule 10C states that: "For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length in relation to the international transaction." Sub-rule (2) of Rule 10C lists certain factors which should be taken into account in selecting the most appropriate method as specified in sub-rule (1). These factors, inter alia, include (a) the availability coverage and reliability of data necessary application of the method'; and (d) the degree of comparability existing between the international transaction and the uncontrolled transaction....." 8.2 An overview of the factors prescribed for choosing the most appropriate method indicates that firstly, the data necessary for application of the given method should be available and secondly, the uncontrolled transactions should be functionally similar, if not identical. A company, in order to be ranked as comparable under the RPM, should preferably be engaged in doing similar activity as that of the assessee or at least of the same genus of the activity, with a different product. The Ld. TPO himself has categorized the corn parables chosen by the assessee as traders akin to computer industry or engaged in trading of instruments. As the basic requirements under rule 10(c)(1) are fulfilled by these corn parables and that the Ld. TPO has not brought on record any evidence to prove material difference between the assessee and the corn parables so selected, we direct the Ld. TPO to calculate the margin of the comparables by using RPM."*

*18. In the case of CIT Vs. L'Oreal India Pvt. Ltd., similar dispute was raised before the Hon'ble High Court of Bombay. In that case, assessee had business in 2 segments viz., manufacturing and distribution, In respect of business of distribution, the TPO suggested transfer pricing adjustment by applying the TNMM and rejected the resale price method (RPM) adopted by the assessee because the TPO found that assessee was incurring loss consistently and hence the price police was not at arm's length. The Hon'ble High Court, having examined all aspects have finally concluded that RPM is the most appropriate method. The relevant observation of the Hon'ble High Court is extracted hereunder for the sake of reference:*

*"7. After having perused the relevant part of the order passed by the Commissioner and this Tribunal on this question, we are in*

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*agreement with Pardiwalla that the Tribunal did not commit any error of law apparent on the face of the record nor can the findings can be said to be perverse. The Tribunal has found that the TPO has passed an order earlier accepting this method. The Tribunal has noted in para 19 of the order under challenge that this method is one of the standard method and the OECD (Organization of Economic Commercial Development) guidelines also state in case of distribution or marketing activities when the goods are purchased from associated entities and there are sales effected to unrelated parties without any further processing, then, this method can be adopted. The findings of fact are based on the materials which have been produced before the Commissioner as also the Tribunal. Further, it was highlighted before the Commissioner as also the Tribunal that the RPM has been accepted by the TPO in the preceding as well as succeeding assessment years. That is in respect of distribution segment activity of the Assessee. In such circumstances, and when no distinguishing features were noted by the Tribunal, it did not commit any error in allowing the Assessee's Appeal. Such findings do not raise any substantial question of law. The Appeal is devoid of merits and is, therefore, dismissed. There would be no orders as to costs."*

*19. Copy of the order of the Tribunal in the case of L'Oreal India Pvt. Ltd., is also placed on record to demonstrate as to under what circumstances the RPM was considered to be most appropriate method. Similarly, in the case of [Mettal Toys India Pvt. Ltd., v. DCIT \(supra\)](#), the Tribunal again reaffirmed its view that in the case of distributor, the RPM is the most appropriate method by holding that ultimate aim of the transfer pricing is to examine whether price of the margin arising from the international transactions with a related party is at ALP or not. The determination of the approximate ALP is a key factor for which most appropriate method is to be followed. Therefore, if at any stage of the proceedings, it is found that by adopting one of the prescribed method other than choosing earlier, the most appropriate ALP can be determined, the assessing authorities as well as the appellate authorities should take into consideration such a plea raised before them provided it is demonstrated as to how a change in the method will produce better or more appropriate ALP on the facts of the case. The Tribunal accordingly rejected the contention of the Revenue and directed the TPO to adopt RPM instead of TNMM for computing the ALP.*

*20. Turning to the facts of the case, we find that undisputedly, assessee is a distributor of AO Smith China which is involved in the manufacture of water heaters and sells the water heater imported from AO Smith China in India without making any value addition to the product in a similar type of case, it has been repeatedly held by the Tribunal and the Hon'ble High Court of Bombay that in case of*

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*distributor, whether the product is being sold to the uncontrolled entities without making any value addition RPM is the most appropriate method and should be preferred over TNMM. Accordingly, we set aside the order of the AO, passed consequent to the direction of the DRP in this regard and direct the AOITPO to adopt the RPM as the most appropriate method."*

*11. Since the facts are identical in this case, we hold that the Resale Price Method is most appropriate method in the facts and circumstances of the present case. Accordingly we direct the AO/TPO to adopt Resale Price Method as most appropriate method and determine the ALP of the transactions accordingly."*

9. In the instant case, the assessee has claimed that it has not carried out any value addition to the products imported by it from its Associated Enterprises. It is also submitted that the functions to be performed by the assessee as a "distributor", which is highlighted by the TPO is normal functions performed in the trade circles even by a non-related party. We notice that the revenue has not negated both these submissions of the assessee. The TPO has also rejected the RPM for the reason that the assessee is incurring Net loss. However, it has held by the Tribunal in various cases that the Gross Profit margin has to be compared under RPM. Accordingly, we are of the view that RPM is the most appropriate method in the facts and circumstances of the case. Accordingly, we direct the AO/TPO to adopt Resale Price Method as most appropriate method and determine the ALP of the transactions accordingly.

10. We shall now take up transfer pricing adjustment made under ITES segment. The assessee adopted TNM method as most appropriate method and Operating Profit/Operating Cost (OP/OC) as Profit Level Indicator (PLI). Rejecting the Transfer pricing study of the assessee, the Transfer Pricing Officer (TPO) carried out his own search and after considering the explanations of the assessee selected 10 comparable companies as final set of comparables. The list of comparable companies selected by the TPO is extracted below:-

| <b>Sl.No.</b>         | <b>Name of the case</b>           | <b>Operating income</b> | <b>Operating cost</b> | <b>OP/OC</b>  |
|-----------------------|-----------------------------------|-------------------------|-----------------------|---------------|
| 1                     | Accentia Technologies Ltd.        | 1,069,026,524           | 82,93,91,898          | 28.89%        |
| 2                     | Acropetal Technologies            | 494,399,332             | 38,97,06,574          | 26.86%        |
| 3                     | Cosmic Global Ltd.                | 62,496,615              | 5,69,15,360           | 9.81%         |
| 4                     | e4e Healthcare (capitaline)       | 613,160,587             | 54,56,25,872          | 12.38%        |
| 5                     | ICRA Online Ltd. (seg)            | 156,691,000             | 11,67,49,267          | 34.21%        |
| 6                     | Jeevan Scientific Technology Ltd. | 1,721,400,000           | 1,00,86,52,592        | 70.66%        |
| 7                     | Infosys BPO Ltd.                  | 11,291,147,909          | 9,57,73,24,546        | 17.89%        |
| 8                     | Jindal Intellicom (capitaline)    | 390,358,799             | 35,12,69,641          | 11.13%        |
| 9                     | Mindtree Ltd. (seg)               | 5,653,000,000           | 5,10,39,05,999        | 10.76%        |
| 10                    | iGate Global Solutions Ltd.       | 11,845,540,000          | 9,47,11,65,000        | 25.07%        |
| <b>Average Margin</b> |                                   |                         |                       | <b>24.77%</b> |

The average mean margin of the comparables selected by the TPO was 24.77%. After granting working capital adjustment of 1.47%, the TPO arrived at the adjusted margin at 23.30%. Accordingly he made transfer pricing adjustment of Rs.49.93 lakhs.

11. The Ld A.R submitted that the DRP excluded seven comparable companies and confirmed following three companies selected by the TPO:-

- (a) Accentia Technologies Ltd
- (b) ICRA online Ltd
- (c) Jindal Intellicom

Before us, the assessee seeks exclusion of M/s Accentia Technologies Ltd and M/s ICRA online Ltd. The assessee also seeks inclusion of two companies, viz., M/s Inhouse Production Limited and M/s Microland Ltd.

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12. The Ld A.R submitted that the companies M/s Accentia Technologies Ltd and M/s ICRA online Ltd have been excluded by the co-ordinate bench in the case of M/s Acusis Software India P Ltd vs. ITO (IT(TP)A No.169/Bang/2016 dated 06-09-2019). Accordingly, he prayed for exclusion of these two comparables.

13. The Ld D.R, however, supported the orders of tax authorities.

14. We heard the parties on this issue and perused the record. The decision in the case of Acusis Software India P Ltd (supra) has considered the comparable company M/s Accentia Technologies Ltd for the very same assessment year under consideration, i.e., for AY 2011-12. The co-ordinate bench has followed the decision rendered by another co-ordinate bench in the case of EMS Software Services (India) P Ltd (IT(TP)A No.273/Bang/2016 dated 25.4.2018) and accordingly directed to be excluded. We notice that the co-ordinate bench in the case of EMS Software Services (India) P Ltd has followed the decision rendered by other co-ordinate benches in the case of M/s Swiss Re Shared Services India P Ltd (IT(TP)A No.380/Bang/2016 dated 08-07-2016) and in the case of Amba Research India P Ltd. Thus, we notice that M/s Accentia Technologies Ltd has been held to be not a good comparable in many cases. Accordingly, following the decision rendered by the co-ordinate benches in the above said cases, we direct exclusion of M/s Accentia Technologies Ltd.

15. The comparable company M/s ICRA online Ltd was also considered by the co-ordinate bench in the case of Acusis Software India P Ltd (supra). We notice that the co-ordinate bench has followed the decision rendered by Mumbai bench of Tribunal in the case of Sitel India Pvt Ltd (ITA No.1821/Mum/2016 dated 03-05-

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2019) and held that ICRA online Ltd is not a good comparable. Accordingly, following the decision rendered by the co-ordinate benches in the above said cases, we direct exclusion of M/s ICRA online Ltd.

16. The assessee seeks inclusion of M/s Inhouse Production Limited and M/s Microland Ltd.

17. With regard to M/s Inhouse Production Ltd, the Ld A.R submitted that the TPO has rejected this company on the ground that the data relating to the same was not available. He submitted that the above said observation of the TPO is against the facts available on record. He submitted that the data relating to this company has been filed by the assessee. In fact, the Ld DRP has examined the annual report of this company and offered its comments by observing that this company has incurred expenses of Rs.4.77 crores in foreign currency as purchase of data base, which makes this company uncomparable. The Ld A.R submitted that the tax authorities have not properly examined the details of this company and accordingly prayed that this company should be considered as good comparable.

18. The Ld D.R submitted that this company may be restored to the file of TPO for examining it afresh.

19. We heard the parties on this issue and perused the record. Since the assessee has submitted that the annual report of this company is available on record and since the Ld DRP has also examined the Annual Report, the TPO was not correct on facts in observing that the data are not available. It is the submission of the assessee that this company is comparable with the assessee and it has not been properly examined by Ld DRP. Accordingly, we restore

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this issue to the file of AO/TPO for examining this comparable company afresh.

20. With regard to M/s Microland Limited, the Ld A.R submitted that the segmental details of this company is available, but the tax authorities have considered the financial results at entity level and accordingly rejected this company. He submitted that the segmental results relating to ITES services should be compared with the assessee company.

21. We heard Ld D.R, who supported the order passed by Ld DRP. Having regard to the submission of the assessee that the segmental results is required to be compared with the assessee company, we are of the view that this issue also requires fresh examination at the end of the AO/TPO. Accordingly we restore this company also to their file for examining it afresh.

22. In the result, the appeal of the assessee is treated as allowed for statistical purposes.

Order pronounced in the open court on 16<sup>th</sup> Sept, 2020

**Sd/-**  
**(George George K.)**  
**Judicial Member**

**Sd/-**  
**(B.R. Baskaran)**  
**Accountant Member**

Bangalore,  
Dated 16<sup>th</sup> Sept, 2020.  
VG/SPS

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**Copy to:**

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore.