

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

Before Sh. Amit Shukla, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

**ITA No. 752/Del/2009 : Asstt. Year: 2002-03
ITA No. 1682/Del/2009 : Asstt. Year: 2003-04
ITA No. 4195/Del/2009 : Asstt. Year: 2004-05**

Dentsply India Pvt. Ltd., Plot No. 263, FIES, Patparganj Industrial Area, Delhi-110092	Vs	DCIT, Circle-10(1), New Delhi
(APPELLANTT)		(RESPONDENT)
PAN No. AAACD3171E		

Assessee by : Sh. Himanshu Sinha, Adv.

Revenue by : Ms. Meera Srivastava, CIT DR

Date of Hearing: 25.03.2021

Date of Pronouncement: 04.05.2021
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ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeals have been filed by the assessee against the order of Id. CIT (A)-XX, New Delhi dated 26.12.2008.

2. At the outset, it is to be mentioned that the assessee has filed application under Rule 11 of the Income Tax (Appellate Tribunal) Rules, 1963 for admission of the additional grounds. The additional ground reads as under:

"The inappropriate use of Transactional Net Margin Method ("TNMM") instead of the Resale Price Method ("RPM") as the most appropriate method ("MAM") for benchmarking the Appellant's international transaction of import of dental products from its

foreign AE i.e. Dentsply International, USA ("international transaction")."

3. It was argued that the grounds taken up involves a legal issue and doesn't require any investigation and can be deciphered from the facts on record. The Id. DR objected to admission of additional ground at this juncture. Keeping in view, the judgment of the Hon'ble Apex Court in the case of National Thermal Power Co. Ltd. Vs CIT (1998) 229 ITR 383, the additional ground filed by the assessee is accepted. The relevant portion of the judgment is as under:

"5. Under Section 254 of the Income-tax Act, the Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit. The power of the Tribunal in dealing with appeals is thus expressed in the widest possible terms. The purpose of the assessment proceedings before the taxing authorities is to assess correctly the tax liability of an assessee in accordance with law. If, for example, as a result of a judicial decision given while the appeal is pending before the Tribunal, it is found that a non-taxable item is taxed or a permissible deduction is denied, we do not see any reason why the assessee should be prevented from raising that question before the tribunal for the first time, so long as the relevant facts are on record in respect of that item. We do not see any reason to restrict the power of the Tribunal under Section 254 only to decide the grounds which arise from the order of the Commissioner of Income-tax (Appeals). Both the assessee as well as the Department have a right to file an appeal/cross-objections before the Tribunal. We fail to see why the Tribunal should be prevented from considering questions of law arising in assessment proceedings although not raised earlier.

6. In the case of Jute Corporation of India Ltd. v. C.I.T. . this Court, while dealing with the powers of the Appellate Assistant Commissioner observed that an appellate authority has all the powers which the original authority may have in deciding the question before it subject to the restrictions or limitations, if any, prescribed by the statutory provisions. In the absence of any statutory provision, the appellate

authority is vested with all the plenary powers which the subordinate authority may have in the matter. There is no good reason to justify curtailment of the power of the Appellate Assistant Commissioner in entertaining an additional ground raised by the assessee in seeking modification of the order of assessment passed by the Income-tax Officer. This Court further observed that there may be several factors justifying the raising of a new plea in an appeal and each case has to be considered on its own facts. The Appellate Assistant Commissioner must be satisfied that the ground raised was bona fide and that the same could not have been raised earlier for good reasons. The Appellate Assistant Commissioner should exercise his discretion in permitting or not permitting the assessee to raise an additional ground in accordance with law and reason. The same observations would apply to appeals before the Tribunal also.

7. The view that the Tribunal is confined only to issues arising out of the appeal before the Commissioner of Income-tax (Appeals) takes too narrow a view of the powers of the Appellate Tribunal [vide, e.g., C.I.T, v. Anand Prasad (Delhi), C.I.T. v. KaramchandPremchand P. Ltd. and C.I.T. v. Cellulose Products of India Ltd. . Undoubtedly, the Tribunal will have the discretion to allow or not allow a new ground to be raised. But where the Tribunal is only required to consider a question of law arising from the facts which are on record in the assessment proceedings we fail to see why such a question should not be allowed to be raised when it is necessary to consider that question in order to correctly assess the tax liability of an assessee.

8. The reframed question, therefore, is answered in the affirmative, i.e., the Tribunal has jurisdiction to examine a question of law which arises from the facts as found by the authorities below and having a bearing on the tax liability of the assessee. We remand the proceedings to the Tribunal for consideration of the new grounds raised by the assessee on the merits.”

4. Respectfully following the above judgment of the Hon'ble Apex Court, the additional grounds taken up by the assessee are hereby admitted.

5. The assessee company is a wholly owned subsidiary of Dentsply International, USA. The assessee company is engaged in manufacturing and trading of dental products. The total sale of the assessee during the year was Rs.14.05 crores. The raw material, for the dental products manufactured by the assessee, is procured from unrelated parties. The products traded by the assessee are entirely purchased from its Associated Enterprises. The trading activity constituted about 95% of the business and the remaining 5% is from manufacturing activity. The dental products manufactured or traded by the assessee are sold to the dealers or distributors of these dental products and also to dentists directly.

6. The TPO used net operating margin as the PLI as against the gross profit margin selected by the appellant and concluded that since the mean operating profit margin of the comparables was 3.40% as against the appellant at -16.06%, therefore, recommended an adjustment of Rs.2,73,65,789/- to the international transactions.

7. The written arguments of the Id. AR with regard to the additional grounds are as under:

"a. The Appellant submits that it is primarily involved in trading of dental products. The trading activities constitute purchase of dental products by the Appellant from its foreign AE and reselling to dealers or distributors of such dental products and also to dentists directly with no addition to the value of such dental products.

b. It is submitted that the transfer pricing regulations contained under sections 92 to 92F of Chapter X of the Income Tax Act, 1961 ("ITA") were made effective from 1 April 2001 (i.e. from AY 2002-03 which is the first AY under consideration). The

Assessee and its consultant were not fully aware about the practices regarding determination of arm's length price, the law being completely new. They were unable to appreciate that for distribution/trading where the trader does not carry out any significant value addition, the RPM should be adopted as the most appropriate method if adequate comparable companies are available. However, the Appellant has adopted TNMM as the MAM by the Appellant itself to benchmark its international transaction in its Transfer Pricing Study Report in AY 2002-03, which was followed in subsequent AYs too.

c. However, given the business model of the Appellant and international transaction entered into by it during the AYs in question, the Appellant is now aware that the RPM is the MAM for benchmarking its international transaction. Thus, the Appellant prays before this Hon'ble Tribunal for adjudicating the appropriateness of use of the RPM as the MAM in the present case.

d. In this regard, reliance is placed on the Order of the Mumbai Bench of this Hon'ble Tribunal in the case of Mattel Toys (I) (P.) Ltd. v. DCIT IT Appeal Nos. 2476 & 2801 (MUM.) of 2008. In the facts of that case, the assessee (a distributor) imported goods from its foreign AE and re-sold such goods to independent parties in India without any value additions. The assessee had applied TNMM as the MAM in its transfer pricing study report and prayed before the Hon'ble Tribunal to change the method of benchmarking to RPM. At para 38 of the Order, the Hon'ble Tribunal held that RPM is the MAM method for determining the arm's length price of an international transaction wherein goods, purchased from the AE, are resold by the assessee without any value additions. Relevant part of the Order is reproduced below for ready reference:

".... This is also what happens in the case of a distributor wherein the property and service are purchased from the A.E. and are resold to other independent entities, without any value additions. The gross profit margin earned in such

transactions becomes the determination factor to see the gross compensation after the cost of sales. In the instant case, the assessee is a distributor of Mattel toys and gets the finished goods from its A.E. and resells the same to independent parties without any value addition. In such a situation, RPM can be the best method to evaluate the transactions whether they are at ALP. "

e. Further, at para 41 of the Order, the Hon'ble Tribunal held that the assessee is not precluded from raising a ground before this Hon'ble Tribunal for the first time if a method, other than the one chosen by it in its transfer pricing study report, should be resorted to for determination of arm's length price in a more appropriate manner.

f. Reliance in this regard is also placed on the following decisions wherein it has been held that the RPM is the MAM for benchmarking the international transaction in which the assessee resells products purchased from its foreign AE to independent third parties without any value additions:

a) DCIT v. M/s. Luxottica India Eyewear Pvt. Ltd ITA no.1115 of 2014 (Delhi - para 10 which was affirmed by the Hon'ble Delhi High Court in CIT v. M/s Luxottica India Eyewear Pvt. Ltd ITA No. 852 of 2015 (Delhi High Court) - para 5A;

b) ITO v. L'oreal India (P.) Ltd. IT Appeal No. 5423 (MUM.) OF 2009 - para 19 which was affirmed by the Hon'ble Bombay High Court in CIT v. L'Oreal India (P.) Ltd. [2015] 276 CTR 484 (Bombay) - para 7;

c) Nokia India (P.) Ltd. v. DCIT IT Appeal Nos.178 & 242 (DELHI) OF 2010 - para 10;

d) DCIT v. M/s. Tupperware India Pvt. Ltd. ITA No. 2140/Del/2011 & ITA No. 1323/Del/2012 - para 16 and 17.

g. The fact that, instead of TNMM the RPM is the MAM, was also ignored by the Ld. TPO/ AO/ CIT (A). It is pertinent to note that the CIT (A) in his order

dated 26 December 2008 (for Assessment Year 2002-03) (at page 32 of the order, page 39 of the Appeal Set) also observed that RPM is appropriate where the reseller does not add substantially to the value of the product/ service. However, despite that, the Ld. CIT (A) wrongfully applied TNMM to benchmark the international transaction of the Appellant."

8. The Id. AR further argued that owing to the nascent stage of transfer pricing development in India, the assessee was also not conversant with the different methods, legality demands that most appropriate method should be used for determining ALP under "Indian Transfer Pricing Regulations".

9. On the other hand, the Id. DR argued that the assessee themselves are following TNMM in the subsequent years hence the argument of the assessed cannot be accepted.

10. Heard the arguments of both the parties and perused the material available on record.

11. We have gone through the various decisions rendered on this issue. For the sake convenience and ready reference, the relevant part containing the entire facts and ratio in the case of *Mattel Toys (I) (P.) Ltd. Vs DCIT in ITA Nos. 2476 & 2801/Mum/2008* is reproduced as under:

"17. Facts in brief:- The assessee is an indirect wholly owned subsidiary of Mattel Inc., U.S.A., which is the worldwide leader in manufacturing and marketing of variety of toy products and games. The entire share capital of the assessee company is owned by Mattel Inc., U.S.A. and partly through its other subsidiary. The assessee is engaged in marketing and selling of toy brands of Mattel Group in India and recorded its turnover of Rs.36 crores during the relevant previous year. Its operations consisted of import of finished

goods from the group companies and selling them in India and also manufacturing of the toy after importing the raw materials from the A.E. The toy brands dealt by the assessee in India included Barbie dolls, Hot Wheels, Fisher Price products and other entertainment games. Thus, the assessee had international transactions with the A.E. with regard to the purchase of finished goods and purchase of raw materials. Looking to the nature of international transactions with its A.E., the Assessing Officer made a reference u/s 92CA(1) to the Transfer Pricing Officer (for short "TPO") for determination of ALP as reported in Form-3CEB filed by the assessee. The turnover of the assessee company along with the net profit before interest and tax for various years were reported in the following manner:-

A.Y.	Sales (Rs.)	Returned income / loss (Rs.)	NPBT (Rs.)	Taxes Paid in India
2003-04	30,41,12,782	(-)18,92,71,790	(-)14,16,04,449	Nil
2002-03	36,58,52,712	(-)22,31,41,398	(-)33,33,51,613	Nil
2001-02	46,56,93,750	(-)34,28,16,554	(-)40,71,57,703	Nil
2000-01	24,80,65,852	(-)12,46,36,005	(-)12,33,00,581	Nil

18. During the relevant assessment year, the assessee has disclosed following international transactions in its transfer pricing report:-

Sl.no.	Sales (Rs.)	Returned income / loss (Rs.)	Method Applied
1.	Purchase of raw materials	2,19,94,477	Cost plus Method
2.	Purchase of finished goods	3,08,16,302	TNMM method
3.	Sale of finished goods	3,28,21,040	TNMM method
4.	Reimbursement	38,21,597	CUP method

19. Insofar as manufacturing activities were concerned, the TPO accepted the assessee's determination of ALP and there is no dispute before us.

20. For the distribution activities which related to purchase of finished goods and sale thereof, the assessee in the transfer pricing report has selected

Transactional Net Margin Method (TNMM) as the most appropriate method to arrive at the ALP. In the said report itself, the assessee has rejected the Resale Price Method (RPM) for the reason that the said method focuses on gross profit margin which is heavily influenced by the scope and function performed and may also vary widely among uncontrolled parties. Further, the assessee could not identify the comparables with the product lines similar to that of the assessee. For the purpose of determining the ALP under the TNMM, the assessee selected six comparables with the average operating profit margin ratio at 0.91% as compared to (-) 51.22% shown by the assessee for the domestic distribution segment for the year ending 31st March 2002. On such margin, the assessee made an adjustment on account Mattel Toys (I) Pvt. Ltd. 9 of advertisement distribution cost and worked out the average operating margins of the six comparables at (-) 17.41%. The TPO has incorporated the original profit margin and the adjusted operating profit margin of the six comparables in Para-6.3 in the following manner:-

<i>Sl. no.</i>	<i>Comparables</i>	<i>Original Operating Profit Margin</i>	<i>Adjusted Operating Profit Margin</i>
1.	<i>Balsara Hygiene Products Ltd.</i>	<i>4.36%</i>	<i>(-) 3.2%</i>
2.	<i>Detergents India Ltd.</i>	<i>(-) 0.43%</i>	<i>(-) 22.46%</i>
3.	<i>Henkel Spic India Ltd.</i>	<i>5.40%</i>	<i>(-) 19.74%</i>
4.	<i>Mueller and Phipps India Ltd.</i>	<i>(-) 0.10%</i>	<i>(-) 20.15%</i>
5.	<i>Nirma Consumer Care Ltd.</i>	<i>(-) 0.83%</i>	<i>(-) 19.15%</i>
6.	<i>Paramount Cosmetics India Ltd.</i>	<i>0.00%</i>	<i>(-) 19.68%</i>
	<i>Average operating margin of comparables</i>	<i>0.91%</i>	<i>(-) 17.41%</i>

21. The TPO further noted that within the distribution activity, the assessee has determined its gross profit margin and operating profit margin under three segments, firstly, imported goods from the A.E. sold in domestic market; secondly, imported goods from the A.E. resold to A.E. and lastly, imported goods from the A.E. and exported to third parties outside India. Based on these three segments of the distribution

activity, he worked out the operating profit margin and gross profit in the following manner:-

<i>Particulars</i>	<i>Import from AE & resale in domestic market (Rs.)</i>	<i>Import from AE and export to AE (Rs.)</i>	<i>Import from AE and export to third parties (Rs.)</i>	<i>Total distribution activity (Rs.)</i>
<i>Sales</i>	<i>11,74,41,770</i>	<i>4,61,57,312</i>	<i>7,49,07,171</i>	<i>23,85,06,253</i>
<i>Less: Cost of Sales</i>	<i>8,40,80,455</i>	<i>4,80,71,836</i>	<i>7,88,74,978</i>	<i>21,10,27,269</i>
<i>Gross Profit</i>	<i>3,33,61,315</i>	<i>(19,14,524)</i>	<i>(39,67,807)</i>	<i>2,74,78,984</i>
<i>Other Costs</i>	<i>9,35,13,477</i>	<i>1,77,22,486</i>	<i>2,87,61,235</i>	<i>13,99,97,198</i>
<i>Op. Profit</i>	<i>(6,01,52,162)</i>	<i>(1,96,37,010)</i>	<i>(3,27,29,042)</i>	<i>(11,25,18,21)</i>
<i>Op. Margin</i>	<i>(51.22%)</i>	<i>(42.54%)</i>	<i>(43.69%)</i>	<i>(47.17%)</i>
<i>Gross Profit</i>	<i>28.40%</i>	<i>(4.15%)</i>	<i>(5.30%)</i>	<i>11.52%</i>

22. After making the analysis in the aforesaid manner, he observed that the assessee's operating profit margin at (-) 51.22% in the domestic segment is much lower than the average margin earned by the other entities (comparables) engaged in the distribution activity in India which is at 0.91%. After inviting the assessee's submissions / objections on the proposed adjustments, the TPO gave a detail reasons for rejecting the assessee's submissions which has been discussed from Paras-6.5 to Para- 11. One of the very important submissions of the assessee before the TPO, vide letter dated 6th October 2004, was that the gross profit margin should be compared instead of operating profit for the three segments of its distribution activities and the most appropriate method for bench marking the ALP should be done through resale price method with the same set of comparables. Such a contention of the assessee has been rejected by the TPO in Para-11.1. The TPO finally determined the ALP in the following manner and made following adjustments:-

12. In view of the above, the arm's length price of the assessee is determined in the following manner:

(a) The Arm's Length Price of the international transactions is calculated as per the segmental costs and revenues submitted by the assessee in its submissions dated 17.11.2004 (segmented costs I

revenue for Domestic segment) and submission dated 01.12.2004 (for segment costs and Revenue for remaining 2 export segments).

(b) The import of finished goods of Rs. 3,08,16,302/- is considered under the Domestic segment.

(c) The assessee has made adjustments to the margin of the comparables on account of difference in advertisement costs. As a result of this, the average operating profit margin of the comparables has been determined at (-) 17.4% which appears very improbable in a distribution activity. The assessee has filed no evidence to support the adjustment made. Hence, the adjustment made by the assessee in this regard is rejected.

(d) The average operating profit on sales ratio of 0.91% as calculated by the assessee is applied for the Domestic segment. Separate relief on account of advertisement costs of the assessee has been given while calculating the ALP. For the segment consisting of export to A.E. ratio of operating profit on costs of 0.92% is applied to determine the ALP.

13. The Arm's Length Price for all the three segments is calculated in the following manner:-

I. Import from A.E and sale in Domestic.

Particulars	Amount (Rs.)	
Operating profit margin on sales of the comparables	0.91%	
Assessee's sales in domestic	11,74,41,770	
Operating profit required on sales @ 0.91%	10,68,720	(A)
Actual loss of assessee	(6,01,52,162)	(B)
Adjustment to International Transaction (A) + (B)	6,12,20,882	
Less: Advertisement costs as charged to this segment as discussed in Para-12(d) (As per Annexure-2 to assessee's letter dt. 17.11.04)	2,53,68,909	
Adjustment to International	3,58,51,973	

<i>Transaction</i>		
<i>Ratio of International Transaction to the cost of sales in this segment (i.e., Rs.3,08,16,302 /Rs.8,40,80,455)</i>	37%	
<i>Hence, 37% of Rs.3,58,51,993 amounts to</i>	1,32,65,230	
<i>Adjustment to the International Transaction</i>	1,32,65,230	

II. Import from A.E. and sale to A.E. (Adjustment being made to sales value).

<i>Particulars</i>	<i>Amount (Rs.)</i>
<i>Actual Sales (International Transactions)</i>	3,29,52,673
<i>Operating profit margin on cost of comparables</i>	0.92%
<i>Total costs of assessee</i>	6,57,94,322
<i>Operating profit required</i>	6,05,307
<i>Actual loss of assessee</i>	19637010
<i>Adjustment to the international transaction</i>	20242317
<i>Arm's Length Price of sales to AE</i>	5,31,94,990
<i>Actual Sales (International Transactions)</i>	3,29,52,673

23. Thus, he made adjustment of Rs.1,32,65,230, in the ALP of international transaction on purchase of finished goods and adjustment of Rs.2,02,42,317 on sale of finished goods thereby making the total adjustment of Rs.3,35,07,547.

24. Before the learned Commissioner (Appeals), the assessee contended that the adjustment made by the TPO is wholly incorrect on facts because the TPO has presumed that the assessee's gross profit margin would work out to 80.57% which is much higher side as compared for average gross profit margin earned by the comparable companies. Further, the TPO has failed to appreciate that the assessee had huge administrative cost to the extent of 79.62% of its total sales and because of such administrative cost, the assessee had to incur huge negative profit. Thus, TNMM cannot be an appropriate method for bench marking its operating net profit. Since the international transactions pertain to import of finished goods from the A.E. and resale in the domestic market, the best way for bench marking such

international transaction was to compare gross profit margin by adopting RPM. Further, it was also stated that the assessment year 2002-03 was the first year of assessee's business in India and, therefore, they have to incur very high administrative cost including advertisement and such expenditures accounted for almost 80% of the sales revenue. To administer the gross profit margin and actual operating profit margin, the assessee furnished chart for six years starting from the years 2001-02 to 2006-07, which has been incorporated in appellate order at Para-6.8 in the following manner:-

<i>Profitability Statement</i>						
<i>Particulars</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>	<i>2005-06</i>	<i>2006-07</i>
<i>Sales</i>	111441770	304112782	305011664	321028703	427450318	550000867
<i>Less: Sales Tax</i>			16740887	13479686	19160394	36392568
<i>Net Sales</i>	117441770	304112782	288270777	307549017	408289924	523608299
<i>Less: Gross Cost</i>						
<i>Cost of Goods Sold</i>	84080485	202386334	139965922	157037068	217642512	237802154
<i>Gross profit (A)</i>	33361285	101726448	148304855	150511949	190647412	285806145
<i>Gross profit (%)</i>	28%	33%	51%	49%	47%	55%
<i>Opr. Margin (%)</i>	-51%	-36%	-15%	-11%	-5%	10%
<i>Adm. Cost as % of sales - Mattel India</i>	80%	69%	66%	60%	52%	45%
<i>Adm. Cost as a % of sales - comparables</i>	12%	21%	20%	17%	18%	Database - Yet to update the info

25. The learned Commissioner (Appeals), insofar as the transactions relating to import of finished goods and resale in India are concerned, rejected the assessee's contentions on various grounds. The sum and substance of such reasoning are -

(i) that the assessee's contention that the current year was the first year of operation and, therefore, they had to incur heavy high administrative cost is not tenable because the assessee has been operating in

India for around 3 to 4 years in the past and in the earlier years also, the assessee had significant turnover. Therefore, there is no justification in assessee's contentions about adjustment of administrative cost;

(ii) the assessee's contention that prices charged by Mattel Europa is at par with the prices charged to other A.Es cannot be accepted because the transfer pricing adjustments have to be based on FAR analysis and if lower prices are being charged in Asia region, the same cannot justify lower profits, because the assessee has not given PLI indices of its A.Es for operating in this region to justify its claim and whether they are also showing abnormal losses in respective markets;

(iii) the gross profit rate in the preceding year was 37.64% whereas in the current year is only 19.90% which supports the TPO's contentions and refute the assessee's claim that negative profits are on account of the fact that this was initial year of operation in India; and

(iv) the assessee's contention that RPM should be followed instead of TNMM cannot be accepted because the assessee in its transfer pricing study report has given a detail analysis as to why RPM could not be followed and TNMM is the most appropriate method for determining the ALP.

26. Further, the learned Commissioner (Appeals) observed that the assessee itself did not make the required adjustment to its profit and left it to the TPO to make the adjustments. Based on these reasons, he upheld the TPO's determination of ALP on the ground that the TPO, while determining the ALP had already excluded the advertisement expenses and, therefore, there remains no valid grievance of the assessee to be considered. Thus, he upheld the adjustment of Rs.1,32,65,320. Insofar as the adjustment on account of import of A.E. and export back to the A.E. is concerned, the learned Commissioner (Appeals) has accepted the assessee's contentions. This aspect would be discussed in the Revenue's appeal.

27. Before us, the learned Counsel, Mr. Mukesh Butani, representing the assessee, narrated the entire facts of the case which has been, by and large, discussed in the forgoing paragraphs and the issue involved. He submitted that due to high administrative cost and advertisement expenses, the TNMM method cannot be taken as most appropriate method in the assessee's case because the net profit margin even after various kinds of adjustment will not result into determination of proper arm's length result. Even though the assessee has adopted the most appropriate method as TNMM in the transfer pricing report, however, such a method fails in this case due to peculiar circumstances in this case and further in the case of companies which are engaged in the distribution activities, RPM is more preferable method. The assessment year 2002-03 being the first year of application of transfer price mechanism, it was not clear even to the professionals what should have been the best methodology and comparability analysis for arriving at ALP for particular type of business transactions. Before the learned Commissioner (Appeals), a specific submission was raised for applying the resale price method in assessee's case because there was huge operating cost in the form of administrative and advertisement cost which has resulted into negative operating margin of (-) 51.22%. This working of the assessee of the actual net margin at (-) 51.22% has not been disputed by the TPO or the learned Commissioner (Appeals) even after adjustment of advertisement expenses. He submitted that net sales under the distribution segment was at Rs.11,74,41,770, as against the total cost incurred by the assessee which was Rs.17,75,93,932 and operating profit was Rs. (-) 6,01,52,162, thereby giving negative operating profit ratio of (-) 51.22%. The reason for such a huge administrative and advertisement cost in this year was that the assessee has started its distribution activities on its own and all the earlier arrangements under the joint venture with Blowplast was discontinued. If the assessee's gross profit margin has to be analysed, then the assessee's margin as compared to the six comparables are much better. Before the Assessing

Officer and the learned Commissioner (Appeals), the revised margin using resale price method was filed which has been rejected by them simply on the ground that the assessee itself has adopted TNMM in the transfer pricing report. He submitted that the assessee being a distributor and in case of distribution activities, the RPM has been recognised to be the most appropriate method for bench marking the ALP while carrying out comparability analysis between controlled and uncontrolled transactions. In support of his contentions, he referred to the guidance note issued by the ICAI wherein it has been clarified that RPM may be adopted for the transactions where there is distribution of goods and there is no value addition. Further, he referred to the various decisions of the Tribunal which are listed below wherein it has been held that in case of distribution, RPM is the most appropriate method:-

i) DCIT vs Quark Systems Pvt. Ltd. [2010] 38 SOT 307 (Chd.)(SB);

ii) DCIT vs Mitsuiosk Lines Meretime India P. Ltd., ITA no. 6397/Mum./2006;

iii) Textronix India P. Ltd. vs DCIT, ITA no.1334/Bang./2010 order dated 31st October 2012; and

iv) ITO vs L'oreal India P. Ltd., ITA no.5423/Mum./2009, order dated 25th April 2012.

28. Regarding the Assessing Officer's and learned Commissioner (Appeals)'s objection that the assessee cannot change the method for determining the ALP at a later stage, he submitted that if the ALP in a particular case can be determined by following any one of the methods, then the same can be raised at any stage after duly explaining as to why such method should be followed. In support of this contention, he relied upon the following decisions of the Tribunal:-

i) DCIT vs MCI Com India P. Ltd., ITA no.2766 & 4187/Del./ 2010; and

ii) *ACIT vs MSS India P. Ltd., [2009] 32 SOT 132 (Pune); and*

iii) *Gap International Sourcing India P. Ltd., 149 TTJ 437.*

29. *Relying on these decisions, he submitted that RPM should be followed in the present case for determination of ALP while evaluating the controlled transactions of the assessee.*

30. *Regarding the comparables as selected by the assessee and accepted by the TPO, he submitted that even though there was no product comparability with that of the assessee but all were functionally comparable, therefore, the same comparables can be taken for the purpose of RPM. In support of this contention that product comparability is not required in RPM, he relied upon the contents of Para-2.26 of the OECD guidelines and the guidelines of ICAI. In case of a distribution, it is very difficult to get the companies with similar product comparability and, therefore, one has to go for functional comparability. Thus, the same comparables can be considered for the purpose of RPM also. He pointed out that if the transfer pricing adjustment as done by the TPO is carried out, then the gross profit margin will become so high which is improbable in any kind of distribution business and in the case of the assessee, the purchase price will almost become negligible. Lastly, by way of alternative arguments, he pointed out that there was certain computational error in the working of TPO. In support of the same, he furnished a chart before us.*

31. *Per contra, the learned Departmental Representative, Mr. Ajit Kumar Jain, representing the Revenue, submitted that the assessee has, first of all, chosen TNMM as most appropriate method in the transfer pricing study. Based on this method, the assessee has selected six comparable companies which were for the purpose of carrying out functional comparability based on TNMM only. These comparables were not selected for the purpose of resale price method. Had the assessee chosen resale price method in the transfer pricing report then the selection of*

comparables would have been different and also the different gross profit margin. Once the assessee itself has given a detailed report and comment in the transfer pricing report as to why TNMM is the most appropriate method in this case and why resale price method cannot be adopted. The assessee cannot justify later on that its approach was wrong when it does not suits its determination of ALP by the TPO or at a later stage. Further, six comparables as chosen by the assessee were dealing in different product lines so they cannot be held to be comparables for the purpose of RPM, however, for the purpose of TNMM, such kind of comparables can be taken as a good comparables for the purpose of comparability analysis. He referred to the various product lines in which these comparables were dealing with like soap, toiletries, etc. He referred to the various paragraphs of OECD guidelines specifically Para-2.25, 2.29 that same kind of products similarities are desirable in RPM and also that in case of the assessee, the trade name is owned by the A.E., therefore, the RPM is not advisable in such case. He also referred to the United Nation Manual on transfer pricing, specifically Para-9.2.9.4, wherein it has been stated that distributors engaged in the sale of markedly different products cannot be compared in resale price method.

32. Moreover, he submitted that the assessee has not given any cogent reason as to why resale price method should be adopted now when TNMM has been accepted by it in the transfer pricing report. The only reason for now adopting the resale price method is to justify the ALP based on the average gross profit rate of six comparables chosen by it though initially selected for the purpose of TNMM. Even after the adjustment of advertisement on the operating profits of six comparables, then also the average net profit margin of comparables comes to (-) 17.41%. Even if that is also accepted as suggested by the assessee, then also the assessee's margin is not at ALP and that is why the assessee has taken a turn around for adopting RPM so as to justify the ALP of it's A.E. transactions. Thus, he submitted that the submissions of the learned Counsel for adopting the RPM should be rejected out rightly.

33. *By way of alternative arguments, the learned Departmental Representative submitted that in case the RPM is accepted to be the most appropriate method for bench marking the ALP, then the matter should be restored back to the file of the TPO and the assessee should furnish a list of fresh comparables for carrying comparability analysis for the purpose of RPM.*

34. *The learned Counsel, in the rejoinder, submitted that in case of RPM, there cannot be any similarity of product comparability but functional comparability has to be seen. He referred to the same OECD guidelines which were referred by the learned Departmental Representative during the course of his arguments. Regarding the learned Departmental Representative's argument that the assessee has adopted RPM before the TPO and the learned Commissioner (Appeals) so as to justify the ALP at gross profit margin level is not correct because the assessee has given a detail reasons before the TPO and the learned Commissioner (Appeals) as to why the RPM should be adopted and none of the authorities have given any cogent reason for rejecting the RPM or assessee's contention.*

35. *We have carefully considered the rival contentions, perused the relevant findings of the Assessing Officer and the learned Commissioner (Appeals) as well as the material placed on record. The only dispute before us relates to adjustment of ALP with regard to the distribution segment i.e., import of finished goods from the A.E. and sale in domestic as well as to the A.E. The assessee had initially adopted TNMM as most appropriate method for bench marking its ALP and for this purpose it has chosen six comparables which has been accepted by the TPO. The assessee's operating margin in relation to the transactions of import of finished goods from the A.E. and resale in the domestic market was at (-) 51.22% and the majority of the operating cost was on account of administrative and advertisement costs. In the transfer pricing report, the assessee had submitted that if the adjustment on account of advertisement is made on the average operating profit*

margin of the six comparables, the operating margin will come down to (-)17.41%. The details of actual operating profit margin and the adjusted operating profit margin had already been incorporated in the forgoing paragraphs. It was submitted by the assessee before the TPO as well as in the transfer pricing report that if the adjustment is made in the ALP based on the operating profit margin of the comparables, then on the peculiar facts of the case such adjustments would result into improbable scenario as the value of imported goods would be determined at a value less than zero, therefore, no adjustment is required and, hence, its margin is at ALP. One of the other main contention of the assessee before the TPO was that the gross profit margin should be compared instead of operating profit of its distribution activities segment following RPM instead of TNMM. Such a submission was made vide letter dated 6th October 2004. This has been rejected by the TPO mainly on the ground that the assessee has itself adopted TNMM as the most appropriate method and has itself rejected the RPM. This objection / submission of the assessee has also been rejected by the learned Commissioner (Appeals) on the same ground. One of the main issues before us at this stage is, as to what should be the most appropriate method on the facts of the assessee's case which has been discussed at length in the earlier paragraphs.

36. According to the provisions of sections 92C r/w 10B, the ALP in relation to an international transactions has to be determined by following any of the most appropriate method viz. (i) Comparable Uncontrolled Price method (CUP); (ii) Resale Price Method (RPM); (iii) Cost Plus Method (CPM); (iv) Profits Split Method (PSM) and (v) Transactional Net Margin Method (TNMM). In CUP method, the focus is directly on the price of the product sold or transferred requiring both functional and product comparability. The RPM and CPM operate at gross profit margin level requiring functional rather than product comparability. The PSM and TNMM operate on operating profit margin level used for a complex and integrated enterprise. These methods are based on price or profit. The centre point of these methods is comparability

analysis with the comparables and the method which provides most reliable way of arriving at the ALP, is considered as most appropriate method. A comparability analysis is done for the comparison of controlled transaction(s) with an uncontrolled transaction(s) and controlled and uncontrolled transactions are comparable if none of the differences between the transactions can materially affect the factor being examined by adopting any of the methodologies as mentioned in section 92C or if any reasonable accurate adjustment can be made to eliminate the material affects of any such difference.

37. The RPM has been prescribed in Rule 10B(1)(b) in the following manner:-

Determination of arm's length price under section 92C.

10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :-

(b) resale price method, by which,—

(i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

38. Thus, the RPM method identifies the price at which the product purchased from the A.E. is resold to a unrelated party. Such price is reduced by normal gross profit margin i.e., the gross profit margin accruing in a comparable controlled transaction on resale of same or similar property or services. The RPM is mostly applied in a situation in which the reseller purchases tangible property or obtain services from an A.E. and reseller does not physically alter the tangible goods and services or use any intangible assets to add substantial value to the property or services i.e., resale is made without any value addition having been made. Since in RPM only margins are seen with reference to items purchased and sold or earned by an independent enterprise in comparable uncontrolled transactions vis-a-vis the one in the controlled transactions, therefore, in such a situation, the nature of products has not much relevance though their closer comparable may produce a better result. The focus is more on same or similar nature of properties or services rather than similarity of products. In RPM other attributes of comparabilities than the product itself can produce a reliable measure of arm's length conditions. The main reason is that the product differentiation does not materially effect the gross profit margin as it represents gross compensation after the cost of sales for specific function performed. The functional attribute is more important while undertaking the comparability analysis under this method. Thus, in our opinion, under the RPM, products similarity is not a vital aspect for carrying out

comparability analysis but operational comparability is to be seen. Since the gross profit margin is the main criteria while evaluating the transactions in the RPM wherein price is identified at which property or services are resold and normal gross profit margin is derived at by the enterprise which is deducted from the resale price of such property or service in comparable uncontrolled transactions. The gross profit margin earned by the independent enterprise in comparable uncontrolled transactions is served as a guidance factor. This is also what happens in the case of a distributor wherein the property and service are purchased from the A.E. and are resold to other independent entities, without any value additions. The gross profit margin earned in such transactions becomes the determination factor to see the gross compensation after the cost of sales. In the instant case, the assessee is a distributor of Mattel toys and gets the finished goods from its A.E. and resells the same to independent parties without any value addition. In such a situation, RPM can be the best method to evaluate the transactions whether they are at ALP.

39. Some of the case laws relied upon by the learned Counsel also support our above conclusion that in case of distribution activities i.e., import of products and services from the A.E. and resale to the independent parties without any value addition, the RPM would be the most appropriate method for determining the ALP. This view has been upheld by the Tribunal, Mumbai Bench, in Textronix India P. Ltd. (supra), L'oreal India P. Ltd. (supra and Star Diamond Group v/s DDIT, 141 TTJ 21. The OECD guidelines and ICAI guidelines as have been referred to by the learned Counsel have also expressed on the similar line that RPM would be the best method when resale takes place without any value addition to a product for bench marking the ALP.

40. On the other hand, under the TNMM, the ALP is determined by comparing the operating profit related to an appropriate base i.e., cost or sale or assets of the "tested party" with the operating profit of an uncontrolled party engaged in comparable transactions. Under the TNMM, net margin or

operating profit is compared against with the independent entities against those achieved in related party transactions. Under the TNMM, the major thrust is to derive at the operating profit at the transactional level and to identify the operating expenses of both the tested party as well as the independent parties. This requires a lot of adjustments to derive at the actual operating profit. If the ALP of any transaction can be determined by applying any of the direct methods like CUP, RPM, CPM then they should be given the preference and once these traditional methods have been rendered inapplicable then only TNMM should be resorted to. On the facts of the assessee's case, in our opinion, the assessee being a distributor who is purchasing the goods from it's A.E. and reselling them to independent parties / unrelated parties, resale price method would be the most appropriate method for determining the ALP of the transactions between the assessee and the A.E.

41. Now coming to the argument of the learned Departmental Representative that once the assessee itself has chosen TNMM as most appropriate method in TPR, then it cannot resort to change its method at an assessment or appellate stage. In our opinion, such a contention cannot be upheld because if it is found on the facts of the case that a particular method will not result into proper determination of the ALP, the TPO or the appellate authorities can very well hold that why a particular method can be applied for getting proper determination of ALP or the assessee can demonstrate a particular method to justify its ALP. Thus, even if the assessee had adopted TNMM as the most appropriate method in the transfer pricing report, then also it is not precluded from raising the contentions / objections before the TPO or the appellate Courts that such a method was not an appropriate method and is not resulting into proper determination of ALP and some other method should be resorted. The ultimate aim of the transfer pricing is to examine whether the price or the margin arising from an international transactions with the related party is at ALP or not. The determination of approximate ALP is the 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 methods other than chosen earlier, the most appropriate ALP can be determined, the assessment authorities as well as the appellate Courts should take into consideration such a plea 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. Accordingly, we reject the contentions of the learned Departmental Representative and also the observations of the Assessing Officer and the learned Commissioner (Appeals) that the assessee cannot resort to adoption of RPM method instead of TNMM.

42. Now, coming to the comparables selected by the assessee, we agree with the contention of the learned Departmental Representative that these comparables were chosen for the purpose of carrying out comparability analysis under the TNMM and even the TPO or the assessee has not carried out any functional analysis of these comparables with regard to the gross profit margin level. In our considered opinion, this matter needs to be restored to the file of the TPO for denovo adjudication. Consequently, we set aside the impugned order passed by the learned Commissioner (Appeals) and restore the issue back to the file of the Assessing Officer who shall decide the issue afresh after requiring the assessee to furnish fresh comparables after considering the RPM as the most appropriate method for determination of ALP. The TPO will also provide due and effective opportunity of hearing and determine the ALP after considering the fresh comparables and following the RPM. Thus, ground no.3, raised by the assessee is partly allowed for statistical purposes.

43. The assessee has also raised additional grounds challenging the TPO's order passed under section 92CA3 on legal grounds."

12. Needless to mention, one of the Members of the Bench was the author of the judgment in the case mentioned above. Since, the facts and legal issue involved in the instant case is akin to

the case of M/s Mattel Toys India Pvt. Ltd. (supra), we hereby direct to revenue to determine Arm's Length Price (ALP) considering Resale Price Method (RPM) as Most Appropriate Method (MAM).

13. As a result, all the appeals of the assessee are allowed.
Order Pronounced in the Open Court on 04/05/2021.

Sd/-

(Amit Shukla)
Judicial Member

Dated: 04/05/2021

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR

		Date	<u>Initial</u>	
1.	Draft punched on computer	15.04.2021		PS
2.	Draft placed before author	15.04.2021		PS