

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

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

**Sh. Yogesh Kumar US, Judicial Member**

**(Through Video Conferencing)**

**ITA No. 2244/Del/2017 : Asstt. Year : 2010-11**

DCIT, Circle-10(2), New Delhi	Vs	M/s Itochu India Pvt. Ltd., Ground Floor, world Trade Tower, Barakhamba Road, Connaught Place, New Delhi-110001
<b>(APPELLANT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AABCI4829F</b>		

**CO No. 170/Del/2017 : Asstt. Year : 2010-11**

M/s Itochu India Pvt. Ltd., Ground Floor, world Trade Tower, Barakhamba Road, Connaught Place, New Delhi-110001	Vs	DCIT, Circle-10(2), New Delhi
<b>(APPELLANT)</b>		<b>(RESPONDENT)</b>
<b>PAN No. AABCI4829F</b>		

**Assessee by : Sh. Vishal Kalra, Adv.**

**Revenue by : Sh. Lakshmi Narayanan, Sr. DR**

**Date of Hearing: 03.02.2022**

**Date of Pronouncement: 07.02.2022**

**ORDER**

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

The present appeal has been filed by the revenue and Cross Objection of the assessee against the order of the Id. CIT(A)-37, New Delhi dated 15.02.2017.

2. Following grounds have been raised by the revenue:

*"1. Whether on the facts and circumstances of the case & in law, the Id. CIT(A) erred in deleting the addition of Rs.6,47,95,611/- made on account of ALP adjustment vide order u/s 154/143(3) r.w.s. 144C of the Income Tax Act, 1961 passed by the DCIT, Cicel-11(1) ignoring the fact that the assessee company has failed to give substantial proof of its claim and also to substantiate the same wholly and exclusively for the purpose of the company."*

3. The assessee is engaged in the business of general trading, procurement and supply of chemicals, textiles, paper, garments, machinery & equipment and entering into strategic alliances by investing in different lines of business and also provide financial, technological, logistic, marketing & administrative support of companies in India and abroad.

4. In this case, a reference was made to the Transfer Pricing Officer, New Delhi for determining the arm's length price u/s 92CA(3) of the Act in respect of international transactions entered into by the assessee during the financial year 2009-10. The issue was examined by the DCIT [TPO-1(5)] and vide his order dated 29.01.2014 passed u/s 92CA of the Act determining the difference in arm's length price in the international transactions of the assessee with its Associated Enterprises (AE) at Rs.8,67,98,011/-. The AO passed order on 29.04.2014 considering the order of the TPO. In addition, the AO has disallowed an amount of Rs.3,24,500/- on account of gift expenses and Rs.3,74,800/- being the 20% of the business expenses unproved and as accepted by the assessee.

5. The Id. CIT(A) deleted the addition made on account of ALP and confirmed the addition made on account of gift expenses and business promotion expenses.

6. Aggrieved the assessee filed appeal before us.

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

8. It has been held by the Co-ordinate Bench of Tribunal that the taxpayer undertakes limited business functions of licensing and facilitation of the business of its AEs, it is not to be treated as part of Sogo Shosha group to be treated as a trader, that the taxpayer does not bear any risk in the nature of credit risk, price risk, inventory risk, storage and handling risk, etc. rather it is assuming limited risk; that the taxpayer has not developed any of its intangibles or accorded locational savings to its AEs.

9. The issue in controversy has been squarely covered in taxpayer's own case for AY 2007-08 and 2008-09 in ITA Nos.6287/Del/2012 & 6288/Del/2012 order dated 18.08.2017 decided by the Co-ordinate Bench of the Tribunal and also relied upon the judgment of Hon'ble Delhi High Court in Li & Fung India Pvt. Ltd. 361 ITR 85 and the decision of the Co-ordinate Bench of the Tribunal in the case of GAP International Sourcing India Pvt. Ltd. in ITA No.5147/Del/2011 & 228/Del/2012.

10. We have examined the decision rendered by the Hon'ble High Court in Li & Fung India Pvt. Ltd. (supra) having identical facts vis-à-vis the taxpayer. The crux of the issue is that the assessee has been held to be a trader and goods sourced from India by its AE of approx Rs. 380 Crs. has been added back as

its operating expenses /cost and thus resultant TP adjustment was made. In the assessee's own case the adjudicating authority held that assessee is in nature of business support service provider and FOB value of goods sourced from India shall not be included while computing operating margins. The Id. CIT(A) has also relied on the judgment of the Hon'ble High Court in the case of Li & Fung India Pvt. Ltd. (supra) and GAP International Sourcing India Pvt. Ltd. (supra).

11. The operating part of the judgment delivered by the Hon'ble High Court in Li & Fung India Pvt. Ltd. (supra) is reproduced for ready perusal as under:

*"The assessee was a wholly owned subsidiary of a company incorporated in Mauritius as a captive offshore sourcing provider. LFT, an associated enterprise, was a group company incorporated in Hong Kong. The assessee entered into an agreement with the associated enterprise, whereby the contract for rendering sourcing services was outsourced or sub-contracted to the assessee, for which it was remunerated at cost plus a mark-up of 5 per cent for services rendered to the associated enterprise, and, ultimately, the associated enterprise's customers. The assessee, during the relevant assessment year 2006-07, entered into international transactions of buying services for sourcing of garments, handicrafts, leather products, etc., in India for its associated enterprise, and was paid service charges of 5 per cent of cost plus mark-up incurred for providing these services. The assessee worked out the arm's length price of the international transactions applying the transactional net margin method by comparing the operating profit margin of 26 companies and the assessee's operating profits/operating costs taken at 5.17 per cent. It contended that it was a low risk captive sourcing service provider performing limited functions with minimal risk*

*as an off-shore provider and substantial functions relating to buying services were performed by the associated enterprise, which also assumed various enterprise risks. Alternatively, the associated enterprise entered into contracts with unrelated third parties for rendering buying services at 4 per cent to 5 per cent of the free on board value of exports. The assessee had in turn received service fee of Rs. 47.69 crores which was equivalent to nearly 4 per cent of the free on board value of the export (by the vendors) from the associated enterprise, which constituted 80 per cent of the consideration received by the associated enterprise, which, in the assessee's opinion ought to have been considered as being at arm's length. The Transfer Pricing Officer held that the cost plus compensation at 5 per cent of cost of incurred by the assessee was not at arm's length and applied a mark-up of 5 per cent on the free on board value of exports of Rs.1,202.96 crores made by the Indian manufacturer to overseas third party customers. The Dispute Resolution Panel reduced the mark-up of 5 per cent of free on board value of exports to 3 per cent. The Assessing Officer computed the assessee's income at Rs. 36,67,95,634 as against the returned income of Rs. 3,08,26,448 after making the addition on account of transfer pricing adjustment. The Tribunal held that the assessee was performing all critical functions with the help of tangible and unique intangibles as well as supply chain developed, which helped the associated enterprise to enhance its business and resulted in location saving to the consumer, compensation for the services rendered by the assessee to the associated enterprise, equivalent to the cost plus 5 per cent mark-up, was not at arm's length. Since the assessee was providing crucial sourcing services and the associated enterprise was remunerated by third parties based on such services, the Tribunal relied upon the mark-up on the free on board value of goods sourced through the assessee as the appropriate method to work out the arm's length compensation. The Tribunal accepted the Transfer Pricing Officer's reasoning*

*for applying the 5 per cent of the free on board value of exports to third parties by Indian manufacturers. On appeal:*

*Held, allowing the appeal, (i) that to apply the transactional net margin method the assessee's net profit margin realised from the international transactions had to be calculated only with reference to the cost incurred by it and not by any other entity either third party vendors or the associated enterprise. The Assessing Officer/Transfer Pricing Officer must operate textually, and within the bounds of the text. Rule 10B(1)(e) of the Income-tax Rules, 1962, does not enable consideration or imputation of cost incurred by third parties or unrelated enterprises to compute the assessee's net profit margin for application of the transactional net margin method. Rule 10B(1)(e) recognizes that the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise. It thus contemplates a determination of the arm's length price with reference to the relevant factors (cost, assets, sales, etc.) of the enterprise in question, i.e., the assessee, as opposed to the associated enterprise or any third party. The textual mandate, thus, is unambiguously clear.*

*(ii) That the Transfer Pricing Officer's reasoning to enhance the assessee's cost base by considering the cost of manufacture and export of finished goods, i.e., readymade garments by third party vendors (which cost was certainly not the cost incurred by the assessee), was nowhere supported by the transactional net margin method under rule 10B(1)(e). Having determined the transactional net margin method to be the most appropriate method, only the rules and norms prescribed in that regard could have been applied to determine whether the exercise indicated by the assessee yielded an arm's length price. The approach of the Transfer Pricing Officer and the tax authorities in essence imputed notional adjustment/income in the*

*assessee's hands on the basis of a fixed percentage of the free on board value of export made by unrelated party vendors.*

*(iii) That the assessee had neither made investment in the plant, inventory, working capital, etc., nor did it claim to have any expertise in the manufacture of garments. More importantly, and given no material to the contrary, the assessee did not bear the enterprise risk for manufacture and export of garments. The assessee's functional and risk profile thus was entirely different and had nothing to do with the manufacture and export of garments by unrelated third party vendors. The assessee rendered support services in relation to the exports, which were manufactured independently. Thus, attributing the costs of such third party manufacture, when the assessee did not engage in that activity, and more importantly, when those costs were clearly not the assessee's costs, but those of third parties, was clearly impermissible.*

*(iv) That once the transactional net margin method was deemed the most appropriate method, the distortions, if any, had to be addressed within its framework. The unrelated transactions which were compared by the assessee had not been adversely commented upon, and neither had the choice of the transactional net margin method. The Transfer Pricing Officer, therefore, ignored relevant and crucial material, and straightaway proceeded to broaden the base for arriving at the profit margin, for attributed income of the assessee. Not only was this a clear infraction of the terms of the Act and Rules; he went ahead to introduce what was clearly alien to the provisions of law and travelled outside the Rules. Therefore, the Transfer Pricing Officer's addition of the cost plus 5 per cent mark-up on the free on board value of exports among third parties to the assessee's calculation of arm's length price using the transactional net margin method was without foundation and liable to be deleted."*

12. The Co-ordinate Bench of the Tribunal held that in view of the undisputed fact that AEs of the taxpayer is into trading activities of various products, such as, textiles, machinery, information and communications related products, metals, products related to oil and other energy resources, general merchandise chemicals, provisions and food and the taxpayer is merely rendering business support services to these AEs in the form of facilitation services to source goods from India. So, the limited activities carried out by the taxpayer for its AEs in the nature of licensing and facilitation of business of its AEs separates the taxpayer from the Sogo Shosha traders. Furthermore, when the taxpayer is not proved to be a risk bearer in the nature of credit risk, price risk, inventory risk, storage and handling risk etc., it cannot be treated as a trader. Moreover when undisputedly the taxpayer has not developed any intangible or accorded locational savings to its AEs and has earned net operating profit margin on cost of 129.34% against the margin of comparable at 14.05%, it cannot be said that the taxpayer has not been adequately compensated.

13. In view of the above, we find no reason to interfere with the impugned order of Id. CIT (A), hence present appeal filed by the Revenue is hereby dismissed on this ground.

**CO No. 170/Del/2017**

**Miscellaneous Expenses:**

14. During the year under consideration, the AO has disallowed gift expenses of Rs.3,24,522/-. We have gone through the entire details placed at page no. 90 of the paper book and find

that these expenses relate to the gifts presented to dignitaries and participants in the meetings, conferences, tea expenses and Diwali gifts, farewell gift which are of token gifts in nature cannot be considered as disallowable. Hence, the appeal of the assessee on this ground is allowed.

**Business Promotion Expenses:**

15. During the year, the AO disallowed an amount of Rs.3,74,800/- being the 20% the total amount claimed of approximately Rs.25,00,000/-. The AO categorically mentioned that the assessee *suo motou* agreed for the disallowance of the 20% of the expenses claimed. The assessee, therefore, deemed to have foreclosed the enquiry. We have also gone through the ledger placed at page no. 101 and find that certain expenses cannot be treated as business promotion expenses. Hence, we decline to interfere with the order of the Id. CIT(A) on this issue.

16. In the result, the appeal of the revenue is dismissed and the CO of the assessee is partly allowed.

Order Pronounced in the Open Court on 07/02/2022.

Sd/-

**(Yogesh Kumar US)**  
**Judicial Member**

Sd/-

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

**Dated: 07/02/2022**

**\*Subodh Kumar, Sr. PS\***

Copy forwarded to:

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

**ASSISTANT REGISTRAR**