

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

**BEFORE SHRI R. S. SYAL, ACCOUNTANT MEMBER  
AND SHRI KULDIP SINGH, JUDICIAL MEMBER**

I.T.A. No.386/Del/2014  
(Assessment Year 2009-10)

Li & Fung (India) Pvt. Ltd., 202-206, Tolstoy House, 15, Tolstoy Marg, New Delhi-110 001 GIR / PAN :AAACL1663M (Appellant)	Vs.	DCIT, Circle 4(1), New Delhi     (Respondent)
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Appellant by : Shri Porus Kaka, Sr. Adv.  
Shri Manish Kant, Adv.

Respondent by : Shri Amrendra Kumar, CIT DR

Date of hearing : 22.03.2016

Date of pronouncement: 23.03.2016

**ORDER**

**PER R. S. SYAL, AM:**

This appeal by the assessee is directed against the final assessment order passed by the Assessing Officer (AO) u/s 143(3) read with section 144C of the Income-tax Act, 1961 (hereinafter

also called 'the Act') on 28.10.2013 in relation to the assessment year 2009-10. The solitary issue raised in this appeal is against the addition of Rs.59,19,00,000/- made by the Assessing Officer on account of transfer pricing adjustment.

2. Briefly stated, the facts of this case are that the assessee, an Indian Company, is a subsidiary Li & Fung (South Asia) Ltd. incorporated in Mauritius. The holding company is a part of Li & Fung group, which is one of the world leaders in export trading, having a worldwide network. The assessee is engaged in the business of providing buying services to its associated enterprises (AEs). The assessee is paid service charges for such services at costs with a 8% markup. An international transaction of 'Provision of buying services' was reported in Form No. 3CEB with transacted value of Rs.116,95,42,324/-. The assessee applied the Transactional Net Marginal Method (TNMM) as the most appropriate method with its Profit Level Indicator (PLI) of

Operating Profit / Total Costs (OP/TC) at 8%. Twenty five companies were chosen as comparable with their average PLI at 9.30%. The assessee claimed that its profit margin at 8% was within permissible range of the profit margin of comparables, and hence the international transaction was at arm's length price (ALP). The Assessing Officer made reference to the Transfer Pricing Officer (TPO) for determining the ALP of this international transaction. The TPO treated the assessee as a tested party and noticed that it was allowed commission @ 8% on the 'Costs' incurred for its sourcing activities. He opined that the compensation ought to have been expressed as a percentage on FOB price of goods sourced through the assessee. Accepting the TNMM as the most appropriate method, the TPO changed the base from 'Costs' incurred to the 'FOB value of exports'. The assessee was seen to have incurred 'Costs' in providing such services at Rs.108.89 crore, on which 8% markup was charged to

have gross revenue at Rs.116.95 crore, which was declared as the value of the international transaction. The TPO substituted the 'cost' base with the 'FOB value of exports'. The amount of new base was calculated at Rs.2935.69 crore by adding value of goods exported at Rs.2826.8 crore to the costs incurred by the assessee at Rs.108.89 crore. He further observed that in an earlier year in which he did similar exercise of substituting the base of 'Cost' with the 'FOB value of goods exported' for applying 8% markup, the Dispute Resolution Panel (DRP) restricted it to 6%. This reduced markup of 6% was applied by him on the new base of FOB value of goods exported at Rs.2935.69 crore, to work out the amount of 'Net operating income' at Rs.176.14 crore. After reducing 'Operating income shown by the assessee' at Rs.116.95 crore from the amount of 'Net Operating income' as calculated by him at Rs.176.14 crore, he determined the amount of transfer pricing adjustment at Rs.59.19 crore. The AO made an addition

of Rs.59.19 crore in the draft assessment order. The assessee remained unsuccessful before the DRP. The said addition of Rs.59.19 crore came to be made in the final assessment order passed by the Assessing Officer. The assessee is aggrieved against this addition.

3. We have heard rival submissions and perused the relevant material on record. There is no quarrel on the fact that the assessee rendered services of buying to its AEs for which it was remunerated with costs incurred with markup at the rate of 8%. This has been substituted by the TPO with 6% markup on 'FOB value of goods exported'. Accepting the application of TNMM as the most appropriate method with PLI of OP/TC, the TPO has worked out the amount of transfer pricing adjustment as under : -

“Net operating income (as calculated above)	Rs.176.14
Operating income shown by assessee	Rs.116.95
Difference	Rs.59.19 crore”

4. Chapter-X of the Act contains special provisions relating to avoidance of tax. Section 92, which is the first section of this Chapter, provides for computation of income from an international transaction having regard to arm's length price. Sub-section (1) of the section provides that : "Any income arising from an international transaction shall be computed having regard to the arm's length price'. Section 92C of the Act enshrines provisions relating to computation of arm's length price. Sub-section (1) of the section states that the arm's length price in relation to an international transaction shall be determined by any of the methods listed herein which include, *inter alia*, the transactional net margin method. Sub-section (2) of section 92C provides that the most appropriate method referred to in sub-section (1) shall be applied for the determination of ALP '*in the manner as may be prescribed*'. Admittedly, the assessee applied the TNMM as the most appropriate method with the PLI of OP/TC, which has not

disturbed by the TPO. Calculation of ALP under the TNMM has been given under Rule 10B(1)(e) of the Income-tax Rules, 1962, which has to be necessarily done '*in the manner ... prescribed*'. This rule states that for the purposes of section 92C(2), the ALP in relation to the international transaction shall be determined as under :

“(e) transactional net margin method, by which,—

(i) the net profit margin *realised* 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 or having regard to any other relevant base ;

(ii) the net profit margin *realised* by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base ;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the

differences, 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 net profit margin in the open market ;

(iv) the net profit margin *realised* by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii) ;

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.'

5. A bare perusal of sub-clause (i) of Rule 10B(1)(e) brings out that the *net profit margin realized* by the enterprise from an international transaction is to be computed in relation to a particular base. Sub-clause (ii) provides that the *net profit margin realized* by the enterprise from the comparable uncontrolled transaction is computed having regard to the same base. Sub-clause (iii) provides that the *net profit margin realized by a*

*comparable company, determined as per sub-clause (ii) above, is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market. It is this adjusted net profit margin of the unrelated transactions or of the comparable companies, as determined under sub-clause (iii), which is used as benchmark for the purposes of making comparison with the net profit margin realized by the assessee from its international transaction as per sub-clause (i). Sub-clause (iv) states that the net profit margin realized by the enterprise, as referred in sub clause (i), is established to be the same as a net profit margin referred in sub-clause (iii) of the comparables. Sub-clause (v) states that the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to international transaction.*

6. On going through the above sub-clauses of Rule 10B(1)(e), it becomes vivid that as per the first step, the '*net profit margin realized*' by the enterprise from an international transaction is to be computed. Use of the word '*net profit margin realized*' in the provision richly indicates that it is the calculation of actual operating profit margin of the assessee earned from international transaction, which cannot be any hypothetical or adjusted figure. Amount of actual net profit margin realized can be calculated from the assessee's Profit and loss account with the starting point of operating gross revenue from which the amount of operating expenses are reduced to find out the amount of operating profit and the resultant percentage of operating profit with reference to a defined base. When we consider sub-clauses (ii) and (iii), it turns out that, firstly, the *net operating margin* actually realized from the comparable uncontrolled transaction is computed, which is determined in the same way as that of the assessee as per clause

(i), that is, actual figures without making any adjustment. Then sub-clause (iii) talks of adjusting the actually *realized margin* of comparables to bring the same at par with the international transaction undertaken by the assessee, so as to iron out the effects of differences between the international transaction and comparable uncontrolled transactions. On going through all the sub-clauses of Rule 10B(1)(e), the position which emerges is that the *net profit margin realized* by the assessee from its international transaction is taken as such, which is then compared with the rate of operating profit margin of comparables for seeing if the assessee's profit margin is at arm's length.

7. Adverting to the facts of the instant case, we do not find any dispute about the assessee actually earning 8% markup on the 'Costs' incurred. The assessee incurred total costs to tune of Rs.101.89 crores. Markup of 8% on such cost comes to Rs.8.06 crore, resulting into gross revenue receipt at Rs.116.95 crores.

When we turn to the calculation of the ALP made by the TPO, it emerges that he has determined this amount as the second figure. Sub-clauses (ii) and (iii) of Rule 10B (1)(e) talk of determination of net profit margin realized by the comparables with reference to the same base as adopted under sub-clause (i) for calculation of the assessee's profit margin. What the TPO has done in the instant case is that he computed 'Net operating income' as the first figure at Rs.176.14 crore, by applying 6% markup on FOB value of goods exported by the assessee at Rs.2935.69 crore. After reducing 'Operating income shown by assessee' at Rs.116.95 crore from the amount of 'Net operating income' of Rs.176.14 crore, the TPO proposed transfer pricing adjustment at Rs.59.19 crore.

8. We find such calculation done by the TPO, neither here nor there. Under sub-clause (i), he was supposed to work out the rate of operating profit margin realized by the assessee to be computed

by dividing the amount of operating profit with total costs as multiplied by 100. As against that, he has simply taken the amount of gross revenue at Rs.116.95 crore, which includes not only the amount of operating profit but also the operating costs incurred by the assessee in providing the services. The course of action adopted by the TPO is not in accordance with law.

9. Then under clauses (ii) and (iii) of rule 10B(1)(e), the TPO was required to determine the rate of profit margin of the comparables to constitute the benchmark. As against that, the TPO has not taken any profit rate of any comparable. He once again adjusted the figures of the assessee by changing the base of 'costs' incurred to the 'FOB value of exports' and rate of markup from 8% to 6%. We fail to comprehend as to how this amount of Rs.176.14 crore can be construed as the operating profit margin of the uncontrolled transactions/comparables. This amount is nothing but a revised compensation amount, which in the opinion of the

TPO should have been earned by the assessee. By no standard, this amount can be construed as the arm's length profit rate, as it is not a profit rate of any uncontrolled transaction/comparables. This is a derivative from the simple rewriting of the compensation amount of the assessee by the TPO.

10. Interestingly, the amount of the transfer pricing adjustment has been calculated by reducing the actual gross receipts of the assessee from its AE at Rs.116.95 crore ('Costs' incurred at Rs.108.89 crore plus 8% markup at Rs.8.06 crore) from the amount of profit margin calculated by the TPO at Rs.176.14 crore (by applying 6% on FOB value of goods exported at Rs.2935.69 crore). We are unable to understand as to how the revenue receipts of the assessee on one hand, which obviously include costs incurred, can be compared with the net operating income on the other hand. It goes without saying that a valid comparison can be made of similar components. One can compare profit margin of

the assessee with the profit margin of the comparables under the TNMM or the price charged by the assessee with the price charged by the comparables under the CUP method etc. Thus the comparison is always of the profit with profit or price with price. Under no circumstance, the amount of transfer pricing adjustment can be calculated by picking up 'profit margin' of the assessee or comparables and then comparing it with the 'price' charged by the comparables or the assessee, as has been done in the extant case. Such calculation of the transfer pricing adjustment by the TPO has resulted into landing in a piquant situation, in which 'ideal profit' has been compared with the 'actual price charged' for the purposes of making a transfer pricing adjustment, which is patent incorrect. We have noted above that the assessee applied the TNMM under which the ALP can be determined by comparing the adjusted profit margin realized by comparables as per sub-clauses (ii) and (iii) with the realized profit margin of the assessee

as per sub-clause (i) of Rule 10B (1)(e). As the TPO has computed ALP of the international transaction with the help of a method unknown to law, which calculation is again flawed because of making comparison of `profit' with the `gross revenue', we cannot countenance the same. The right course for the TPO was to compute assessee's profit margin realized under the TNMM as per Rule 10B(1)(e)(i) from its annual accounts without any adjustment and then compare it with the adjusted net operating profit margin of the comparables with the same base. This would have led to the determination of ALP of this international transaction.

11. Ordinarily, we would have set aside the assessment order in the present circumstances remanding the matter to the AO/TPO for a *de novo* calculation of the ALP of the international transaction as per the TNMM accepted by him as the most appropriate method. But, we are desisting from adopting such a course because the assessee has demonstrated to the TPO that this

international transaction is at ALP under the TNMM, which is manifest from page 5 of the order of the TPO, showing that the assessee calculated its OP/TC at 8% and average OP/TC of 25 comparable companies at 9.30%. Correctness of these figures recorded in the order has not been disputed by the TPO. If we ignore the exercise done by the TPO, which is clearly not in conformity with any of the prescribed methods, what remains for consideration under TNMM is, the assessee's profit margin at 8%, which is within the permissible range of the profit margin of comparables at 9.30%, necessitating no transfer pricing adjustment.

12. Be that as it may, it is noted that the TPO determined ALP of the assessee's international transaction for the year under consideration in the same manner as was done by him for the earlier years. Though the tribunal affirmed the shifting of the base of the assessee from 'Costs' incurred to the 'FOB value of

exports' and sustained the addition, but the Hon'ble Delhi High Court was pleased to delete such addition in *Li & Fung India Pvt. Ltd. Vs CIT (2013) 87 CCH 105 Del. HC* by holding that : 'the TPO's arbitrary exercise of adjusting the cost plus mark up of 5% on the FOB value of exports finds no mention in the IT Act nor the Rules'. Similar view has been taken by the Hon'ble Delhi High Court in the assessee's own case for the assessment years 2007-08 and 2008-09.

13. In view of the foregoing discussion, we are satisfied that the action of the AO/TPO in making/proposing addition/adjustment on account of transfer pricing, cannot be upheld for the reason that the shifting of the base on which markup has been applied has been turned down by the Hon'ble Delhi High Court in assessee's own case; the mechanism followed by the TPO for calculating the transfer pricing adjustment has no legal legs to stand on; and further the assessee's profit margin is at

ALP under the TNMM on the basis of figures mentioned in the TPO's order, whose correctness has not been disturbed by the TPO. *Ex consequenti*, the addition is hereby deleted.

14. In the result, this appeal of the assessee is allowed.

Order pronounced in the open court on 23<sup>rd</sup> March, 2016.

Sd./-

Sd./-

(KULDIP SINGH)  
JUDICIAL MEMBER

(R. S. SYAL)  
ACCOUNTANT MEMBER

Date: 23.03. 2016

Sp.

Copy forwarded to:-

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

True copy.

By Order

(ITAT, New Delhi)

S.No.	Details	Date	Initials	Designation
1	Draft dictated on	22/3/16		Sr. PS/PS
2	Draft placed before author	23/3/16		Sr. PS/PS
3	Draft proposed & placed before the Second Member			JM/AM
4	Draft discussed/approved by Second Member			AM/AM
5	Approved Draft comes to the Sr. PS/PS			Sr. PS/PS
6	Kept for pronouncement			Sr. PS/PS
7	File sent to Bench Clerk			Sr. PS/PS
8	Date on which the file goes to Head Clerk			
9	Date on which file goes to A.R.			
10	Date of Dispatch of order			

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