

आयकर अपीलिय अधिकरण, पुणे न्यायपीठ "बी" पुणे में  
**IN THE INCOME TAX APPELLATE TRIBUNAL  
PUNE BENCH "B", PUNE**

श्री डी. करुणाकरा राव , लेखा सदस्य  
एवं श्री विकास अवस्थी, न्यायिक सदस्य के समक्ष

**BEFORE SHRI D.KARUNAKARA RAO, AM  
AND SHRI VIKAS AWASTHY, JM**

आयकर अपील सं. / ITA No. 235/PUN/2013  
निर्धारण वर्ष / Assessment Year : 2008-09

Fresenius Kabi India Private Limited,  
A-3, MIDC, Ranjangaon Ganpati,  
Taluka-Shirur, Pune 412 220  
PAN : AAACF2614E

..... अपीलार्थी /  
Appellant

बनाम v/s

DCIT, Circle-1(2),  
Pune

..... प्रत्यर्थी /  
Respondent

Assessee by : Shri Ketan Ved  
Revenue by : Shri Adarsh Kumar Modi

सुनवाई की तारीख / Date of Hearing :12.06.2017	घोषणा की तारीख / Date of Pronouncement: 16.06.2017
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**आदेश / ORDER**

**PER D. KARUNAKARA RAO, AM :**

This appeal filed by the Assessee is against the order of AO/TPO/DRP for the Assessment Year 2008-09.

2. The grounds raised by the assessee reads as under :

*"The Appellant objects to the order dated October 25,2012 passed by the learned Deputy Commissioner of Income Tax, Circle - 1(2), Pune ["DCIT"] under section 143(3) r.w.s.144C(13) of the Income-tax Act, 1961 ["the Act"] in pursuance of the directions of the learned Dispute Resolution Panel, Pune ["DRP"] dated September 5, 2012 for the assessment year 2008-09 on the following among other grounds:*

1. *The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in making an adjustment amounting to Rs. 5,95,47,550 to the value of international transactions entered into by the Appellant with its Associated Enterprises in respect of international transactions relating to manufacturing and trading activities.*

*2. Benchmarking of transaction by transaction approach rejected - Manufacturing Activity*

*2.1 The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in not accepting the benchmarking of manufacturing activity done by the Appellant using "transaction by transaction" approach and has instead adopted the "aggregation" approach.*

*2.2 The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in not accepting the alternative benchmarking of international transactions in respect of export of goods to AEs and receipt of IT support services from AEs.*

*3. Rejection of Resale Price Method (RPM) and selecting of Transactional Net Margin Method (TNMM) as the most appropriate method - Trading Activity*

*3.1 The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in not accepting the benchmarking of trading activity done by the Appellant using "Resale Price Method" and adopting "Transactional Net Margin Method" as the most appropriate method.*

*3.2 The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in wrongly applying the turnover filter while selection of comparable companies.*

*3.3 The learned DCIT pursuant to the directions of the learned DRP erred in law and on the facts and in circumstances of the case in not accepting the alternative benchmarking of import of finished goods for resale submitted by the Appellant.*

*4. The learned DCIT pursuant to the directions of learned DRP has erred in law and on the facts and in circumstances of the case in not granting the benefit of +/- 5 percent as per proviso to section 92C (2) of the Act.*

*5. Each one of the above grounds of appeal is without prejudice to the other.*

*6. The Appellant reserves the right to amend, alter or add to the grounds of appeal."*

3. From the above grounds, it is evident that Ground Nos. 1, 5 and 6 are general in nature. Accordingly, they are dismissed as general as they do not require specific adjudication. Ground No.4 is also dismissed as not pressed by the Ld. Counsel for the assessee. That leave Ground No. 2 and 3 for specific adjudication. To start , we shall take up Ground No.2 along with its sub-grounds in the succeeding paragraph.

4. Ground No. 2 relates to benchmarking of transactions involving the Manufacturing segment of the assessee. Brief facts relating to the issue are that assessee is engaged in the business of manufacture and trading of wide range of intravenous (IV) fluids. Company is wholly owned subsidiary of M/s.Fresenius Kabi AG, Germany (FKAG). This, FKAG is, inturn, a wholly owned subsidiary of Fresenius AG, Germany (in short 'FAG'). There was import of finished goods from the Associated Enterprises and selling them in the domestic market. It is a part of the "Trading Segment" of the assessee. Further, raw material necessary for manufacturing activity of Intravenous fluids are also imported from the company's Associated Enterprises. Thus, the import of raw materials, finished goods and fixtures, assets as well as export of manufacturing goods, receipt of sales commission, receipt of I.T. services, payment of testing charges and payment of interest on loans are the company's international transactions which are subject matter of TPO's analysis are tabulated as under :

<i>Name of the Activity</i>	<i>Manufacturing Activity</i>	<i>Trading Activity</i>
<i>International Transactions</i>	<i>Import of Raw materials</i>	<i>Import of finished goods</i>
	<i>Export of finished goods</i>	<i>Receipt of sales commission</i>
	<i>Receipt of IT Support Services</i>	
	<i>Payment of testing charges</i>	

4.1 From the above extract, it is evident that the exports to related companies amounting to Rs.1,06,31,811/- is the transaction benchmarked by the TPO adopting the PLI of the Manufacturing Segment of the assessee, i.e. 0.54%. Otherwise, PLI of this sub-segment is 17.97%.

5. So far as the manufacturing activity is concerned, the TPO in his order dated 21-10-2011 benchmarked the relevant transactions and the adjustments

added by him works out to Rs.13,45,500/- and the relevant Para No. 7.2 of the TPO's order in this regard reads as under :

*"7.2 The major transaction is of exports at Rs.1,06,31,811/-. The other receipts are for IT services at Rs.66,18,055/-. The margin in manufacturing activity is 0.54%. The PLI of comparables is 8.34% for F.Y. 2007-08 (Annexure 8 B of TP report). Hence adjustment of  $(8.34-0.54) \times (1,06,31,811 + 66,18,055/100) = Rs.13,45,500/-$  is made to the International transactions reported."*

6. In short, the reasons given by the TPO in support of his finding and as per the discussion given in Para 7 of his order, includes that the sub-segments of the manufacturing activity namely; (1) Transaction with the related companies, (2) Raw material import from related parties and finished goods sold to exports third party, (3) Third parties and (4) Total manufactured exports, were not audited by the statutory auditors in the TP study furnished by the assessee. TPO is of the view that there is no audited segmental or sub-segmental accounts to support the conclusions of the TP study. Therefore, the assessee's margin in manufacturing activity, i.e. operating profit/sales at 0.54% is unsupported by the audited accounts. Further, the TPO is of the view that the expenditure allocated among the said sub-segments is arbitrary and are not based on the actual expenditure. Therefore, as per the TPO, the figures and expenditure allocated among the 4 sub-segments of Manufacturing activity are linked to the sales on the basis of some keys is unsustainable. Thus, the margins of each of the sub-segment are not credible for benchmarking study. Otherwise, it is undisputed that significant expenditure is allocated on keys, such as Production, Manufacture of bottles, ratio of sales revenue, etc. As per the TPO, all transactions are intrinsically closely linked and they are required to be aggregated. In that case, the PLI of this segment is worked at 0.54%. It is the reasoning of the Revenue authorities that the transaction with Associated Enterprises are 'profit

oriented' and the domestic transactions are 'loss oriented'. The segregation made by the assessee among the sub-segments is self-serving. Therefore, there is requirement of benchmarking the transactions leading to the adjustment of Rs.11,45,500/-. In the draft assessment order, the AO adopted the said adjustments to the manufacturing activity and they were subject matter of scrutiny before the DRP.

7. In response to the assessee's objection on the above said adjustments, as per the discussion given in Para 3.1, the DRP confirmed the TPOs adjustments. On scrutinizing the said para, it is prima-facie noticed that the DRP has not really examined the requirements of sub-segments. They merely rejected the assessee's contention by mentioning that :

*"3.4 . . . . . As regards the segmental analysis in respect of in respect of import of raw materials and export of finished goods, the contention of the assessee that there is no statutory requirement necessitating the Assessee to provide audited segmental information and hence contention of the learned TPO that segments made for the transfer pricing study needs to be supported by audited segmental accounts is not justified, is not acceptable."*

8. From the above, the DRP did not justify the legal requirement of audited segmental/sub-segmental information and the statutory requirements, if any, in this regard. Further, regarding allocation of expenses also, as per the DRP, the assessee could not counter-comment satisfactorily with the working demonstrating the actual allocation of expenditure. Thus, the AO was directed by the DRP to proceed to make adjustments as proposed in the draft assessment order.

9. Before us, Ld. Counsel for the assessee made various submissions. To start with, bringing our attention to the contents of Para 452 of the paper book, Ld. Counsel for the assessee submitted that the manufacturing activity has 4 distinct sub-segments and the allocation of expenditure was made substantially on the base of actual expenditure. He also submitted that there

is no requirement for compulsory audit of the segmental accounts/sub-segmental accounts or mandated by any statute. Bringing our attention to various sub-paragraphs to Para 8.2 in general, and sub-para 3.1, in particular, the Ld. Counsel demonstrated that the allocation of expenses was mostly based on the actual expenditure with the exception of expenditure relating to "other expenses" and "General Admin expenses". These are allocated based on production units and sales basis respectively. Ld. Counsel for the assessee is of the opinion that expenditure relating to payment of employees and selling and marketing expenses is allocated based on cost centres. The expenditure, which is allocated not based on the actual, is extremely negligible against Rs.55 crores out of gross expenditure of Rs.106 crores determined by the TPO. Thus the same constitutes a patent mistake which requires amendment. This mistake has driven the officers to the wrong conclusions in the matter.

10. Further, regarding the statutory auditing of the segments/sub-segments of Manufacturing activity and further, bringing our attention to certain judicial decisions (M/s. 3i Infotech Ltd. in ITA No.21/Mds/2013 order dated 07-05-2013), Ld. Counsel submitted that there is no requirement for auditing of the various segment/sub-segments of the assessee. Thus, it is the argument of the Ld. Counsel that the TPO's twin fold objection that the segmental/sub-segmental accounts are required to be statutorily audited and the allocation expenses being interlaced are not properly allocated, are unsustainable. Therefore, the adjustments made by the TPO are required to be deleted.

11. In reply to the same, Ld. Departmental Representative for the Revenue brought our attention to the fact that the accounts of the assessee suggest the segmental auditing of its accounts. In that case, it is not clear as to why

the assessee failed to furnish sub-segmental accounts duly audited by the qualified auditors. Further, justifying the TPOs finding regarding the interlacing of expenditure thereby the domestic sales registered huge losses unlike the international sales, where huge profits are registered. Replying to the Ld. Authorised Representative's argument that there are extraordinary circumstances that led to the registering of loss in the domestic sales, Ld. Departmental Representative for the Revenue submitted that none of these events are duly audited by the statutory auditors in which case the arguments of the Ld. Authorised Representative is unsustainable.

12. On hearing both the parties on these issues raised by the TPO, on perusal of the order of the DRP dated 12-01-2012 in general and Para 3.4 in particular, which was already extracted above, we are of the opinion that the DRP order does not provide reasons how the requirement for the assessee to furnish audited segmental/sub-segmental accounts in the TP study is needed. We understand the requirement of auditing the accounts of the assessee and it has the strength of the provisions of Section 44AB of the Act. But when it comes to the TP study matters, there is responsibility cast on the assessee to conduct TP study and there is a role/participation of the assessee. As in the matter DRP should have given reasons as to how the TP study also demands the Auditing of the segmental accounts or sub-segmental accounts. As such, it is not clear as to why the contents of page 492 of the paper book is not audited before filing the same before the lower authorities or the Tribunal. Assessee is under obligation to discharge the onus as to how said artificial allocation of expenses does not constitute a self-serving exercise rather than the reliable/credible TP study needed for benchmarking of the International transactions under consideration. In the absence of the same, the role of the AO or the TPO in making adjustments is sustainable in law. However, holding

this view at this point of time constitutes premature. It is also noticed that the decisions furnished by the assessee's counsel regarding the non-requirement of furnishing of the audited accounts of the segmental accounts and sub-segmental accounts, were ignored by the TPO/DRP without giving reasons. Regarding other aspects relating to allocation of interlaced expenditure, such as Employees cost, Selling and Marketing expenses, General Admin Expenses etc., we are of the opinion that basis for allocating the said expenses among the 4 sub-segments does not appear to be the actual expenditure although they were argued by the Ld. Counsel for the assessee as actuals. There is some adhoc allocation based on certain keys/parameters such as sales, cost centres, production units is involved. In our view, prima facie, the decision of the TPO/DRP constitutes reexamination. Therefore, we are of the considered opinion the issue of adjustment to the manufacturing segment is required to be remanded to the file of AO/TPO/DRP for fresh adjudication of the issue. AO is directed to grant reasonable opportunity of being heard to the assessee in accordance with the principles of natural justice. Thus, the relevant issue raised in Ground No.2 with its sub-grounds are allowed for statistical purposes.

13. Ground No.3 relates to the "most appropriate method" in case of the trading activity of the assessee – the distributor activity. The assessee considered himself as the one in distribution activity. Assessee imports the finished goods and sells the same in the domestic market with a markup. During the studies by the TPO, it is noticed that the assessee debited huge expenditure on account of selling and marketing expenses. Thus, the TPO is of the view that the distributor, who merely imports the items for selling without any value addition, is not required to incur such expenses. Further, he discussed about the branded nature of the products in question and given

various reasons discussed in Para 8.2 of the TPO's order and came to the conclusion that the Resale Price Method (RPM) adopted by the assessee as most appropriate method for TP studies of the segment, is not appropriate. There is an observation that distributor segment shown the operating loss before interest and depreciation. As per the TPO/AO, the distributor does not suffer losses normally. There was also discussion about the quality of the comparables considered for TP study before concluding that the most appropriate method for benchmarking the trading activity of the assessee is TNMM and rejected the Resale Price method chosen by the assessee.

14. In the DRP proceedings, assessee contested the findings of the TPO. As per the discussion given in Para No.5.4 and its sub-paragraphs, the DRP upheld the views of the TPO.

15. Aggrieved with the same, the assessee raised Ground No.3 before us. In this regard, Ld. Counsel for the assessee brought our attention to the said Para No.5.4 and demonstrated that the DRP merely extracted some paragraphs from the OECD Transfer Pricing Guidelines 2010 without applying the same to the facts of the assessee. Relevant operational para from the DRP's order (page 15) is extracted as under :

"5.4 .....

.....  
*For achieving proper comparability in the light of above mentioned aspects of business of a distributor, it is amply clear that complete information about business profile and financial data is not available in respect of all the parties which are examined as comparables. Under the circumstances the TPO has rejected the Resale Price Method and TNMM is considered as most appropriate method as other methods like CUP, CPM are not applicable to the facts of the case. In view of the above, the A.O. is directed to proceed as proposed in draft assessment order."*

16. Criticizing the above finding of the DRP, Ld. Counsel for the assessee submitted that the DRP failed to consider the fact that the assessee merely is a distributor engaged in the trading activity of importing finished goods and

selling the same in the domestic market. DRP has not given any reasons how Resale Price Method is not applicable to such distribution activity of the assessee and how the TNM method is most appropriate as held by the TPO.

17. Reacting to the reasoning of the TPO regarding the selling and marketing expenses debited to the profit and loss account, Ld. Counsel submitted that there is no value addition to the products distributed by these expenses incurred by the assessee. According to Ld. Authorised Representative, so long as there is Nil value addition to the products distributed by the said expenditure, the Resale Price Method is the most appropriate one. Relying on the following decisions, Ld. Counsel for the assessee read out the contents of relevant paras on this issue :

*(1) Textronix India Pvt. Ltd. Vs. DCIT in ITA No.1334/Bang/2010 order dated 31-10-2011.*

*(2) M/s. Frigoglass India Pvt. Ltd. Vs. DCIT in ITA No.463/Del./2013 order dated 11-04-2014*

*(3) Nokia India Pvt. Ltd. Vs. DCIT and vice versa in ITA Nos.242/Del/2010, 178/Del/2010 and CO No.77/Del/2010 order dated 31-10-2014*

*(4) Bose Corporation India Pvt. Ltd. Vs. ACIT reported in 77 taxmann.com 194 (Delhi Tribunal)*

*(5) M/s. OSI Systems Pvt. Ltd. Vs. DCIT in ITA Nos. 683 and 542/Hyd/2014 order dated 12-08-2015*

18. On the other hand, Ld. Departmental Representative for the Revenue heavily relied on the orders of the AO/TPO/DRP dutifully.

19. We heard both the sides on this issue, i.e. most appropriate method for benchmarking the international transaction of a distribution segment of the assessee. We have also given special attention to the fact of incurring selling and marketing expenses by the distributor qua the appropriate method for benchmarking. On perusal of the decisions cited by the Ld. Authorised Representative for the assessee, we find the Bangalore Bench of the Tribunal

in the case of Textronix India Pvt. Ltd. (supra) is on identical issue and relevant observations (sub-paragraph of Para No.5) are extracted as under:

*"We have considered the rival submissions. The dispute is with regard to the ALP in respect of international transactions whereby the assessee imports equipments from its AE and re-sells them without any value addition to the Indian customers. In similar circumstances, Mumbai Bench of the Tribunal in the case of L'Oreal India Pvt. Ltd. (supra) has taken the view that the RPM would be the most appropriate method for determining the ALP. The Mumbai Bench of Tribunal, in this regard, has referred to the OECD guidelines wherein a view has been expressed that RPM would be the best method when a re-sale takes place without any value addition to a product. In the present case, the assessee buys products from the AE and sells it without any value addition to the Indian customers. In such circumstances, we are of the view that the ratio laid down by the Mumbai Bench of the Tribunal in the case of L'Oreal India Pvt. Ltd. (supra) would be squarely applicable to the facts of the assessee's case. In that event, the GP as a percentage of sales arrived at by the TPO in Annexure to the TPO's order insofar as trading activity of comparables identified by the TPO at 12.90%. The GP as a percentage of sales of the assessee is at 35.6% which is much above the percentage of comparables identified by the TPO. In such circumstances, we are of the view that no adjustment could be made by way of ALP. We, therefore, accept the alternative plea of the assessee and delete the addition made by the AO. In view of the above conclusion, we are not going into the other issues on merits raised by the assessee on the approach adopted by the TPO in arriving at the ALP. Thus, ground Nos.2 to 7 are allowed."*

20. Further, the Delhi Bench of the Tribunal in the case of M/s. Frigoglass India Pvt. Ltd. (supra) held that Resale Price Method is the most appropriate method in case of a distributor. Relevant operational Para No.5 reads as under :

*"5. We have heard the rival contentions and perused the material available on record. In our considered view, once assessee has given a methodology for working of ALP on selection of a particular method supported by appropriate comparables, the working can be dislodged by TPO on the basis of cogent reasons and objective findings. In this case except theoretical assertions and generalized observations, no objective findings have been given to come to a reasoned conclusion that assessee's adoption of CPM for manufacturing segment and RPM for trading segment was Factually and objectively not correct. Thus the rejection of methods by TPO as adopted by assessee is bereft of any cogency and objectivity. The same is a work of guessing and conjectured. Similarly the TNMM method applied by the TPO suffers from the same inherent aberrations as mentioned above. In these circumstances we are of the view that Assessee's methods of CPM and RPM respectively worked by applying appropriate comparables is to be upheld. Thus the ALP working returned by the assessee is upheld. Assessee's TP grounds are allowed."*

21. We further find the Delhi Bench of the Tribunal in the case of Bose Corporation India Pvt. Ltd.(supra) held that Resale Price Method is the best suited method for determining the ALP of an international transaction in nature of purchase of goods from Associated Enterprises which are sold as such to related parties. Operational Para No.7.6 reads as under :

*"7.6 We are unable to accept the contention advanced on behalf of the Revenue. The obvious reason for this is that the incurring of high advertisement and marketing expenses by the assessee does not in any manner affect the determination of ALP under the RPM. It is but natural that only those expenses can have bearing on the gross profits that are debited to the Trading account. As the amount of advertisement and marketing expenses finds its place in the Profit and loss account, the higher or lower spend on it cannot affect the amount of gross profit and the resultant ALP under the RPM."*

22. Our view is further fortified by the order of the Tribunal in the case of M/s. OSI Systems Pvt. Ltd. Vs. DCIT in ITA Noo.683/Hyd/2014 order dated 12-08-2015 where all the above referred decisions were considered before deciding the issue in faovur of the assessee and in favour of 'Resale Method Price method' in case of distribution activity of the assessee.

23. From the above, it is settled legal position at the various Benches of the Tribunal that, in case of distribution activity, even when there are selling and marketing expenses are borne by the assessee, there cannot be any value addition to the product in question. In such cases, Resale Price Method is the most appropriate one and accordingly we reverse the decision given by the AO/TPO/DRP in thrusting on the assessee the TNM method to the transaction under consideration. In any case, it is not the case of the Revenue the assessee is not into distribution activity. Accordingly, in principle, Ground No.3 raised by the assessee is allowed.

24. On having held the 'Resale Price Method' is the most appropriate method to the distributor segment of the assessee, there is a need for

benchmarking of the transactions applying the good comparables. We find the TPO has given a finding in Para (xi) of Para 8.2 with regard to the adjustments even if Resale Price Method is applied. As stated by the Ld. Counsel for the assessee before Bench, that this part of benchmarking the transactions applying the Resale Price Method should be referred to the file of AO/TPO/DRP for a fresh decision after granting reasonable opportunity of bearing heard to the assessee.

25. Further, Ld. Counsel for the assessee brought our attention to the "additional ground" filed on 08-03-2015 and 08-06-2015 and submitted that these grounds relate to benchmarking of the transactions from the trading segments. Decision on the "most appropriate method" (Resale Price Method) makes most of these additional grounds infructuous. However, it is the prayer of the Ld. Counsel for the assessee that these additional grounds may be admitted and remitted to the file of the AO/TPO/DRP for considering the same at the time of benchmarking study of the international transactions in the trading segment applying Resale Price Method.

26. On hearing both the sides on the issues of additional ground, we find the additional ground, being legal in nature, are required to be admitted and should be remitted to the file of the AO/TPO/DRP for considering his benchmarking studies applying Resale Price Method. We find these grounds relate to the aspects of benchmarking of International transactions of trading activity. In our view, TPO should be directed to apply Resale Price Method as most appropriate method for the reasons discussed above and undertake the exercise of benchmarking them as per the rules on the subject. AO/TPO shall grant reasonable opportunity of being heard to the assessee in accordance with the set principles of natural justice. Hence, for the time being, these

additional grounds are treated as academic and are remanded to the file of AO.

27. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on this 16<sup>th</sup> day of June, 2017.

Sd/-  
**(VIKAS AWASTHY)**  
**JUDICIAL MEMBER**

Sd/-  
**(D. KARUNAKARA RAO)**  
**ACCOUNTANT MEMBER**

पुणे Pune; दिनांक Dated : 16<sup>th</sup> June, 2017.  
सतीश

**आदेश की प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :**

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. The CIT(A)-11, Pune
4. CIT-11, Pune
5. DR, ITAT, "B Bench" Pune;
6. गार्ड फाईल / Guard file.

**आदेशानुसार/ BY ORDER,**

//True Copy //

सहायक रजिस्ट्रार/Assistant Registrar  
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune