IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH "I" NEW DELHI)
BEFORE SHRI I.C. SUDHIR AND SHRI T.S. KAPOOR

ITA No. 6463 & 5082/Del/2011
Assessment Year: 2007-08

Mitsui & Co. India Pvt. Ltd., Plot No.1, 4th Floor, Salcon Ras Vilas, District Centre Saket, New Delhi. (PAN: AADCM4488J)	vs.	Deputy CIT, Circle 6(1), New Delhi.
(Appellant)		(Respondent)

Appellant by: Shri Ved Jain & Ms. Rano Jain, CAs
Respondent by: Shri Sanjay Prasad, CIT(DR)

Date of hearing : 26.05.2015
Date of pronouncement: 20:08.2015

ORDER

PER I.C. SUDHIR: JUDICIAL MEMBER

These are two appeals for the assessment year 2007-08 and 2008-09 directed against the order dated 21-10-2011 and 26-11-2012 passed by the Deputy Commissioner of Income Tax, Circle 6(1), New Delhi under Section 143(3) read with Section 144C of the Income Tax Act.

2. Since the facts and the issue raised in both these appeals are common, the same are being disposed of by a common order and for the purpose of adjudication the facts of assessment year 2007-08 are being taken up.

3. The assessee has raised as many as seven grounds of appeal. However, the core issue involved in these appeals is addition made by the AO on account of the arm's length price determined by the Transfer Pricing Officer and confirmed by the Dispute Resolution Panel.

4. The assessee company is a wholly owned subsidiary of Mitsui & Co. Ltd., Japan. Mitsui & Co. Ltd., Japan is one of the leading *sogo shosha* establishment in Japan. *Sogo shosha* means general trading and these companies are general trading companies. These companies play an important role in linking buyers and sellers for wide range of products. The range is very wide that it includes grain and oil, machinery, equipment, etc.

5. The assessee company being a subsidiary of the Mitsui & Co. Ltd., Japan provide support services to the various group entities of Mitsui & Co. Ltd., Japan. This support services is the main activity whereby it acts as a facilitator for the transactions entered into by Mitsui & Co. Ltd., Japan and other group entities of the Mitsui & Co. Ltd., Japan.

6. During the assessment year 2007-08 the assessee company has entered into following transactions:-

		Transaction (Rs.)
1.	Provision of services	528,379,089
2.	Purchase and sale of goods	118,385,397
3.	Purchase of capital goods	1,987,760
4.	Interest received	2,227,448
5.	Reimbursement of expenses received/ receivable	52,587,644
6.	Reimbursement of expenses paid/payable	100,737,320

7. The learned TPO noted that the assessee has used TNMM (Transactional Net Margin Method) as the most appropriate method and the Profit Level Indicator (PLI) selected is 'Berry Ratio' against operating expenses. The contention of the assessee was that the average berry ratio come out to 1.34 as against 1.09 computed on the basis of the 20 comparables set out in the transfer pricing study and hence the transactions entered into by the assessee company was at arm's length price.

8. The learned TPO, however, did not agree with the assessee's contention. The TPO was of the view that under Rule 10B(4, the data to be used has to be only of the related financial year. The leaned TPO was also of the view that the way the assessee has computed arm's length price by using berry ratio as PLI, the entire international transactions relating to sales and services of the commodities have remained out of the PLI. The learned

TPO was of the view that the cost of sale is to be included in the denominator of the PLI used. It was the contention of the learned TPO that as per the Income Tax Rules operating expenses cannot be the basis as these expenses do not include cost of sales. The TPO in support thereof invoked the provisions of Rule 10B(1)(e)(i) to hold that net profit margin realized by an assessee from an international transaction entered into with associated enterprises is to be computed in relation to costs incurred, sales effected or assets employed by the assessee. The TPO further held that as regards the support services provided by the assessee is concerned, the right course will be to treat such services as equivalent to trading and the income received by the assessee from such support services is to be considered as income from trading and comparison need to be made accordingly.

9. On the above principle the learned TPO identified seven new comparables and accordingly issued a show cause notice as under:-

> *"7. It is proposed to treat the service and commission income segment as equivalent to trading segment and therefore, propose to add the result of commission and service segment related to AEs and include Rs.4512 crores as cost of goods sold in this combined AE segment. You are hereby required to show cause as to why the service/commission income is not treated as trading business in substance.*

You are also required to show cause as to why Rs.4512 crores should not be included in the cost base of service/commission segment. I propose to apply OP/TC percentage of comparable companies, searched from Prowess on the combined cost base, including the value of goods on which commission is earned by Mitsui India, related to AE segment to arrive at the arm's length profit fro the trading and service/commission segment. A set of following comparable companies were search from database available in the public domain after applying a turnover filter of Rs.100 Crore in the trading companies. Final set of the comparable companies are hereunder:

Company Name	OP/OE (percentage)*
Frost International Ltd.	1.99
P K S Ltd.	4.34
General Commodities Pvt. Ltd.	3.04
Sakuma Edports Ltd.	2.08
Kotak Ginning & Pressing Inds. Ltd.	2.94
Cottage Industries Exposition Ltd.	3.04
Euro Vistaa (India) Ltd.	5.78
Average (Mean) (percentage)	3.32
*Note:	Financial Data of FY 2006-07

9. Computation of arm's length profit from service/commission segment is given below:

Approx. Cost base of AE-segment (AE service segment + AE- trading segment)	*45,589,044,859*

(A)	
Mean of OP/TC of comparables (Arm's length OP/TC): (B)	*3.32%*
Operating profit reported before including value of goods on which commission is earned: (C)	*59,774,453*
Arm's length profit(D)=(A)X(B)	*1,513,556,289*
Deficit = D-C	*1,453,781,837*

The above difference of Rs.1,453,781,837 is proposed as an adjustment to the value of international transactions for FY 2006-07"

10. In response to the show cause notice issued by the learned TPO the assessee submitted a detailed reply contending as under:-

"i. The assessee essentially in the business of providing sales support and coordination activities in relation to its international transactions: The assessee argued by comparing the FAR of trader vis-à-vis a service provider and concluded that the FAR of the assessee is akin to the FAR of a service provider.

ii. Berry Ratio has been rightly selected as the PLI:

iii. Value of Rs. 4512 Crores should not be added to the cost base of the assessee's international transactions: The assessee claimed that adding Rs.4512 Crores in the cost base of the AE segment tantamount to recharactersing the

service segment as a trader. The assessee once again reiterated that the FAR of the service and commission business is different from FAR of the trading business. It claimed that FAR of the AE segment of the assessee is akin to FAR of a service provider and therefore Rs.4512 Crores should not be included in the cost base.

iv. Comparables selected by the TPO are incorrect and the margins computed by the assessee be accepted as the same is derived from annual report which more reliable source than Prowess."

11. The TPO, however, did not agree with the contention of the assessee and proposed an adjustment of Rs.107,53,92,764 as under:-

> *"It is concluded that the assessee has not been able to substantiate its arguments with valid documentary evidences. Following the discussion the preceding paras, the FOB value of goods sourced from India, being Rs. 4512 Crores shall be taken as part of the cost base to calculate the remuneration of the assessee. Computation of arm's length profit for the combined AE segment (computation of profit of AE segment is attached as Annexure 1) is given below:*

Cost base of AE segment (AE-service segment + AE-Commission segment) (A)	*45,589,044,859*
Mean of OP/TC of comparables	

(Arm's length OP/TC): (B)	*2.49%*
Operating profit reported: (C)	*59,774,453*
Arm's length profit (D)=(A)X(B)	*1,135,167,217*
Difference to be adjusted = D-C(Rs)	*1,075,392,764*

12. Aggrieved by the draft assessment order passed by the AO as per the recommendations of the TPO, the assessed filed objection before the learned DRP.

13. The learned DRP upheld the action of the learned TPO in re-characterizing the transaction as that of a trader as against service provider. It, however, directed the TPO to exclude one comparable viz., Cottage Industries consequent to which the margin got increased from 2.49% to 2.56%. The adjustment thus was increased from Rs.107,53,92,764/- to Rs.110,73,05,095/- in assessment year 2007-08.

<u>In the A.Y. 2008-09</u>

14. During the assessment year 2008-09, the assessee company entered into following transactions:-

		Transaction (Rs.)
1.	Provision of services	687,916,048
2.	Purchase of goods	127,624,787
3.	Sale of goods	23,900,120
4.	Purchase of assets	1,289,604
5.	Reimbursement of expenses received/ receivable	53,342,485
6.	Reimbursement of expenses paid/payable	127,537,685

15. The learned TPO following order of assessment year 2007-08, re-characterized the transaction as trading transaction and by including Rs.4005 Crores as cost of goods sold in the combined AE segment and by applying a margin of 2.91% proposed an addition of Rs.116,60,28,331/-.

16. In this A.Y. 2008-09, the learned DRP again upheld the action of the learned TPO. However, it directed the TPO to exclude three comparables consequent to which the margin got reduced to 2.82% and accordingly adjustment also got reduced to Rs.112,93,80,700/-.

17. Aggrieved by the order passed by the DRP and the consequential final assessment order passed by the AO, the assessee is in appeal before us. It was contended by the learned AR that the action of the TPO and the DRP in

making the above adjustment on account of arm's length price is against the Transfer Pricing Regulations as well as decided case laws under similar set of facts. The activities of purchase and sale i.e. trading involves risk and finance whereas in the activity of support services i.e. intending transactions the assessee company has neither to incur any financial obligation nor carries any significant risk. The nature of two activities is absolutely different. The activities of trading i.e. purchase and sale are highly insignificant as compared to activity of support service which constitutes the core business activities of the assessee company. The learned TPO and the learned DRP has gone wrong in applying the trading margins ignoring the facts of the case that the assessee being a service provider the trading margins cannot be applied. Further the learned TPO and learned DRP has gone wrong in including the cost of sales in OP/TC ignoring the fact the value of the sale under no circumstances effects the activities of the assessee company, a service provider. For support services the correct method is the TNMM and the assessee has computed the same on the basis of OP/TC. The TPO was not justified in ignoring the same. The OECD guidelines also supports this contention that in TP study business transactions cannot be re-characterized. The support service or intending provided by the assessee company is nothing but a trading facilitation both in form and substance.

There is no allegation nor any material brought on record to suggest that support services/intending transactions are trading transactions submitted by the Learned AR. He submitted further that the TPO has not been able to identify any intangible being created as is being alleged regarding human intangible/supply chain. The Mitsui Japan has been operating since long and doing business on its own since long. The assessee company was established only to provide support services to the existing business of the Mitsui Japan and as such to cut price such transaction and compare the same with the trading transactions is not correct.TPO has not been able to point out any error in the comparables submitted by the appellant company and the same being at arm's length, the adjustment proposed by the TPO and as confirmed by the DRP needs to be deleted. The TPO has gone wrong in benchmarking the business support services provided by the assessee company to AE with that of independent trading transactions for determining the arm's length price in respect of business support services.

18. It was further argued by the ld. AR that the company is engaged in providing business support services to various group companies of Mitsui Japan. For this it has entered into arrangements whereby it provides business support services which include:-

(i) Support in business promotion
(ii) Collection of market information
(iii) Coordination with customers
(iv) Collection of account receivables from client on behalf of AE
(v) Administrative services
(vi) Networking
(vii) Other support services

The Learned AR submitted that the trading activities are undertaken by Mitsui Japan not by Mitsui India. If it is import of goods for buyers in India, the Mitsui Japan has a contract with the Japanese suppliers and Mitsui Japan also enters into contract with the buyers in India. Similarly for exports from India, Mitsui Japan enters into a contract with Indian supplier directly for the purchase and sales transactions. Thus the role of Mitsui India, the assessee company is a mere facilitator, a mere service provider. Mitsui India does not take title or possession of the merchandise at any moment and bears no price risk. Mitsui India does not take inventory risk, it does not take warranty risk, it does not take credit risk. It does not employ its capital. In purchase and sale, inventory, advances, debtors, Mitsui India's main function is to maintain contact with the suppliers to ensure timely delivery of merchandise to the customers in the quality and grade desired, communicating with Mitsui India or its affiliates, gathering information on demand and supply conditions of the commodities. The above functions are entirely different than the trading business. In trading activities, one ventures himself. Buys

and sells goods in it's account. It takes price risk, inventory risk, it deploys capital in inventory, debtors. It takes risk in warranty, credit, etc. Thus the functions performed, assets deployed and risk assumed in trading are entirely different than that of business support services. The TPO has gone wrong in holding that margins earned in trading are in identical circumstances as while providing support services.

19. The learned AR further contended that the finding given by the TPO that appellant company has over a period of time developed a supply chain intangibles, which is all about having the right product in the right place, at the right price, at the right time and in the right condition, is wrong and against the facts. In this regard reference made by the TPO in its order about the assessee company having developed knowledge of products and design, knowledge of acquisition, knowledge of quality control, knowledge of storage is wrong and against the facts. These are none of the activities of the assessee company as is evident from the description of business support service provided by it. Assessee company simply provides facilitation services to entities in supply chain without being a part of the supply chain. The assessee company has created human intangibles. In this regard the AR submitted that TPO has just made a literary reference in his order about human intangibles and held that assessee has created human capital intangible ignoring the facts and the detailed reply submitted by the

assessee. The facts are that the activities performed by the assessee are routine, preparatory and auxiliary in nature which does not create any intangibles. Organizations providing support services employ human resources for the same and that does not lead to creation of any intangibles. Assessee's role is limited to that of a routine coordination and support service provider. It is Mitsui Japan which has the expertise, a strong relation with a vast network of manufacturers, distributors and buyers.

20. On the issue of inclusion of cost of sales in the denominator it was submitted by the Learned AR that reasoning given by the TPO in the order that compensation model in the case of the assessee should be expressed as a percentage of FOB price of goods serviced through the assessee is also wrong. In this regard the observation of the TPO that the assessee has played a major role in identifying supplier raw material are factually incorrect. The Mitsui Japan has been in the business since long. It has been doing international trading and making sale and purchase from India. It is not that the business has been developed by the assessee company for Mitsui Japan. The assessee company has been incorporated in March, 2005 to provide facilitation services. Its role is to provide business support services only. The comparison model as a percentage of the value of the goods can

be good where the service provider has knowledge of the product, knowledge of the quality, its usage and has developed competency. In this regard this model can't be applied to an entity which is just providing support services to an entity who in turn has core competency of that business, its product, design, etc. There is a difference in carrying on the business oneself and providing support service to the one who is doing the business.That reasoning given by the TPO for adding cost of goods sold while computing margin is not correct. The Rule 10B(e)(i) specifically provides that net profit margin in relation to transaction entered into with an AE is computed in relation to costs incurred, or sales effected or assets employed or to be employed by the enterprise. The cost incurred here will mean the cost incurred by the enterprise which will in the case of the assessee mean the cost incurred in providing services. Since no sales have been effected by the assessee company it is not appropriate to take cost of sales for computing margin.That even otherwise the compensation model to determine the arm's length price based on a single rate of commission on total FOB value of all types of goods to be sold will not be appropriate. The percentage of brokerage or commission for procuring business in respect of luxury goods or commodities is higher as compared to the percentage of commission or brokerage for high value products like gold, bullion.

Similarly the percentage of commission or brokerage for consumer products is always higher as compared to the industrial products. Thus even where commission rate based on value of goods sold to be applied the nature and type of product n respect of which such services have been rendered have to be taken into consideration and then a comparison needs to be made with the commission rate prevalent in respect of such product goods. In the present case the nature of products and items varies a lot. The TPO without even looking at any of these items details has in a most arbitrary manner considered trading as one and the same to support services and applied trading margin in different nature of the product and items to the support services taking turnover of the AE as the basis. That the TPO was not justified in re-characterizing the transaction of business support services as that into trading and applying the profit margin in the trading as the PLI.

21. It was argued by the ld. AR that in the preceding assessment year i.e. 2006-07, the assessee's method of benchmarking its international transaction relating to provision of business support services using TNMM at the most appropriate method with OP/TC as PLI has been accepted and the addition was made only with regard to the margin computed with reference to the comparables used. The basis for computation i.e. OP/TC as PLI was not

tinkered with. That there is no change in the nature of services being provided by the assessee company to its associate enterprise since 2003 when the appellant company was incorporated and it has been consistently benchmarking its international transaction relating to business support services using TNMM at the most appropriate method with OP/TC as PLI. This is the correct method. The method adopted by the TPO is not a method at all prescribed. As per the balance sheet of the company the total capital of this company is just Rs.24.30 Crores (PB Pg. 140 – Vol. II) and its main activity is just to provide support services. It is just unimaginable that a company with a capital of Rs.24.30 crores can do a trading of more than Rs.4500 crores and earn a profit of Rs.114 crores as has been determined by the TPO.

22. It was further submitted by the learned AR that the issue is squarely covered by the judgment of Delhi Tribunal in the case of Sojitz India (P) Ltd. vs. DCIT 24 ITR (Trib) 474 (Del), where facts being identical, exactly the same issue has come up. Sojitz India (P) Ltd. was also a subsidiary of Sojitz Corporation, Japan. Sojitz Corporation, Japan was also a *sogo shasha* company i.e. general trading company. Sojitz India (P) Ltd. was also engaged in providing support services to the Sojitz Corporation, Japan and

its group companies. The major activities of the Sojitz India (P) Ltd. were to provide support services. A very small part of the activity was trading in India as is the case here. The TPO was of the view that the activities of service provider is similar to the activities of the trader and hence by applying margin in trading activities he made an adjustment to the arm's length price in respect of the support services.

23. The ITAT Delhi Bench after elaborate discussion has held as under:-

> *"12.19. On a consideration of the business profile of the assessee as available on record and the nature of services rendered and the risk profile of the assessee, we are of the view, that the TPO erred in considering that the activity of a service provider is similar to the activity of a trader."*

24. The learned AR further submitted that the issue is also covered by the judgment of Hon'ble jurisdictional Delhi High Court in the case of Li and Fund India Pvt. Ltd. vs. CIT 361 ITR 85 (Delhi). Further the above judgment has also been considered again recently by Delhi Bench of ITAT in the case of Mitsubhishi Corporation India (P) Ltd. vs. DCIT, ITA No. 5042/Del/11 dated 21.10.2014 where facts are identical and similar issue has come up and the coordinate bench has held that TPO was not justified in re-

characterizing the transaction as trading transaction and it has been further held that cost of sales can't be included.

25. It was further submitted by the learned AR that even as per TPO's computation no adjustment can be made to the arm's length price in view of the proviso to Section 92C as applicable for the assessment years under consideration the margin is within 5% of the price at which international transaction has been undertaken by the assessee company. In this regard the learned AR submitted that the TPO after holding that cost of goods sold is a relevant criteria has not taken the issue to its logical conclusion. Per contrary he has proposed an adjustment of Rs.107,53,92,762/- whereas considering the provisions of proviso to section 92C(2) no adjustment was called for. It was submitted that the proviso to Section 92C actually talks about comparing the price of international transaction with the Arm's length Price so determined. Thus even if it is assumed, without accepting it, that TPO has correctly calculated the mean PLI of 2.49%, then also TPO has erred in making addition to the income of the assessee as the transaction of the assessee are within + / - 5% range, as provided in the proviso to section 92C as can be seen from the following table:-

Particulars	Amount – Rs.	
	A.Y. 2007-08	A.Y. 2008-09
Cost of Base of AE Segment (Z) … refer TPO order Pg. 21	45,589,044,859	4071,95,89,546
Operating Profit Reported by the assessee (Y) … refer TPO order pg 21	59,774,453	1,89,11,725
Total Sales / Commission Income (A) = (Z) + (Y)	45,648,819,312	4073,85,01,271
Mean OP/TC (B)	2.56%	2.28%
Arm's Length Profit as per mean OP/TC (C) = B * Z	116,70,79,548	114,82,92,425
Arm's Length Cost (D) = A – C	4448,17,39,764	3959,02,08,846
Total Cost Base as per TPO (Z)	45,589,044,859	4071,95,89,546
Difference	110,73,05,095	112,93,80,700
5% of the ALP (As per proviso to Sec 92C) i.e. 5% of (D)	222,40,86,988	197,95,10,442

In the present case undisputedly even if cost of goods sold is included as has been done by TPO in the total cost the gap is less than 5% and hence no adjustment otherwise can be made.

26. The learned CIT(DR) supported the order of the learned TPO as confirmed by the Dispute Resolution Panel (DRP). It was contended that the TPO has given detailed reasoning in his order for making adjustment to the arm's length price. It was further contended that the comparables selected by the assessee and used in its TP report are not correct comparables and accordingly the TPO was justified in rejecting the same. As regards the

contention of the learned AR that the facts of the case are similarto the case of Sojitz India (P) Ltd. (Supra) and Mitsubishi Corporation India (P) Ltd. (Supra) it was submitted that though facts of the present case are almost similar to the facts of these two judgments relied upon by the AR as all these companies are providing support services to the parent company in Japan engaged in Sogo Shosha i.e. general trading companies, but still each of the case has to be considered on its own merit.

27. On the issue of consistency as argued by the learned AR it was submitted by the Learned CIT(DR) that in the year under consideration the TPO has carried out an in-depth analysis and hence the acceptance of the assessee's arm's length price in the preceding year cannot be a ground to not to make adjustment in the year under consideration. On the issue of the alternative submission of the learned AR it was submitted that this benefit is not available to the assessee company as the method applied is only one method i.e. Transactional Net Margin Method. It was contended that the benefit of this proviso will be available only when arm's length price is determined by applying two methods and the difference in the two methods is within 5 per cent.

28. We have considered the arguments advanced by the parties and gone through the orders of the authorities below as well as the judgments relied upon. On going through the order of TPO in the case of the assessee and the order passed by the ITAT in the case of Mitsubishi Corporation India (P) Ltd., we note that the facts of the two cases are almost similar. In this regard we note that the ITAT in Para 7 of its order has recorded the FAR analysis carried out by the TPO. It may be relevant to quote para 7 of the order passed by the ITAT in the case of Mitsubishi Corporation India (P) Ltd. (supra) as under:-

> *"7. As the Transfer Pricing Officer rightly noted, the main issue in this case is adjudication on the question "whether …(the assessee).. is being adequately compensated" for the functions performed by the assessee. The TPO then proceeded to analyze functions of the assets, risks assumed by the assessee and assets employed by the assessee. He noted that, as set out in paragraph 3.4 of the transfer pricing study, the assessee has provided the services for (a) facilitating communication between buyer and seller; (b) arranging freight, insurance and custom clearance through third parties; (c) collecting market information; (d) identifying potential customers (in import transactions only) or suppliers (in export transactions only); and (e) advising an associated enterprise or third party in regulatory or financial matters. It was also*

noted that, as stated in the transfer pricing study, "the presence of assessee in India provides AEs a medium of communication through which they can compete with their competitors eyeing similar business in India". The TPO was of the view that "the assessee has performed all the critical functions, assumed significant risks and used both tangible and unique intangibles developed by it over a period of time". He then summarized the FAR analysis as follows:

Functions performed by the assessee:
-Purchasing activities: Mitsubishi India places orders with related party vendors after receiving orders or projections from its customers

-Distribution activities: In some of the principal transactions, Mitsubishi India warehouses Inventory at public bonded warehouses and maintains sufficient Inventory as per agreement with customers. It performs Inventory control and ships goods to customers. Mitsubishi India's customers sometimes arrange for their own shipping and handling.

-Sales marketing and after sales activities: In principal transactions, the Group Companies coordinates in negotiating prices with Mitsubishi India's customers. Mitsubishi India's sales personnel requirements are Identified by Mitsubishi India and also remuneration of sales personnel is determined by Mitsubishi India. Mitsubishi India is responsible for billing and collection. Mitsubishi India provides market research relating to local market and develops marketing strategy.

-Identifying potential customers and suppliers.

-Information gathering.

-Facilitating communication

-Arrangement of logistics.

-Accounting and administration.

-Developing long term strategic policies.

-Dealing with finance, accounting, IT and legal issues.

-Human Resource Management:

(b) risks assumed by the assessee:

-bears volume risk

-bears foreign exchange risk

-bears manpower risk

(c) assets used by the assessee:

-Fixed asset"

29. In the order passed by the learned TPO in the case of the assessee before us, the FAR analysis stated by the TPO in para 5.2.1 is exactly the same as stated hereinabove in the case of Mitsubishi Corporation India (P) Ltd.. The conclusion drawn by the TPO and quoted in the judgment of the Mitsubishi Corporation India (P) Ltd. in para 9 of the order are also exactly the same as in para 5.3 of the TPO's order in the case of the assessee

company. Thus we are of the view that the facts of the present case are similar to the facts of the Mitsubishi Corporation India (P) Ltd. In the Mitsubishi Corporation India (P) Ltd.(supra), the ITAT has held that it is impermissible to make notional addition in the cost base and then take into account the cost which are not borne by the assessee. The ITAT while giving the above finding has relied upon the judgment of the Hon'ble jurisdictional Delhi High Court in the case of Li & Fung (Supra) whereby the Hon'ble Court has held as under:-

> *"……..This Court is of opinion that to apply the TNMM, the assessee's net profit margin realized from international transactions had to be calculated only with reference to cost incurred by it, and not by any other entity, either third party vendors or the AE. Textually, and within the bounds of the text must the AO/TPO operate, Rule 10B(1)(e) 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 TNMM. 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 ..." (emphasis supplied). It thus contemplates a determination of ALP with reference to the relevant factors (cost, assets, sales etc.) of the enterprise in*

question, i.e. the assessee, as opposed to the AE or any third party. The textual mandate, thus, is unambiguously clear.

40. The TPO's reasoning to enhance the assessee's cost base by considering the cost of manufacture and export of finished goods, i.e., ready-made garments by the third party venders (which cost is certainly not the cost incurred by the assessee), is nowhere supported by the TNMM under Rule 10B(1)(e) of the Rules. Having determined that (TNMM) to be the most appropriate method, the only rules and norms prescribed in that regard could have been applied to determine whether the exercise indicated by the assessee yielded an ALP."

30. In view of the above judgment of Hon'ble jurisdictional High Court, we hold that it was not correct on the part of the TPO to include the cost of sales incurred by the AEs in respect of which the assessee company has rendered services and then to work out the profit for determination of the arm's length prices. Our view is also supported by the judgment of the Delhi Tribunal in the case of Sojitz India (P) Ltd. vs DCIT (Supra) where a similar issue has come up. In that case also the learned TPO has included the cost of sale of all the AEs while determining the arm's length price and has also considered the transactions entered into by the assessee company as transaction that of

trading activity. The ITAT has examined this issue and has held as under:-

> *"12.18 In the aforementioned background we are of the view that in order* to *adjudicate upon the issues it would be appropriate for us to formulate the questions as under:-*
>
> *(a) Whether the TPO on facts was justified to treat the indenting activity at par with the trading activity ;*
>
> *(b) If the answer to the query posed in (a) is "yes" then were the margins earned in the trading activity by the assessee with non AEs correctly applied to the indenting activity with AEs ;*
>
> *(c) If the answer to the query posed in (b) is "yes" then would the 'costs' referred to in Rule 10B (1) (e) (i) be the FOB value of goods on the facts of the present case or would it be the operating cost of the assessee;*
>
> *(d) If the answer posed to the query in (a) is "no" then is there any justification on facts in applying the margins earned in the trading activity to the profits of indenting activity for working out the Arms Length Price.*
>
> *12.19. On a consideration of the business profile of the assessee as available on record and the nature of services rendered and the risk profile of the assessee, we are of the view, that the TPO erred in considering that the activity of a service provider is similar to the activity of a trader. The decisive factors as to why the question framed in (a) has been*

answered in the negative, are being elaborated in the following paras based on the Business Profile, FAR analysis etc. which we have deliberated on in the earlier paras.

12.20. The unrebutted facts available on record is that the assessee is a service provider to the extent of 88.67% of its total earnings. As per the contracted terms and the unrebutted stand of the assessee it is merely providing indenting services. At no point of time the title in goods or possession of the merchandise is in assessee's hands. The contract is entered into by SCJ and Indian customers directly whether for export or import. The negotiations are directly done by SCJ and the Indian customers and the assessee merely functions as a facilitator. Looking at the nature of services rendered and the arguments advanced which also remain unrebutted and as such are taken to be correct the assessee does not need to incur cost either for maintaining or storing the inventory or for the transportation as the title in goods is never held by the assessee for its indenting activity as a service provider. Consequently the assessee is not exposed to any credit risk in maintaining the inventory nor is the assessee exposed to price risk or the risk linked with offering credit sales. From the nature of the risk profile of the assessee and on considering the functions performed and the assets deployed it can be safely concluded to be that of a low risk business, which has also been the claim of the assessee. It is a matter of record that in these years the assessee has also shown profits on its

own trading with non AEs. In the facts available on record, nothing has been brought on record by the TPO to either justify that the assessee has made a wrong claim on facts while claiming to be engaged in indenting activities or was infact performing all or some of the functions of a trader, in which eventuality the TPO would have been well within his rights to re-characterize the assessee's indenting activities as a trading activity. It is an accepted economic principle that the trader acting as an entrepreneur is exposed to price risk, cost risk, credit risk, warranty risk etc, which would necessitate the contract being entered into and negotiated by assessee. In its indenting activity these facts are not evident. Accordingly the question posed in (a) is answered in the negative.

12.21 Considering the next question posed, even if the answer in (a) is in the negative, we see that there is no reasoning and justification for applying the margins earned in trading activity to indenting activity as the two are distinct and separate. Merely because the assessee was also having a small level of trading activity in its own name, there is no reason available on record either justifying the action of re-characterizing the nature of assessee's activity from a service provider to that of a trader. As observed, neither the TPO has lead any discussion nor has the DRP cared to throw any light on the aspect for upholding the action of the TPO. Where all the critical functions were being performed by the AE, the

services provided, as a facilitator, by the assessee cannot be treated as a trading activity. The performance of the critical functions, like decisions to enter into contract, to negotiate the terms of the contract, to decide the level and extent of exposure for price risk, credit risk, warranty risk etc are some of the risks to which a trader is exposed. The record shows that at no point of time the assessee was ever exposed to any of those risks as such, the two activities could not be treated at par and thus invited a similar treatment.

12.22. The Ld. CIT DR has relied upon various decisions in support of the TPO's order and the order of the DRP which we propose to discuss subsequently. However it can never be over emphasized that each decision operates on its own peculiar facts and circumstances. This holds equally good for orders and judgments rendered in the context of transfer pricing as each change or nuanced change in facts and circumstances would call for a detailed appreciation of facts and circumstances of both sets of cases. Transfer pricing litigation as we have seen is very fact drive. Consequently for appreciating the principles laid down in the judgements and orders, a detailed factual study of the business model FAR analysis and even economic conditions, if need be, have to be closely examined. Only then the applicability or relevance of the principle laid down be considered. The issues being purely factual necessarily warrant a detailed discussion.

12.23. In the facts of the present case it is seen that the assessee is using the network of SCJ for rendering its services. Reference may also be made to page 248 of the paper book which contains the TP study of the assessee the same is reproduced for ready reference.

"Patents, License Rights, and other Intellectual Property Rights

The various intangibles required to carry out the operations of the Assessee namely trademark, patents, licence, are owned by Sojitz Japan.

Sojitz Japan possesses entrepreneurial knowledge with respect to the operation of the global trading network. Sojitz India has not developed and does not use any intangible assets in its business operations in India."

12.24. As such it is seen that no intangible assets are held by the assessee in terms of supply chain intangibles etc. It is further seen that the AE is trading in a diverse range of goods right from aero space, chemicals, plastics, high technology machinery, automobiles, tele-communications industry or reality etc. and no effort has been made to show that the limited trading activity belongs to which of those segments were anyway the FAR analysis shows that there is no comparison in the two activities

12.25. Accordingly on account of these facts, we are unable to agree with the TPO who chose to re-characterize the activities

of the service provider and treated them at par with the activities of a trader since the nature of the activities of a trader and service provider are materially distinct and different.

12.26. As we have held on facts that the two sets of activities are distinct and different, consequently we are of the view that there is no justification for applying the margins earned in trading activity to those earned in the indenting services. As such, we find ourselves unable to agree with the reasoning and the decision of the TPO which has been upheld by the DRP. At the cost of repetition the consistent and unrebutted material available on record shows that in the trading activity, the assessee has entered into contracts with the parties in India in its own name. The title in goods has been held for these contracts in assessee own name as such the assessee as any other trader has exposed itself to the price risk, the credit risk and other related risks of inventory risk etc. The negotiations for the same has directly been done by the assessee and not by the SCJ. As such not only the efforts required but even the risk borne is completely different. The risks being of a higher level the rewards if the venture succeeds can also move upwards in regard to the trading activity. This fact is demonstrated from assessee's own record of the two years under consideration whereas in the first year it is 1.81%, in the other it is 13.29%.

12.27. While holding that the margins of one activity cannot be applied to other activity we consider it necessary to address another aspect of the issue as Ld. CIT DR has specifically relied upon orders of the ITAT for the proposition that the TPO can re-characterize the transaction under the Act. We hold that no doubt that the TPO under the Income Tax Act and the rules there under has the powers to re-characterize the transaction if so warranted on facts, in the facts of the present case, this power has been erroneously exercised. On a detailed consideration of the functions performed by the assessee in the two separate class of activities and, considering the assets utilized by the assessee in the two ventures and on a consideration of the risks to which the assessee is exposed to in the two activities as discussed above we are of the considered that on facts re-characterization was not called for and further the margin earned in one cannot be blindly applied to the other activity in the facts of the present case.

12.28. Thus in view of the above the answer posed in (b) which was to be answered only if (a) was in the affirmative, has still been decided as parties had addressed and the facts were available on record, is also necessarily answered in the negative.

12.29. The query posed in (c) calls upon us to decide whether as per Rule 10B(1)(e)(i), the TPO, in the facts of the present case, was justified in holding that net profits margins should

be computed in relation to FOB value of goods/ or the operating cost to the assessee. The said query was also to be addressed only if the answer posed to us in the said question was in the affirmative. Herein also it is seen that although the answer is in the negative but, since the parties have addressed and the facts are available on record we propose to deal with the said question also.

12.30. Rule 10 B (1) (c) (i) reads as under:-

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 :

(a) ** ** **

(b) ** ** **

(c) ** ** **

(d) ** ** **

(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;

** ** **

12.31. In the facts of the present case which have been discussed at length while considering the action of the TPO in re-characterizing the transactions, we are of the view that on the basis of the detailed FAR analysis of the assesses, the "costs" referred to in Rule 10 B (1)(e)(i) does not suggest that in the facts of a case like the present case the 'costs' would mean the FOB value of goods. The assessee demonstrably is a low risk entity as a service provider functioning as a facilitator who is not exposed to price risk, warranty risk, inventory risk, etc., whose funds are not locked in the cost of goods, title in goods never vests with the assessee contracts are entered in the name of SCJ and its affiliates at one end and the customers in India also in their own names. In these unrebutted facts on record, the TPO was not correct in holding that the 'costs' as per the Rule were FOB value of goods. As such (c) is also decided accordingly.

12.32. Arguments on the creation of and contributing to the human intangibles and supply chain intangibles have been addressed as such we propose to addresses these also at this stage. Since we are of the view that issues in transfer pricing are very fact specific and conclusion necessarily are fact driven as such it may be pertinent to add that while deliberating on facts we have also taken into consideration the orders relied upon by the parties, specifically the department, while deciding the issue in assessee's favour. However in

order to maintain coherence and lucidity in our findings which are fact driven, we propose to discuss the judgements subsequently. For the present purposes on consideration of the functions performed by the assessee, the assets deployed using the intangibles of SCJ networks, the risks to which the assessee is consequently exposed we are unable to concur with the conclusion of the TPO that the assessee has created human assets and supply chain intangibles. The unrebutted fact on record is that the assessee has been able to render services utilizing the network of the AE and all intangibles and patents etc. utilized internally belong to the AE and the level and degree of the qualification required of the personnel of the assessee is low and skill requirement is so low that no specific skills are required by the personnel who replace the existing personnel who may choose to move on for better options. The assessee does not need to and cannot restrain the leaving personnel from utilizing any skills which they may have acquired during employment as no specific skills for indenting are required for indenting and acting as a facilitator. It is not the case of the department that the assessee is performing critical functions which admittedly are performed by the AE or that the assessee is contributing by way of analysis, reports and opinions, being provided as such value added services are being performed wherein the analysis/opinions may turn out to the correct or grossly wrong as such due to the high risks of both eventualities occurring the personnel are necessarily highly qualified sought after

experts, commanding high salaries. The simple performance of a low risk activity of facilitator does not lead to the conclusion that a human intangible is being created. It is seen that there is no material on record as to how supply chain intangibles are being created as the assessee is using the network and intangibles of its AE.

12.33 Coming to the final question (d), which we have posed to ourselves since the answer to question (a) is in the negative the question regarding justification on facts in applying margins earned in trading activity to the profits of indenting activity for working out the Arms Length Price requires to be considered. For the said purpose we are of the view that elaborate discussions are not necessary as it would necessitate re-iterating the distinctions in the two separate sets of activities and the conclusions on the detailed FAR analysis already done in the earlier paras especially while considering queries (a) and (b). Accordingly relying on the same we hold that there is no justification to apply the margins of trading activity to indenting activity in the facts of the present case.

12.34. We further support the view taken, by referring to 2006-07 assessment year wherein the Revenue has accepted the method applied and only on comparables there have been a dispute. Similarly in 2008-09 assessment year, that is the immediately subsequent assessment after the two years under consideration, same method has been followed by the

assessee. According to the Ld. CIT DR the method has not been accepted though adjustments have not been made as the margins in the trading activity vis-à-vis the indenting activity, declined. The Ld. CIT D.R has been at pains to emphasize that no doubt no adjustment was made in the TP proceedings for 2009-10 assessment year but no deviation has been made from the stand taken by the department in the TP proceedings.

12.35. Accordingly on facts for the detailed reasoning given hereinabove on the issues addressed before us we are of the view that the TPO's action upheld by the DRP cannot be upheld by us."

The issue is also covered by the judgment of the Mitsubishi Corporation India (P) Ltd. vs. DCIT (Supra) where the coordinate bench has held as under:-

"35. In the cases in which no economic risk for inventories is assumed, in which these inventories do not even find their way to the current assets, and in which no functions are performed in respect of these inventories, except to facilitate trading in respect of the same, the very raison d'être for the cost of inventories being included in the cost base ceases to exist. The FAR analysis set out in the TPO's order, which is summarized in paragraph 7 earlier in this order, does not support the inclusion of inventory costs in the cost base either.

57. In our considered view, to sum up, in a situation in which a business entity does not assume any significant inventory

risk or perform any functions on the goods traded or add any value to the same, by use of unique intangibles or otherwise, the right profit level indicator should be operating profit to operating expenses i.e. berry ratio. In such a situation, no other costs are relevant since (a) the cost of goods sold, in effect, is loses its practical significance, (ii) there is no value addition, and, accordingly, there are processing costs involved, and (iii) there is no unique intangible for which the business entity is to be compensated.

65. As for the objection that use of berry ratio is not permitted under rule 10B(1)(e)(i) as it does not deal with costs incurred, sales effected or assets employed or to be employed, it proceeds on the fallacy that the basis of computation, as set out in rule 10B(1)(e)(i), is exhaustive whereas it is only illustrative and it ends with the expression "or having regard to any other relevant base". Just because a cost base is not of costs incurred, sales effected or assets employed, such a base does not cease to permissible under rule 10B(1)(e)(i) unless such a base can be held to be irrelevant. In view of the elaborate discussions earlier, justifying exclusion of inventory costs, the cost of base of the operating expenses is relevant. When cost of inventory is excluded from the cost base, for all practical purposes, cost bases consists only of the operational costs. In our considered in a situation in which trading is on back to back basis without anything actually going to the current assets and flash title of goods is held only momentarily, it could

indeed actually be a relevant base as to what are the operating costs or value added expenses - particularly when, as we have noted above, no resources are used in the inventories.

80. Coming to the service fee/commission segment, we have noted that as regards the service fee/commission segment, the TPO has re-characterized the same as trading activities as he was of the view that the right course of action will be to treat the same as equivalent to trading segment, because what the assessee has disclosed as service/commission income is infact trading income. Accordingly, the cost of goods sold by the AEs, which was □ 2927,92,05,406, was also to be included in cost base of the service/commission segment and then ALP was recomputed. So far as this aspect of the matter is concerned, the issue is now covered in favour of the assessee by Hon'ble jurisdictional High Court's decision in the case of Li & Fung wherein Their Lordships have, inter alia, observed as follows:

…….This Court is of opinion that to apply the TNMM, the assessee's net profit margin realized from international transactions had to be calculated only with reference to cost incurred by it, and not by any other entity, either third party vendors or the AE. Textually, and within the bounds of the text must the AO/TPO operate, Rule 10B(1)(e) 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 TNMM. 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 ..." (emphasis supplied). It thus contemplates a determination of ALP with reference to the relevant factors (cost, assets, sales etc.) of the enterprise in question, i.e. the assessee, as opposed to the AE or any third party. The textual mandate, thus, is unambiguously clear.

40. The TPO's reasoning to enhance the assessee's cost base by considering the cost of manufacture and export of finished goods, i.e., ready-made garments by the third party venders (which cost is certainly not the cost incurred by the assessee), is nowhere supported by the TNMM under Rule 10B(1)(e) of the Rules. Having determined that (TNMM) to be the most appropriate method, the only rules and norms prescribed in that regard could have been applied to determine whether the exercise indicated by the assessee yielded an ALP.

81. Clearly, therefore, it is impermissible to make notional additions in the cost base and thus take into account the costs which are not borne by the assessee. It is so opined by Hon'ble jurisdictional High Court on a careful analysis of rule 10B(1)(e)(i). It is, therefore, no longer open to the revenue authorities to reconstruct the financial statements of the assessee by including the cost of products incurred by the

> *AEs, in respect of which services are rendered, in its reconstructed financial statements, and then putting the hypothetical trading profits, so arrived at in these reconstructed financial statements, to the tests for determining arms' length price. Respectfully following the esteemed views of Their Lordships, we hold that the adjustments carried out in the cost base of ALP computation, in respect of service fee/commission segment, are indeed devoid of legally sustainable merits. We direct the Assessing Officer to delete these adjustments."*

31. Respectfully following the above judgment of the coordinate benches we are of the view that the adjustment made to arm's length price as upheld by the DRP cannot be sustained.

32. We are of the further view that the adjustment as confirmed by the DRP is otherwise untenable in view of the proviso to section 92C of the Act. The TPO has included the cost of sales of the AEs while making adjustment to the arm's length price. The cost base as determined by the learned TPO in the assessment year 2007-08 is Rs.4558,90,44,859. The adjustment proposed after order from the DRP is Rs.116,70,79,548. This amount is within 5% of the cost base of Rs. 5589044859/- determined by the learned TPO himself. The cost base as determined by the TPO in the assessment year 2008-09 is Rs.4071,95,89,546. The adjustment proposed

after order from the DRP is Rs.114,82,92,425. This amount is also within 5% of the cost base determined by the TPO himself. Accordingly, no adjustment could have been made in view of the proviso to section 92C of the Act. The TPO is not right in including the cost of sales while determining arm's length price and not considering the same while applying proviso to section 92C of the Act. The language of the proviso to Section 92C as it was applicable for the assessment year under consideration is very clear and unambiguous. According to provision of section 92C first arm's length price has to be determined. Thereafter the same has to be compared with the price charged by the assessee and if the difference between the price determined by TPO and the price charged by the assessee is within ±5% then no adjustment is required to be made.

33. Further the contention of the learned CIT(DR) that the proviso to section 92C is applicable only when two different methods are adopted is also not correct. The language of the proviso in this regard is quite clear. First the most appropriate method has to be determined. Based on that arm's length price is to be found out by using various comparables. When more than one comparable is applied then arithmetical mean is to be worked out and no adjustment is to be made when arm's length price is

determined on the basis of such arithmetical mean is within 5% of the cost paid or charged by the assessee.

34. In the present case the most appropriate method applied by the learned TPO is TNMM. The arm's length price has been determined using more than one comparable as is evident from the TPO's order for both the assessment years. This arithmetical mean has been taken into consideration for determination of the arm's length price by the TPO as is evident from the TPO order and accordingly the proviso to section 92C will be applicable to the present case. Since in the present case such difference is less than 5% and hence no adjustment can be made.

35. Accordingly under the facts and the reason discussed hereinabove and respectfully following the order of the co-ordinate bench on an identical issue under almost similar facts, we are of the view that adjustment made by the Assessing Officer in the assessment order cannot be sustained and the same are directed to be deleted. Accordingly, Ground no.1 to 4 of both the assessment years i.e. 2007-08 and 2008-09 are allowed.

36. In view of our above finding on ground nos. 1 to 4, ground nos. 5 to 7 of both the assessment years need no adjudication and accordingly the same are dismissed as having been infructuous.

36. In result, the appeals are allowed.

Decision pronounced in the open court on 20.08.2015

Sd/-	Sd/-
(T.S. KAPOOR)	(I.C. SUDHIR)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Dated: 20/08/2015
Mohan Lal

Copy forwarded to:

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

ASSISTANT REGISTRAR

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