

[2022] 141 taxmann.com 373 (Mumbai - Trib.) [22-07-2022]

TRANSFER PRICING : For benchmarking of international transaction of trading activities where assessee imported finished goods and sold it to third party without undertaking any value addition, resale price method should be adopted as most appropriate method



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IN THE ITAT MUMBAI BENCH 'J'

Torrecid India (P.) Ltd.

v.

ACIT*

**PRASHANT MAHARISHI, ACCOUNTANT MEMBER
AND MS. KAVITHA RAJAGOPAL, JUDICIAL MEMBER**

IT APPEAL NO. 7076 (MUM) OF 2017

[ASSESSMENT YEAR 2013-14]

JULY 22, 2022

Section 92C of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price (Methods for determination of - Resale price method) - Assessment year 2013-14 - Whether for benchmarking of international transaction of trading activities where assessee imported finished goods and sold it to third party without undertaking any value addition, resale price method should be adopted as most appropriate method - Held, yes [Para 17] [In favour of assessee]

CASE REVIEW

ITO v. L'Oreal India (P.) Ltd. [2012] 24 taxmann.com 192/53 SOT 263 (Mum.) (URO) (para 17) followed.

CASES REFERRED TO

ITO v. L'Oreal India (P.) Ltd. [2012] 24 taxmann.com 192/53 SOT 263 (Mum.) (URO) (para 10).

Sunil M. Lala, AR for the Appellant. Ms. Neelu Jaggi, DR for the Respondent.

ORDER

Prashant Maharishi, Accountant Member. - This appeal is filed by Torrecid India Private Limited (the Appellant/Assessee) against the Assessment order passed by the learned Assistant Commissioner of Income Tax, 11(3) (1), Mumbai (the learned Assessing Officer) u/s 143(3) read with section 144C of the Income-tax Act, 1961 (the Act) dated 30th October, 2017, in pursuance of the direction issued by the Dispute Resolution Panel -2, Mumbai [The Ld DRP].

2. By this order, the return filed by the assessee on 27th November, 2013 at a loss of Rs. 5,08,81,923/- is assessed at a loss of Rs. 2,09,75,382/- by making a transfer pricing adjustment of Rs. 2,99,06,541/-.

3. Assessee has preferred this appeal raising following grounds of appeal :-

"Based on the facts and circumstances of the case, and in law, Torrecid India Private Limited (hereinafter referred to as 'the Appellant') respectfully craves leave to prefer an appeal against the order passed by learned Assessing Officer (ld. AO)/learned Transfer Pricing Officer ("ld. TPO (dated 13 October 2017 received on 16 October 2017) in pursuance to the directions issued by Hon'ble Dispute Resolution Panel ("DRP") (dated 23 August 2017) under section 143(3) read with Section 144C(13) of the Income-tax Act, 1961 (the Act) on the following grounds :

1. Transfer Pricing Adjustment: INR 29,906,541

On the facts and in the circumstances of the case and in law, the learned AO erred in making an addition of Rs. 29,906,541/- to the appellant's total income by virtue of re computation of arm's length price of the international transaction under section 92 of the Act.

2. Rejection of methodical Transfer Pricing analysis and selection of Most Appropriate Method for Benchmarking Analysis

On the facts and in the circumstances of the case and in law, the ld. AO/ld. TPO erred in and the Hon'ble DRP further erred in upholding/confirming the action of the ld. AO/ld. TPO in rejecting the Resale Price Method (RPM) considered by the Appellant and selecting the Transactional Net Margin Method ("TNMM") method, as the most appropriate method for benchmarking the international transaction of import of finished goods for distribution without providing any cogent reasons for the rejection of RPM.

3. Without prejudice erred in not appreciating the economic adjustment made due to devaluation of currency

On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in not appreciating the economic adjustment made due to devaluation of Indian currency *vis-à-vis* foreign currency as appellant majorly imports its finished goods from associated enterprises in foreign currency.

4. Without prejudice erred in not appreciating the business reasons for losses

On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in not granting the benefit of commercial expediency for incurring business losses as the same are

incurred on account of commercial factors which are beyond the appellant's control.

5. Erred in initiating penalty proceedings On the facts and in circumstances of the case and in law, the Ld. AO erred in initiating penalty proceedings under section 271(1)(c) of the Act, in his assessment order, for concealment of income or furnishing of inaccurate particulars on part of the appellant. The appellant contends that the adjustment was merely on account of difference of opinion, besides, the appellant has neither defaulted in complying with the procedural requirements nor understated the income fraudulently.

The above grounds of appeal are mutually exclusive & without prejudice to each other.

The appellant prays for appropriate relief based on the said grounds of appeal and the facts and circumstances of the case.

The appellant craves leave to add, amend, alter and/or rescind any of the above grounds of appeal and to submit such statements, documents and papers as may be considered necessary at the time of or before the hearing of this appeal as per law."

4. Brief fact of the case shows that assessee is a subsidiary of a foreign company engaged in manufacturing products for ceramic industries. Holding company is engaged in the business of ceramic frits, glazes, colour, and ceramic liquid colour.

5. Assessee filed its return of income on 27th November, 2013 at a loss of Rs. 5,08,81,923/-. During the course of assessment proceedings, the learned Assessing Officer noted that assessee has entered into certain international transactions and therefore, reference was made to the Dy. Commissioner of Income-tax transfer pricing, 4(2)(2), Mumbai, [The Id TPO] to determine Arm's Length Price of the international transaction.

6. Assessee benchmarked the international transaction of

- a. Import of finished goods adopting the resale price method taking the profit level indicator of gross profit/sales where margin of the assessee was 15.35%, margin of the third parties was 14.60%, and therefore the import of finished goods transaction was stated to be at arm's-length.
- b. With respect to the transaction of import of from material from clichés SA Mexico AE, assessee adopted CUP method taking the foreign AE as a tested party compared with the prices charged by the comparable companies and stated that the prices charged to the assessee is less than the price charged by them to the comparable companies and therefore same is at arm's-length.
- c. With respect to the transaction of import of raw material from Toreecid SA, Al fabren SA, Torrecid Suzhou, assessee adopted the foreign AES tested party adopted profit level indicator of operating profit/total cost and found that tested party results are less than the result of comparable companies and concluded that the international transactions are at arm's-length.

7. The learned Transfer Pricing Officer examined and found that assessee has not produced the

audited accounts of the tested party therefore, PLI determined by assessee is not verified, and hence, benchmarking by the assessee was rejected. The learned transfer pricing officer combined the transactions of import of raw material as well as the import of finished goods and took assessee as a tested party computed margin of the assessee at (-) 8.26%, took 8 different comparables whose average margin was 14.60% and issued show cause notice for the adjustment.

8. Assessee filed reply to that which was not found acceptable. However, the objection to the margin with respect to the comparables was accepted and OP/sales margin of the comparables was scaled down from 14.60% to 3.07%. Accordingly, on the total purchases from Associated Enterprises of Rs. 43,86,47,813/-, Arms Length Price was computed at Rs. 39,27,40,921/- resulting in to an adjustment of Rs. 4,59,06,891/- made by order under section 92CA (3) of the Act on 14th October, 2016.

9. Consequently, a draft assessment order was passed on 25 November 2016 against which assessee filed objections before the learned Dispute Resolution Panel.

10. The learned Dispute Resolution Panel considered the objection no. 2 of the assessee, it accepted that the assessee is engaged in trading as well as manufacturing activities noting that assessee has an individual manufacturer and also engaged in trading activity for procurement of finished goods from Associated Enterprises and sale to local customers. Thus, assessee is engaged in separate business activity, which cannot be clubbed for the benchmarking of international transaction. The learned Dispute Resolution Panel also looked into the fact that trading and manufacturing activities have been separately segmented and the gross profit can be arrived at. Further, the overheads can be allocated appropriately and therefore, it cannot be said that assessee is not maintaining any segmented accounts. The learned Dispute Resolution Panel further held that assessee has also allocated overhead in the ratio of Revenue realization and therefore, they directed the Transfer Pricing Officer to compute the net profit and profit level indicator of the trading activity only. With respect to the selection of foreign Associated Enterprises as the tested party by the assessee, the Dispute Resolution Panel held that the Transfer Pricing Officer is right in rejecting foreign Associated Enterprises as tested party. For selection of TNMM as the most appropriate method by the TPO, where assessee has selected resale price method as the most appropriate method, for import of traded goods, assessee relied on the decision of the Hon'ble Bombay High Court, wherein adoption of resale price method with respect to distribution activities was upheld. The learned Dispute Resolution Panel rejected the same. The reasons given by the learned Departmental Representative is that assessee is in two different segments *i.e.* trading as well as manufacturing. Assessee imports the furnished goods as well as raw materials from Associated Enterprises. Segmented financials are also available to the gross profit level and therefore, the Transitional Net Margin Method (TNMM) adopted by the Transfer Pricing Officer is the appropriate method. It rejected the reliance on the decision of Hon'ble Bombay High Court stating that in case of *ITO v. L'Oreal India (P.) Ltd.* [2012] 24 taxmann.com 192/53 SOT 263 (Mum.) (URO), it was having only trading business. Accordingly, it rejected the contention of the assessee that resale price method for benchmarking of transaction for import of goods for resale in Indian market is the most appropriate method. Accordingly, they upheld the adoption of TNMM method by the Transfer Pricing Officer. After considering the other objections, the directions were passed on 23 August 2017, which culminated, into an assessment order.

11. As per the direction of the Dispute Resolution Panel, the original adjustment to the Arms Length Price import of furnished goods was determined at Rs. 2,99,06,541/-. The assessment order determined the total loss at Rs. 2,09,75,382/-.

12. The learned Authorized Representative submitted that objection no. 3 decided by the learned Dispute Resolution Panel is the solitary ground of appeal no. 2, which is contested. This ground is the grievance of the assessee that learned Assessing Officer applied TNMM method instead of resale price method adopted by the assessee for import of finished goods. He submitted that assessee has categorically argued before the learned dispute resolution panel that on identical facts and circumstances in case of *L'Oreal India (P.) Ltd. (supra)* with respect to distribution and marketing activities resale price method is held to be the most appropriate method. He submitted that there is no difference in the facts of that case as well as the case of the assessee. He referred to the direction of the learned Dispute Resolution Panel at paragraph no. 7.2.5 as well as at 7.3.1. He specifically stated that the learned Dispute Resolution Panel rejected the reliance on the above decision stating that *L'Oreal India (P.) Ltd. (supra)* was having only trading business, whereas, the assessee is having trading and manufacturing activities. He submitted that assessee [L'Oreal] was also engaged in manufacturing and trading in cosmetics. For this proposition, he referred to the decision of the co-ordinate Bench in case of *L'Oreal India (P.) Ltd. (supra)*, which travelled before the Hon'ble High Court. Therefore, he submitted that the decision of the *L'Oreal India (P.) Ltd. (supra)* was also with respect to an assessee carrying on trading and manufacturing in cosmetics. He therefore submitted that this issue is clearly covered in favour of the assessee by the decision of Hon'ble Mumbai High Court. He therefore stated that resale price method adopted by the assessee is the right method and hence, adjustment of Rs. 2,99,00,000/- made by the learned Assessing Officer deserves to be deleted on this reason only.

13. The learned Departmental Representative supported the orders of the lower authorities.

14. We have carefully considered the rival contentions and perused the orders of the lower authorities and direction of the learned dispute resolution panel. Facts at the cost of the reiteration are stated that assessee is subsidiary of a foreign company engaged in the manufacture of products for the ceramics and glass industry. Company purchases the finished goods for distribution in India. It also imports raw material, which is used in the manufacturing activity. The international transaction shown by the assessee as under :—

Serial number	Nature of transaction	Value of the transaction	Most appropriate method selected by assessee
1	Import of raw materials from Torrecid SA, Al farben SA and Torrecid Suzhou	14,02,80,914	Transactional net margin Method taking foreign associated enterprises as tested parties
2	Import of raw materials from Chilches materials SA Torrecid Maxico	74,07,971	CUP
3	Import of finished goods from Torrecid SA and Digital Services	29,09,58,928	Resale price method taking assessee as a tested party

15. Now there is no dispute with respect to the benchmarking of transaction stated at serial number 1 and 2 of the above table.

16. Only issue that remains for our adjudication is whether the transactions listed at serial number 3 being import of finished goods from associated enterprises amounting to Rs. 290,958,928/- benchmarked by the assessee adopting the resale price method where the profit level indicator is determined of gross profit ratio and the gross profit ratio of assessee was found to be at 15.35% whereas of the other comparable companies was 14.64% which is stated to be at arm's-length by the assessee, is proper or not.

17. The assessee submitted before the lower authorities that assessee does not undertake any value addition to the goods imported from its associated enterprises and sold them to the independent third parties. Despite these facts, the learned transfer-pricing officer selected transactional net margin method without providing any cogent reasons for changing the method adopted by the assessee. Assessee is aggrieved since the learned transfer-pricing officer did not provide the assessee of an opportunity of being heard on this aspect. The claim of the assessee is that the honourable Bombay High Court affirmed a decision of the coordinate bench accepting the taxpayer's use of the resale price method is the most appropriate method with respect to its distribution activity in case of *L'Oreal India (P.) Ltd. (supra)*. The learned dispute resolution panel agreed that assessee is engaged in two different segments of business (1) trading of finished goods importing the same from the associated enterprises and (2) manufacturing of certain products in India for which it imports raw material from associated enterprises. The learned DRP also confirmed that assessee is maintaining segmental financial results of up to level of gross profit. It also recorded a fact that assessee is not in the business of trading only but also in the business of manufacturing. However it held that it cannot be said that assessee is only engaged in business of resale of finished products imported from the associated enterprises, as it is also engaged in manufacturing activities, therefore learned that DRP upheld the action of the learned TPO in rejecting the resale price method adopted by the assessee and transactional net margin method adopted by the TPO for benchmarking of trading segment as well as manufacturing segment of the assessee was upheld. It also rejected the reliance on the decision of the honourable Bombay High Court stating that assessee was only having trading business in that decision whereas in the issue before them, in the present assessee's case it is engaged in trading as well as manufacturing activity. We find that when the learned dispute resolution panel has concluded that assessee is engaged in two different segments (1) trading, (2) manufacturing segment. The details with respect to the gross profit level are available as depicted from the segmental accounts produced. Therefore, when it is claimed undisputedly by the assessee that with respect to the trading of goods, assessee does not undertake any value addition, we failed to understand the reasoning given by the learned dispute resolution panel in rejecting the resale price method as most appropriate method and upholding transactional net margin method. According to rule 10B(1) (b) resale price methods is the method where the normal gross profit margin earned by a tested party is required to be compared with comparable uncontrolled transactions. When undeniably assessee is selling the goods imported from associated enterprises to the third parties, the resale price

method is the most appropriate method, where the segmental results to the gross profit level are available. Direction of the learned dispute resolution panel in rejecting reliance on the decision of the honourable Bombay High Court in case of *L'Oreal India (P.) Ltd. (supra)* is also not proper. The finding of the learned dispute resolution panel that in that case that assessee was engaged only in trading activities is clearly an incorrect fact recorded by the learned dispute resolution panel, which can be gathered from the coordinate bench decision *L'Oreal India (P.) Ltd. (supra)*, which was challenged by the revenue before the honourable Bombay High Court. Thus, in that case honourable Bombay High Court in case of an assessee who was engaged in the business of manufacturing and trading in cosmetics held that for the trading activities in cosmetic segment, adoption of the resale price method by the assessee was upheld. In view of this, we do not have any hesitation in accepting submission of the assessee that for benchmarking of the international transaction of trading activities where assessee imports finished goods and sold it to third party without undertaking any value addition, resale price method should be adopted as most appropriate method. The submission of the assessee is also supported by the order of the honourable jurisdictional High Court. As we already noted that the margin shown by the assessee of gross profit is 15.35% compared to the comparable companies of 14.60%, we direct the learned transfer pricing officer/AO to delete the consequent adjustment of Rs. 2,99,06,541/-Accordingly we reverse the order of the learned lower authorities and allow ground number 2 of the appeal.

18. In view of our above decision with respect to ground number 1 is general in nature and ground number 3 - 5 are only consequential in nature and hence dismissed.

19. In the result, appeal of the assessee is allowed.

POOJA

*In favour of assessee.