

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I-2': NEW DELHI**

**BEFORE SHRI J. SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND
SHRI AMIT SHUKLA, JUDICIAL MEMBER**

**ITA No.6401/Del/2012
Assessment Year : 2008-09**

**Assistant Commissioner
of Income Tax,
Circle-5(1),
New Delhi.**

(Appellant)

**Vs. M/s Kobelco Construction
Equipment India Limited,
C-20, South Extension,
Part-II,
New Delhi – 110 049.
PAN : AACCK9469N.**

(Respondent)

Appellant by : Shri T.M. Shivakumar, CIT-DR.

Respondent by : Shri Tarandeep Singh, Advocate.

Date of hearing : **22.03.2017**

Date of pronouncement : **17.04.2017**

ORDER

PER AMIT SHUKLA, JM :-

The aforesaid appeal has been filed by the Revenue against impugned order dated 15th October, 2012, passed by learned CIT(Appeals)-XX, New Delhi, for the quantum of assessment passed u/s 143(3) of the Income-tax Act, 1961, for the assessment year 2008-09.

2. In the grounds of appeal, the Revenue has raised following grounds :-

“1. Whether on the facts and in the circumstances of the case, the learned CIT(A) erred in deleting the adjustment of Rs.7,33,66,467/- in arms length price as proposed by the TPO.

2. Whether on the facts and in the circumstances of the case, the learned CIT(A) erred in accepting TNMM as the most appropriate method for benchmarking the international transaction.

3. Whether on the facts and in the circumstances of the case, the learned CIT(A) erred in accepting RPM the most appropriate method with GP/Sales as PLI instead of TNMM as done by TPO despite the fact that proper adjustments required for the application of the method were not carried out by the assessee.

4. Whether on the facts and in the circumstances of the case, the learned CIT(A) erred in rejecting the comparable T&I Global as product similarity is not very vital in TNMM and functions are more important.

5. Whether on the facts and in the circumstances of the case, the learned CIT(A) has erred in admitting the additional evidence when assessee could not give any sufficient cause as to why he could not furnished that evidence during the proceeding before TPO in violation of Rule 46A of the Income Tax Rules.

6. Whether on the facts and in the circumstances of the case, the learned CIT(A) erred in giving decision on the applicability of CUP when there are geographical differences.”

3. The brief facts qua the issue of transfer pricing adjustment are that the assessee company is engaged in the distribution of heavy machines like earthmoving equipment, hydraulic excavators manufactured by its Associated Enterprises (AE), ‘Kobelco Construction Machinery Company Limited’, Japan. Its prime

activities include sale of machines; spare part stock; and sales and service of Kobelco hydraulic excavators. The functional analysis carried out by the assessee as reported in TP study report can be summarised in the following manner :-

(i) Trading: -

(a)Purchase activities: whereby the assessee purchased products within group companies;

(b)Distribution: the assessee company maintains dealership networks, warehouses for the finished goods and performs inventory control functions;

(c)Sales : sale of finished goods directly to the customers at high sea sales and in some cases, finished goods are sold through dealers. Spare parts are primarily sold through dealers to the customers; and

(d)The entire inventory management is the responsibility of the assessee.

(ii) Marketing and administrative activities : The entire marketing strategy, advertisement etc. for sale of goods are done by the assessee.

(iii) Post sales activities are done by the assessee but cost is being reimbursed by the AE.

(iv) Assets : The manufacturing and R&D is done by the AE and assessee, being a normal distributor, does not have any tangible or intangible assets.

(v) Risk analysis : The market risk is borne by the assessee. So far as the high sea sales are concerned and with respect to Indian operations, the normal market risk is also on the assessee. The warranty/product liability risk is only for a limited period and that too is reimbursed by the AE. Customer credit risk is also borne by the assessee and also the foreign exchange risk. All other risk compliance is borne by the assessee. In other words, the risks undertaken by the assessee are the normal distribution risks which are taken by a full-fledged distributor.

4. During the year, the assessee had undertaken the following international transactions with its AE :-

Nature of transaction	Value in INR	MAM
Purchase of finished goods	70,78,75,417	RPM
Purchase of spare parts	4,62,82,136	RPM
Purchase of hydraulic excavators (in the nature of fixed assets)	22,25,324	CUP
Reimbursement of expenses	48,502	CUP
Recovery of expenses	1,50,68,075	CUP

In the transfer pricing study report, the assessee has chosen “Resale Price Method” (RPM) as the “Most Appropriate Method” (MAM) and PLI was taken as gross profit/operating income. The assessee had shown gross margin of 14.86% and to benchmark the said margin, the assessee had identified seven comparable companies for comparative analysis and the average GP margin of the comparables was arrived at 16.78% based on multiple year data. Since the gross margin by the assessee vis-a-vis the

comparables was within arm's length range of plus/minus 5%, hence, it was reported that its international transactions are at arm's length price.

5. The learned TPO, however, rejected the selection of RPM as MAM and instead held that TNMM should be adopted as MAM. While rejecting the assessee's method, he tried to explain the concept of RPM in his order from pages 12 to 15 of the order. However, the entire discussion by the TPO is mere reproduction of OECD guidelines wherein he has highlighted the strengths and weaknesses of the RPM method. He has not analyzed the FAR analysis of the assessee and the overall business model under which assessee operates. At page 13 of his order, he also made reference that the assessee is maintaining very high inventory which is almost 6.25% of the purchases. However, this observation is sans any data from the comparables as to whether 6.25% inventory is very high or not. In his order he has also gone off-track by noting that assessee is a seller of jewellery and luxury watches. This merely refers to his callousness. The TPO has further observe that the comparables selected by the assessee were having different product profile and therefore, RPM could not be selected as correct method in such case. While adopting TNMM, the learned TPO has taken three comparables of the assessee (out of seven selected by the assessee), viz., i) Cuprum Bagrodia Ltd.; ii) Gmmco Limited; and iii) India Tech Limited. Apart from that, he also took two fresh comparables viz., TIL Limited; and T & I Global Limited. After discussing the issue in detail, he held that, *firstly*, RPM is not the most appropriate method in the case of the assessee; *secondly*,

TNMM should be adopted as MAM for benchmarking net profit margin of the assessee; and *lastly*, made an adjustment of Rs. 7,33,66,467/- by taking the average margin of the comparables at 6.56% and calculated the arm's length price in the following manner :-

Calculation of arm's length price

Total sales	(A)	91,22,16,382
Total cost	(B)	92,57,41,454
Operating profit of the tested party	(C=A-B)	(-)1,35,25,072
Arm's length mean margin (OP/Sales) %	(D)	6.56%
Arm's length operating profit	(E=D*A)	5,98,41,395
Difference	F=(E-C)	7,33,66,467
Total purchases of finished goods made from AE (as per Form 3CEB)	G	70,78,75,417
ALP of above purchases	(G-F)	63,45,08,950
% of adjustment w.r.t. total purchases	(F/G)	10.36%

6. Before the learned CIT(A), apart from contesting that the RPM should be the most appropriate method, additional evidence was submitted by the assessee by way of secondary analysis by giving CUP data which was in the form of invoices of the AE for sale of hydraulic excavators to the independent parties during the same financial year. It was pointed out that the assessee has sold five models in India and same models were also sold to third parties by the AE. This information was already submitted before the TPO in the course of transfer pricing proceedings. Assessee's detail submission on the issue and rebuttal of TPO's order has been elaborately incorporated by the Ld. CIT(A).

7. The learned CIT(A), after considering the entire submissions and material placed on record, observed that assessee is clearly a full-fledged distributor of earth moving equipments and some of the observations of the TPO are incorrect when he says that assessee is a seller of jewellery and luxury watches. This shows that the TPO has not applied his mind and rejection of RPM is not based on sound analysis of FAR. The TPO has not brought any evidence to show that the assessee is performing additional function other than the distribution activities. The advantages or disadvantages of the methods given in OECD cannot be the basis unless it is analyzed on facts. After holding that single year data should be used and also analyzing the comparables of the assessee as well as the TPO, he held that RPM was the correct method on the facts of the assessee's case and out of the two comparables selected by the TPO, he included one comparable viz., TIL Limited. The final set of comparables taken by the learned CIT(A) is as under :-

S.No.	Name of Comparable Companies	GP/Sales (%) 2007-08
1.	Cuprum Bagrodia Limited	28.41
2.	Gmmco Limited	18.26
3.	India Techs Limited	5.76
4.	TIL Limited	16.50
	Arithmetic mean	17.23

Since the said margin was within the tolerance range of plus/minus 5%, hence the Ld. CIT(A) held that no TP adjustment

should be made. He further held that the assessee was also able to justify its arm's length price of the international transaction by of secondary analysis by way of CUP method.

8. Before us, the learned counsel submitted after explaining the facts submitted that even as per the OECD guidelines, RPM has been reckoned as one of the standard methods for distribution and marketing activities where the goods are purchased from the AE and sold to unrelated parties without any value additions. In support, he had relied upon the following two decisions :-

- (i) L'oreal India (P) Ltd. – 53 SOT 263 (Mum)(URO) – this decision has also been approved by Hon'ble Bombay High Court in 228 Taxman 360 (Bom).
- (ii) Luxottica India Eyewear Pvt. Ltd. – 2014-TII-236-Del-TP – Hon'ble Delhi High Court has upheld this decision in 2015-TII-50-HC-Del-TP.

After referring to the FAR analysis, he submitted that the entire functions are that of a normal distributor with normal distribution risk and therefore, under such situation, the most appropriate method should be RPM wherein the distribution activities are best suited to be analyzed under RPM. So far as the TPO's observation that RPM cannot be accepted because the comparables did not have similar product profile, he submitted that under the RPM, similar product is not very essential but similar FAR is an important factor. In the case of the assessee, the comparables given were those of the distributors of computer parts/peripherals and also distributors of equipment which is akin to the assessee. He

thus strongly relied upon the observations and findings of the learned CIT(A).

9. On the other hand, learned CIT-DR submitted that even though the TPO's observations may be general in nature and some of the observations are not correct, but he has analyzed the assessee's FAR and also the fact that product similarity is to be seen to analyze the gross margin under the distribution of various kinds of products. For example, the margin on a similar product would be different than the gross margin in a product like heavy machines like hydraulic excavators etc., which the assessee is selling. He also pointed out that in the case of one of the comparables i.e., Gmmco Limited, this company is also into manufacturing and, from the financial statements which were enclosed in the paper book, he pointed out that if the comparable is into manufacturing, then its gross margin cannot be accepted to be comparable and therefore, by selection of comparables itself, it can be seen that RPM cannot be the MAM in the present case.

10. By way of rejoinder, the learned counsel clarified that in the case of Gmmco Limited, the RPM has been taken for segment of "Caterpillar Dealership Division" which relates to trading of Caterpillar brand of products. The other segment of "Chemical Division" which is engaged in manufacturing has not been used. Not only that TPO has accepted this comparable. Therefore, such contention raised by the learned DR cannot be accepted.

11. We have heard the rival submissions and perused the relevant finding given in the impugned order as well as the material placed on record. It is an admitted fact that the assessee imports finished goods manufactured by its AE, like earthmoving equipment, hydraulic excavators, etc. for resale in India and it undertakes the entire function of a 'distributor'. It mainly sells finished goods directly to the customers at high sea sales and some of the finished goods are sold through network of dealers. For the sale of spare parts, the assessee imports and then sells them through the network of dealers to the customers. From the FAR analysis as discussed above, it is ostensible that the assessee is performing the function of a normal distributor with normal risk and the goods which have been purchased have been resold without any value addition. This fact is undisputed that there is no value addition by the assessee. As discussed above, the learned TPO has mainly gone on general proposition of the guidelines given in the OECD which mainly highlights the strengths and weaknesses of the RPM method. He has not analyzed the actual facts of the case as well as the FAR analysis vis-a-vis the comparables. Out of the seven comparables, three comparables of the assessee have been accepted by the TPO for analyzing the same under TNMM. The RPM has been prescribed in Rule 10B(1)(b) in the following manner :-

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 :—

(b) resale price method, by which,—

(i) the price at which properly purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

12. Thus, the RPM method identifies the price at which the product purchased from the A.E. is resold to an unrelated party. Such price is reduced by normal gross profit margin, i.e., the gross profit margin accruing in a comparable controlled transaction on resale of same or similar property or services. As per OECD guidelines and also now it is quite settled by various judicial precedence that the RPM is mostly applied in a situation in which the reseller purchases tangible property or obtained services from an A.E. and reseller does not physically alter the tangible goods and services or use any intangible assets to add substantial value

to the property or services i.e., resale is made without any value addition having been made. In the case of **Mattel Toys (I) Pvt.Ltd. reported in (2013) 158 TTJ 461 (Mumbai)**, the Tribunal has analyzed the RPM as enshrined in the aforesaid Rules in the following manner :-

“38. xxxx

Since in RPM only margins are seen with reference to items purchased and sold or earned by an independent enterprise in comparable uncontrolled transactions vis-a-vis the one in the controlled transactions, therefore, in such a situation, the nature of products has not much relevance though their closer comparable may produce a better result. The focus is more on same or similar nature of properties or services rather than similarity of products. In RPM other attributes of comparabilities than the product itself can produce a reliable measure of arm's length conditions. The main reason is that the product differentiation does not materially affect the gross profit margin as it represents gross compensation after the cost of sales for specific function performed. The functional attribute is more important while undertaking the comparability analysis under this method. Thus, in our opinion, under the RPM, products similarity is not a vital aspect for carrying out comparability analysis but operational comparability is to be seen. Since the gross profit margin is the main criteria while evaluating the transactions in the RPM wherein price is identified at which property or services are resold and normal gross profit margin is derived at by the enterprise which is deducted from the resale price of such property or service in comparable uncontrolled transactions. The gross profit margin earned by the independent enterprise is also what happens in the case of a distributor wherein the property and service are purchased from the A.E. and are

resold to other independent entities, without any value additions. The gross profit margin earned in such transactions becomes the determination factor to see the gross compensation after the cost of sales. In the instant case, the assessee is a distributor of Mattel toys and gets the finished goods from its A.E. and resells the same to independent parties without any value addition. In such a situation, RPM can be the best method to evaluate the transactions whether they are at ALP.

39. *Some of the case laws relied upon by the learned Counsel also support our above conclusion that in case of distribution activities i.e., import of products and services from the A.E. and resale to the independent parties without any value addition, the RPM would be the most appropriate method for determining the ALP. This view has been upheld by the Tribunal, Mumbai Bench, in *Textronix India P. Ltd. (supra)*, *L'oreal India P. Ltd. (supra)* and *Star Diamond Group v/s DDIT, 141 TTJ 21*. The OECD guidelines and ICAI guidelines as have been referred to by the learned Counsel have also expressed on the similar line that RPM would be the best method when resale takes place without any value addition to a product for bench marking the ALP.*

40. *On the other hand, under the TNMM, the ALP is determined by comparing the operating profit related to an appropriate base i.e., cost or sale or assets of the "tested party" with the operating profit of an uncontrolled party engaged in comparable transactions. Under the TNMM, net margin or operating profit is compared against with the independent entities against those achieved in related party transactions. Under the TNMM, the major thrust is to derive at the operating profit at the transactional level and to identify the operating expenses of both the tested party as well as the independent parties. This requires a lot of adjustments to derive at*

the actual operating profit. If the ALP of any transaction can be determined by applying any of the direct methods like CUP, RPM, CPM then they should be given the preference and once these traditional methods have been rendered inapplicable then only TNMM should be resorted to. On the facts of the assessee's case, in our opinion, the assessee being a distributor who is purchasing the goods from its A.E. and reselling them to independent parties/unrelated parties, resale price method would be the most appropriate method for determining the ALP of the transactions between the assessee and the A.E."

13. The aforesaid decision clearly clinches the issue that under the RPM, the focus is more on same or similar nature of properties or services rather than similarity of products and functional attribute is a primary factor while undertaking the comparability analysis under RPM. Further, RPM is mostly applied in the case of a distributor where reseller purchases tangible property and obtains services from the AE and without making any value addition, resells the same to third parties. Under these circumstances and looking to the fact that functions performed by the assessee is of distributor only, therefore, RPM should be reckoned as the most appropriate method and accordingly, we agree with the learned CIT(A) that on the facts of the present case, RPM should be the adopted as the most appropriate method for benchmarking assessee's international transactions. So far as the two comparables chosen by the TPO apart from assessee's comparables are concerned, we find that, T & I Global Limited has rightly been rejected by learned CIT(A), because this company was manufacturing machinery, therefore, same cannot be compared

with the assessee which is purely performing the distribution function. Thus, the final list of comparables, i.e., three chosen by the assessee and accepted by the TPO and one as selected by the TPO and upheld by the learned CIT(A), is sustained for comparing the margins under RPM. As a consequence, we hold that the TP adjustment made by the learned TPO has rightly been deleted by Ld CIT(A). Accordingly, the grounds raised by the Revenue are dismissed.

14. As regards the secondary analysis given by the assessee by adopting CUP method to justify the Arm's length price of its international transactions, we are not adjudicating the same as it is purely an academic exercise when RPM has been held to be the most appropriate method and entire TP adjustment stands deleted.

15. In the result, the appeal of the Revenue is dismissed.

Decision pronounced in the open Court on 17.04.2017.

Sd/-

(J. SUDHAKAR REDDY)
ACCOUNTANT MEMBER

Sd/-

(AMIT SHUKLA)
JUDICIAL MEMBER

VK.

Copy forwarded to: -

1. Appellant : **Assistant Commissioner of Income Tax,
Circle-5(1), New Delhi.**
2. Respondent : **M/s Kobelco Construction Equipment India
Limited, C-20, South Extension, Part-II, New
Delhi - 110 049.**
3. CIT
4. CIT(A)
5. DR, ITAT

Assistant Registrar