

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K" MUMBAI**

**BEFORE SHRI SAKTIJIT DAY (JUDICIAL MEMBER) AND
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)**

**ITA No. 2051/MUM/2016
Assessment Year: 2011-12**

Elcome Technologies Private
Limited,
Elcome House, A-06, Infocity,
Sector-34, Gurgaon-122002

Deputy Commissioner of Income
Tax-Range 15(1)(1), Mumbai.

PAN No. AAACE7023Q
Appellant

Respondent

Assessee by : Mr. Dhanesh Bafna /Mr. Arpit Agrawal, AR
Revenue by : Mr. Anand Mohan/Mr. Michael Jerald, DR

Last Date of Hearing : 23/06/2020
Date of Pronouncement : 09/09/2020

ORDER

PER N.K. PRADHAN, A.M.

This is an appeal filed by the assessee. The relevant assessment year is 2011-12. The appeal is directed against the order dated 29.01.2016 passed by the Dy. Commissioner of Income Tax- 15(1)(1), Mumbai (hereinafter 'AO') u/s 143(3) r.w.s. 144C(13) of the Income Tax Act 1961, (the 'Act').

2. The grounds of appeal filed by the assessee read as under:

1. On the facts and in the circumstances of the case and in law, the DRP and AO erred in partly upholding the action of the TPO by making transfer pricing adjustment in relation to the international transaction of purchase of finished goods at Rs. 6,62,46,133.
2. On the facts and in the circumstances of the case and in law, the DRP and AO erred in rejecting comparables namely, P L Enterprise Ltd. and PAE Ltd. from

the economic analysis of the Appellant, which were comparable to the Appellant's distribution activity in relation to the international transaction of purchase of finished goods in terms of functions, asset base and risk profile.

3. On the facts and in the circumstances of the case and in law, in relation to the international transaction of purchase of finished goods, the benefit of (+/-) 5% range available under proviso to section 92C(2) of the Act, be granted to the Appellant, if eligible.
4. On the facts and in the circumstances of the case and in law, the AO erred in charging interest under Section 234B and 234C of the Act.
5. On the facts and in the circumstances of the case and in law, the AO erred in initiating penalty proceedings under section 271(1)(c) of the Act.

I

3. Briefly stated, the facts of the case are that the appellant filed its return of income for the assessment year (AY) 2011-12 on 30.09.2011 declaring total income at Rs.9,92,01,580/-. Subsequently, it revised the return of income on 21.02.2012 declaring total income at Rs.9,04,85,647/-. As per the documents filed before the Assessing Officer (AO), the appellant is a subsidiary of Leica Geosystems AG, Switzerland. The appellant represents Leica Geosystems AG, Switzerland (subsidiary company of Hexagon Group, Sweden) for positioning technologies, which include geodesy, high-end GPS and the highly specialized Industrial Measurement Systems (IMS) and high definition surveying systems. The appellant is engaged in trading of above related surveying and measurement equipments.

During the course of assessment proceedings, the AO made a reference u/s 92CA(1) to the Transfer Pricing Officer (TPO). We find that *vide* order dated 27.01.2015, the TPO framed an order u/s 92CA(3) proposing an adjustment of Rs.9,33,15,374/- towards transfer pricing.

Thereafter, the AO passed a draft assessment order dated 10.03.2015 u/s 143(3) r.w.s.144C and forwarded a copy of it to the appellant. Before the Dispute Resolution Panel (DRP), the appellant filed objections in respect of variations made by the AO in the said draft assessment order. In respect of the comparables, the appellant submitted the following details before the DRP:

Sr. No.	Name and Business description of the Company as per TP Study	The TPO/AO's Contentions	Assessee's objections
1.	<p>Kusam Electrical Industries Ltd. - The Company is involved in manufacturing and trading of electrical & electronic measuring & testing instruments.</p>	<p>The TPO has observed that the company is involved in manufacturing and trading of electrical measuring and testing instruments.</p>	<p>The TPO has failed to appreciate and take cognisance of the detailed explanation submitted by the assessee vide Annexure C along with supporting document i.e. extract of Annual report of the Company as Annexure C1 (yellow highlighted paras) vide submission dated January 19, 2015.</p> <p>The assessee would like to reiterate that, "... on perusal of this, you would appreciate that the company is involved in the trading/distribution of electrical and electronics measuring instruments".</p> <p>Further, it can also be observed that the company only deals in trading of goods. It is evident from the cost of sales and indirect expenses incurred are mainly in the nature of packaging, transport and administrative expenses.</p> <p>Hence, this company can be considered as comparable to ETPL's distribution business of measuring and surveying equipments.</p>
2.	<p>Matra Kaushal Enterprise Ltd. (formerly known as P L Enterprise Ltd.) - The company is</p>	<p>The TPO has observed that the company is</p>	<p>The TPO has failed to appreciate and take</p>

	involved in trading of voltage stabilisers and other electronic appliances.	involved in trading of Voltage stabilizers.	cognisance of the detailed explanation submitted by the assessee vide Annexure C along with supporting document i.e. extract of Annual report of the Company as Annexure C2 (yellow highlighted paras) vide submission dated January 19, 2015. The assessee would like to reiterate that, ".... on perusal of this, you would appreciate that the company is involved in the trading / distribution of voltage stabilisers, DVD's and other electronic appliances". Further, from the extract of Annual report, it can be clearly observed that (i) company has 100% of trading sales; and (ii) cost of goods sold also shows that the company has opening stock, purchases as well as closing stock of finished goods (trading) only. Hence, this company can be considered as comparable to ETPL's distribution business of measuring and surveying equipments.
3.	P A E Ltd. - Company is involved in the trading of industrial batteries and power solutions. Its products include automotive parts, lead acid storage batteries, power backup systems and solar photovoltaics.	The TPO has observed that the company is involved trading of batteries.	The TPO has failed to appreciate and take cognisance of the detailed explanation submitted by the assessee vide Annexure C along with supporting document i.e. extract of Annual report of the Company as Annexure C3 (yellow highlighted paras) vide submission dated January 19, 2015. The assessee would like to reiterate that, ".... on perusal of this, you would appreciate that the company is involved in the trading / distribution of auto batteries, solar and power backup systems.". Hence, this company can be considered as comparable to ETPL's distribution business of measuring and surveying equipments.
4.	Alert Fire Protection Systems Pvt. Ltd. - The Company is involved in the supply of fire alarm and detection equipments, control panels and related components/spare parts.	The TPO has observed that the company is involved in supply of fire alarms.	The TPO has failed to appreciate and take cognisance of the detailed explanation submitted by the assessee vide Annexure C along with supporting document i.e. extract of Annual report of the Company as

			<p>Annexure C4 (yellow highlighted paras) vide submission dated January 19, 2015.</p> <p>The assessee would like to reiterate that,".... on perusal of this, you would appreciate that the company is involved in purchase and supply of fire alarm and detection equipments, control panels and related components or spare parts."</p> <p>Further, from the extract of Annual report, it can be clearly observed that company is involved in only in one segment of purchase and supply of fire alarm and detection equipments, control panels and related components or spare parts. Inventory of the company also consists of trading goods.</p> <p>Hence, this company can be considered as comparable to ETPL's distribution business of measuring and surveying equipments.</p>
5.	<p>Adtech Systems Ltd. - The Company is involved in the business of supplying, installation, commissioning and servicing of Electronic Article Surveillance Systems, Access Control Systems, CCTV video surveillance through Closer Circuit Television system, Fire Alarm System etc.</p>	<p>The TPO has observed that the company is in the business of supplying, installation and commission of electronic article surveillance systems. On going through the financials it is seen that the company has received INR 2.16 crores from AMC and installation charges.</p> <p>Further, Adtech has 2 vertical business segments namely Retail Chain Segment in the supply and installation of anti-shop lifting systems and Commercial industrial segment where the company supplies electronic article surveillance equipments. The company has given segmental accounts. The assessee however,</p>	<p>The TPO has failed to appreciate and take cognisance of the detailed explanation submitted by the assessee vide Annexure C along with supporting document i.e. extract of Annual report and Website of the Company as Annexure C5 (yellow highlighted paras) vide submission dated January 19, 2015. The assessee would like to reiterate that, ".... on perusal of this, you would appreciate that the company is in the business of Electronic Article Surveillance Systems, Access Control Systems, CCTV video surveillance through Closer Circuit Television system, Fire Alarm System etc. Installation is an activity conducted by the company along with its main business and income corresponding to installation is also minuscule".</p> <p>The Hon'ble Panel would observe from the search strategy followed by the</p>

		<p>worked PLI at entity level despite segmental available.</p> <p>assessee, the companies are selected only if sales trading as a percentage of sales greater than 75% in order to select companies those were primarily engaged in trading activity (Please refer page nos. 112-115 of the paper book). Further, the Hon'ble Panel would appreciate that AMC and installation charges received by this company, as contended by the TPO of INR 2.16 Crores is even less than 1% of the total sales income of the company during FY 2010-11. In respect of the TPO's contention that the assessee has worked PLI at entity level despite segmental available, we would like to state following as provided in the Segment accounting policies of this company in FY 2010-11:</p> <p>"The Company operates mainly in one single segment viz Supply and integration of Electronic Security Systems. Though not strictly necessary, the Company has, for as a measure of providing greater understanding, divided this segment into two viz the Electronic Article Surveillance Systems (EAS) used for providing security to the retail segment and the Commercial Industrial (C/I) for providing security solutions for industrial use."</p> <p>Hence, it can be observed that the company primarily operates in single segment viz Supply and integration of Electronic Security Systems and its functions are broadly same in EAS and C/I segments. Accordingly, the TPO's contention to reject this company as comparable to ETPL based on (i) this company provides installation and AMC services; and (ii) assessee has erred in not using segmental data available in the financials are erroneous and needs to be quashed. Hence, this company can be considered as comparable to ETPL's distribution business of measuring and surveying</p>
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The DRP observed that “functionally AE and non-AE business are not comparable. In respect of non-AE business, the assessee is required to assess the specific needs of the clients, select suitable hardware and software, prepare a bid document, undertake project management and planning, get on-site construction/engineering work done and do maintenance, installation and training in accordance with the terms of the tender. Even though prices may be indicated separately for each of the items, it is the profitability as a whole which is required to be considered in respect of such projects. As against this, the AE business is a standalone product selling business in which the assessee acts as a distributor. This business is primarily driven by the brand value of the AE and much less efforts and risks are involved. In its non-AE business, the assessee is benefitted from the expertise developed by it over a period of time in integration of various non-AE products and also from the fact that it has got very little competition.”

On the basis of the above observations, the DRP held that the AO was not justified in applying internal RPM (based on sale price quoted for goods in the tender documents) for benchmarking the payments made to AE towards purchase of finished goods.

Further, the DRP observed that the appellant was not justified in benchmarking the transactions with the AE by considering gross profit at entity level because profit margin in non-AE transactions is much higher. Thus holding that RPM should have been applied to the AE transaction only, the DRP directed the AO to compare the gross profit of the AE business with the comparables selected by the appellant. While giving the

above direction, the DRP directed the AO to reject the comparable PL Enterprises which was rejected by the DRP in the preceding assessment year. Also the DRP directed the AO to reject the comparable PAE Ltd. which is involved in trading of auto batteries, solar and power back-up systems which are low end items and face a lot of competition from unorganized sector/small enterprises. Finally, the DRP held that the TPO shall accept Adtech Systems, since installation and AMC charges received by the company are very small.

The AO, following the direction of the DRP passed the final assessment order u/s 143(3) r.w.s. 144C(13) on 29.01.2016, restricting the disallowance of adjustment of arm's length price (ALP) to Rs.2,70,69,241/-.

II

4. Before us, the Ld. counsel for the appellant submits that :

“ The appellant is a wholly owned subsidiary of Lecia Geosystem AG. (“AE”). The appellant is engaged into the business of trading in surveying and measurement equipments.

- During the year under consideration, the appellant purchased finished goods from its AE for trading amounting to Rs.54,22,80,618/-.
- The appellant chose “Resale Price Method (“RPM”) as “most appropriate method (“MAM”) to benchmark the impugned international transaction and selected “Gross Profit/Sale” as profit level indicator”. The appellant earned a GP Margin of 29.50% (entity level).
- The appellant chose a set of 5 comparables and arrived at an arithmetic mean of 28.28%. Since, the appellant's GP margin was higher than that of the comparables and hence, it was concluded that the impugned international transaction was at arm's length.

- The TPO applied internal RPM and compared AE's margin of 28% with Non AE margin 39.92% and accordingly, made an upward TP adjustment of Rs.9,33,15,374/-.
- The DRP rejected the internal RPM applied by the TPO and directed to apply external RPM. However, while dealing with the comparable selected by the appellant, the DRP excluded PL Enterprises Ltd. and PAE Ltd. as comparable for the reasons stated in para 2.6.6 (page 22) of the DRP Order.
- Post the direction of the DRP, the AO made an upward TP adjustment of Rs.6,62,46,133/-.
- The appellant is in appeal before your Honours to contest the action of the DRP in excluding the above mentioned 2 comparables.

The arithmetic mean of Gross Profit to Sales computed by the TPO/DRP of the comparables and the appellant's contentions are explained :

Sr. No.	Name of Comparable Company	Assessee in its TP Study	OP/OC as per DRP	OP/OC as per Appellant	Respondent's contention
1.	Adtech Systems Ltd.	36.27%	36.27%	36.27%	-
2.	Alert Fire Protection Systems Ltd.	31.88%	31.38%	31.88%	-
3.	Kusam Electricals Industries Ltd.	41.74%	41.74%	41.74%	-
4.	PL Enterprises Ltd. (now known as "MatraKaushal Enterprises Ltd.)	22.24%	-	-	-
5.	PAE Ltd.	9.76%	-	9.76%	<ul style="list-style-type: none"> ➤ The DRP has excluded this comparable on the reason that this company is engaged into trading of auto batteries, solar and power back systems which is different from the Appellant. ➤ In this regard, the appellant submits that the same comparable has been retained by the TPO as well as by the DRP in the previous Assessment Year i.e. 2010-11. Further, the

					<p>appellant relies on the following decisions wherein it has been held that under RPM, the focus is more on similarity of functions (which in present case is trading) and not on products:</p> <ul style="list-style-type: none"> • Mattel Toys (I) Pvt. Ltd. v. DCIT (144 ITD 76 (Mum) (page 12-13, para 36-38) • ACIT v. Kobelco Construction Equipment India Ltd. (186 TTJ 790) (Del) (Page 6-8, Para 11-13)
	Arithmetic Mean	28.28%	36.46%	29.78%	
	Appellant's Margin (AE Segment)			28%	Respondent's Margin Fits within the +/-5% range as provided under section 92C(2) of the Act. Hence, the transaction is at arm's length

Thus the Ld. counsel submits that under RPM, only gross margins are seen with reference to items purchased and sold or earned by an independent enterprise in comparable uncontrolled transactions *vis-à-vis* the one in the controlled transactions, therefore, the nature of products has not much relevance; the focus is more on same or similar nature of functions rather than similarity of products. Also it is stated by him that if the above contention of the appellant is accepted and PAE Ltd. is included in the final list of comparable, then arithmetic mean of the gross margin of the comparable will work out to 29.78% which will fit within +/-5% of the appellant's gross margin of the AE segment (i.e. 28%). Thus, the Ld. counsel argues for inclusion of PAE Ltd. in the final set of comparables. The working as submitted by the Ld. counsel is as under :

Sr. No.	Name of Comparable Company	Gross Margin in its TP Study
1.	Adtech Systems Ltd.	36.27%
2.	Alert Fire Protection Systems Ltd.	31.88%
3.	Kusam Electricals Industries Ltd.	41.74%
4.	PL Enterprises Ltd. (now known as "MatraKaushal Enterprises Ltd.)	-
5.	PAE Ltd.	9.76%
	Arithmetic mean	29.78%
	Appellant's Margin -28% (AE Segment)	Appellant's margin fits within the +/-5% range as provided under section 92C(2) of the Act. Hence, the transaction is at arm's length.

III

5. On the other hand, the Ld. Departmental Representative (DR) submits that the company PAE Ltd. is involved in the trading of industrial batteries and power solutions; its products include automotive parts, lead acid storage batteries, power back-up systems and solar photovoltaics. Thus it is explained by him that PAE Ltd. is not at all comparable to the appellant's business of trading in geodesy, high-end GPS and highly specialized industrial measurement systems and high definition surveying systems.

Regarding the contentions of the Ld. counsel that the TPO as well as DRP has retained PAE Ltd. as a comparable in the previous assessment year 2010-11, the Ld. DR submits that facts being different, the TPO/DRP has rightly excluded the above company as a comparable in the impugned assessment year.

IV

6. We have heard the rival submissions and perused the relevant materials on record. The reasons for our decision are given below.

The dispute here, as per the contentions of the Ld. counsel which has been extracted fully at para 4 hereinabove, is the exclusion of PAE Ltd. as a comparable by the AO in the impugned assessment year.

Before adjudicating the issue, we may refer to the background facts of the case. The appellant has selected itself as a tested party to the transaction and adopted Resale Price Method (RPM) as the most appropriate method. It considered gross profit to sales ('GP/Sales') as the profit level indicator (PLI) since the finished goods were purchased from AEs and then sold to the customers without much value addition. The appellant reported the 5 companies mentioned below as comparables :

Sr. No.	Name of the Company	As per TP Report	Single Year Margin
1.	Kusam Electrical Inds. Ltd.	41.74%	41.46%
2.	PAE Ltd.	9.76%	11.30%
3.	Alert Fire Protection Systems Pvt. Ltd.	31.38%	33.63%
4.	Adtech Systems Ltd.	36.27%	34.93%
5.	Matra Kaushal Enterprises Ltd. (PL Enterprises)	22.24%	14.74%
Mean		28.28%	27.21%

The appellant submitted before the TPO that as its gross profit margin at the entity level is 29.50% which is better than the margin of comparables at 27.21%, therefore, the transactions are at ALP.

However, the TPO was not convinced with the above explanation of the appellant and applied internal RPM and compared AE's margin of 28% with Non-AE margin of 39.92% and accordingly made an upward TP adjustment of Rs.9,33,15,374/-.

The DRP held that the AO was not justified in applying internal RPM (based on sale price quoted for goods in the tender documents) for benchmarking the payments made to AE towards purchase of finished goods.

Further, the DRP observed that the appellant was not justified in the benchmarking the transactions with the AE by considering gross profit at entity level because profit margin in non-AE transactions is much higher. Thus holding that RPM should have been applied to the AE transaction only, the DRP directed the AO to compare the gross profit of the AE business with the comparables selected by the appellant. While giving the above direction, the DRP directed the AO to reject the comparable PL Enterprises which was rejected by the DRP in the preceding assessment year. Also the DRP directed the AO to reject the comparable PAE Ltd. which is involved in trading of auto batteries, solar and power back-up systems which are low end items and face a lot of competition from unorganized sector/small enterprises. Finally, the DRP held that the TPO shall accept Adtech Systems, since installation and AMC charges received by the company are very small.

As mentioned earlier, the AO by following the direction with the DRP restricted the transfer pricing adjustment to Rs.2,70,69,241/-.

A

6.1 At this moment, we discuss the case laws relied upon by the Ld. counsel. In the case of *Mattel Toys (I) (P) Ltd.* (supra), the assessee-company, a wholly owned subsidiary of a USA company (Associated Enterprise) was engaged in marketing and selling of toys and games

imported from its AE. The assessee-company also returned some unsold goods to its AE. The assessee adopted transactional net margin method (TNMM) in its transfer pricing report and rejected the resale price method (RPM). The TPO made certain adjustments. He also treated the goods returned to the AE as export of goods to AE. On appeal, the assessee claim that RPM should be followed instead of TNMM, which was rejected by the Commissioner (Appeals) on the ground that the assessee itself had given a detailed analysis as to why RPM could not be taken in its TP report. On appeal, the Tribunal held that (i) RPM is the most appropriate for benchmarking ALP, where resale takes place without any value addition to the product by the assessee, (ii) where, at any stage of proceedings, it is demonstrated by the assessee that most appropriate ALP can be determined by adopting a prescribed method than that chosen by it earlier, same should be considered and (iii) where internal comparables are available, they are preferred over external comparables.

Having gone through the above decision, we may mention here that there is no dispute on the findings in the above case. We are concerned here only with the comparability of PAE Ltd.

In the case of *Kobelco Construction Equipment India Ltd.* (supra), relied on by the Ld. counsel, the assessee imported finished goods manufactured by its AE, like earthmoving equipment, hydraulic excavators, etc. for resale in India. It undertook the entire function of a 'distributor'. It mainly sold finished goods directly to the customers at high sea sales and some of the finished goods were sold through network of dealers. For the sale of spare parts, the assessee imported and then sold them through the network of dealers to the customers. 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 per cent and to benchmark the said margin, the assessee had identified seven comparable companies for comparative analysis. The TPO, however, rejected the selection of RPM as MAM and instead held that TNMM should be adopted as MAM. The TPO had further observed 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 TPO had taken three comparables of the assessee. The Commissioner (Appeals), after considering the entire submissions and material placed on record, observed that assessee was clearly a full-fledged distributor of earth moving equipments. The TPO had not brought any evidence to show that the assessee was performing additional function other than the distribution activities. 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 Ltd. Since the margin of said comparable was within the tolerance range of plus/minus 5 per cent, the Commissioner (Appeals) held that no TP adjustment was called for. On appeal, the Tribunal held that (i) RPM is applied in case where reseller purchases tangible property and obtains services from AE and without making any value addition, resells same to third parties and (ii) Company engaged in manufacturing machinery, cannot be compared with assessee which was purely performing distribution functions.

Having gone through the above decision, we may mention here that there is no dispute on the ratio laid down in the above case. We are concerned here only with the comparability of PAE Ltd.

B

6.2 We may examine the contentions of the Ld. counsel that as the TPO/DRP has retained PAE Ltd. as a comparable in the previous assessment year, it should be included as a comparable in the impugned assessment year.

Two companies can be treated as comparable when both are discharging the overall similar functions, though there may be some minor differences in such functions. Notwithstanding the functional similarity, many times a company ceases to be comparable because of other reasons as well. For example, if company 'X', though functionally similar to company 'Y', but has related party transactions (RPTs) breaching a particular level, then, such company should not be considered as comparable to company 'X' in the year in which the RPTs breach has occurred. Also, a company might have been treated as non-comparable due to the TPO adopting its entity level results for comparable with the segmental results of the case before him, but in the later case, the TPO may take only the related segment results. In such a later case, the company treated as non-comparable to the first company may become comparable to the second company. The comparability of each company needs to be ascertained only after matching the functional profile and the other relevant reasons of the other company. Functional analysis enables comparison of controlled transactions with uncontrolled transactions. The Hon'ble Supreme Court in the case of *Morgan Stanley & Company Inc* (2007) 292 ITR 416(SC) has placed significant emphasis on FAR (functions performed, assets owned and risks assumed by the associated enterprises involved) analysis for benchmarking exercise, also known as comparability

analysis, for determination of arm's length price of a transaction between associated enterprises. Their Lordships have observed:

“Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case.”

The Hon'ble Delhi High Court in *Li & Fung India (P) Ltd v. CIT*(2014) 361 ITR 85(Del.) has held that FAR analysis plays a critical role in determining the ALP of an international transaction entered between AEs.

The Hon'ble Delhi High Court in *Rampgreen Sales Pvt. Ltd. v. CIT* (2015) 377 ITR 533 (Del) has held that the comparables should be selected on the basis of similarity. Thus it is evident that the functional comparability cannot be seen on a broader categorization but on functional level. The Hon'ble High Court further laid down that the selection of comparables does not differ with the method adopted.

In the instant case, the appellant has not filed before the Tribunal, documents concerning its comparability, as described above, with PAE Ltd. in AY 2011-12 *vis-a-vis* AY 2010-11.

Selection of the PLI depends on the factual position of the case, on comparable companies and FAR analysis which may vary on year to year basis.

Comparability of a case has to be considered on year to year basis and, therefore, merely because a case has been held to be comparable for one year cannot *per se* be considered as comparable for succeeding year as well. Whether a particular company is a comparable or not is an exercise which

has to be carried out every year in case of an assessee considering facts of that specific year.

For the purpose of computing yearly profits and gains, each year is a separate self-contained period time. Under transfer pricing, the transaction (controlled transaction) between the taxpayer and its associated enterprise or related party, as the case may be has to be at arm's length price. It is to this that we turn below.

C

6.3 Contextually, we mention below the functions of the appellant and PAE Ltd.

Elcome Technologies Pvt. Ltd.

The assessee is a subsidiary of Leica Geosystems AG, Switzerland. It represents Leica Geosystems AG, Switzerland (subsidiary company of Hexagon Group, Sweden) for positioning technologies, which includes geodesy, high-end GPS and the highly specialized Industrial Measurement Systems (IMS) and high definition surveying systems.

The assessee is engaged in the trading of above related surveying and measurement equipments.

PAE Ltd.

During the financial year 2010-2011, PAE restructured operations and transitioned from a horizontal organization structure to a more defined, vertical structure. Under the revised organization layout, PAE's business will be divided into 5 business verticals for better internal monitoring:

- Auto Batteries
- Auto Parts
- Industrial Batteries
- Power Backup Systems

- Solar

Each vertical will perform as an independent Strategic Business Unit (SBU), focused on growing sales and optimizing operations.

D

6.4 What is the architecture of RPM? In this context, we seek guidance from (i) OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (July 2017), (ii) United Nations Practical Manual on Transfer Pricing for Developing Countries (2017) and (iii) Guidance Note on Report u/s 92E of the Income-Tax Act, 1961 (Transfer Pricing) (Revised 2019), issued by the Institute of Chartered Accountants of India.

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (July 2017) mentions the following :

“2.31 Although broader product differences can be allowed in the resale price method, the property transferred in the controlled transaction must still be compared to that being transferred in the uncontrolled transaction. Broader differences are more likely to be reflected in differences in functions performed between the parties to the controlled and uncontrolled transactions. While less product comparability may be required in using the resale price method, it remains the case that closer comparability of products will produce a better result...”

United Nations Practical Manual on Transfer Pricing for Developing Countries (2017) contains the following:

“B.3.2.7.2. Accounting consistency is extremely important in applying the RPM. Gross profit margins will not be comparable if accounting principles and/or practices differ between the controlled transaction and the uncontrolled transaction. For example, the comparable distributors may differ from the related sales company in reporting certain costs (e.g. discounts, transportation costs, insurance and costs of performing the warranty function) as operating expenses or as cost of goods sold. Differences in inventory valuation methods will also affect the gross margins. It is thus important that the analysis does not compare “apples with oranges” but rather, “apples with apples”. Therefore, appropriate adjustments should be applied to the data used in computing the gross margin to make sure that “similar” gross margins are compared.

B.3.2.9.3. While product differences may be more acceptable in applying the Resale Price Method as compared to the CUP Method, the property transferred should still be broadly similar in the controlled and uncontrolled transactions. Broad differences are likely to reflect differences in functions performed, and therefore gross margins earned, at arm's length.

B.3.2.9.4. The compensation for a distribution company should be the same whether it sells washing machines or dryers; because the functions performed (including risks assumed and assets used) are similar for the two activities. It should be noted, however, that distributors engaged in the sale of markedly different products cannot be compared. The price of a washing machine will, of course, differ from the price of a dryer, as the two products are not substitutes for each other. Although product comparability is less important under the Resale Price Method, greater product similarity is likely to provide more reliable transfer pricing results. It is not always necessary to conduct a resale price analysis for each individual product line distributed by the sales company. Instead, the Resale Price Method can be applied more broadly, for example based on the gross margin a sales company should earn over its full range of broadly similar products.”

Guidance Note on Report Under Section 92E of The Income-Tax Act, 1961 (Transfer Pricing) (Revised 2019), issued by the Institute of Chartered Accountants of India states the following :

“6.16 On application of RPM, the UN in the Practical Manual on Transfer Pricing has observed as under:

“6.2.9.3 While product differences may be more acceptable in applying the Resale Price Method as compared to the CUP Method, the property transferred should still be broadly similar in the controlled and uncontrolled transactions. Broad differences are likely to reflect differences in functions performed, and therefore gross margins earned, at arm's length.

6.2.9.4 Example: The compensation for a distribution company should be the same whether it sells washing machines or dryers, because the functions performed (including risks assumed and assets used) are similar for the two activities. It should be noted, however, that distributors engaged in the sale of markedly different products cannot be compared. The price of a washing machine will, of course, differ from the price of a dryer, as the two products are not substitutes for each other. Although product comparability is less important under the resale price method, greater product similarity is likely to provide more reliable transfer pricing results. It is not always necessary to conduct a resale price analysis for each individual product line distributed by the sales company. Instead, the resale price method can be applied more broadly,

for example based on the gross margin a sales company should earn over its full range of broadly similar products.”

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6.5 To recapitulate in brief, RPM is applied where a product that has been purchased from a related party is resold to an independent party. Essentially, it values the functions performed by the “reseller” of a product. In this method, the resale price to the independent party is reduced by a comparable gross margin (the “resale price margin”) to arrive at the arm’s length price of the product transferred between the related parties. Under arm’s length conditions, the resale price margin should allow the reseller to recover its selling and operating costs, and earn a reasonable profit based on its FAR. As gross profit margins represent the gross compensation (after cost of sales) for specific FAR, product differences are less critical than under the CUP method. Nonetheless, the more comparable the products, the more likely the resale price method will produce better results.

As regards the external data, the gross profit margin of the reseller in the controlled transaction is compared with the gross profit margin earned by an independent third party in a comparable uncontrolled transactions. Minor differences in the products are acceptable if they are less likely to have effect on the gross profit margin earned from sale of such products- for example, Gross profit margin earned from trading of Microwave ovens in controlled transactions can be compared with gross profit margin earned by unrelated parties from trading of Toasters. Gross profit margin earned from trading of Laptops in controlled transactions can be compared with gross profit margin earned by unrelated parties from trading of

Desktops. This is because, both are consumer durables and fall in within the same industry.

RPM is unlikely to give accurate result, if there is difference in level of market, functions performed, or product sold. For example, Gross profit margin of a chocolate distributor cannot be compared with Gross profit margin of a cosmetics distributor even though both products fall under FMCG category. This is because, there are huge differences in the products which affect the Gross profit margin.

The fact remains that prices for different products would tend to equalize only to the extent that those products were substitutes for one another.

RPM is a GP margin based method. It is a traditional transaction method. It primarily compares controlled and uncontrolled transactions. Under RPM we can tolerate slight differences in the products distributed by the two types of distributors as long as the broad category of products distributed is the same.

As mentioned earlier while product differences may be more acceptable in applying the RPM as compared to CUP method, the property transferred should still be broadly similar in the controlled and uncontrolled transactions. Broad differences are likely to reflect differences in functions performed, and therefore, gross margins earned, at arm's length. It should be noted that distributors engaged in the sale of markedly different products cannot be compared.

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6.6 To sum up, in the instant case, there is no similarity in the products between the appellant and PAE Ltd as gleaned from the activities delineated at para 6.3 hereinabove. Because of lack of similarity, it has impact on functions performed and on gross margins earned.

In the instant case, the product differences between the appellant and PAE Ltd. are not at all acceptable in applying the RPM.

In RPM, the compensation for a distribution company should be the same. The similar level of compensation is expected for performing similar functions across different activities. In the instant case similar level of compensation is not expected for performing similar functions across different activities.

RPM can be applied more broadly, for example based on the gross margin a sales company should earn over its full range of broadly similar products. In the instant case RPM cannot be applied more broadly, for example based on the gross margin because there is no similarity in the products of the appellant *vis-a-vis* PAE Ltd.

United Nations Practical Manual on Transfer Pricing for Developing Countries (2017), in para B.3.2.7.2 succinctly describes in the context of RPM “It is thus important that the analysis does not compare ‘apples with oranges’ but rather, ‘apples with apples’.

In view of the above factual scenario and principles governing RPM, the AO has rightly excluded PAE Ltd in the final set of comparables. To hold

otherwise would be to exalt artifice above reality and to deprive the settled principles in question of all relevant purpose.

Accordingly, 1st, 2nd and 3rd grounds of appeal are dismissed. The 4th ground of appeal is consequential in nature and the 5th ground of appeal is premature.

7. In the result, the appeal is dismissed.

Order pronounced in the open Court on 09/09/2020

Sd/-
(SAKTIJIT DEY)
JUDICIAL MEMBER

Mumbai;

Dated: 09/09/2020

Rahul Sharma, Sr. P.S.

Sd/-
(N.K. PRADHAN)
ACCOUNTANT MEMBER

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai