

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: "I" NEW DELHI**

**BEFORE SMT. DIVA SINGH, JUDICIAL MEMBER
AND
SHRI B.C.MEENA, ACCOUNTANT MEMBER**

**IN I.T.A .Nos.-5186/Del/2011 & 5433/Del/2012
(ASSESSMENT YEARS-2007-08 & 2008-09)**

Sojitz India (P) Ltd.,
7th Floor, EROS Corporate Towers,
Nehru Place, New Delhi.

PAN-AAICS8883N
(APPELLANT)

vs

DCIT,
Circle-9(1),
C.R. Building,
New Delhi

(RESPONDENT)

Appellant by: Sh.Ved Jain, FCA
Respondent by: Sh.Peeyush Jain, CIT DR TP

ORDER

PER DIVA SINGH, JM

In both these appeals filed by the assessee against the assessment orders for 2007-08 and 2008-09 assessment years, there is a common issue of arms' length price adjustment. As such it is considered appropriate to decide the appeals by way of a common order.

2. The grounds raised by the assessee in 2007-08 & 2008-09 assessment years read as under :-

In ITA No.-5186/Del/2011

- “1. That the learned Deputy Commissioner of Income Tax, Circle 9(1), New Delhi has erred both on facts and, in law in determining income of the Appellant at Rs.5,86,29,915/- in an order of assessment dated 22.09.2011 framed u/s 143(3) read with section 144C of the Act as against the declared income of the Appellant of Rs.1,88,72,880/-
2. That the learned Additional Director of Income Tax, Transfer Pricing Officer-II(2), New Delhi (Ld. TPO)/ Ld. AO have erred both in law and on facts in making an addition of Rs.3,97,10,488/- on account of alleged understatement of arm’s length price in respect of commission income earned by the Appellant from its Associated Enterprises (“herein after referred to as AEs”). The finding and conclusions in this regard have been reached without any material and is a vitiated finding.
3. The order of Ld. AO & directions of Ld. DRP along with learned Transfer Pricing Officer’s order under section 92CA(3) of the Act is based on complete disregard of the facts of the case of the Appellant and the statutory provisions of law.

The learned AO/TPO/DRP has erred in disregarding the following apparent on facts and in law on the facts and circumstances of the case of the Appellant:

- a) That the Appellant has complied with the Indian transfer pricing regulations by maintaining appropriate documentation as mandated by Section 92D of the Act and Rule 10D of the Income-tax Rules, 1962 (“Rules”). Further, the Appellant’s use of Transaction Net Margin Method (“TNMM”) with OP/TC as the

- Profit Level Indicator ("PLI" has been discarded without any justification whatsoever;*
- b) That the learned AO/TPO/DRP has erred in adopting his own method to determine the ALP of the Appellant's international transactions without demonstrating the existence of any one of the four conditions provided in Section 92C(3) which is a mandatory requirement for making adjustment under section 92CA(3) of the Act;*
 - c) That the learned AO/TPO/DRP's method of computing the arm's length price is not in accordance with any of the methods specified in Section 92C(1);*
 - d) That the learned TPO has erred in re-characterizing the commission/indent transactions of the Appellant as trading/proper transactions and by applying the gross profit margin earned from trading transactions in the non-associated enterprise segment on the value of goods on which commission was earned.*
 - e) That the learned TPO has erred in treating the commission and trading transactions as comparable without any regard to principles laid down in sub-rules (2) and (3) of Rule 10B;*
 - f) That the learned AO/TPO/DRP has failed to appreciate the difference in risk profile of the indent and proper transactions. In particular, in the indent based transactions there are negligible credit risk and foreign exchange risk on account of fluctuation of rate of exchange. In fact, in the indent based transactions, the function is to merely follow up on behalf of the customers and not deal with the prospective customers of the customers of the Appellant; the risk is limited to the commission amount and not to the gross amount of sales;*
 - g) That the learned AO/TPO/DRP has overlooked that in respect of indent based transaction,*

service tax is applicable and in respect of principal based transactions, sales tax is applicable. Thus, apparently, the two transactions are different classes of transactions.

4. *That the learned AO/TPO/DRP has erred in holding that the Appellant has created human and supply chain intangibles for which it is not being adequately compensated by the AE.*
5. *That on facts and in law the Id. AO/TPO/DRP erred in not granting relief of +/-5% under proviso to section 92C(2) of the Act;*
6. *On the facts and circumstances of the case, the Ld. DRP has erred in not examining the validity of initiation of penalty proceedings u/s271(1)(c).*
7. *The above grounds of appeal are mutually exclusive and without prejudice to each other.*

The Appellant craves leave to add, alter, amend or vary any of the above grounds either before or at the time of hearing as we may be advised. The arguments taken hereinabove are without prejudice to each other.”

In ITA No.-5433/Del/2012

- “1. *On the facts and circumstances of the case, the order passed by the learned Assessing Officer (AO) under Section 143(3) read with Section 144C of the Act is bad, both in the eyes of law and on the facts of the case.*
2. *On the facts and circumstances of the case, the learned AO has erred, both on facts and in law in assessing the income of the Appellant at Rs.146,77,09,241/- as against income of Rs.3,13,76,134/- declared by the Appellant.*
3. *On the facts and circumstances of the case, the learned AO has*

erred, both on facts and in law in making an addition of Rs.143,63,07,142/- as difference in arms" length price determined by Transfer Pricing Officer (TPO) and the appellant.

- 4(i) On the facts and circumstances of the case, the Hon'ble DRP has erred, both on facts and in law, in making addition on account of arm's length price by applying the gross profit margin earned from trading transaction with non-associated enterprises on the value of goods on which commission has been earned.*
- (ii) On the facts and circumstances of the case, the TPO has erred, both on facts and in law, in altering the business model of the Appellant by re-characterizing the commission transactions of the Appellant as trading transactions, and by applying the Gross Profit margin earned from trading transactions with non-associated enterprises on the value of goods on which commission income has been earned by the Appellant.*
- 5. On the facts and circumstances of the case, the learned TPO has erred, both on facts and in law, in making the above addition on the basis that the assessee has created "human intangibles" and "supply chain intangibles" for which it has not been adequately compensated ignoring the nature of the business transaction undertaken by the appellant.*
- 6. Without prejudice to above, the learned TPO has failed to appreciate the fact that even if the addition proposed to the total income of the Appellant is accepted the Appellant's operating profit on cost would increase to an absurdly high figure of more than 973%.*
- 7(i) On the facts and circumstances of the case, the learned TPO has erred, both on facts and in law, in*

arbitrarily rejecting the detailed transfer pricing study done by the assessee as per Section 92D of the Act.

- (ii) *On the facts and circumstances of the case, the learned TPO has erred, both on facts and in law in determining the arm's length price of commission earned from Associated Enterprises based on conjecture and surmises.*
8. *On the facts and circumstances of the case, the Hon'ble DRP has erred, both on facts and in law, in rejecting the contention of the assessee that the benefit of arms' length range of $\pm 5\%$ be given in view of proviso to section 92C(2) of the Act.*
9. *On the facts and circumstances of the case, the learned AO has erred both on facts and in law in disallowing an account of Rs.25,965/- on account of depreciation on printer at the rate of 15% as against 60% claimed by the assessee, allowable under the Act.*
10. *On the facts and circumstances of the case, the learned AO has erred both on facts and law in levying interest under Section 234B of the Act.*
11. *The appellant craves leave to add, amend or alter any of the grounds of appeal."*

3. From a perusal of the grounds in 2007-08 assessment year, it can be seen that out of the 7 grounds raised, which have been reproduced above, ground nos.-1 & 7 are general in nature and are specifically addressed vide ground nos.-2-5 qua the adjustment of Rs.3.97 crores odd. We find that Ground no-6, is pre-mature and since it does not arise in the present proceedings the same is dismissed.

4. Similarly, on a perusal of the grounds agitated in 2008-09 assessment year reproduced in the earlier part of this order, it would

be seen that in all the assessee has raised 11 grounds . Out of these, ground nos.-1,10 & 11 are general in nature as such stand covered in ground nos.-3-8 which are raised agitating the addition of Rs.143.63 crores, vide ground no-9, it is agitated that the depreciation on computer printer should be allowed at 60% as against 15% allowed by the Assessing Officer (hereinafter referred to as the AO)

5. We first propose to discuss the facts available on record qua each of the years separately.

Facts pertaining to 2007-08 assessment year :

6. In 2007-08 assessment year, the assessee declared an income of Rs.1,88,72,880/- by way of filing a return. The business profile/ownership structure of the assessee as discussed by the transfer police officer (**hereinafter referred to as the TPO**)of his order all as under and extracted here under:-

2. Business Profile :-

Profile of the Company:-

The Sojitz was formed through the business integration between Nichimen Corporation and Nissho Iwai Corporation. These two companies have a history of over a century. This business integration took shape in Dec 2002 and was followed on April 2003 by the incorporation of a joint holding company. The principle operating arm's of the Group, Nichimen Corporation and Nissho Iwai Corporation were merged to form a new single entity, Sojitz Corporation on April 1, 2004.

Sojitz Corporation Japan (SCJ) is a entity headquartered in Tokyo. SCJ is a general trading company (also popularly

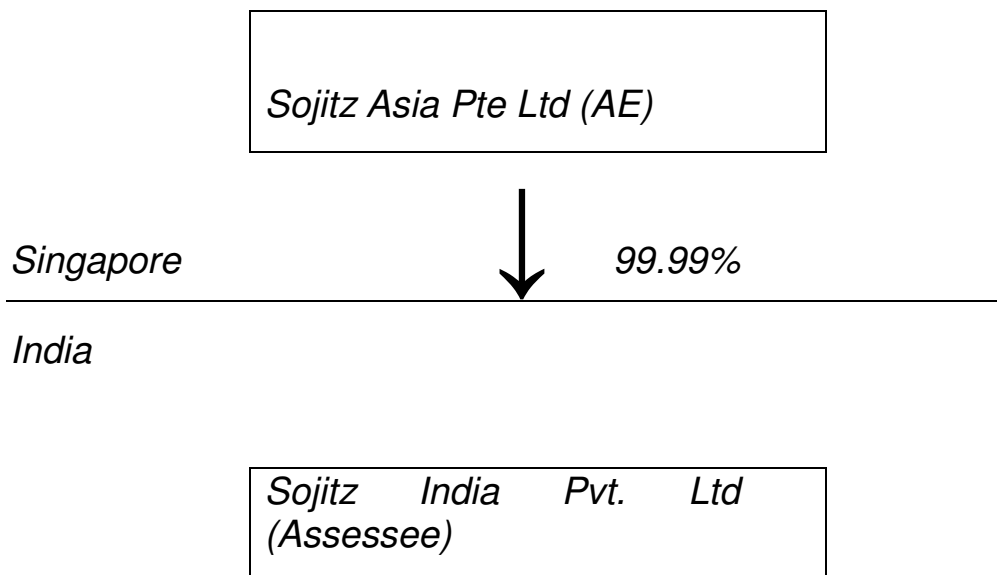
known as sogo shosha in Japanese terms) dealing in a wide range of products and services. Sojitz Group has operations in around 50 countries worldwide and operates with a network of 740 consolidated subsidiaries and affiliated companies in Japan and overseas. Sojitz' business activities are wide ranging, covering machinery and aerospace, energy and mineral resources, chemical and plastics, real estate development and forest products, consumer lifestyle related business and new business development including IT solutions.

The services typically provided by Sojitz India are as follows :-

- *Support Services for facilitating trading activities of AE.*
- *Networking with customers.*
- *Identifying potential customers or suppliers.*

Ownership Structure :

Sojitz Corporation Japan has the ownership control of Sojitz Asia which in turn holds 100% share capital of Sojitz India.





6.1. The T.P.O considering the fact that the assessee company was a 100% subsidiary of Sojitz, AE (**Associate Enterprises**) Asia which was itself a 100% subsidiary of Sojitz Corporation, Japan, (**hereinafter referred to as SCJ**) who was providing services of a service provider had also undertaken some trading activities on its own required the assessee to explain why margins earned in the trading activity with non AE be not applied to the Margins earned in activity with the AEs. The TPO observed that the assessee had entered into the following international transaction in 2006-07 financial year:-

S.No.	Type of international transaction	Method selected	Total value of transaction (Rs.)
1.	Imports	TNMM	837,321
2.	Provision of business information and sales support services	TNMM	173,018,363
3.	Reimbursement of Expenses by associated enterprises	TNMM	77,663,108

6.2. The TPO had noted that the assessee had benchmarked its international transaction relating to providing business support Services using the transactional net margin method (**hereinafter referred to as TNMM method**) as the most appropriate method (hereinafter referred to as MAM) with operating profit/total cost as profit level indicator) (hereinafter referred to as OP/TC as PLI). The assessee computed itself as

the tested party showing a margin of 5.47% and the margin of the 13 comparables taken was computed at 9.15%. Exercising the \pm 5% option under the proviso to section 92C(2), the assessee claimed its international transaction to be at arms' length.

6.3. The method adopted by the assessee was not approved by the TPO for the following reasons :-

- In the PLI calculated, the denominator did not contain the FOB value of the goods.
- The computation of margin in the case of comparables similarly did not demonstrate the value of goods or services on which return had been calculated.
- The FOB value of goods transacted through assessee were not furnished.
- In a separate class of transactions entered into with unrelated parties, in identical circumstances, assessee had earned a different margin as compared with the assessee transacting with its AE.

6.4. Accordingly for the above mentioned reasons, the assessee was issued a show cause notice and required to explain the same. The show cause noticed issued to the assessee is reproduced in internal pages 3,4 & 5 of the TPO's order. Apart from that the TPO

also compared the commission earned on trading sales made in non-AE segment with the assessee's services as a service provider segment and observed that the margin earned respectively was 1.81% and 1.48%. Accordingly he required the assessee to explain why margin of 1.81% should not be adopted to compute the margin that the assessee should have earned on the total FOB value of the goods transacted by it.

6.5. It may be pertinent at this point to extract the relevant portion from the show cause notice reproduced in the TPO's order.

6.6. The same reads as under:-

"8. On comparison of commission earned on trading, sales made in non AE segment and in your AE segment, the following position emerges :

<i>Particulars</i>	<i>Non-AEs</i>	<i>AE</i>	<i>Total</i>
<i>FOB Value of goods traded</i>	<i>959,808,865</i>	<i>12,151,252,480</i>	
<i>Commission earned</i>	<i>17,393,089</i>	<i>180,227,181</i>	<i>197,620,270/-</i>
<i>Segmental Gross Profit margin (as calculated)</i>	<i>1.81%</i>	<i>1.48%</i>	

From an analysis of the above computation, it is seen that in your trading transaction with your AE, you have earned a gross profit margin of 1.48%. In the segment relating to trading with non AEs, you have earned a gross profit margin of 1.81%. On the basis of detailed examination of FAR analysis in your TP report, it is noticed that there is no significant difference between the functions performed, assets utilized and risks

assumed by you in your trading transaction in your non AE segment and also the transactions performed by you wherein you have purportedly earned only commission income or a fixed fee. While analyzing the functions performed by you, it is also noticed that you are creating human intangibles and supply chain intangibles, for which apparently you are not being adequately compensated in your transactions with your AE.

6.7. In response thereto, the assessee submitted that for benchmarking of the international transaction relating to rendering of “support services”, it has used the TNMM as the most appropriate method. It was also clarified that the comparables selected in the transfer policy (**hereinafter referred to as the T.P**) report, are also service companies and for the computations the return on operating expenses is the treatment of both the comparable companies and the tested parties was alike.

6.8 It was also clarified that the assessee is a routine auxiliary support service provider with limited risk, it was also urged that compared to its support service segment its trading , with non- AEs business was comparatively very meagre. It was also submitted that there was a significant difference in the nature, of business and the functions performed; assets deployed and risks assumed,(**hereinafter referred to as FAR analysis**) ,of the two different activities. It was explained that in auxiliary support service return is earned on the value added expenses, it incurs in performing the routine marketing support functions. Accordingly in such cases, adding cost of goods sold (**hereinafter referred to as COGS**) cannot be the basis for considering bench marking as it is merely providing support service to

its AE's. It was urged that if the margin of the limited trading activity entered into by the assessee on its own with non-AE's is considered to be applied to the commission earned as a service provider then it would necessarily tantamount to re-characterization of its auxiliary support service as a trading activity and as such would run foul of Rule 10B(1)(e)(i).

6.9. It was further elaborated that COGS did not address the functions performed assets employed and risks assumed. The cost of sales in the denominator would have been included, had the entity been performing manufacturing functions which is not the position in the case at hand.

6.10. Referring to the definition of the TNMM in Rule 10B(1)(e)(i) & (ii), it was submitted that the cost referred therein did not include COGS because no such 'cost' has been incurred by the assessee in the performance of its business functions. The functions performed by the assessee are marketing supportive functions the cost of which is reflected in the operating expenses.

6.11. Addressing the observations of the TPO, in Para 4.7 in regard to the creation of human intangibles and supply intangibles, it was submitted that the detailed FAR analysis in the TP Report had characterized the assessee as low end service provider who bears a miniscule risk. The low end activities performed, it was submitted do not require any specific skills set as such no human intangibles or supply chain intangibles are created. The activities performed, it was stated are routine, preparatory and auxiliary in nature and it can not

be said to create any intangibles. An intangible, it was contended would necessarily mean to be an asset which would be capable of being transferred or licensed for a consideration. The assessee, it was submitted merely acted as a link between the suppliers and the customers. Many customers in India are global customers for the AEs and the role and functions of Sojitz India, it was stated is limited to that of a routine coordination and support service provider.

6.12. Assailing, the belief that the assessee has created supply chain intangible the submissions advanced on behalf of the assessee before the TPO from Paper 8 are extracted hereunder :-

“Supply chain activities transform raw materials and components into a finished product that is delivered to the end customer, International supply chain includes manufacturing, selling, distributing, warehousing, logistic and buying activities performed by several entities across the boundaries of the nations. Sojitz India merely provides facilitation services to entities in the supply chain without being a part of supply chain barring a few cases where it does principal business in the Non AE segment. In fact, Sojitz India has been able to perform its facilitation activities because Sojitz Japan has strong relation with a vast network of manufacturers, distributors, and buyers. In the given factual matrix, there is nothing which can be classified as “human” or “supply chain” intangible. Even if such an intangible is assumed (without conceding) to exist, it is neither created nor owned by Sojitz India. Providing support services by no stretch of imagination can be considered as creation of intangibles for the AEs in India.”

6.13. However not convinced with the explanation offered, the TPO held that the PLI used by the assessee did not capture the cost of the goods transacted through it, hence it was held that it is not an appropriate PLI. Further on considering Rule 10B(1)(e)(i), he was of the view that the net profit margin should be computed in relation to cost incurred or sales affected or assets employed or to be employed and they did not prescribe for value added expenditure to be considered as base for computing the net profit margins. Thus he was of the view that the compensation module should be expressed as a percentage of FOB price of goods. He also held that human intangible and supply chain intangible had also been created. Accordingly he was of the view that while computing arms' length price, the gross profit margin of 1.81% earned by the assessee on its trading segment should be applied and not the margin of 1.48% earned in its 'trading transaction' with its AE. Accordingly an arms' length adjustment of Rs.3,97,10,488/- was made as under:-

*“Commission Income earned from AEs @ 1.48% on
Rs.12,151,252,480/- =Rs.180,227,181/-*

*Arm's length commission income @1.81% on
Rs.12,151,252,480/-=Rs.219,937,669/-*

Difference=Rs.39,710,488/-

*% of arm's length margin to international transaction
=22.03%.”*

6.14. Acting on the recommendation of the TPO, the AO made an adjustment of Rs.3,97,10,488/- in the arm's length price.

7.1. Aggrieved by this, the assessee approached the Dispute Resolution Panel (**hereinafter referred to as DRP**) objecting to the adjustment recommended by the TPO and proposed by the AO in the draft assessment order. However, not convinced by the objections and the arguments advanced on behalf of the assessee, the DRP confirmed the action of the TPO.

7.2. Accordingly the AO passed the impugned order in conformity with the directions of the DRP. Aggrieved by which the assessee is in appeal before the Tribunal.

Facts pertaining to 2008-09 assessment year :-

8. The assessee in the year under consideration declared an income of Rs.313,76,134/- herein also the assessee bench-marked its international transaction relating to business support service using TNMM as the most appropriate method with OP/TC as PLI.

8.1. The TPO in the year under consideration also did not accept the characterization of the assessee which according to the assessee's FAR analysis was as under :-

“The functional analysis serves as a foundation to characterize entities for purposes of inter-company transfer pricing. Based on the facts as presented in the above analysis of functions performed, assets employed and risks borne, it is possible to characterize Sojitz India as a routine service provider that assumes normal business risks.”

8.2. The TPO following the view taken in the earlier year was of the view that on examining the details, the following points emerged:-

“5.5. On the basis of above details furnished by the assessee following

points emerged:-

- *The assessee has two kinds of international transactions viz. Trading and Indenting.*
- *The assessee has chosen external TNMM to benchmark the international transactions by aggregating all the international transactions.*
- *While computing the margin of the tested party the sale and the commission income received on the Indenting have been clubbed and the margin has been computed using OP/OC as the PLI.*
- *The FOB value of goods transacted through the assessee has not been considered while compensating the assessee.*
- *In a separate class of transactions entered into with unrelated parties, in identical circumstances, the assessee had earned a different margin as compared to the assessee transacting with its AE.”*

8.3. Accordingly consistent with the view taken in the earlier year, the TPO was of the view that the assessee has created human intangibles and supply chain intangibles. Thus in line with the view taken in the earlier year, he was of the view that it would be appropriate to apply the margin earned by the assessee in the trading transaction in the non-AE segment which was 13.29% to the FOB of the goods transacted through the assessee with its AE.

8.4. Accordingly after issuing a show cause notice to the assessee and considering the explanation, he proposed an adjustment of Rs.14,3637,142/- in the following manner :-

Details	Amount
FOB Value of goods	12,129,455,163
Gross Margin as earned by the assessee in the Non AE Trading Segment	13.29%
Gross arms's length margin	1,612,004,591
Less Gross Margin shown by the assessee	175,697,449
Difference for which adjustment is required to be made	1,436,307,142

9. In this year also the assessee agitated the addition made in the draft assessment order based on the TPO's order before the DRP. Accordingly before the DRP also the assessee raised various grounds as in the earlier year agitating the issues on the ground that re-characterization on the facts was not permissible under law; the method applied by the TPO was assailed, the action of holding that the commission is earned on the FOB values of goods was also assailed; the action was further assailed on the ground that absurd results would arise if the consequences of proposed addition were applied as then impossibly high operating profit and cost would be yielded. Similarly, the finding that the assessee had created human and supply chain intangibles were also assailed.

9.1. However, the DRP did not agree with the contention advanced on behalf of the assessee and upheld the action of the TPO which resulted in the passing of the impugned order under challenge by the assessee.

9.2. The specific reasoning and finding of the DRP on the issue is found discussed in para 5.1 & 5.2 of the said order. The same is reproduced hereunder :-

“5.1. During the hearing before the Panel, submissions made before the TPO were reiterated. It was argued that the TPO was not justified in re-characterizing the commission/indent transactions to the trading transactions and by applying gross Profit margin earned in non-AE trading segment. It was argued that assessee was a support service provider and not a full fledged trader as held by the TPO. It was contended that there was no justification in including the value of goods in the OC and PLI as the taxpayer never took possession of the goods, did not carry out any warehousing activity and did not assume the risks which a normal trader undertakes. In support of the claim that it was a service provider, it was stated that assessee had paid Service tax and VAT. As regards the intangibles, it was stated that the assessee was a routine service provider and did not own any intangibles. It was also contended that the TPO had not followed any of the methods prescribed in the Act. It was also argued that the TPO has not demonstrated as to which of the four conditions mentioned in section 92C(3) of the Act existed.

5.2. This panel has carefully considered the facts of the case and submissions of the assessee. As mentioned above, the assessee provided useful information and

support services to the AEs in facilitating their trading activities. The functions performed by it have been discussed in detail in the order of the TPO. It has been rightly observed by him that the assessee played a major role in identifying the suppliers, networking with the buyers, helps in collections of accounts receivable, quality control, logistics and vendor development.”

10. Aggrieved by this, the assessee is in appeal before the Tribunal in both the years.

10.1. Inviting attention to the material available on record and reading from the orders of the TPO, Ld. AR addressed the Bench on the nature of activities undertaken by the assessee and referring to the material available on record, it was contended that the assessee is only a service provider to the various group entities of Sojitz Corporation, Japan (SCJ) and SCJ along with its affiliates has been in this line of business, for almost six decades. It was submitted that for more than 50 years, SCJ has an international presence and a global recognition amongst its customers spread over more than 17 odd countries and has been carrying on this business even prior to the existence of the assessee company who has come into existence only in March 2005. In the background where the assessee has been in existence as a service provider only for the last couple of years and in fact this is the first year in which the company is fully functional as a service provider, the occasion of creating human chain and supply chain intangibles did not arise. Referring to the material available on record, it was contended that it is an accepted position as far as the nature of services provided by the assessee to its group entities of

SCJ, is concerned that the assessee is admittedly a service provider only. The services it was stated have been enumerated in both the years in the TPO's orders for both the years as well as the DRP's orders, which clearly address the fact that it was a mere service provider. The service rendered it was stated have even been enumerated in para 5.6 of the DRP's order in 2008-09 assessment year as well as in the earlier year. Thus the activities as a service provider are accepted by the department. It was elaborated that it is not the case of the department that the orders have been procured by the assessee for SCJ as the record shows that SCJ negotiates contracts with its customers directly and the record also shows that Sojitz India i.e the assessee came into existence in 2005. The SCJ, Japan it was stated has its own customers who have been interacting with SCJ over the years. It was elaborated that as and when SCJ wants to import goods for buyers in India, SCJ contacts its Japanese suppliers and SCJ itself enter into a contract with the buyers in India; similarly for exports from India, it was urged that SCJ enters into a contract with Indian supplier directly. The role of the assessee i.e Sojitz India is that of a mere facilitator and a mere service provider.

10.2. It was emphasized that the assessee does not bear any risk whatsoever as neither the title in goods rests in assessee's name at any point of time nor does it hold possession of the merchandise at any point of time as such at no point of time does it bear any, of the risks to which a normal trade is exposed namely, price risk, inventory risk, warranty risk, credit risk, etc. as at no point of time its capital is employed either in purchase, sale or inventory or making purchases

on credit or sales on credit which are some of the risks to which a normal trader would be exposed as its main function and infact the only function is to maintain contact with the suppliers to ensure a timely delivery of merchandise to the customers in the quality/grade and quantity desired and for the said purpose it communicates with SCJ or its affiliates and gathers information on demand and supply of the commodities. The said functions, it was contended are completely distinct and separate and operate in entirely different business model vis-à-vis a trading business.

10.3. In the limited trading activities in which the assessee has ventured into it was urged that the customers have been identified by the assessee at its own initiative and these are not the customer of SCJ. It was elaborated that as is well known a trader ventures for himself, consequently he exposes himself to all the risks of buying and selling activities as such as a trader the assessee in the said activity has necessarily taken a price risk; an inventory risk; risk of capital deployment in inventory debtors etc. and is called upon to take risks on warranty and on credit extended etc. Accordingly the functions performed, the assets deployed and the risk assumed in trading activity are materially distinct and peculiar to the said activity and can no where to be stated to be identical to what risks a business support service provider would be exposed to. The risks being high, it was urged if the venture succeeds the rewards can also be high. As such the action of the TPO in treating the two separate sets of activities at par is unwarranted on law and facts. It was submitted that the DRP in upholding the order of the TPO had gravely erred in treating the

trading activity and the activity of a support service provider also at par. The DRP has also erred on facts and law in presuming that the margins earned by the trader would necessarily apply to the support service provider ignoring that the facts and circumstances of the two activities are entirely distinct and separate.

10.4. Similarly, the findings of the TPO in the two years under consideration which have been upheld by the DRP in regard to human intangibles and supply chain intangibles were also assailed. It was reiterated that it seems to have been lost sight of the basic fact that the assessee cannot be credited for developing the business of SCJ Group of entities. The business of SCJ affiliates with its customers either for export or for import in India and in the rest of the world has been developed and created and has been in existence much prior to the creation of the assessee as such to conclude that the supply chain intangible and human intangible are being created by the assessee it was urged is a complete misunderstanding of facts and ignoring the material available on record. It was submitted that the assessee has been arguing right from the TPO stage in both the years that the activities performed are routine preparatory and auxiliary in nature and as such do not create any intangibles. Assessee's role it was urged is limited to providing support service as a facilitator. It was urged that no where has it been brought on record that it was the expertise of the assessee which has resulted in bringing business for the AE as the facts on record are that SCJ, Japan has relied upon its own relations with its own vast network of manufacturers, distributors and buyers for business wherein the assessee only provides routine

services for which no separate skills are required. It was urged that in the eventuality an employees leaves, he does not carry any specific skills or knowledge for which the assessee can restrain him from using it elsewhere in the business world and similarly the substitute does not require any specific training to adjust with the requirement of the role as a service provider as the assessee performs the function of a mere facilitator.

10.5. Similarly, in regard to the allegations of the creation of supply chain intangibles herein also it was urged the assessee company has not developed any knowledge of product, design nor knowledge of or quality control or storage etc as the only service provided by the assessee is of a facilitator. These facts will be evident from the description of the business support service provided to the TPO in the both years. It was urged that the assessee, merely provided facilitating services to entities in the supply chain without ever being part of the supply chain.

10.6. In the above background, it was contended that the reasoning of the TPO for adding cost of goods sold while computing margin is not the correct approach and Rule 10B(1)(e)(i) specifically prohibits such an action. The said Rule, it was submitted, specifically provides, that net profit margin in relation to transaction entered into with an AE is to be computed in relation to cost incurred or sales affected or assets employed or to be employed by the enterprise. It was submitted that the cost incurred herein would mean the cost incurred by the enterprise which in the case of the assessee would mean the cost incurred in providing the services. As admittedly since

no sales have been affected by the assessee, it would not be appropriate to take costs of sales for computing margin.

10.7. It was also argued by him that even otherwise it is not correct to apply commission rate based on the value of goods sold because it is an accepted fact that the commission would be dictated apart from other various factors also by the nature and type of product in respect which the services have been rendered. It was his argument that when the nature of services have been rendered and the trading has been closed qua the same product then all things being equal, some comparison could have been contemplated but here there is no attempt even to look at the merchandise in which trading has been ventured for the first time. It was emphasized that 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 etc. Similarly, the percentage of commission for consumer products is always higher as compared to the industrial products as the sale and prices of the consumer products are dictated by fads and trends in the market which may be of short duration. It was his submission that even where commission rate based on value of goods sold is to be applied similarity in nature and type of product in respect of which services have been rendered has to be established same. In the facts of the present case, the nature of products and items vary a lot and no such effort has been made by the TPO. On account of this fact, it was his contention that the compensation model to determine the arms length price based on a

single rate of commission of total FOB value of all types of goods to be sold most definitely will not be an appropriate method. In the facts of the present case, it was his contention that the TPO without looking at any of these items details has in a most arbitrary manner considered trading activity as one and comparable, to the activity of support services and applied trading margin earned in different nature of products and items for which support services have been rendered to the AEs.

10.8. It was urged that if we consider transfer pricing adjustment as proposed by the TPO and upheld by the DRP very absurd results will follow. For the said proposes attention was invited to synopsis dated 19.02.2013 in 2008-09 assessment year relevant portion from pages 13-14 is being extracted hereunder:-

Particulars	Audited Accounts	Reconstructed accounts by Ld. TPO
Total Income	30,40,69,090	30,40,69,090
Total Expenditure	27,66,12,688	27,66,12,688
Profit Before Tax	2,74,56,402	1,46,37,63,544
PBT/Sales/revenue	9.03%	481.39%
Capital	8,00,00,000	8,00,00,000
Reserves and surplus	1,98,15,112	1,98,15,112

Net worth	9,98,15,112	9,98,15,112
Return on capital employed	27.51%	1466.47%

Perhaps, it is impossible to earn 1466.47% return on capital in any business. If we take the transfer pricing adjustment and reconstruct accounts with indent sales treating as trading sales, then the turnover ratio will be as below.

10.9 Addressing the past history in assessee's own case, it was his argument that this itself will demonstrate as to how and why re-characterizing of the business support service into trading activity can lead to extremely impossible results. Elaborating this argument, further attention was invited to the position in 2007-08 assessment year i.e the first year under consideration. Referring to the same, it was submitted that it can be seen that whereas in one year the TPO applied the margin of 1.81% to the support services and in the next assessment year 2008-09, the margin applied has been 13.29%, in both the years the activity remained the same. It was emphasized that in 2006-07 assessment year, the assessee's method of benchmarking its international transaction relating to provision of business support services using TNMM as 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. It was emphasized that the basis for computation i.e OP/TC as PLI was not interfered with and has been consistently shown by the assessee and only in these two years, the method was

not accepted. The absurd results to which this method of the TPO if followed is applied it was urged can be demonstrated further from the fact that on more or less the same turnover, applying the trading margin in the two years namely 1.81% and 13.29% will lead to absurd situations.

10.10 Inviting attention to the TPO's order for the subsequent assessment year i.e 2009-10, it was submitted that the arms' length price determined by the assessee has been accepted as the department found that margins in service provider sector were higher. This fact it was urged shows that the risks in the two activities were very different, consequently the rewards also. The trading activity has shown in the three years a range of 1.81%, 13.29% and 0.59% because the risks are high and thus varied.

10.11. It was emphasized that there is no change in the nature of services being provided by the assessee to its associates enterprises since March 2005 when the assessee company was incorporated and the assessee has been consistently bench-marking its international transaction relating to business support services using TNMM as the most appropriate method with OP/TC as PLI. As such it was his argument that this is a correct method which in the immediately preceding assessment year to the years under consideration has been accepted and in the immediately subsequent assessment years, no addition was made by the TPO. Accordingly where the nature of services remain the same applying the margin earned in the trading activity is not the correct approach either under law or on facts.

10.12 Emphasis was laid on the aspect that there is no dispute over the fact that the nature of services provided by the assessee have remained the same. As such there was no occasion for the TPO to re-characterize the transaction of business support services as trading activity. Reiterating the facts reliance was placed on the past history of the assessee on the issue it was urged that absurd conclusions can be drawn if the said action is upheld. Attention was invited to the adjustment of Rs. 3 crore odd and Rs.143 crore odd proposed by the TPO more or less from the same turnover from the very same activities applying the margins of 1.81% and 13.29%, would result where cost as adopted by the TPO based on FOB value of goods is varying between Rs.1215 crore odd and Rs.1212 crore odd. The commission earned by the assessee, it was urged is commensurate with the volume namely Rs.18 crore odd and Rs.17 crore odd in the years under consideration. The addition proposed, on the other hand for the very same activity and volume is varying from Rs.3 crore odd to Rs.143 crore odd. The absurdity in the same it was submitted is demonstrated from the fact that the nature of the activity remains the same.

10.13 It was submitted that if the facts for the two years under consideration are perused, it would show that despite there being no difference in the nature of activity by the assessee and negligible variation in volume of business simply applying the margins, earned in the trading activity of the two years, the absurd results are yielded. It was his submission that the TPO has completely ignored the fact that even the total profit of the AE for whom services have been

rendered by the assessee would be much less than what, it is suggested the assessee should have charged for the support service to AE. Elaborating this argument further it was contended that a perusal of the balance sheet of the company would show that the TPO presumes that on the total capital of the assessee company which was just Rs. 8 crores and the company whose main activity admittedly was just to provide support services is considered to have done, business with just Rs. 8 crore trading of more than Rs.1200/- crores and earn a profit of almost Rs.161 crores as has been determined by the TPO. The position devices economic principles, and is unimaginable.

10.14 . Reliance was placed upon in ITA No-5147/Del/2011 in the case of GAP International Sourcing India Pvt. Ltd. vs. ACIT dated 18.09.2012 wherein it has been accepted that in respect of a facilitating function which is similar to a service provider in the case of the assessee, the appropriate PLI for determining arms' length price would be OP/TC and not percentage of FOB value of the goods.

10.15 Reliance was also placed upon the order of the Tribunal in the case of DCIT vs CHEIL Communication India Pvt. Ltd. 137 TTJ 539(Del) wherein it has been held that in the type of services which the assessee therein was engaged in namely assessee was an advertising agency engaged in undertaking advertising services for its customers in respect of their products and brands in the capacity of an agent. The payments made to the third parties were claimed to mere pass through in nature and recovered from the customers and assessee was a mere intermediary between the vendor and the

ultimate customers. The assessee had followed net revenue recognition method and the Tribunal upheld the CIT(A)'s action in holding that mark up is to be applied to the cost incurred and not the cost of rendering advertising space on behalf of AE. Accordingly it was the contention that the proposed additions upheld by the DRP proved by the AO deserves to be deleted.

11. The Ld. DR, on the other hand relied upon the order of the TPO's and the DRP which confirmed the TPO's order in both the years.

11.1. In support of the same, it was contended that the TPO has held that the method adopted by the assessee is not the correct method as such heavy reliance is being placed thereon. It was also his argument that no doubt the assessee is a service provider but for bench-marking what better comparison than assessee's own activity with non-AE. Inviting attention to the well accepted common practice in the market, it was his submission that it is a well known fact that commission in respect of business transaction is always computed with reference to the value of goods for which the commission has been received. As such there, it was urged there was no relevance in the arguments advanced on behalf of the assessee that the FOB value is to be disregarded.

11.2. Addressing the arguments that the past history of the assessee on which heavy reliance is being placed, it was his submission that each year is an independent year and acceptance of the assessee's method in the preceding assessment year cannot be a

binding precedent. Regarding the position for 2009-10 assessment year, it was his submission that even though no addition has been made but the fact remains that the method of the assessee has not been excepted. Accordingly it was his submission that the departmental stand has not varied.

11.3. It was his earnest submission that internal comparables are the preferable comparables and the TPO is justified in applying such internal comparables and it is of no consequences that in one year such internal comparables give a very low margin as compared to a higher margin in the subsequent year. For the said proposition, reliance was placed upon in ITA No.-3869/Del/2010 in Birlasoft India Ltd. vs DCIT order of the Delhi Bench dated 28.01.2011.

11.4. Inviting further attention to Rule 10B(1)(e)(i) regarding TNMM, it was contended that the said Rule clearly stated that the net profit margin realized by an enterprise from international transaction is to be computed in relation to sales affected. Accordingly It was urged that the TPO was correct in bench-marking, the service charges received by the assessee in relation to the sales affected.

11.5. Supporting the action of the TPO in re-characterizing the transaction and bench-marking the same, reliance was also placed upon ITA No-2469/Mum/2006 in Serdia Pharmaceuticals India vs ACIT by its order dated 31.12.2010. In the facts of the present case, it was submitted that the TPO has rightly re-characterized the transaction of the assessee as a trader and has rightly bench-marked the same with a similar activity carried by the assessee with non AEs.

The margins so earned in respect of the activities carried out for the supplies have rightly been applied for determination of the arms' length price.

11.6. Addressing the findings of the TPO upheld by the DRP in regard to the development of the human chain intangibles, it was his contention that the assessee has built the same and due importance has not been given by the assessee in the course of the arguments, to the said fact. As such these are assets of the assessee company and while determining the arms' length price, the assets so used have to be taken into consideration.

11.7. It was also his submission that it is a well known fact that in such a business, the basis of the starting point is always the gross value of the goods in respect of which services have been rendered and most definitely not the cost incurred in providing indenting services. For the said purpose, reliance was placed upon, order dated 16/12/2012 ITA No.-7977/Mum/2010 in the case of Bayer Material Science Pvt. Ltd. vs ACIT.

11.8. Reliance was also placed upon the judgement of the Co-ordinate Bench in the case of Li and Fung India Pvt. Ltd. 12 ITR (TRIB) 748 wherein it has been held that the Indian entity should get 80% of the total margin earned by its associates enterprise on account of the fact that there was a human chain intangibles asset which the assessee had deployed.

11.9. Attention was also invited to another order of the Delhi Bench of the Tribunal which had already been relied upon by the Ld.

AR namely GAP International Sourcing Pvt. Ltd. referring to the said order, it was his submission that although therein the cost of goods sold has not been the basis of the TP adjustment however the TP was upheld by adopting and adding 32% of the cost incurred in providing support services.

11.10. It was also submitted that the argument advanced on behalf of the assessee that profit earned by the AE should have any relevance and bearing on the issue it was urged cannot be a consideration while bench-marking the international transaction entered into with the AE and for determining the arms length price. As such it was not relevant to consider in the facts of the present case as to how much profit the AE has made in the present case in respect of the trading business for which it provided support services and what was relevant is the determination of the ALP with reference to the services provided and the TPO on these facts is very much justified in considering the margin earned with trading entered into with non AE.

11.11. Accordingly in the arguments that there is a variation in the two years of margins applied namely 1.81% and 13.29%, it was urged is not relevant. Attention was also invited to another order of the Delhi Bench in ITA No-5568/Del/2010 and ITA No.-5680/Del/2011 dated 31.10.2012 in the case of Interra International Technologies India Pvt. Ltd. The said order, it was his submission also support the departmental stand. As such, it was his submission that the impugned orders deserve to be upheld.

12. We have heard the rival submissions and perused the material available on record. In our experience the transfer pricing issues necessarily are extremely factual in nature and any attempt to ignore the nuanced changes in facts and circumstances can lead to wrong conclusions. Consequently for a person or an authority adjudicating on the issues arising in these matters, the need to maintain a constant alertness of not falling in the trap/ dangers of applying principles which may not be supported by FAR analysis etc so that the conclusions do not suffer from the taint of subjectivism and arbitrariness, cannot be over emphasized. Thus on a careful consideration of the facts circumstances and position of law in the light of the judgements and orders cited before the Bench, we are of the view that in the peculiar facts and circumstances, it is necessary first to consider the nature of the business and the business profile of the assessee for our purposes in order to decide the issues before us. The relevance and importance of such an exercise cannot be over emphasized as it is on this edifice that the conclusion in the context of the Rules and provisions, in TP matters can be drawn. Similarly the applicability of the principles of law, as considered in the judgements and orders on which reliance has been placed upon by the parties can be thus considered. In the facts present in the case at hand it is trite law to mention that a judgement decides only what it is called upon to decide. Contextually the principles laid down therein are to be considered in the context of the questions which are required to be considered in peculiar facts and circumstances of that specific case. Thus emboldened by the over-riding and imperative necessity and obsessive compulsions of addressing the facts

correctly, we propose to set out once again for out consideration the facts available on record despite, the fact that they had been discussed in the earlier past of this order. Being a fact driven branch of law to our minds the said exercise is necessary.

12.1 As observed in the earlier portion of this order, we have brought out the business profile of the assessee as taken into consideration by the TPO in both the years and have also dwelled upon the ownership structure. It is seen that neither the TPO nor the DRP or for that matter the CIT DR assessee has either disputed the business profile or the ownership structure. The business profile of the assessee shows that it came into existence in March 2005. Since then it has been rendering services to the group entities of Sojitz Corporation, Japan, headquartered in Tokyo. It may be pertinent to refer that Sojitz Corporation, Japan has the ownership and control of Sojitz Asia Pvt. Ltd., Singapore, i.e the associate enterprise AE which in turn holds 99.99% share capital of the assessee. It is not disputed that the assessee has been providing services to the Sojitz Corporation, Japan and its group entities. SCJ is a general trading company (popularly known as Sogoshosho in Japanese terms) dealing in a wide range of products and services. It is an admitted fact that SCJ has operations in around 50 countries world-wide and operates with a network of 740 consolidated subsidiaries and affiliated countries in Japan and Overseas.

12.2. The nature of the business activities are stated to be wide ranging covering machinery and aero space energy and mineral resources, chemical and plastics, real estate development and forest

products, consumer life style related business and new business development including IT solutions. These facts have not been disputed either by the TPO or the DRP or for that matter by the Ld. CIT DR in the course of his arguments. For ready-reference, it is considered appropriate to extract relevant portion from the TP study of 2006-07 financial year:-

“2. BUSINESS DESCRIPTION

2.1 The Ownership Structure

Sojitz Corporation Japan (hereinafter referred to as “SCJ”) has the ownership control of Sojitz Asia which in turn holds 100% share capital of Sojitz India. SCJ was established in April, 2003.

The Sojitz Group was formed through the business integration between Nichimen Corporation and Nissho Iwai Corporation. These two companies have a history of over a century. This business integration took shape in December 2002 and was followed on April 1, 2003, by the incorporation of a joint holding company. The principal operating arms of the Group, Nichimen Corporation and Nissho Iwai Corporation were merged to form a new single entity, Sojitz Corporation on April 1, 2004.

SCJ is a Japanese entity headquartered in Tokyo. SCJ is a general trading company (also popularly known as sogo shosha in Japanese terms) dealing in a wide range of products and services. Sojitz group has operations in around 50 countries worldwide and operates with a network of 740 consolidated subsidiaries and affiliated companies in Japan and overseas. Sojitz’ business activities are wide-ranging, covering machinery and aerospace, energy and mineral resources, chemicals and plastics, real estate

development and forest products, consumer lifestyle-related business, and new business development including IT solutions.”

12.3. The profile of the SCJ Corporation is as under :-

2.2. Profile of the Group

There are two major categories of trading companies in Japan: a “sogo Shosha,” which is a general or integrated trading company, and specialized trading companies that deal only in specific fields.

These sogo shosha are a unique type of business enterprise that is seen only in Japan. They supply raw materials and technologies purchased from around the world to steel, chemical and other manufacturing companies, whereupon those that were provided with such raw materials, etc., played the role of processing these materials and manufacturing them into products to be sold, and selling them in domestic and overseas markets. The functions of the sogo shosha included the following:

- *Transaction functions, such as trading; stocking functions, such as warehousing; Information-related functions, such as information gathering;*
- *Financial functions, such as financing;*
- *Marketing functions; and*
- *Coordinator functions.*

Due to this varied functions handled by these companies, their relationship with manufacturers and retailers went beyond that of a wholesaler that simply passed goods from one to another. They also supplied their customers with business-related information, made various business-related proposals, and became joint guarantors, etc., supporting their customers in various aspects as a business partner.

The profile of the Sojitz group in particular is domestic trading, import/export, and overseas trading of various products as mentioned above.

The main business of SCJ can be categorized under the following segments:

Machinery & Aerospace Division

- ***Automobiles***
Automobile operations of the group consists of the export of complete builtup (CBU) vehicles and knocked down (KD) components, and assembly and sales; automobile parts and engineering; and activities in after-sales markets.
- ***Information & industrial machinery***
Information & industrial machinery operations mainly consist of the manufacture and sale of bearing, primarily at a JV in China, sales of Surface Mounted Technology (SMT) equipment and telecommunications equipment, and steel plant transactions in Japan and overseas.
- ***Aerospace***
Aerospace business involves support for sales of Boeing commercial aircraft in Japan (Which have a market share of more than 85%) and the sale of Canada's Bombardier commuter aircraft in Japan (market share of 100%).
- ***Ships***
Ships involve the supply of shipbuilding equipment and marine-related equipment, the brokering, purchase and sale of new and secondhand ships, and the ownership of ships.

Energy & Mineral Resources Division

- *Oil, gas, and LNG*
Oil and gas includes upstream investments and loans; FPSO (floating production, storage, and offloading) vessel ownership; the sale of production equipment and devices; and petroleum product trading, imports, and sales throughout Asia.

LNG operations involve investments in gas liquefaction facilities and receiving terminals; LNG vessel ownership; and the import and sale of LNG.
 - *Coal*
Coal involves investing in, developing and operating coal mines and the sale of steaming, coking and PCI (pulverized coal injection) coal.
 - *Mineral resources*
Mineral resources activities include investments in mines and the sale of ore; importing of iron ore, aluminum ingots and copper billet to Japan; and trading of precious metals.
 - *Power and energy & chemicals plants*
Power and energy & chemicals plants operations include energy and chemical plants, and the supply and operation of power plants in Japan and overseas.
 - *Renewable energy*
- Chemicals & Plastics Division**
- *Chemicals*
Chemical products involve the handling of about 1,400 items worldwide, including organic, inorganic, specialty and fine chemicals.
 - *Plastics*

Plastics include the supply of plastic materials of overseas plants of Japanese companies, mainly in China and Asia, and the supply of plastic parts, packaging materials, electronic materials, and other products through JVs with prominent overseas manufacturers.

- *Fertilizer*
Fertilizer operations cover fertilizer manufacturing and sales companies in Thailand, the Philippines and Vietnam;
- *Methanol*
Methanol operations are centered on a methanol plant in Indonesia.

Real Estate Development & Forest Products Division

- *Condominiums*
Condominiums and the development of retail property are the core business. The objective is to contribute to society through business that accurately reflect changes in society and markets.
- *Development of retail property*
In real estate operations, Sojitz is a comprehensive real estate developer with a diverse range of development expertise backed by a powerful business network and information gathering skills.
- *Forest products*
In forest products, Sojitz is recognized as a leader in Japan's forest products market. Sojitz imports timber and timber products from many sources, conducts offshore trading of forest products, invests in overseas forest product supply bases, and has operations in Japan covering the distribution of

forest products and housing and construction materials.

Consumer Lifestyle Business Division

- *Textiles*
Textiles are one of Sojitz's traditional strengths. The company has competitive products in many categories, including raw materials for textiles, textile fabrics, bed linen and apparel.
- *Foods*
Food operations are guided by the main themes of "food safety and peace of mind" and include grains, seafood, meat, and other products. Sojitz has a large number of contract producers and JVs in Japan and other countries. Overall, the company has an integrated value chain extending from upstream raw materials and processing to downstream retail sales.
- *General commodities*
General commodities cover products such as woodchips, infant products, tobacco, motorcycle parts, tires, and many other items. Sojitz has its distinct supply chains in each market.

New Business Development Group

- *ICT*
Information & Communication Technology (ICT) operations include consolidated subsidiary Nissho Electronics Corporation, which provides customers with highly advanced network solutions.
- *Content*

Content operations include the provision of capital to a production committee and the export of anime and other content through Sojitz' overseas network.

- *Environment*
Environmental operations include a comprehensive recycling business that primarily involves the recycling of automobiles and the proper management of waste materials.
- *Healthcare*
In its healthcare business Sojitz undertakes a broad range of activities from supplying the latest medical equipment to acting as licensing agent for drug discovery ventures, providing health foods and essential healthcare services, as well as clinical trial support and other services.

Over the years, SCJ expanded to become a major commercial enterprise trading both in Japan and overseas.

It operates through 12 domestic and 91 foreign branches with consolidated employee strength of 18,642 employees, offering a truly global network of services.

These companies play an important role in linking buyers and sellers for products. What make them unique are their size, scope, information-gathering capabilities, and functional diversity. The Sogo Shosha traditionally and still today, are concentrated in high-volume, low-margin commodities. They handle the importing, exporting, and trading of over 20,000 items including metals, machinery, energy, chemicals, textiles, foodstuffs, and general merchandise.

Some of the Value Added Services being provided by Sojitz Group include Market Information Provision, Credit Supervision & Financing, Transportation Logistics and Project Organizer.

12.4. In the description of assessee's business, TP study brings out the following facts :-

2.3 Description of the Assessee's Business

Sojitz India has its corporate office at New Delhi and a branch office along with a warehouse at Mumbai. Sojitz India was primarily incorporated to undertake trading activity. The company is engaged as a service provider to the various subsidiaries of SCJ for providing sales support and business information.

SCJ undertakes its trading activities in India through Sojitz India. In case of import of goods for buyers in India, SCJ has a contact with the Japanese supplier. Further, SCJ also enters into a contract with the buyers in India. Accordingly, Sojitz India is a mere facilitator for these import sales transaction. Similarly, for exports also Sojitz India is a mere facilitator. SCJ enters into a contract with the Indian supplier directly for the purchase and sales transactions.

The assessee has entered into various arrangements with different subsidiaries of SCJ and the main services among others include the following:

Business support services

- *Support in business promotion*
- *Support in after sales services*
- *Collection of market information*
- *Coordination with customers*
- *Collection of Account Receivables from client on behalf of AE.*

Divisions

Sojitz India is provides support services to its Sojitz Overseas Group Companies. Sojitz India handle different products and commodities during the Financial Year

2006-07 through its different commodity departments, some of which are mentioned below:

- *Machinery;*
- *Automobiles;*
- *Telecommunications;*
- *Chemical; and*
- *Iron Ore etc*

Primarily, Sojitz India deals in export of iron ore, chemicals, marine products and any other industrial products to Japan and other parts of the world.

Imports consist of chemicals, high technology machinery, components for the automobile and telecommunication industry, and items of general merchandise.

*In general, Sojitz India's trading transactions can be classified into **two groups-indent sales and proper sales. Indent** can also be classified into-import from other country into India, export from India into other country.*

***On its indent trading transactions,** Sojitz India's role is that of a mere service provider. Therefore, Sojitz India never takes title or possession of the merchandise at any moment and bears no price risk on inventory.*

***Commission earned by Sojitz India in the indent sales accounts for around 88.67% of its total** turnover during FY 2006-07. Majority of the commission earned is from AE. And among the Group Companies Sojitz India's majority of the commission is from Sojitz Japan.*

Sojitz India's only risk on these transactions is volume risk (or loss of customer risk-i.e., the turnover of this business may not be sufficient to cover its costs). The main types of commodities traded on this basis are iron ore, machinery, chemicals etc.

Sojitz India's main function in indent sales business is to maintain close contacts with the suppliers to ensure timely delivery of merchandise to the customers, in the quantity and grade desired (for exports); maintaining close contacts with Sojitz Japan's customers in India to understand their needs (for imports); communicating with Sojitz Japan or its affiliates; gathering information on demand and supply conditions of these commodities in India; and liaising with government or industry groups.

In case of proper transactions, the Assessee performs trading function. *It takes the ownership of the goods before selling to the buyer. Sojitz India doesn't engage in any significant proper transaction during this period.*

Accordingly, Sojitz India provides support services for facilitating both exports and imports in India through Sojitz Japan and other Group Companies. The support services include gathering information about customer requirements, products, local prices, market trend, etc.

12.5. In regard to the competition, it faces following facts are narrated :-

12.5.1. Competition

The Assessee faces a competition from players operating in India and across the globe. The Assessee has to provide competitive services to its AE, so as to secure its income source. The AE has the liberty to route the trading business transaction and to avail the services of any other intermediary for sourcing the products from India. The support services that the assessee is performing are also performed by other players as well like Marubeni and Itochu. Therefore there is a competition in the market for the said services.

However during the part other national trading companies have also arisen. There are some south Korean trading companies as well that have become substantial in scope and size in recent years and have contributed significantly to the economic development of Korea. Other large, multiproduct trading companies exist: Kesco in Finland; Beijerinvest and KR in Sweden; CFBally in Switzerland, Acklands and Provingo, H Russel, Wajax, and Westburne International in Canada; Jardine Matheson in Hong Kong; and Bousteadco and Inchcape in Singapore.

12.6. The nature of services rendered by the assessee are also not disputed for which payments have been made as commission namely

- i) Support services for facilitating the trading activities of AE:
- ii). Networking with customers;
- iii). Identifying potential customers or suppliers etc.

12.7. A perusal of volume –I page 214-296 of the assessee's paper book which contains a transfer pricing documentation for the year under consideration would show that the description of assessee's business profile describes assessee as a mere facilitator for import/export of goods for SCJ. The contract entered into by SCJ is directly with the Indian buyer or seller as the case may be and the assessee only provides services of a facilitator. In its business profile, it is also set out in its TP study that the transactions which the assessee enters into can be classified into two groups namely a) indent sales and ii) proper sales. The indent sales have been further classified into import from another country into India and export from India to another country.

12.8. On the indenting transactions, the assessee is a service provider and in that capacity at no point of time either it takes possession of the merchandise or enters into contracts in its own name. Consequently it bears no price risk on inventory risk. It is also narrated in the TP study filed by the assessee that the commission earned by the assessee in the indent sales accounts, be it export or import it accounts for about 88.67% of its total turn over for 2006-07 financial year and majority of the commission earned is from its AE and amongst the group companies, the assessee's majority of the commission is from SCJ, Japan and the only risk which the assessee is exposed to is the volume risk. As assessee is a mere service provider and all decision making negotiating planning and network of SCJ is utilised by SCJ itself Since volume risk is directly borne by the SCJ and its associates the assessee's risk here is also minimal. The functions in indent sales business is to maintain close contacts with the suppliers to ensure timely delivery of merchandise to the customers in that quantity and grade desired for exports; maintaining close contacts with SCJ customers in India to understand the needs for imports communicating with SCJ, Japan etc.

12.9. The un rebutted TP Report states that in the category of proper transactions as opposed to indent sales, the assessee has performed trading functions at its own risk. Herein like a normal trader, the assessee takes the ownership of the goods before selling them to the buyers. The TPS study defines that the assessee's engagement in this activity is not significant. However it has not engaged in any significant proper transaction during this period.

12.10. The transfer pricing study in Chapter 2 as reproduced above, addresses the competition, it faces from the players operating in India and across the globe. Accordingly it seeks to justify that the services provided have to be competitive so as to secure its income source as the AE has the liberty to route the trading business transactions and to avail the services of any other intermediaries for sourcing the products from India.

12.11 In the TP study, addressing the Functions, Assets and Risks analysis at page 239, of the paper book (internal page 22 of the TP study) it is informed that the Associated Enterprise undertakes all the trading activity and core marketing functions and the assessee provides only support services. The functions of the AE as informed whether as an exporter or an importer and even as a domestic trader in Japan involves sourcing products and developing business opportunities worldwide, marketing and distribution of wide variety of products. The AE enters into a contract with the buyer/ seller with regard to the supply of goods directly.

12.12. The T.P study further shows that the development of strategies, entering new ventures, marketing and sales functions are all performed by the AE, all major decisions relating to servicing the contract and related services are also taken by the AE in terms of the extent, timing, sequence and prioritization etc. Further decisions relating to entering into new markets and forays into emerging technologies are also taken by the AE. The assessee on the other hand undertakes indent sales on behalf of SCJ. The transactions involved as per page 240 of the paper book (internal page 23 of the

TP study), are described as low level activity and relatively limited risk for the assessee in comparison to a typical Indian export/import company.

12.13. It is seen that it is claimed that the assessee merely acts as an intermediary and at no point of time is part of the supply chain. The contracts as per the TP study are always entered into by the SCJ or its group entities with the Indian exporter or importer as the case may be. Since the customers are located in India, the assessee merely maintains relationship with the customers in India for SCJ and its affiliates. Addressing the low level of functions performed, the TP study, describes the assessee as acting merely as a conduit. The customers largely being traditional, consequently the marketing efforts in identifying the customers are also minimal. The negotiations with the supplier and the customers are always undertaken by SCJ and the assessee merely acts as a conduit for passing the information between the SCJ and the customers. Consequently analyzing the functions performed show that the assessee was described as a limited service provider with a minimum risk in regard to the strategic policies: Finance and Accounting, IT Legal and Human Resources Management etc.

12.14. It is seen that the assets utilized by the assessee are vehicles, lease hold improvements, computers office equipment, furniture and fixture all totaling to about Rs.1,10,10,079/-[as per the page 248 of the TP report]. As per the TP Study Report on record which has not been controverted the intangibles required to carry out the operations of the assessee are owned by SCJ and that the SCJ

possesses entrepreneur knowledge with respect to the operation of the global trading network. The assessee is stated to have neither developed nor does not it have any intangibles asset in its business operation in India. For rendering services to the AEs the assessee uses the global network of SCJ.

12.15. Looking at the risks to which the assessee is exposed as per the Transfer Pricing Report, it is seen that assessee has no Credit Risk (as the AE is directly invoicing the end customer the risk is borne by them); Volume Risk (assessee's commission is dependent on business Sojitz Japan gets from India, and therefore the assessee bears this risk, as low turn over may affect its profitability which risk too is directly borne by the AE so assessee is only indirectly affected); Foreign Risk (assessee paid in currencies of AE so difference in respective currency and conversion rates is borne by assessee), Warranty Risk (no warranty risk borne by the assessee). Considering all these aspects the assessee is classified as low risk borne company. Accordingly after considering the detailed, FAR analysis of the assessee considered the TP study available on record which has not been controverted by the TPO or the DRP, it is seen that as far as the indenting activities are concerned the assessee is engaged in a low risk activity.

12.16 A further study of its transfer policy report shows that the assessee, for selecting the most Appropriate Method (MAM), considering the applicability/ feasibility of each of the prescribed methods namely

- * Comparable Uncontrolled Price Method (CUP)
- * Resale Price Method (RPM)
- * Cost Plus Method (CPM)
- * Transaction Net Margin method (TNMM)
- * Profit Split Method.(PSM)

discards all except TNMM, for the reasons given at pages 251 to 255. Since the selection of method is not an issue in the present proceedings reference there to is being avoided. Considering the nature of the transaction and the availability of relevant comparable data, TNMM was considered to be the most appropriate method in selecting the comparables. Discussion thereon is also being avoided as it is not an issue raised in the present proceedings. The assessee took itself as the tested person the OP/TC was considered as the most appropriate PLI by the assessee.

12.17. In the above background it is seen that the TPO has discarded the method and computed the Arms Length Price (ALP) on the basis of profit earn by the assessee in its trading activity and the margin earned thereon has been applied on the basis of total FOB value of the goods.

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 judgements 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 :

(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 utilising 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.

13. We now propose to discuss the orders/judgements which have been referred to by the parties, for our consideration which we have considered before arriving at the conclusion. The principles laid down in the judgements/orders in the facts of the cases have been kept in mind before arriving at the conclusion. However for the sake of convenience and lucidity they are being discussed separately hereunder:-

13.1. The first order which we propose to discuss is the order dated 16.12.2011 in 13.1.2 **ITA No.07977/Mum/2010 in the case of Bayer Material Science Pvt. Ltd.**

13.1.1 It is seen that therein the stand of the assessee, was that the trading activity and the indenting activity was similar as such segmental profits were not required to be considered. This stand of the assessee was neither approved by the TPO nor by the ITAT as the FAR analysis demonstrated that the function and risks of the two activities were very different.

13.1.2 The assessee's claim was that assets utilized were same for both the activities and certain expenses on being asked, were allocated on a turnover basis. The approach of the assessee in allocating the common assets utilized at 1:1 ration was not approved.

13.1.3 The material fact prevalent in the said case was that the turnover was achieved through the efforts of the assessee which is a relevant point/ fact to be taken into consideration and it is not a fact in the present proceedings. In the facts of the present case the assessee is only a service provider and acts as a facilitator and the FAR analysis available on record has not been rebutted. The stand of the TPO which has been approved by the ITAT infact supports, the view taken in the present proceedings that the indenting activity cannot be treated at par with the trading activity.

13.2. Order dated 31.12.2010 in ITA No.02469/Mum/2006 and others in the case of **Serdia Pharmaceuticals (India) Pvt. Ltd. Vs ACIT, Mumbai** has also been referred to by the Ld. CIT DR in support of the proposition that transactions can be re-characterized by the T.P.O.

13.2.1 At the outset there can be no quarrel with the said proposition as powers to do so have been vested on the TPO. However, there is a caveat which operates while exercising the power which necessarily is to be balanced with the duty to do so only on consideration of the facts available on record which necessitate such an action and it is not an arbitrary unfettered power.

13.2.2. A perusal of the said order would show that the findings therein were on a peculiar and specific, set of facts in which the assessee was operating and those facts are not in operation in the present proceedings. For ready-reference, we reproduce para 92 from the said order :-

“92. We, however, see no substance in this plea. When an excessive payment for goods or services is made to an associated enterprises, it has two implications- first, that domestic tax liability is reduced in respect of income of the enterprises situated in that tax jurisdiction, and – second, a payment for dividend, royalty or other income is made to the foreign AE in the garb of payment made to the foreign AE is wrongly characterized as payment of goods or services, it is only a natural corollary of this finding that the payment so made in excess of arm’s length price must have some other character. While a lower deduction, on account of ALP adjustment, neutralizes the erosion of domestic tax base caused by reporting artificially lower profits, a simplicitor ALP adjustment does not neutralize the non-taxability, in source country, of the payment of dividend, royalty or other incomes to the foreign AEs, in the garb of payment for goods or services. Many countries, including Canada- by way of Section 247(2) of Canadian Income Tax Act, neutralize this ill effect of a payment in excess of arm’s length price by providing for re-characterizing the amount paid in excess of ALP. In India, re characterization provisions in respect of payments made in excess of ALP have not yet been legislated, but that does not mean that judicial precedents from the countries where recharacterization of payment in excess of ALP payment is permissible, cease to be relevant in India. These decisions, though they go a step further than the present legal position in India, continue to

be as relevant and as useful as they would have been in the absence of such re characterization provisions in the respective countries. The rationale and logic of these decisions continues to remain unaffected by these provisions. The objection raised by the learned counsel is devoid of legally sustainable merits.”

13.2.3 However for the justification of re-characterizing the indenting activities as a trading activity in the present case some necessary exercise has to be done by the TPO. It has to be demonstrated from facts to show as to how the assessee though calling itself a “service provider” was actually acting as a “trader”. No such discussion, reasoning or fact is on record. On the contrary, the consistent stand of the assessee is that neither the goods have been purchased in its name nor are the contracts entered into are in the name of the assessee as such neither there is a price risk, inventory risk nor, credit risk etc. As such in the absence of facts justifying the re-characterization of the transaction the powers of the TPO which have been upheld for re-characterizing in the facts of Serdia Pharmaceuticals case does not help the Revenue, in the present proceedings. The TPO in Serdia Pharmaceutical case had discussed the FAR analysis of the assessee and found it to be contrary to the stated stand. On the facts of the present case, we are unable to concur with the stand of the Revenue namely that the TPO was justified in re-characterizing the transaction, as the order of the TPO and the DRP are devoid of discussion on facts and proceed on general assumptions. The order of the Mumbai Bench of the Co-ordinate Bench in the case of Serdia Pharmaceuticals India vs ACIT

proceeds on facts available on record and which are peculiar to itself and it does not lay down any general proposition.

13.3. Attention has also been invited by the Revenue to the order dated 20.01.2011 in ITA No.-3839/Del/2010 and others in **Birla Soft (India) Ltd. vs DCIT** in support of the proposition that internal comparables are preferable to other comparables.

13.3.1 The said proposition is an accepted proposition. The rationality for preferring them is based on the fact that for internal comparables no adjustments, need be made as FAR analysis remains the same. However for doing so the nature of service/product in respect of which transactions, have been undertaken with related parties and unrelated parties are necessarily have to be the same and identical.

13.3.2 In the facts of the present case, looking at the diverse nature of trading activities entered into by the associated enterprise with its Indian customers ranging from machinery and aerospace, energy and mineral resources, chemical and plastics, real estate development and forest products, consumer lifestyle related business and new business development including IT solutions wherein the assessee is a service provider and the trading activity which the assessee has done at its own level is limited to some sales to local entities. No comparison has been made and the material distinction in the two activities namely that of a facilitator and those of a trader are separate and distinct which makes the conclusion arrived at in the said order/inapplicable.

13.3.3. There is no similarity between the internal comparables applied and the international transactions of support services entered into with the AE. Not only the two activities are entirely distinct which is the material distinction but even otherwise, no similarity has been established in the nature of goods in which the AE's have transacted with the buyer Indian supplier and the assessee has traded at its own level.

13.4. Attention has also been invited on behalf of the revenue to the order dated 31.10.2012 in ITA No.-5568/Del/2010 in the case of **Interra Information Technologies (India) Pvt. Ltd** for the proposition that profit of the AE cannot be a consideration while bench-marking the international transactions in order to arrive at Arms Length Price.

13.4.1 A perusal of the said order shows that Ld. AR in the facts of the said case requested the Bench to lay down the proposition that transfer pricing adjustment at best cannot exceed the amount of margins retained by the assessee, as well as the AE. A perusal of para 67,68 & 69 would show that the said request was turned down on the reasoning that in the absence of any provision in the Act and the Rules and also practical difficulties as the profile of the entire group was not subjected to scrutiny of the Indian authorities, the request was turned down.

13.4.2 In the facts of the present case, neither the TPO has directly proceeded on that footing nor has that been the rational canvassed by the assessee for assailing the departmental stand. The said order has no relevance in the facts of the present case. The

TPO has proceeded on the footing that the two activities are similar and on consideration of the business profile, a FAR analysis of the assessee, we have come to the conclusion that the two activities are not similar as such the proposition that profit of the AE can not be a consideration while bench-marking the international transactions in the facts of the present case has no relevance. Consequently the finding therein has no bearing on the present proceedings.

13.5. Reliance on behalf of the Revenue has also been placed upon the order dated 30.09.2011 of the Tribunal in ITA No-5156/Del/2010 in the case of **Li & Fung (India) Pvt. Ltd. copy** filed by the Ld. CIT DR.

13.5.1 A perusal of the said order rendered by one of us (Ld. AM) would show that the assessee company therein provided buying/sourcing services for supplying the consumer goods from India for its AE Li Fung India Pvt. Ltd, Hong Kong who was sourcing the goods on behalf of its international customers. The assessee was paid service charges for the services computed on the basis of cost plus mark up method.

13.5.2 The crucial fact for holding that FOB value of goods should be the basis for commission of the assessee was the fact that the assessee admittedly utilizing its human intangibles and supply chain intangibles which had created by it at its own cost **had performed all, the critical functions and in the facts of that case and the AE demonstrably and admittedly had no competence to execute the contracts on its own and thus being completely dependent on**

assessee for rendering the services, was earning commission on FOB value of goods and the assessee, on the other hand was being meagerly compensated by cost plus mark up.

13.5.3 Thus in those facts where all the critical functions were being performed by the assessee utilizing its unique intangibles, who had the professional and technical capabilities which was further demonstrated from the fact as the assessee in the facts of that case in the earlier years was claiming and had been allowed Sec 80.0 deductions. Thus the existence of expert knowledge and the demonstrated core competence of the assessee was on record. There is no such evidence/material available on record to suggest that the assessee which came into existence in March 2005 had the expert knowledge available for taking critical decision. The critical decisions admittedly were taken by the AEs i.e SCJ and its affiliates who have been global players for over 50 years. The contracts were entered into in their names, negotiations were done by them and the critical decisions of timing, extent, exposed were all taken by them wherein the assessee was merely a facilitator.

13.5.4 As such the finding arrived in the order of Li & Fung India Pvt. Ltd. proceeds on peculiar facts and circumstances of that case where the AE was held to be not capable of executing the contracts and was receiving commission on FOB value and all the critical functions were being performed by the assessee who was paid only on cost plus basis. Thus on these facts, it was held that such a transaction in the face of it could not be said to be at arm's length. The earning of the AE received as a percentage of FOB was completely dependent on

the assessee who had used its tangible and unique intangibles developed over the years at its own cost utilised the supply chain management and delivery, location & advantage qua manufactures and labour costs and its pricing cost advantages to make available to the AE who was unable to execute the contracts on its own, thus when the AE could earn commission on FOB value of goods why should the assessee be deprived of it since critical functions were being performed by the assessee. As a result the overall earnings of the AE were reduced to 20:80 ratio. The facts and FAR analysis, in the present proceedings are entirely different. It was also held therein that the amount of adjustment computed by the TPO can not exceed the amount which could have been received by the AE. The compensation was allocated in the ratio of 80:20 between the assessee and its AE.

13.6 Attention on behalf of the Revenue has also been invited to order dated 31.01.2013 in ITA No-5095/Del/2011 in the case of **Sumitomo Corporation India Pvt. Limited Vs. DCIT case.**

13.6.1. A perusal of the said order shows that trading transactions were held to be different from indenting transactions as such it supports the view taken. The assessee there in agreed that the margins earned with non-AEs, be applied to margins earned from the AE as it was the same service. Thus when there were internal comparables in the same nature of transactions they were the preferable, comparables. Relevant findings are reproduced hereunder from the said order:-

“23. We agree with the assessee’s proposition that the nature of indenting transaction is different from the trading transactions. The trading transaction involves risks and finances. Whereas in the indenting transaction the assessee has not to incur any such financial obligation or carry any significant risk. Moreover, we note that in respect of indenting transaction with non-AEs, the average mean margin of profit of 2.26% has been accepted by the TPO. We further find that the indent business of the assessee was nothing but trade facilitation and is purely of indent nature both in form and substance. No material has been brought on record to regard the indent transaction as trading transactions.”

Accordingly it is seen that no strength can be derived by the Revenue from the said order as in the facts of the present case it supports the case of the view taken.

13.7 Reliance has also been placed on order dated 18.09.2012 in ITA No-5147/Del/2011 in the case of **Gap International Sourcing (India) Pvt. Ltd. vs ACIT (2012) 25 Taxmann.com 414** for the proposition that Li & Fung case was considered and distinguished by the assessee. The Revenue has relied upon the same for the proposition that make up of 32% was upheld in the TP adjustment.

13.7.1 For the said purpose it is necessary to refer to the facts considered by the co-ordinate Bench. In the said case, the

assessee was a wholly owned subsidiary of GAP International, USA, and was engaged in facilitating sourcing of apparel merchandise from India for the parent group. It filed its TP report claiming TNMM with cost plus 15 per cent remuneration to be the most appropriate method for determination of 'ALP'. The TPO, however, looking at the function assets and risks analysis (FAR) and other factors, rejected the assessee's cost plus 15 per cent ALP and held that commission at the rate of 5 per cent on the FOB value of goods sourced by the foreign enterprise through Indian vendors was the most appropriate profit level indicator (PLI) for determining ALP. This was so because the functions performed, assets owned and risks assumed by the assessee were substantially more than limited risk and assessee's functions were not only that of a service provider but of a higher responsibility. Further it was inferred that the assessee created substantial intangible assets through its operations. The TPO also alleged that on account of operating in a low cost economy, the assessee had generated location savings in India which had not been factored into its remuneration model. The TPO thus rejected the assessee's cost plus remuneration based model. TPO's report was

accepted by DRP. The issue was agitated by the assessee before the Tribunal.

13.7.2 Considering the FAR analysis it was held by the co-ordinate Bench that the assessee was a low risk procurement service provider. The co-ordinate bench concluded that the assessee proposed the use of TNMM as the most appropriate method with net profit/total cost as PLI. The department accepted the TNMM with a percentage of FOB value of goods procured by parent as PLI. The dispute in regard to use of the same considering the FAR analysis and order of Li & Fung the issue was decided in the following manner:

“vi. Considering above we conclude that non risk bearing procurement facilitating functions which are preordained by contract and hand book, the appropriate PLI will be net profit/total cost and not the % of FOB value of goods sourced by AE. Accordingly, we uphold the net profit/total cost remuneration model adopted by the assessee. Having held so now we proceed to decide the percentage of markup to be applied to assessee’s cost.”

13.7.3. Since in the facts of GAP International Sourcing the assessee had applied cost plus 15 % ALP and the entire commission of Li & Fung Group to Li & Fung India was worked out as per the calculations provided by the assessee’s counsel, his suggestion that the OP/TC of Li & Fung India worked out of 32.43 % be applied. The said proposal of the assessee was accepted and 32% cost plus mark up was accepted in GAP International. In the facts of the present

case the said findings has no role to play as it was a concession given by the assessee in the said case.

14. Accordingly for the reasons discussed hereinabove on facts and law in the light of the arguments advanced before the Bench and the material available on record the ground no 2-5 in ITA No-5186/Del/2011 and ground NO 3 to 8 in ITA No- 543e/Del/2012 are decided in assessee's favour.

15. In ITA 54331/Del/2012 in the remaining ground 9 the assessee has assailed the action of the TPO upheld by the DRP in limiting depreciation to 15% in regard to the computer peripherals as opposed to the 60 % as per assesses claim . It is seen that the issue is no longer res integra as the same stands covered by the judgment of the jurisdictional High Court in assessee's favour in the case of CIT Vs. BSES Rajdhani Limited Both the parties have been heard. The AO is directed to grant necessary relief. Ground NO-9 is allowed.

In the result, ITA 5186/Del/2011 is allowed and ITA 5433/Del/2012 is partly allowed for statistical purposes.

The order is pronounced in the open court on 15th of May 2013.

Sd/-

(B.C. MEENA)

ACCOUNTANT MEMBER

Dated:15/05/2013

**Amit Kumar*/R.Naheed*

Sd/-

(DIVA SINGH)

JUDICIAL MEMBER

Copy forwarded to:

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

ASSISTANT REGISTRAR
ITAT NEW DELHI