

TPO couldn't adopt a method different from earlier year for ALP computation without assigning cogent reasons

Summary – The Kolkata ITAT in a recent case of DIC India Ltd., (the Assessee) held that where T.P.O. applied TNMM to benchmark international transaction of assessee in earlier year and subsequent years for similar transaction of same value, it was not open to TPO to take a different base, i.e., CPM, for working of ALP without assigning cogent reasons

Facts

- The assessee-company was engaged in the business of manufacturing, trading and selling of printed inks, industrial adhesive & other allied products. The assessee had imported products for trading and exported manufactured goods to its AE.
- The assessee in its transfer price study had worked out the mean PLI (operating profit/sales) of the comparable companies at the rate of 3.10 per cent in relation to its export to its AE. The assessee had demonstrated that its operating profit was at rate of 4.58 per cent on the value of the exports. Accordingly, the assessee submitted that there was no need to make any adjustment in the amount of profit as it had exported the goods to its AE at ALP or imported the goods from AE at ALP.
- The Assessing Officer disagreed with the method adopted by the assessee for working out ALP of the goods exported/imported. He observed that the transactions with AE were less than 5 per cent and, therefore TNMM was not the most appropriate method. The Assessing Officer also observed that the assessee for the earlier assessment year used the CPM method for the export to AE and RPM method for the Export from AE and adopted the CPM and worked out the ALP for the exported goods. Hence, upward adjustment of export to AE at the rate of 3 per cent was worked out. Similarly, the Assessing Officer worked out the ALP for the trading goods using the resale price method. The TPO disregarded the plea of the assessee by observing that the assessee himself used RPM for earlier assessment year to determine the ALP of the import transactions with.
- The Commissioner (Appeals) held that the TPO was not justified in rejecting TNMM for the reasons set out in his order because in the immediately preceding year also, assessee had adopted the same method. The TPO took into account only the direct material consumption cost but failed to consider the proportionate manufacturing cost, royalty & commission payments. The TPO did not appreciate facts of the case in proper perspective but made comparison of profit margins of dissimilar products having different end uses and, therefore, profit margins of such dissimilar products could not be considered for determination of ALP.
- On revenue's appeal:

Held

- There is no provision under the Act with regard to the value of the transactions for selecting the method for the determination of ALP. In the instant case the TPO has rejected the transfer pricing study of the assessee holding that the international transaction is less than the 5 per cent to the

business and, therefore, he adopted the other method for determining the ALP. But contrary to his finding the TPO has accepted the other international transactions where the volume was again less than 5 per cent to the total turnover of the assessee *i.e.* Royalty, commission *etc.* in the earlier years and subsequent years, the assessee entered into international transactions with similar value but no addition was made and, therefore, it was not open to the TPO to take a different base for the working of ALP without assigning cogent reasons than that of the method followed consistently. The arguments of the department that the TPO did not reject the TNMM on the ground that CP Method & RP Method were used by the assessee in earlier year but the TPO worked out the ALP of the International transactions on the basis of functional analysis do not hold good. Before adopting the CPM/RPM, the TPO had to first reject TNMM and that too with reasons for the rejection. The TPO has considered only cost of raw materials consumed and no other associated costs was considered in arriving at the G.P. margin. The TPO in order to apply CP Method, should take into consideration cost pertaining to raw materials, labour, factory overheads, direct & indirect expenses, *etc.*, All the aforesaid cost heads are included for determination of the 'cost of goods sold' as per rule 10B which lays down the manner in which the CP method is to be applied.

- From bare perusal of the rule 10B it is evident that for applying CP method, one has to compute the cost of production which shall include both direct & indirect costs. The TPO was therefore clearly wrong in considering only the 'cost of raw materials' as the complete 'cost of production'. Similarly the product similarity in the products is essential for the determination of ALP. The profit margins of products sourced locally or imported varied significantly. These infirmities were not considered by the TPO. The profit margins varied significantly depending upon the fact that the products were either sourced locally or imported. The assessee had imported printing inks from AEs worth Rs. 7.06 crores which was sold to unrelated parties for Rs. 8.09 crores resulting in gross profit margin of 13 per cent. Correspondingly, the assessee had imported press chemicals from related parties worth Rs. 1.75 crores which was sold to unrelated parties for Rs. 2.02 crores yielding profit margin of 14 per cent. Without prejudice to the assessee's contention that the aforesaid margins would require turnover adjustment and working capital adjustment, it was observed that the margin of 13 per cent earned from transactions with related parties was found comparable to margin of 14 per cent earned from uncontrolled transactions and was therefore held to be at arm's length by the Commissioner (Appeals). The difference in margin of 1 per cent was well within the permitted range of +/- 5 per cent allowed in second proviso of section 92C. In view of above, there is no infirmity in the order of the Commissioner (Appeals).