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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 738/2016

PRINCIPAL COMMISSIONER OF
INCOME-TAX – 2 ..... Appellant

Through: Mr. Dileep Shivpuri, Mr. Sanjay Kumar and Mr. Vikrant A. Maheshwari, Advs.

versus

M/S BESTSELLER UNITED INDIA PVT. LTD. ..... Respondent

Through: Mr. Himanshu Sinha and Ms. Vrinda Tulshan, Advs.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

O R D E R

% 21.11.2016

1. The Revenue has appealed against the order of the Income Tax Appellate Tribunal (in short 'ITAT') which had set aside the Transfer Pricing ('TP') Adjustment made to the Arms Length Price ('ALP') finally determined by the Transfer Pricing Officer (in short 'TPO') and endorsed by the assessee. This was partly modified by the Dispute Resolution Panel (in short 'DRP') in the course of its order.

2. The assessee AE is the parent company of an international organization engaged in the business of trading of clothes under its brand which are primarily manufactured in Asia and sold in Western Europe. The AE owns several wholesale entities around the world responsible for selling and distributing its goods in the domestic

market. Local retailers are its customers; the goods are retailed in Bestseller concept stores as well as independent multi brand retailers.

3. For the relevant Assessment Year ('AY') 2008-09, in the TP Report the assessee claimed an OP/OC (operating profit/ operating cost) margin of 437%, which is best represented in a tabular format as follows:

Particulars	**Amount (in Rupees)**
Commission Income	138843318/-
Administrative & Other Expenses	25633901/-
Depreciation	241608/-
Total Operating Cost	25875509/-
Operating Profit (OP)	1129678090/-
OP/OC	437%

4. In the course of the TP's analysis for ALP determination the TPO concluded that the comparables used were not appropriate having regard to the nature of the assessee's activities and risks it undertook. The TPO also took exception to the multi-year data used by the assessee in this case. The assessee approached the DRP complaining that the ALP determination was flawed. It was contended that the comparables rejected by the TPO were erroneous and also that the data of the comparables used were inappropriate because all those entities were involved in manufacturing, which the assessee was not involved in. The DRP partially gave relief to the assessee. As against the profit margin determined at 8.07% of the FOB value of the goods by the TPO, the DRP reduced it to 5%.

5. The ITAT reversed the view of the DRP on the ground that the facts shown indicate that the assessee's margin of profit was correctly reported and secondly that the comparables used in the TP exercise by the TPO itself were inappropriate because all concerns were involved in manufacturing. In the course of its order the ITAT relied upon the previous Division Bench's ruling in ***Li & Fung India Pvt. Ltd. vs CIT (2014) 361 ITR 85 (Del)***.

6. We have heard the counsel for the parties. The learned counsel for the Revenue reiterated that a close reading of TPO's order would show that the assessee undertook significant risks, such as the examination of samples, which had a high probability of being rejected. Besides, the learned counsel submitted, the assessee was involved in complex technical functions which included negotiation for procurement of raw-material and samples that ultimately had to be manufactured. In these circumstances the application of the comparables by the TPO i.e. as endorsed by the DRP were justified and could not have been upset. The ITAT's decision in this case *inter alia* reasons as follows:

> *"...... 16. TPO while rejecting the TP study relied upon by the assessee company for benchmarking its international transactions proceeded to hold that the unique intangibles created by the assessee company over a period of time have given an advantage to the AE in the form of low cost of product, quality of product and enhanced the profitability of the AE but the cost for development and use of intangible was not taken into account for computation of routine mark-up of 2.5%. The*

TPO came to the conclusion that, " the remuneration model used in this case does not provide compensation to the assessee at ALP as the model does not include compensation from development and use of intangibles and moreover, the cost of goods has not been reflected while computing the remuneration."

17. The TPO primarily based his findings to determine the ALP of the international transactions of the assessee company by relying upon the case of Li and Fung India Pvt. Ltd. (supra), which has been set aside by the Hon'ble jurisdictional High Court, on the grounds, inter aha, that the assessee falls in the category of "contract manufacturing" that the assessee performed all critical function relating to contract manufacturing, assumed significant risk and used both tangibles and unique intangibles developed over a period of time, thus become a full risk bearing contract manufacturing; that it is highly unlikely and impractical that there is a direct communication between vendors and the AE of the assessee company; that the very fact of outsourcing of the manufacturing process does not convert assessee from manufacturing to sourcing agent; that the AE has deployed the assessee in India to oversee the manufacturing of the required goods, handle the required quality control, the logistic, the documentation process related to export, etc., so, the assessee bears the entire risk relating to the manufacturing and sales of those goods and as such, the assessee's compensation model does not capture the reality of the FAR, that the TPO, after considering the FAR analysis of the assessee and various other factors as to the development and use of intangibles and locational savings enjoyed by the assessee company and its AE, the compensation that received in a cost plus model is not adequate and as such, does not meet arm's length principle; that the TPO came to the conclusion that since the difference of the arm's length margin and the margin shown by the assessee

> *varies by more than 5% of the ALP and by computing arm's length margin at 8.07% at Rs. 44,81,86,231/-, made an adjustment of Rs. 30,93,42,913/-...."*

7. The ITAT examined the close commonalities between the facts in ***Li & Fung India Pvt. Ltd.*** (supra) and the present case and listed no less than 21 reasons to support this conclusion that the OP/TC of the assessee at 437% was much higher than 12.27% of the comparable companies which were involved. Such comparable companies were engaged in activities similar to or identical with that of the assessee and were not manufacturing comparables as in the case of TP/DRP's findings.

8. Having regard to the fact that the analysis carried out by the ITAT was both intensive and exhaustive and also in view of the fact that it held the ruling of this Court in ***Li & Fung India Pvt. Ltd.*** (supra) as against the TPO and DRP, who held the ruling of the ITAT in ***Li & Fung India Pvt. Ltd.*** which had been set aside by this Court, we are of the opinion that the impugned order is not erroneous. No question of law arises. The appeal is, therefore, dismissed.

S. RAVINDRA BHAT, J

NAJMI WAZIRI, J

NOVEMBER 21, 2016/kk