Product similarity is must for applying CUP method, not for TNMM. Where assessee sells non-whisky alcoholic beverages(Vodka, Gin, Brandy, Rum etc) to non-AEs and whisky to AEs, Net Profit Margin on sale by assessee of non-whisky alchololic beverages cannot be rejected as internal TNMM for calculating ALP on assessee's sale of whisky to AEs simply based on distinction between whisky & non-whisky as two different products

Summary – The Assessee, (M/s Diageo India Pvt. Ltd.) was engaged in the business of manufacturing and trading of various brands of alcoholic beverages. The assessee, in the transfer pricing report and also before the TPO, submitted that it has carried out comparability analysis between the transaction involving A.E. and domestic transactions and treating it to be internal comparable under the Transactional Net Margin Method (for short "TNMM"). The TPO required the assessee to explain as to why internal transactions of purchase be not benched marked on the basis of net margin of comparable companies. In response, the assessee furnished 15 comparables with their net profit margin following TNMM. The TPO rejected the internal TNMM adopted by the assessee and after taking 15 comparables as furnished by the assessee and bench marked the average arithmetic mean of 0.96% as arrived with that of the assessee's operating margins and made the adjustment of Rs. 1.56 crores. The Mumbai Tribunal held that rejecting of internal TNMM simply on the basis of distinction between whisky and non-whisky as two different products is wholly undesirable and cannot be a ground for rejecting internal comparability and, therefore, such a finding and observation of the Tribunal cannot be said to be a binding precedence in the present case. In view thereof, the adjustment of Rs. 1.56 crores made by the TPO/DRP was deleted.

Facts

• The assessee is a subsidiary company of Selviac Netherlands, B.V. which is a part of worldwide Diageo Group which holds 100% of the equity share capital of the assessee.

• Diageo is the world leading alcoholic drink manufacturing company and is carrying on trading in over 180 countries.

• The assessee's key business activities in India comprised of manufacturing and marketing of various international brands of alcoholic beverages.

• The assessee maintained segmental accounts with regard to its transactions with A.E. as well as non–A.E.

• The A.E. transactions were mostly related to whisky segment non A.E. transactions consisted of non whisky segment viz. Vodka, Rum, etc.

• In the transfer pricing report, the assessee had submitted that it had carried out comparability analysis between the transactions involving the A.E. and the domestic transactions treating it to be the internal comparable under the TNMM. The assessee also submitted 15 external comparables as desired by the TPO wherein the average profit margin worked out to 0.96% whereas the assessee's operating profit upon total sales came to (–) 20.71%.

• The TPO, after rejecting the internal TNMM adopted by the assessee in the transfer pricing report benchmarked the operating profit margin with that of the 15 external comparables and made an upward adjustment of Rs. 1.56 crores.

Held

• The Mumbai Tribunal held that from the segmental details of assessee for transactions with AE & transactions with non-AEs it is evident that that there is functional similarity not only with regard to the business line but also the entire operations of business functions, assets employed and other variables of cost and operating expenses.

• The operating income as well as the operating expenses and profit level indicators were quite similar. Thus, this case was a fit example of 'internal comparability' as one is a controlled transaction with the related party and other is an uncontrolled transaction with the unrelated party.

• The arm's length result under TNMM is determined by reference to net profit margin of a comparable transaction under comparable circumstances. The profitability derived from uncontrolled parties engaged in similar business activity under similar circumstances is the measure of arm's length result.

• The focus under the TNMM is on transactions rather than operating income of the enterprise as a whole. Once in a particular case, the nature of transactions and functions between controlled transactions with the related party and uncontrolled transactions with unrelated party are similar then internal comparability would result in a more appropriate result of ALP and it will require the least amount of adjustments.

• The product similarity has to be seen while applying CUP method and not under the TNMM because under the CUP, the focus is on the price of the product sold or transferred and not on the transaction.

• In assessee's case, the transactions with the A.E. and unrelated parties relate to alcoholic beverages and these are similar business lines. Making an intra distinction between types of alcoholic beverages like "whisky" and "other than whisky", is not desirable while carrying out comparability analysis under the TNMM.

• Because under the TNMM, functional comparability of transactions are to be analysed at net profit margin level, if such a high degree of similarity is seen in a TNMM, then it would become impractical to apply TNMM in any of the cases.

• Thus, the Tribunal held that, rejecting of internal TNMM simply on the basis of distinction between whisky and non–whisky as two different products is not desirable and cannot be a ground for rejecting internal comparability and, therefore, such a finding cannot be said to be a binding precedent in the present case.

• In view of the above, the adjustment of Rs 1.56 crores made by the TPO / DRP was deleted.