

Delhi ITAT uses 'Berry Ratio' to determine ALP for Sogo Sasha entity by following case of 'Mitsubishi'

Summary – The Delhi ITAT in a recent case of Marubeni Itochu Steel India (P.) Ltd., (the Assessee) held that Berry ratio can be used as PLI in benchmarking ALP for indenting and steel trading transactions of assessee; it does not offend rule 10B

Facts

- The assessee a Japanese company was engaged in the business of trading of steel items and providing liasioning support services to its parent and affiliates for purchase and sale of goods in India. It acted as a communication channel between its parent/affiliates companies and third parties in India.
- During the relevant assessment year, the assessee undertook 2 types of international transactions with its Group Companies, namely, provision of support services *i.e.* service segment and purchase of steel products from its group companies, for the purpose of resale in India *i.e.* the trading segment.
- The assessee adopted TNMM as the most appropriate method and, Operating Profit/Value Added Expenses (OP/VAE) for support services and Operating Profit/Sales (OP/Sales) for trading activity was selected as the Profit Level Indicator (PLI) to benchmark its international transactions entered with its Associated Enterprises (AEs). The assessee identified comparable companies and using multiple year data of 3 years justified its international transactions to be at arm's length.
- The TPO re-characterized the indent based transactions as trading transactions and alleged that assessee, being the owner of supply chain management and human intangibles, the compensation model of the assessee did not account for the profit attributable to location savings. TPO also held that berry ratio was contrary to rule 10B(1)(e), and undertaking a fresh search of comparables (companies engaged in steel trading activities), used OP/TC margin of selected trading companies *i.e.* 2.26 per cent as benchmark for making addition on the enhanced cost. Accordingly, TPO made adjustment of Rs. 20.99 crores.
- The DRP directed Assessing Officer/TPO to adopt Rs. 648 crores as against 955-58 crores as the correct FOB value for the purpose of computing adjustment for the value of international transactions and upheld the order of the Assessing Officer/TPO in respect of all other grounds. Accordingly, TP adjustment was revised to Rs. 14.21 crores.
- On appeal to Tribunal :

Held

Mitsubishi's case

- The assessee-company is a part of one of the leading 'Sogo Shosha' establishment in Japan. 'Sogo Shosha', a Japanese expression, means 'general trading'. So they are generally described as 'general trading companies'. The assessee is a wholly owned subsidiary of MO. These 'Sogo Shosha'

companies are unique in the world of commerce and play an important role in linking buyers and sellers for products ranging from bulk commodities, such as, grain and oil to more specialised products like industrial equipments, ranging from noodles to missiles. The peculiarities of 'Sogo Shosha' companies have been given elaborately by the Co-ordinate Bench of this Tribunal in *Mitsubishi Corpn. India (P.) Ltd. v. Dy. CIT* [\[2014\] 50 taxmann.com 379/\[2015\] 67 SOT 83 \(URO\)](#). In the instant case also, the same issues, which are seen in this matter, have been discussed in detail, evaluated and adjudicated. The TPO had observed that the PLI arrived by the assessee taking the 'Berry Ratio' has not been found acceptable for the TPO because, as per him, the provisions of rule 10B(1)(e)(i) prescribe that net profit margins should be computed in relation to costs incurred, sales effected or assets employed or to be employed and as per him, the rules do not prescribe for value added cost or value added expenditure to be considered as base for computing net profit margins. On the said reasoning, the claim of the assessee for use of 'Berry Ratio' was not accepted by the TPO which, according to him, being contrary to rule 10B(1)(e)(i). The same issue, was before the Co-ordinate Bench in *Mitsubishi Corpn. India (P.) Ltd. (supra)* wherein the Tribunal dealt with the same and negated the contention of TPO and upheld the assessee's action of use of berryratio, and facts and circumstances of that case were identical and similar.

Location savings

- Before going to the berry ratio, the Bench in *Mitsubishi Corpn. India (P.) Ltd. (supra)* went ahead to address the TPO's view that compensation model of assessee does not include the profit attributable to the assessee on account of location saving, which in the instant case also the TPO was of the same view.
- The facts and circumstance being similar, the adjustment for use of locational savings was unwarranted.

Use of intangibles

- The other issue in respect to the TPO's contention that the assessee is the owner of the supply chain intangibles and human asset intangibles has also cropped in *Mitsubishi Corpn. India (P.) Ltd. (supra)*.
- Since the facts and circumstance of instant case are similar, therefore the finding of the Co-ordinate Bench is acceptable and respectfully following the same it is to be held that use of intangibles cannot be inferred or assumed and needs to be demonstrated on the basis of cogent materials by the TPO/Assessing Officer and adjustment for use of intangibles was unwarranted.

Berry Ratio

- Thereafter, the Co-ordinate Bench adjudicated the berry ratio and held that there is nothing inappropriate in the use as such of berry ratio *per se*, nor there are any real issues with respect to accounting policies of the assessee *vis à vis* accounting policies of the comparables finally selected.

- In the light of the above decision, respectfully following the same, the contention of the TPO is rejected and the contention of the assessee that berry ratio adopted by the assessee does not offend rule 10B is to be upheld.
- In view of above discussions, the use of berry ratio as PLI is appropriate to the facts and circumstances of this case, the objections taken by the authorities below to the use of berry ratio are unsustainable in law, and the adjustments for use of intangibles and locational savings are unwarranted. With these observations, the computation of ALP so far as buy sell segment of assessee's activities are concerned stands restored to the assessment stage. The matter will be examined afresh in the light of the above observations as laid by the co-ordinate bench in *Mitsubishi Corpn. India (P.) Ltd. (supra)* and the matter is remanded back to be examined afresh at the assessment stage.

Service fee segment

- In respect to the computation of ALP by the assessee reflected for trading segment, it is not disputed by the TPO. However, in respect to the other segment which was claimed by the assessee as income from service fee/commission fee segment, the TPO, however, disagrees with the assessee's contention and treats it as income from trading activity. The same issue cropped in *Mitsubishi Corpn. India (P.) Ltd. (supra)* wherein the Co-ordinate Bench following the order of the High Court decision in the case of *Li & Fung India (P.) Ltd. v. CIT [2014] 361 ITR 85/223 Taxman 368/[2013] 40 taxmann.com 300 (Delhi)* has upheld the contention of the assessee that it is no longer open to the revenue authorities to reconstruct the financial statements of the assessee by including the cost of products incurred by its AEs, in respect of which services are rendered, in its reconstructed financial statements and then putting the hypothetical trading profits, so arrived in their reconstructed financial statements, to the tests for determining arms' length price.
- Respectfully following the ratio laid by the High Court in *Li & Fung India (P.) Ltd.* and that of the co-ordinate bench in *Mitsubishi Corpn. India (P.) Ltd. (supra)* it is appropriate to uphold the grievances of the assessee in principle, as the terms above, delete the notional adjustments by TPO's adopting cost base of the AEs in assessee's ALP determination, and remit the matter to the file of the TPO for the necessary factual verifications on impact of this corrections. Accordingly, the matter stands restored to the file of the TPO in this respect also.
- In the result, so far as grievances against ALP adjustment are concerned, the matter stands restored to the file of the TPO, in the terms indicated above. Thus, the appeal is partly allowed for statistical purposes.