IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-1 : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI AMIT SHUKLA, JUDICIAL MEMBER

ITA Nos.433 & 6139/Del/2012
Assessment Years : 2007-08 & 2008-09

Brown Forman Worldwide LLC India, Branch Office, 148, Centrum Plaza, 1st Floor, Golf Course Road, (Opposite Sun City Complex), Gurgaon. PAN: AACCB2612A	Vs.	DDIT (Int. Taxation), Circle 3(2), Drum Shaped Building, New Delhi.
(Appellant)		(Respondent)

Assessee By	:	Shri Himanshu Sinha, Advocate, Shri Reena Garg, CA & Shri Bhuvan Dhropar, Advocate
Department By	:	Shri Sanjay I Bara, CIT, DR

Date of Hearing	:	10.05.2018
Date of Pronouncement	:	11.05.2018

ORDER

PER R.S. SYAL, VP:

These two appeals filed by the assessee relate to the assessment years 2007-08 & 2008-09. Since some of the issues raised in these appeals are common, we are, therefore, disposing them by this consolidated order for the sake of convenience.

Assessment Year 2007-08

2. The assessee is aggrieved against the addition on account of transfer pricing adjustment amounting to Rs.1,06,56,851/- in the international transaction of `Provision of marketing support services'.

3. Briefly stated, the facts of the case are that the assessee is an Indian branch of Brown Forman Worldwide LLC (hereinafter called `the Head office'). The assessee is engaged in providing Marketing support services and other similar auxiliary sale, support/assistance services to its Head office. The assessee reported an international transaction of 'Provision of marketing support services' with transacted value of Rs.6,43,25,676/- in Form No.3CEB. The Assessing Officer (A.O.) made reference to the Transfer Pricing Officer (TPO) for determining the arm's length price (ALP) of the international transaction. The assessee chose the Transactional Net Margin Method (TNMM) as the most appropriate method with the Profit level indicator (PLI) of Operating Profit/Total Cost.

11 comparables were selected, whose average margin was shown to be less than that of the assessee. The TPO did not dispute the application of TNMM as the most appropriate method and also the PLI of OP/TC. He TPO did not accept the use of multiple-year data by the assessee, which position has not been disputed by the assessee in the appeal before us. All the 11 comparables chosen by the assessee were rejected by the TPO. He chose 14 fresh comparable companies. With the average OP/TC of such comparables at 22.33%, the TPO proposed transfer pricing adjustment of Rs.1,05,83,368/-. The assessee approached the Dispute Resolution Panel (DRP), which directed to exclude two comparables. The TPO, in giving effect to the directions of the DRP, re-worked out the fresh PLI of comparables at 22.45% and recommended transfer pricing adjustment of Rs.1,06,56,851/-. The Assessing Officer made the above addition in his final order, against which the assessee has come up in appeal before the Tribunal.

4. We have heard the rival submissions and perused the relevant material on record. There is no dispute on the selection of the TNMM as the most appropriate method and also the PLI of OP/TC. The controversy

revolves around selection/ignorance of certain comparables. Out of the final list of 12 comparables, the assessee has challenged 8 inclusions apart from disputing three exclusions made by the authorities below.

5. In order to appreciate the comparability or otherwise of the companies challenged before us, it is *sine qua non* to first consider the functional profile of the assessee under the international transaction of 'Provision of marketing support services.' The TPO has simply mentioned on page 2 of his order that the assessee is engaged in providing marketing support services and other similar auxiliary sale support/assistance services. There is not much amplification of such services. We have gone through the Transfer pricing study report of the assessee, whose copy is available on page 120 of the paper book. Elaboration of the services rendered by the assessee is contained on page 136 of the paper book. Such services encompass Liaison activities, Market information activities and Sales support to the existing customers in India. Under the Liaison activities, it has been stated that the market in India for alcoholic beverages, being the product which is sold by the Head office in India, is a regulated market and falls in the State List of the Constitution, implying that each State of the

country has its own individual policies and regulations. The assessee as a branch office is in rationalization of policies in respect of selling and distribution of alcoholic beverages. Under the head Market information activities, it has been mentioned that the assessee is engaged in providing information of Indian markets and assists its head office in creating market for them. Under the last category, the assessee is extending support to the existing customers in India. We have also gone through the Agreement dated 04.09.2012 between the assessee and its Head office pursuant to which such services were rendered. A copy of such Agreement is available on page 454 of the paper book. This Agreement characterizes the nature of services as `Marketing support services' and provides that the assessee : `will provide Marketing Support Services and other similar auxiliary sale support services in respect of BFC products'. It has also been mentioned that the assessee : `shall use its best efforts to support BFC, identify and predict market trends, analyze customer needs, improve customer relations and facilitate the information flow between BFC and its customers'. Clause 2 of the Agreement sets out 'Price for the services.' It provides that : `The price, which BFC (the head office) shall pay to BFWBO (the assessee) for the Marketing Support Services shall be an amount equal to BFWBO's Cost plus 5% (the `Profit Margin'). The above narration of facts transpires that the assessee is basically engaged in rendering marketing support services to its Head office, for which it is remunerated at cost plus 5% mark-up. With the above understanding of the nature of services rendered by the assessee and the business model, we shall proceed to examine the comparability or otherwise of the companies assailed before us.

(i) <u>Priya International Ltd. (Seg.)</u>

6. The TPO included this company in the list of comparables setting aside the assessee's objection that it was dealing in chemicals and was in indenting business only. The DRP upheld the inclusion of this company.

7. We have gone through the Annual report of this company, whose copy is available on page 1 onwards of the Paper book. Profit & Loss Account of this company shows that it has mainly two streams of income, viz., Sales of Rs.4.98 crore and Commission of Rs.1.52 crore. It is the Commission segment which has been adopted by the TPO for inclusion in the list of comparables. As against this, the assessee company is providing marketing

support services on a cost plus 5% mark-up basis. There is an apparent difference in the business model of earning Commission on sales and getting remunerated at cost plus basis. Whereas in the case of commission business, no income is earned unless the efforts made by incurring expenses fructify into orders, in the case of Cost plus basis, a company gets remunerated on all the costs incurred with a particular mark-up irrespective of any actual sales made. These two business models, namely, of commission and cost plus basis, cannot, by any standard, be brought on a same pedestal. This basic difference in the two business models results in varying profit margins and distorts comparability. In view of the fact that Priya International Ltd. is following a business model of `commission', as against the assessee rendering marketing support services on `cost plus basis', we hold that the two cannot be considered as comparable.

8. Apart from that, it is vivid from the Annual report of this company that there is a huge amount of 'Unallocated expenses', which has been ignored by the TPO in computing the segmental margin of this company for the purposes of comparison. In view of the foregoing facts, we direct to exclude this company from the list of comparables.

(ii) Hightemp Techmat Pvt. Ltd.

9. The TPO included this company despite the assessee's objection that it was engaged in manufacture and trade and not into services. No relief was allowed by the DRP.

10. We have gone through the Annual report of this company which is available in the paper book. A copy of its Profit & Loss Account indicates total revenue of Rs.3,69,94,830/- is from 'Sales and other income.' It is the solitary item reflected on the revenue side of this company. Detail of 'Sales and other income' is available in Schedule I, which indicates figures of Sale at Rs.10,449/-, Processing charges at Rs.3,69,13,597/- and Other income at Rs.70,784/-. It has incurred Manufacturing expenses and also expenses on Material consumed. It is thus palpable that this company is mainly in the Processing business. Per contra, the assessee company is only providing Marketing support services to its Head office, which is quite distinct from that of Hightemp Techmat Pvt. Ltd. We, therefore, order to exclude this company from the list of comparables.

(iii) ICRA Management Consulting Services.

11. The TPO included this company by rejecting the assessee's contention of functional dissimilarity. No relief was allowed by the DRP.

12. We have gone through the Annual report of this company, whose copy is available on page 27 onwards of the paper book. Its Director's Report shows that it has completed 650 projects for about 350 clients, and its area of operation extends to a mix of national and international organizations, Governments, regulators, banks and corporate entities. This company is also into Government and infrastructure practices, in addition to rendering banking and financial services. Apart from the corporate advisory practices, this company has also established two specialized divisions, viz., Information technology (IT) and Research activities. These divisions lend support to the Consulting divisions and also provide value added products for its clients. Such detail of the functional profile of ICRA Management Consulting Services proves beyond a shadow of doubt that it is nowhere close to the assessee company insofar as the functionality is

concerned. We, therefore, order to exclude this company from the list of comparables.

(iv) IDC (India) Ltd.

13. The TPO included this company in the list of comparables notwithstanding the assessee's objections that it was into conducting Research and survey and management consulting. No relief was allowed by the DRP.

14. On considering the Annual report of this company, whose copy is available in the paper book, it is observed that its operational income of Rs.13,38,00,870/- has been classified as 'Sales & Service income'. Page 65 of the paper book indicates that: "The company is a research company, primarily dealing in research and survey services and products." These facts amply prove that not only the nature of services rendered by this company is different, but, it is also engaged in selling products, which is absent in the case of the assessee. As the TPO has adopted entity level figures, which comprise sale and service income both, and no separate figures of service income are available, the company loses comparability. We, therefore, order to remove this company from the list of comparables.

(v) IL & FS Ecosmart Ltd.

15. The TPO included this company despite the assessee's objections that it was mainly earning income from advisory and consultancy services. The DRP did not concur with the assessee's submissions. The assessee is aggrieved before the Tribunal.

16. We have gone through the Director's Report of this company which is available on page 82 of the paper book. It indicates that during the year the company was engaged in four business lines, namely, Waste management; Resource conservation; Information systems; and Consulting & advisory services. Under the Waste management line, this company has reported that it developed the waste management strategy for treatment and disposal of Mumbai's 6000 tons per day of municipal solid waste; it sought approval for revival and implementation of an existing 150 TPD composting plant at Okhla; and DPR for SWM for Nanded Corporation etc. Under the Resource conservation line, it has been mentioned that the company has signed a Memorandum of Understanding with Gujarat State Petroleum Corporation Ltd. for implementing a 100 TPD Integrated Biodiesel project in Gujarat apart from hosting an international conference on the carbon

market. Under the 'Information systems' line, the company has reported that it has moved the Environmental Information Centre initiated by the Ministry of Environment and Forests from the pilot phase into a self sustaining entity. Under the Consulting and advisory services line, this company has reported that it is serving Delhi City Development Plan, Sub-City Plan – New Delhi Municipal Corporation, Master Plan for Sabarimala and R&R for Mittal Steel India. Apart from the ostensible differences in the nature of activities carried out by this company *vis-à-vis* the assessee company, this company has also made certain sales which are part of its Profit & Loss Account. In view of these glaring differences, we have no doubt whatsoever in holding that it is functionally different from the assessee and cannot be considered as comparable. It is, therefore, directed to be excluded from the list of comparables. &&

(vi) Inmacs Management Services Ltd.

17. The TPO included this company in the list of comparables without making any discussion about the functional profile or otherwise of this company in his order. In fact, there is no discussion about this company in his order. The DRP upheld its inclusion in the list of comparables.

18. We have gone through the Annual report of this company which is available on page 118 onwards of the paper book. Profit & Loss Account of this company depicts 'Income from operations' at Rs.1,08,08,028/- with necessary detail in Schedule 5 and the Schedule simply states 'Professional income.' Page 134 of the paper book, being, 'Balance sheet abstract and company's general business profile' shows description of nature of services as 'Consultancy.' Apart from this, there is no discussion in the Director's Report or other documents about the functional profile of this company. In view of the fact that the TPO treated this company as comparable without showing any similarity between the nature of services rendered by this company *vis-à-vis* the assessee and the further fact that the true nature of services is not discernible even from its Annual report, we hold that this company does not qualify inclusion in the list of comparables. The same is, therefore, directed to be excluded.

(vii) <u>RITES Ltd.</u>

19. The TPO treated this company as comparable despite the assessee's objections that it was functionally dissimilar. The DRP upheld the

inclusion by observing that it was engaged in providing `Technical consultancy'.

20. We have gone through the Annual report of this company which is available in the paper book. Page 152 is Schedule 'L' to the Annual accounts containing `Principal accounting policies'. Item 2 under this Schedule is 'Revenue recognition'. It has been mentioned that Consultancy fee 'also includes supplies.' Apart from that, this company is in 'Construction management/supervision contracts', whose fees 'is calculated as percentage on the value of work done/built up cost of each contract as determined by the management.' Further, this company is in receipt of `mobilization fee'. In addition, this company has made export sales and is also in providing leasing services. There is no separate segmental information and all the receipts have been classified under the primary segment of 'Consultancy services'. In view of such a diverse nature of services rendered by this company, the same cannot be considered as comparable to the assessee company providing only marketing support services. We, therefore, order to exclude this company from the list of comparables.

(viii) Tecnicom-Chemie (India) Pvt. Ltd.

21. The TPO included this company in the list of comparables ignoring the assessee's objection that it was functionally dissimilar. No relief was allowed by the DRP.

22. After considering the rival submissions and perusing the relevant material, we find from the Profit & Loss Account of this company, whose copy is placed on page 184 of the paper book, that its operational income has been classified as `Commission, Consultancy & Services'. There is no separate segmental information as regards 'Services', which could be considered as comparable to the assessee company. This deciphers that the revenue of this company also includes 'Commission', which is a different business model as discussed while dealing with M/s Priya International Ltd. (supra). Following the same view, we direct to exclude this company from the list of comparables.

23. Apart from challenging the inclusion of above 8 companies, the assessee has also assailed the exclusion of three companies, namely, Shree

Raj Travels and Tours Ltd., Spencer's Travel Services Ltd. and Trade Wings Ltd.

24. We have gone through the Annual reports of Shree Raj Travels and Tours Ltd. and Trade Wings Ltd., whose copies are available on pages 245 and 283 of the paper book. It can be seen that both the companies are engaged in the `Commission' business. Following the reasoning given above for directing the exclusion of M/s Priya International Ltd. and M/s Tecnicom-Chemic (India) Pvt. Ltd., we hold that these two companies were rightly excluded as these are in a different business model *vis-à-vis* the assessee.

25. In so far as Spencer's Travel Services is concerned, we have gone through the Annual report of this company, whose copy is placed on page 200 of the paper book. It is apparent that this company is also engaged in making Sales. Since the assessee company is only rendering Marketing support services and not into Sales, we hold that this company was also rightly excluded.

26. The assessee has raised an additional ground against not allowing working capital adjustment. Despite the fact that such an issue was not

raised before the authorities below, we find that there can be no legal impediment in claiming such an adjustment, if it is otherwise admissible. We, therefore, admit this additional ground for disposal on merits.

27. The working capital adjustment is restricted to inventory, trade receivables and trade payables. If a company carries high trade receivables, it would mean that it is allowing its customers relatively longer period to pay their amounts, which will result into higher interest cost and the resultant low net profit. Similarly, by carrying high trade payables, a company benefits from a relatively longer period available to it for paying back to its suppliers, which reduces the interest cost and increases profits. In order to neutralize differences on account of inventory, trade payables and trade receivables, it becomes essential to allow working capital adjustment for bringing the case of the assessee at par with other functionally comparable entities. We, therefore, agree in principle with the grant of working capital adjustment.

28. However, we find that there is insufficient material readily available on record for calculating the working capital adjustment in respect of

comparables *vis-a-vis* the assessee. Under such circumstances, we are of the considered opinion that it would be more appropriate if this issue is considered and examined by the original authority. We order accordingly and direct the AO/TPO to compute working capital adjustment, if any, available to the assessee as per law.

29. To sum up, we set aside the impugned order on the issue of addition towards transfer pricing adjustment and remit the matter to the file of AO/TPO for a fresh determination of the ALP of the international transaction of ‘Provision of Marketing support services’ in consonance with our above directions. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings.

30. In the result, the appeal is partly allowed for statistical purposes.

<u>A.Y. 2008-09</u>

31. In this appeal the assessee is aggrieved against an addition of Rs.55,68,219/- towards transfer pricing adjustment in the international transaction of `Marketing support services’.

32. The assessee reported an international transaction of provision of `Market support services' with the transacted value of Rs.6,40,37,573/-. The Assessing Officer made reference to the TPO for determining the ALP of this international transaction. The TPO did not dispute the application of TNMM as the most appropriate method with the PLI of OP/TC. The assessee had selected 11 companies as comparable. The TPO rejected all of them and made a list of 10 new comparable companies with their average OP/TC at 17.76%. This led to the transfer pricing adjustment of Rs.77,82,089/-. The assessee challenged the draft order, incorporating the addition on account of transfer pricing adjustment, before the DRP, which excluded three companies from the list of comparables drawn by the TPO. The assessee is aggrieved in the instant appeal against the inclusion of two companies, namely, Choksi Lab Ltd. and WAPCOS Ltd. (Seg.).

33. It is an admitted position that the functional profile of the assessee is similar to that of the preceding year. In fact, the same Agreement is stated to be governing the year under consideration as well. As such, there is no need to separately analyze the nature of the functions performed by the assessee under the international transaction of `Marketing support services'.

Thus, the functional profile discussed above while dealing with the appeal for the assessment year 2007-08 is adopted for the purposes of examining the comparability or otherwise of the companies in challenge before us.

(i) Choksi Lab Ltd.

34. The TPO included this company in the list of comparables despite the assessee's objection that it was functionally different.

35. We have gone through the Annual report of this company, which is available in the paper book. Note no. 8 to Part B - 'Notes forming part of the accounts' - provides that this company is a commercial testing house engaged in testing of various products and also offers services in the field of pollution control as allied activity. From the above description of the nature of services carried on by this company, it becomes evident that it is basically engaged in providing testing services for various products and also offers services in the field of pollution control. As against this, the services provided by the assessee are purely in the nature of marketing support to its Head office. We fail to appreciate as to how marketing support services can be equated with testing services. When we peruse

Schedule of fixed assets of this company, it can be seen that the major asset is 'Instruments.' It is with the help of these instruments that the company is providing services in the nature of testing of various products. By no standard, this company can be considered as comparable with the assessee company. We, therefore, direct the exclusion of this company from the list of comparables.

(ii) WAPCOS Ltd. (Seg.)

36. The TPO considered this company as comparable by observing that it was providing support services in terms of technical support, technical know-how valuation and assistance in development/upgradation of potential suppliers, etc. The assessee's objections about the functional dissimilarity of this company, were rejected.

37. After considering the rival submissions and perusing the relevant material on record, we find from the Annual report of this company that it has two segments, namely, 'Consultancy and engineering projects' and 'Lumpsum turnkey projects.' The TPO has taken 'Consultancy and engineering project segment' for the purposes of comparison with the

assessee company. This company is engaged in infrastructure development projects. This company is also working as independent review and monitoring agency for projects in some States. It is also providing supervision and quality control consultancy for construction/upgradation of rural roads under PMGSY. It also secured projects for development and hygiene education, development of dry pit latrines, designs for local conditions for household and schools and solid waste management. It also secured projects for transmission line Kirti Irti to Sta, Treng, Camhodia. A review of the above services provided by this company, it can be easily ascertained that it is nowhere close to the rendering of marketing support services, which is being done by the assessee under this segment. The nature of activity done by the assessee is quite distinct from this company. We, therefore, direct to exclude WAPCOS Ltd. (Seg.) from the list of comparables.

38. Apart from challenging the inclusion of the above two companies, the assessee has also challenged the exclusion of two companies, namely, Interads Ltd. and PL Worldways Ltd.

39. We have gone through the Annual report of Interads Ltd., whose copy is available on page 93 onwards of the paper book. Page 108 is copy of its Profit & Loss Account, which shows 'Exhibition revenue' at Rs.4.34 crore. This is a major item representing income from operations. Detail of `Exhibition revenue' is contained in Schedule 12, which divulges that this company is earning income from Participation fee, onsite service fee and other miscellaneous receipts. The nature of services rendered by this company is nowhere close to the rendering of marketing support services as done by the assessee company. We, therefore, hold that this company was rightly excluded by the authorities below.

40. As regards PL Worldways Ltd., we find from the copy of its Profit & Loss Account, which is placed on page 148 of the paper book, that its major income from operations is 'Commission.' While dealing with certain companies in our order for the immediately preceding assessment year, we have held above that carrying on of business on commission basis is an entirely different business model *vis-à-vis* carrying on of business on cost plus basis. Following the view taken hereinabove, we hold that PL Worldways Ltd. was also rightly excluded by the authorities below.

41. We, therefore, set aside the impugned order on the issue of addition towards transfer pricing adjustment and remit the matter to the file of AO/TPO for a fresh determination of the ALP of the international transaction of 'Provision of Marketing support services' in consonance with our above directions. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings

42. In the result, the appeal is partly allowed for statistical purposes.

The order pronounced in the open court on 11.05.2018.

Sd/-	Sd/-
[AMIT SHUKLA] JUDICIAL MEMBER	[R.S. SYAL] VICE PRESIDENT

Dated, 11th May, 2018.

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Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.