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

% *Date of decision: 10.04.2018*

+ ITA 811/2017

ORIFLAME INDIA PRIVATE LIMITED Appellant

versus

ASSISTANT COMMISSIONER OF INCOME TAX

..... Respondent

+ ITA 812/2017

ORIFLAME INDIA PRIVATE LIMITED Appellant

versus

ASSISTANT COMMISSIONER OF INCOME TAX

..... Respondent

+ ITA 813/2017

ORIFLAME INDIA PRIVATE LIMITED Appellant

versus

DEPUTY COMMISSIONER OF INCOME TAX..... Respondent

+ ITA 825/2017

ORIFLAME INDIA PRIVATE LIMITED Appellant

versus

ADDITIONAL COMMISSIONER OF INCOME TAX,

..... Respondent



Present: Mr.Himanshu Sinha and Mr. Bhuwan Dhoopar,
Advocates for petitioner.
Mr.Deepak Anand, Jr.Standing Counsel for Revenue.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE A.K. CHAWLA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

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1 Admit.

2 The following question of law arises for consideration in all these appeals:

“1.Did the ITAT fall into error in regard to the finding with respect to inclusion of a comparable Modicare Limited and the exclusion of the other comparables, (which are involved in trading in similar products), having regard to the facts and circumstances of the case?”

3 The appellant is a wholly owned subsidiary of Oriflame Investments Limited, Mauritius. Its business is the distribution and sale of cosmetic products primarily through direct selling channel. The direct seller to individual intermediaries is characterized as



“consultant” who then sells the products to the user. This distribution system does not involve other trade intermediaries, as the whole-sellers, distributors and stockist etc. The assessee offered its income tax return and also filed transfer pricing reports, as required, as it was involved in internal transaction of the filing within the meaning of Section 92(A) of the Income Tax Act (hereinafter referred to as the “Act”). The Transfer Pricing adjustment made by the TPO was for Rs.14,29,23,995/-, for Assessment Year 2009-10 and other amounts for later A.Ys. The assessee challenged the methodology and approached the DRP, it was unsuccessful for each of the assessment years. Having regard to the TPO determination and ruling of the final assessment only by the Assessment Officer, it became the subject matter of challenge before the ITAT. The appellant’s grievance is that the ITAT noted the significant difference between the entities which were involved in marketing the products through direct marketing between the loan direct marketing comparables i.e. Modicare Ltd. and the assessee. The grievance nevertheless, the ITAT directed a remand categorically ruling out the case of Modicare Limited (supra). It is highlighted on behalf of the assessee in this regard that the significant



differences between the two i.e. Modicare and the assessee are incapable of adjustment. Learned counsel highlighted upon this functional dissimilarity with respect to the differential products range in which both the entities were involved; the low proportion of total product turnover attributable to cosmetic and related line (personal care) and the most segmental data. It is submitted that having regard to these circumstances, the ITAT's findings are both inconsistent and contrary to law on functional differences. It was also submitted that having regard to these functional differences, the assessee had offered other comparables that did not involve direct marketing but were trading entities with appropriate adjustments having regard to the dissimilarities that could be eliminated and appropriately adjusted. These issues were, however, not considered and no findings were returned.

4 Learned counsel for the Revenue relied upon Rule 10B of the Income Tax Rules, 1962 and submitted that the impugned order should not be interfered with. It was stated that the dissimilarity, if any and even the appropriateness of the "Most Appropriate Method" can however be argued by the assessee consequent upon the remand.



It is stated that appropriate adjustment with regard to the alleged dissimilarity can be carried out by the Revenue Authorities in regard to the facts and circumstances of the case. The ITAT's findings pertinently with respect to the appropriateness or otherwise of Modicare Ltd. as a comparable are contained in paras 5.9, 5.11 and 5.12 of the impugned order. The Tribunal noted that Modicare Ltd. as a standalone comparable (since all other comparables were eliminated by the revenue authorities at the early stage of the proceedings) was "ideally not an appropriate comparable" and has also canvassed that the comparables selected by the taxpayer have wrongly been rejected by the tax authorities. In paras 5.8 and 5.9 it is stated as follows:

"5.8 Thus when considered in the light of the aforesaid statutory Rules, we find that the tax authorities while considering the grievance of the tax payer admittedly have taken a position contrary to what has been envisaged under the Rules.

5.9. Having so addressed, we find that over the years primarily the taxpayer has raised the issue that Modi Care Ltd. as a stand-alone comparable was ideally not an appropriate comparable and has also canvassed that the comparables selected by the taxpayer have wrongly been rejected by the tax authorities. One of the many lines of arguments taken by the taxpayer is that firstly



Modi Care Ltd. has a very limited cosmetic and personal care product category thus it lacks product similarity; secondly it also has income from franchisees, hence it is not a similar service, thirdly its discounts are below the line expense and Revenue recognition policies are also significantly incomparable; fourthly it has high AMP spend; fifthly it has fluctuating sales; its incentives schemes are different it has wide variation between its gross margins and net margins thereby giving weight to the allegation that heavy functions are being performed at the operating level”.

5 Its final conclusions with respect to Modicare Ltd. include the observations that the comparable company differed from the assessee in reporting its cost. The highlighted differences were in regard to the discount, transportation costs, insurance and performing the warranty function as operating expenses or its costs of goods sold or the difference in the inventory valuation method. These variations will affect the gross margin. The Tribunal then concluded in para 5.12 as follows:

“Accordingly, in view of the above, we are of the considered view that ideally the tax authorities should not have selected Modi Care Pvt. Ltd. as a standalone comparable. The tax authorities should have carried out a search or directed the assessee to carry out a fresh search ensuring that the comparables selected were



primarily engaged in direct sales with no meaningful value addition activities. To the extent possible product similarities should have been aspired for and if it was found in a particular year that it was not available then carrying out the necessary adjustments on the comparables selected attempted to approach near comparable FAR. Thus complying with the requirements of sub-Rule (2) and (3) of Rule 10B and sub-clause (iv) of clause (b) of sub-Rule (1) of Rule 10B ideally more comparables should have been selected. We note that there is sufficient guidance and clarity in the aforesaid statutory provisions to ensure that the grievance of the assessee can be addressed as it has amply been provided that wherever the gross margins are demonstrated to be impacted either with incomparable activities; functions, accounting practices; product dissimilarities; etc. then necessary adjustments should be made. Herein noting that the tax payer's first grievance is that with necessary adjustments, even if Modi Care Limited is taken as a standalone comparable as has been done by the tax authorities even then adjustments proposed by the tax payer on valid grounds namely incomparable activities, functions accounting and Revenue recognition policies etc. is necessitated. We are given to understand that service income has been excluded by the TPO himself in the subsequent years and in fact in one of the years in the present proceedings. It has been argued that if the adjustments are thus made then no adjustments to be arm's length price of the assessee would be necessitated. We note that the tax authorities have not considered the calculations as principally they have been of the opinion that no relief was warranted. Holding the said approach of the tax



authorities contrary to the statutory position we direct the TPO to look into the claim of adjustments required to be made to Modi Care Limited. While so directing it is made clear that the responsibility for providing the supporting data to the satisfaction of the TPO rests with the assessee. The TPO cannot be burdened to look for possible adjustments. In case the tax payer does not succeed on this ground then the TPO may consider directing the assessee to carry out a search of comparable companies from the list of direct sellers in the market, as has been referred to in the TPO in the respective years and the CIT(A) has also specifically mentioned the direct sellers at pages 8 and 9 of his order. The comparable companies with suitable adjustments adhering to the requirements as set out in sub-Rule (1), (2) and (3) of Rule 10B of the IT Rules may be selected.”

6 It is notable at the outset from the above quotation that the Tribunal was conscious of the significant differences yet it did not address how these differences could be adjusted so to speak. The assessee is involved solely in the marketing of cosmetics. However, Modicare Ltd. is also engaged in the marketing of other products, “laundry and home care, personal care, tea, agriculture, jewellery, cosmetics and health care” and “others”. Each one of these have a separate proportion to the total product turnover. A tabular chart in this regard appears to have been noticed by the Tribunal in its impugned order, the same is reproduced herein as below:



<i>S.N.</i>	<i>Product</i>	<i>Sales (INR)</i>	<i>% of the total turnover product</i>
1	<i>Laundry and Home Care</i>	78,765,810	14.34%
2	<i>Personal Care</i>	120,292,729	21.89%
3	<i>Agriculture</i>	79,718,481	14.51%
4	<i>Tea</i>	8,045,875	1.46%
5	<i>Jewellery</i>	53,766,590	9.79%
6	<i>Cosmetics</i>	86,129,350	15.68%
7	<i>Healthcare</i>	88,886,747	16.18%
8	<i>Others</i>	33,819,599	6.16%
	<i>Total</i>	549,425,182	

7 The assessee argued that the dissimilarity with respect to the products sold and the proportion borne by each of the turnover cannot but impact the profitability of the entity as a whole and further emphasized that segmental laid for each of these product lines is missing for the relevant year (with respect to the data available vis-à-vis Modicare Ltd.). In the opinion of this Court, it is of vital importance and was not addressed by the ITAT which even while noticing the significant differences and seemingly accepting the



assessee's arguments nevertheless did not exclude Modicare Ltd. altogether. In the opinion of this Court, this is a very vital infirmity which needs to be corrected.

8 As far as the reasoning of the Revenue Authorities, which has not been commented upon by the ITAT for excluding the other comparables offered by the assessee goes, for one, it was stated that mere acceptance in the past of such comparable did not bind the Revenue. The other was with respect to the differential marketing strategy adopted for the two sets of entities i.e. the trading entity/comparable on the one hand as opposed to the direct marketing entity i.e. assessee on the other hand. The assessee had stressed that if appropriate marketing was made from the data available, the differential marketing strategy per se would not pose a difficulty with respect to the transfer pricing adjustment. The Court finds some merits in the arguments, especially since what the Revenue Authorities would be left with if the ITAT's order was not to be disturbed, would be what a comparable in the form of Modicare Ltd (*supra*).

9 In view of the above reasons, this Court is of the opinion that the appeal should be re-examined by the ITAT; it should be addressed on these two aspects i.e. firstly, the appropriateness of including Modicare Ltd.



having regard to the availability of data with respect to the different product segments, and secondly, involving the comparable, the functional difference with respect to its marketing strategy (i.e. discount, transportation costs, insurance and performing the warranty function). Having regard to the factors mentioned in clause 5.10 of the impugned order, the ITAT is also directed to re-examine whether and to what extent adjustment can be reasonably made, having regard to the available data in respect to the trading comparables offered for ALP determination, for all the relevant years by the assessee. It is also directed to consider the feasibility again having regard to the available data for all the concerned assessment years- marking appropriate adjustments (including with respect to the working capital adjustments as is sought to be urged by the assessee) in regard to the trading comparables offered by the assessee for these given years.

10 This Court is of the opinion that the ITAT may task the Transfer Pricing Officer (TPO) with specific remand report on these issues and seek a report in a time bound manner and thereafter proceed to return its findings having regard to the parties' submissions. All the rights and contentions of the parties are kept open. Having regard to the above directions, it is open to the assessee to urge that TNMM is the most appropriate method instead of



RPM. In these circumstances, it is also clarified that in the event the submission is accepted there would be no enlarging of a comparable offered.

11 The parties are directed to be present before the ITAT on 2nd of May, 2018.

12 Appeals are allowed in the above terms.

S. RAVINDRA BHAT, J

A. K. CHAWLA, J

APRIL 10, 2018

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