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

Decided on 11th March, 2015

+ **ITA 505/2014**

+ **ITA 506/2014**

THE COMMISSIONER OF INCOME TAX-II Appellant

Through: Mr.Kamal Sawhney, Sr.Standing
counsel with Mr.Mukul Mathur and
Mr. Shikhar Garg, Advs.

versus

LI & FUNG (INDIA) PVT. LTD. Respondent

Through: Mr.Porus Kaka, Sr.Adv. with
Mr.Neeraj Jain, Mr.Manish Kant
Advs.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE R.K.GAUBA

MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)

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1. The Revenue is aggrieved by the common order passed by the Income Tax Appellate Tribunal (ITAT) in ITA No.5298/Del./2011 and 5903/Del./2012 for the Assessment Years (AY) 2007-08 and 2008-09. The question of law urged is: *“Correctness of the ITAT’s order directing the AO/TPO for fresh determination of the addition originally made on account of Arm’s Length Price, which was specified in the course of the proceedings.”*



2. At the outset, this Court notices that the basis on which the Transfer Pricing Officer's (TPO) directions were acted upon by the Assessing Officer (AO) in finalising the assessment was by the increased cost base of the total cost incurred for determining ALP in both the years in question.

3. On this the ITAT noticed that this Court's decision in *Li and Fung India Pvt. Ltd. vs. Commissioner of Income Tax* (2014) 361 ITR 85 (Del) held that there is no legal authority under the Income Tax Act, 1961 or the Rules to broaden the cost base in that manner. Consequently, the ITAT directed a remission of the matter to the AO for redetermination of the cost base in tune with this Court's judgment in *Li and Fung India Pvt. Ltd.* (supra). In the abovesaid judgment, this Court held as under:

“39. The TPO's determination enhanced LFIL's cost base for applying the operating profit over total cost margin. LFIL's compensation model is based on functions performed by it and the operating costs incurred by it and not on the cost of goods sourced from third party vendors in India. Allotting a margin of the value of goods sourced by third party customers from Indian exporters/vendors to compute the appellant's profit is unjustified. This Court is of opinion that to apply the TNMM, the assessee's net profit margin realized from international transactions had to be calculated only with reference to cost incurred by it, and not by any other entity, either third party vendors or the AE. Textually, and within the bounds of the text must the AO/TPO operate, Rule 10B(1)(e) does not enable consideration or imputation of cost incurred by third parties or unrelated enterprises to compute the assessee's net profit margin for application of the TNMM. Rule 10B(1)(e) recognizes that “the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise ...” (emphasis supplied). It thus contemplates a determination of ALP with reference to the relevant factors



(cost, assets, sales etc.) of the enterprise in question, i.e. the assessee, as opposed to the AE or any third party. The textual mandate, thus, is unambiguously clear.

40. The TPO's reasoning to enhance the assessee's cost base by considering the cost of manufacture and export of finished goods, i.e., ready-made garments by the third party vendors (which cost is certainly not the cost incurred by the assessee), is nowhere supported by the TNMM under Rule 10B(1)(e) of the Rules. Having determined that (TNMM) to be the most appropriate method, the only rules and norms prescribed in that regard could have been applied to determine whether the exercise indicated by the assessee yielded an ALP. The approach of the TPO and the tax authorities in essence imputes notional adjustment/income in the assessee's hands on the basis of a fixed percentage of the free on board value of export made by unrelated party vendors."

4. Such being the position, this Court is of the opinion that question of law urged in both the appeals does not arise since it already stands settled in the previous order – pertaining to the present assessee.
5. The appeals are, therefore, dismissed.

S. RAVINDRA BHAT, J

R.K.GAUBA, J

MARCH 11, 2015

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