

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "A"**

BEFORE SHRI D. MANMOHAN, V.P. AND SHRI R.K. PANDA, A.M.

ITA No. 2000/Mum/2010

Assessment year 2004-05

Asst. Commissioner of Income Tax – 8(1), R. No. 210, 2 nd Floor, Aayakar Bhawan, M.K. Road, MUMBAI - 20.	Vs.	M/s Agility Logistics Pvt. Ltd. (Formerly – Geologistics Pvt. Ltd.) Vaman Centre, 3 rd floor, Makwana Road, Off Andheri Kurla Road, Andheri (E), Mumbai. 59 PAN AAACL 3717A
Appellant		Respondent

ITA No. 6004/Mum/2010

Assessment year 2005-06

Deputy. Commissioner of Income Tax – 8(1), R. No. 210, 2 nd Floor, Aayakar Bhawan, M.K. Road, MUMBAI - 20.	Vs.	M/s Agility Logistics Pvt. Ltd. Vaman Centre, 3 rd floor, Makwana Road, Off Andheri Kurla Road, Andheri (E), Mumbai. 59 PAN AAACL 3717A
Appellant		Respondent

ITA No. 8146/Mum/2010

Assessment year 2006-07

M/s Agility Logistics Pvt. Ltd. (Formerly – Geologistics Pvt. Ltd.), Vaman Centre, 3 rd floor, Makwana Road, Off Andheri Kurla Road, Marol Andheri (E), Mumbai. PAN AAACL 3717A	Vs.	Addl. Commissioner of Income Tax – 8(1), MUMBAI..
Appellant		Respondent

Assessee by	Shri Bipin Pawar & Shri Raju Vakharia (Assisted by Shri Arun Sari Palli, Shri Rajesh Kotak & Shri Sunny Bilaney
Department by	Smt. Usha Nair

Date of hearing	1.7.2011
Date of pronouncement	25.01.2012

ORDER

PER R.K. PANDA A.M.

ITA No. 2000/Mum/2010 and ITA No. 6004/Mum/2010 filed by the Revenue are directed against the separate orders dt. 11.01.2010 and 28.05.2010 of the Id. CIT(A)- 15, Mumbai relating to A.Y. 2004-05 & 2005-06 respectively. ITA No. 8146/Mum/2010 filed by the assessee is directed against the order dt. 17.9.2010 of the DRP-1, Mumbai relating to A.Y. 2006-07. Since common grounds are involved in all the above appeals, therefore, these were heard together and are being disposed of by this common order for the sake of convenience.

ITA No. 2000/Mum2010, A.Y. 2004-05 (By the Revenue).

2. The only effective ground raised by the Revenue reads as under:-

“On the fact and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition made by the A.O. on account of adjustments made to the Arms Length Price of ₹ 27,54,34,623/- u/s 92CA(3) in respect of international transactions entered into with Associate Enterprise without appreciating the facts of the case.”

2. Facts of the case in brief are that the assessee company is engaged in the business of international freight forwarding by air and sea, logistics activities and customs clearance. A reference u/s 92CA(1) of the I.T. Act for A.Y. 2004-

05 was made to the TPO for computation of Arm's Length Price (ALP) in relation to the international transactions with the Associate Enterprises (AEs). The TPO noted that the assessee is a logistics service provider, offering a comprehensive portfolio of international, domestic and specialized freight handling services. It is an indirect subsidiary of Geologistics Corporation, US.

2.1. The TPO summarized the international transactions of the assessee which are as under:-

Sr. No.	Nature of Transaction	A.Y.04-05 Amount	Method used
I	Payment of Freight Expenses to AE's	618021644	CUP
II	Receipt of Freight Revenue from AE's	39005798	-do-
III	Reimbursement of marketing expenses	7417923	Reimbursement
	Total	1015497165	

2.2. The TPO noted that the assessee has employed CUP as the most appropriate method for benchmarking its international transactions with its Associated Enterprises (AE). The assessee does not have any internal CUP in respect of its transactions with any unrelated parties and hence it had used an internal CUP using transactions between GeoUKMgt, a group company and unrelated companies. On being questioned by the TPO it was explained that it is a corporate policy of the AEs all over the world that after payment of the costs the profits are shared equally between the AEs that have participated in the transaction. The TPO reproduced the analysis of four agency agreements used by the assessee which are as under:-

Licensor	Licensee	Services	Profit Split
1. GeoUKMgt	United Freight International Pvt. Ltd.	Air and Ocean	Air: 50:50 Ocean: 50/50
2. GeoUKMgt	AbdulRahman Mohaman Al-Bahar & Sons W.L.L	Air and Ocean	Air: 50:50 Ocean: 50/50
3. GeoUKMgt	Delta Trans-Transporte Sp.	Air Ocean and Overland	Air: 50:50 Ocean: 50/50

	Z.o.o		
4. LEP International Management Ltd.	Florde Assessoria & Despacheos Ltd.	Air and Ocean	Air: 50:50 Ocean: 50/50

2.3 According to the TPO the transaction of assessee with GeoUKMgt could not be considered as an internal CUP due to the following reasons :

2.4 GeoUKMgt is situated in UK whereas the assessee is operating in India. Application of CUP using data of companies operating in different geographical locations would not provide a realistic measure because of differences in economic conditions and policies of the government which would affect the cost and profitability. Clause 2 of Rule 10B of the Income Tax Rules, 1962 also states that for the purposes of comparability, geographical location is an important factor to be considered. Accordingly, considering differences in geographical regions, the GeoUKMgt CUP cannot be applied in the present case. Additionally, the agreements are entered into on a Profit split basis and not on the basis of a rate. Therefore, there is in fact no internal CUP.

2.5. Since the TPO did not accept CUP method used by the assessee as the most appropriate method he proceeded to analyse the international transactions of the assessee using the TNMM Method. The TPO noted that assessee had taken OP / VAE (Value added expenses) as it PLI which comes to 18.97%. He, therefore, issued a show cause notice asking the assessee to explain as to why PBT / TC should not be used to benchmark the transactions instead of OP/VAE.

2.6 In response to the same the assessee submitted that PBT as defined by the TPO includes interest and other non-recurring income and expenses which are non-operative in nature and hence will not result in a reliable PLI for transfer pricing purposes. Explaining as to why OP/VAE was considered as the

PLI it was submitted that costs typically in logistics companies comprises of direct costs and value added costs. Direct cost comprises of freight charges, customs clearance cost etc. while the value adding expenses mainly comprise of personnel cost, selling cost and administrative costs.

2.7 However, the arguments in favour of OP/VAE was not accepted by the TPO because according to him OP/VAE calculation of the assessee is based on net figures of the P&L A/c. and thus it gives a distorted view of the assessee's margins. According to the TPO when direct costs are excluded then no analysis of the effect of payments to AE can be done. However, taking note of the facts put forth by the assessee that PBT would include interest and other income, the TPO computed the assessee's margins using Adjusted PBIT/Sales which is as under :

PBIT	4,66,17,123
Less : Other Income	34,69,843
Adjusted PBIT	<u>4,31,47,280</u>
 Total Cost	 2,11,82,56,978
Adjusted PBIT/Total Cost	2.04%
 Sales/Operating Inc	 2,15,41,44,562
Adjusted PBIT/Sales	2.00%

The TPO thus observed that if other income and interest is excluded, the PBIT/sales comes to 2% as against 18.97% determined by the assessee by using OP/VAE.

2.8. The TPO noted that the assessee has taken the following companies as comparables:

S.No.	Name of Company	OP/VAE
1	Blue Dart Express Ltd.	43.30%
2	Patel On-Board Couriers Ltd.	27.50%
3	Hindustan Cargo Ltd.	18.60%
4	Peirce Leslie Freight Systems Ltd.	-10.38%
5	Gordon Woodroffe Logistics Ltd.	30.43%
6	Skypak Service Specialists Ltd.	-0.91%
	Average	18.11%

2.9 The TPO issued a show cause notice along with the list of following companies asking the assessee to explain as to why the said list should not be taken as comparable companies.

1. Hindustan cargo Ltd.
2. Shreyas Shipping & Logistics Ltd.
3. All Cargo Global Logistics Ltd.
4. Blue dart Express Ltd.
5. DHL Danzas Lemuir Pvt. Ltd.
6. Excel India Pvt. Ltd.
7. Freight Systems (I) Pvt. Ltd.
8. Fritz Freight Forwarding India Pvt. Ltd.

2.10 The assessee submitted that the companies listed in Sl No. 5 to 8 above are Private Limited Companies and since the data for the same is not available in public domain the said companies should not be included as comparable companies. In respect of Sl. No. 2, it was submitted that it is a Container Feeder Shipping Co. and hence cannot be considered as a comparable.

2.11 The TPO noted that the assessee has included Sl No. 1 & 4 in its T.P. report. The TPO after considering the comparables noted that the adjusted PBIT/sales is only 2% whereas the margin of the comparables is 12.68%. Therefore, the difference between the margin is quite high and hence he proceeded to recompute the ALP. According to the TPO Application of CUP

using data of companies operating in different geographical locations does not provide a realistic measure due to differences in economic conditions and policies of the government which would affect costs and profitability. Agreements with third parties are entered into on a profit split basis and not on the basis of a rate. Rejecting the various submissions made by the assessee, the TPO adjusted an amount of ₹ 10,65,74,328/- to be received and an amount of Rs. 16,88,60,295/- to be paid thereby making an adjustment of ₹ 27,54,34,623/-.

2.12 During the course of assessment proceedings, the A.O. confronted the report of the TPO to the assessee. Rejecting the various contentions of the assessee, the A.O. added this amount of ₹ 27,54,34,623/- to the total income of the assessee apart from making addition of ₹ 65,15,000/- on account of adjustment for A.Y. 2003-04.

2.13 Before the CIT(A) the assessee justified the use of CUP method by making submissions, the gist of which are as under:-

- The comparable uncontrolled price is the rate (50:50 ratio) at which Geologistics and the network members (unrelated third parties) split their residual gross profit. In every margin, the residual gross profit is shared between the origin company, and destination company in a 50:50 ratio.
- Accordingly, in each geographical location, while the cost and profitability of the network members (including unrelated third parties) may vary based on the economic conditions and policies of the respective governments, the same has no impact on the rate (50 : 50 ratio) at which the gross profit is split between the origin company and the destination company.
- Rule-10B(3) - an uncontrolled transaction shall be comparable to an international transaction, if none of the differences, if any, between the transactions being compared or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, such transactions in the open market.

- Rule 10B(3) squarely applies in the company's case. Accordingly, the rate (50:50 ratio) at which Geologistics and the network members (that are unrelated third parties) split their residual gross profit, clearly constitutes a CUP.
- Both the origin company and destination company in the network perform comparable functions; i.e., they coordinate with third party service providers (such as clearing and forwarding agents, carriers, transporters who transport the goods and assist in loading and unloading the cargo) to provide logistics services to the client. It was pointed out that a logistics company only coordinates with third party service providers to provide logistics services – a logistics company does not undertake loading, unloading or transportation of the cargo itself. Therefore, the functions performed by both the origin company and the destination company are those of coordination only, and are therefore fully comparable. Both the origin company and the destination company own comparable assets i.e. office infrastructure. As stated earlier, a logistics company such as the assessee and its AEs, only coordinates with third party service providers – a logistics company does not undertake loading, unloading or transportation of the cargo itself (which functions are typically outsourced to third party service providers). The assets owned by both the origin and the destination company are only office infrastructure assets. It may also be noted that while the level of assets employed by the origin and the destination company may depend on the volume handled by each company, the level of assets employed per transaction/shipment will be closely comparable thereby justifying a 50:50 split for each transaction/shipment. Both origin company and the destination company assume comparable risks. For instance, if either of the origin or destination company were to be located in a country with civil or political disturbance resulting in loss or delay of cargo, the residual gross loss (if any) will also be shared between the origin and destination company in a 50:50 ratio. Based on the above, considering the integrated nature of the operations and the comparable levels of functions performed, assets employed and risks borne by the origin company and the destination company, the risks and rewards of the business are also shared in a 50:50 ratio.
- On a without prejudice basis, the assessee argued that even if one were to assume (for the sake of discussion) that the 50:50 arrangement can potentially produce at less than equitable profit for an origin or destination company in a given transaction, it could only mean bad business judgment but correct transfer pricing. To illustrate this point, the Appellant cited the example of an apple vendor who procures apples at ₹ 100 / kg and sells the same at ₹ 90 / kg to

related and unrelated parties. In such a scenario, the price of ₹ 90 / kg cannot be rejected as a CUP merely because it results in a loss of ₹ 10 / kg. The appropriate analysis in this situation would warrant a consideration of the following:

- Industry norm being followed i.e. whether the industry in general transacts at the same price (i.e. ₹ 90/kg in our example); and
- Consistency of the pricing while transacting with related and unrelated parties.

Since, the same sale price is adopted while transacting with related and unrelated parties, the price of ₹ 90/kg ought to be considered as a CUP for benchmarking the transaction with the related party.

The appellant therefore asserted that where a valid CUP does exist for benchmarking an international transaction, any analysis of the net profit margin is not warranted.”

2.14 It was submitted that there are hundreds of agency agreements between the Geologistics Group and unrelated parties that are substantially the same. The profit split information contained in all of the agreements is 50:50, is very typical of the industry and are very standard for logistics and freight forwarder service providers. Therefore, in the TP study, the company analysed a sample of four agency agreements between the Geologistics group and different third party licensees. It was demonstrated before the Id. CIT (A) that the agreements were virtually identical in terms. It was emphasised that even in India's neighbouring countries where the economic conditions are similar to those in India, the contractual terms agreed between GeoUKmgt and the third party network members are the same i.e. residual gross profit is shared between the origin company and the destination company in a 50:50 ratio. The assessee also brought to the notice of the Id. CIT(A) similar agency arrangements with third party network members in Pakistan and Bangladesh to show that in these agreements, the residual gross profit is shared between the origin company and the destination company in a 50:50 ratio. Accordingly it was submitted that the CUP data furnished by the assessee should have been accepted by the TPO.

2.15 It was argued that para 2.7 of the OECD guidelines on transfer pricing states that the CUP method is the most direct and reliable way to apply the arm's length price and is preferable over all other methods. Since CUP is the most direct method, it should be used to test the arm's length nature of the transactions of the assessee.

2.16 Challenging the order of the TPO rejecting the OP/VAE as the profit level indicator, it was submitted that the operational efficiency is best measured in terms of whether its gross margin is adequate to cover the costs associated with its own functions and not those of the airlines or other freight carriers in respect of which assessee adds little or no value. The assessee provided a composition and ratio of direct and value added costs for the comparable set of companies. It was submitted that direct costs vary depending on the volume of business and thus fluctuate inherently. Referring to clause 7.36 of OECD guidelines, it was submitted that agency service providers need not apply a mark-up to "pass through" expenses which are passed on to customers. It was submitted that a qualitative analysis of costs by differentiating between pass-through and agency is essential so as to reach correct transfer pricing conclusions. Rule 10B(e)(i) at para 3.41 of the OECD guidelines was brought to the notice of the Id. CIT(A) and it was submitted that the cost incurred by the assessee in procuring services from the airlines etc. should clearly be removed before calculating the mark-up earned by the assessee from the provision of services. It was submitted that value added expenses are therefore an appropriate PLI when using the TNMM.

2.17 It was submitted that in the preceding A.Y. 2002-03 and 2003-04 the TPO had accepted the CUP (50:50 model) adopted by the assessee and also the corroborative TNMM analysis performed using OP/VAE as the PLI. It was submitted that since the pricing arrangement in respect of the international

transactions has remained unchanged vis-a-vis the earlier years the TPO should not have deviated from his earlier stand.

2.18 Based on the arguments advanced by the assessee, the Id. CIT(A) deleted the addition of ₹ 27,54,34,623/- by holding as under:-

“10. I have perused the TPO's order of the year as well as earlier years order for A.Y. 2002-03 & 2003-04. I have also examined the written submission and oral arguments of the appellant. It is observed that the appellant has regularly adopted a CUP method on the international transaction relating to freight expenses and receipts. The comparable uncontrolled price is at the rate (50.50 ratio) at which Geologistics and the network members (unrelated third parties/split their residential gross profit. Thus the Arms Length price was based on CUP. In the earlier years too (2002-03 & 2003-04) the ALP was determined by adopting the CUP and after due scrutiny accepted by the TPO's and no adjustments was made. The nature and character of transaction remains the same as in earlier years.

10.1 This year the TPO has rejected the CUP on the ground that companies are operating in different geographical locations and the agreements with third parties are entered into on a profit split method and not on the basis of rate.

10.2 The appellant in its submissions has clearly demonstrated that geographic difference is not material so far it applies to the Logistics Industry. It has also shown that even in Pakistan, Bangladesh and Srilanka which all under same geographical region, there is splitting of gross profit equally at 50:50.

10.3 The appellant had carried out FAR of the origin country as well as destination country and established that the operations in this industry are an integrated one where both the parties provide similar functions employs equal assets and assumes the same risk and hence entitled to 50 : 50 gross profit.

10.4 The appellant had produced agency agreements between the Geologic group and unrelated parties that are substantially the same. The profit split information contained in all the agreements (50 : 50) is typical of the industry i.e, Standard or formula for Logistics and freight forwarding service provides. The TPO has ignored this crucial aspect of the business as well as orders of his predecessors and hence arrived at an erroneous finding.

10.5 It is not out of place to mention in the case of MSS India Pvt. Ltd. 25 DTR 119 the Pune Bench of the ITAT has held that on a conceptual note the TNMM method is to be treated as a method of

last resort and is to be pressed into service only when the “standard methods” which are also termed as “traditional method” (i.e. CUP, RPM and CPM) cannot be reasonably applied. The Bench had further held that in a situation in which the assessee has followed one of the standard methods of determining the ALP, such a method cannot be discarded in preference over the transactional profits method unless the revenue authorities are able to demonstrate the fallacies in application of standard method. In any event any preference of one method over the other method must be justified by the TPO on the basis of cogent material and sound reasoning. The TPO has failed to point out fallacy in application of the CUP method by any sound reasoning. A valid CUP method does exist for bench marking the international transaction in this case as conditions are identical.

10.6 to sum up, the appellants contention on CUP method supported with third party agreements and the understanding of comparable level of functions performed, assets used and risk borne by the original company and the destination company has merit. As such I am in agreement that the risk and records of the business is to be shared in a 50:50 ratio.

10.7 Further there is force in the concepts of OP/VAE used as a profit level indicator by the appellant as it is based on the principles of business economies. However, since the CUP method has been accepted as the most appropriate method the corroborative findings under the TNMM is not warranted.

10.8 As such the TPO/AO erred in adjusting the ALP by a sum of Rs.27,54,34,623/- and so the same is deleted.”

2.19 Aggrieved with such order of the Id. CIT(A), the Revenue is in appeal before us.

3. The Id. D.R. strongly relied on the order of the A.O. She submitted that although the assessee had stated that it had followed the CUP method but actually it had followed the ‘profit split method’. She submitted that ‘CUP’ method is a traditional transaction method which compares the ‘prices’ charged for property or services of the controlled and uncontrolled transactions, whereas ‘profit split’ is a ‘transactional profit method’ which first identifies the ‘profit’ to be split between the associated enterprises from controlled transactions in which the associated enterprises are engaged. The enterprises then splits the profit between the associated enterprises on an

economically valid basis that approximates the diversion of profits that would have been anticipated and reflected in an agreement made at arm's length.

3.1 She submitted that the TPO had already pointed out in the order for A.Y. 2005-06 that the transactions entered into by the assessee are not of uniform pattern. In some cases, the assessee may have to take over the goods from the warehouse of the exporter and deliver it to the godown of the importer. In some other cases it may be port to port transactions. Still in some other cases, it may take over from the warehouse in India and deliver the goods to the port abroad. Since there are differences in the functions performed, therefore, splitting the profit at 50:50 is not the correct method even if "profit split" is considered as CUP. Further, the geography and size of a country like UK and India are totally different. Variation will occur on account of assets employed. Further, risks are also considered in assessing the comparability of transactions. There are more risks involved in countries where the law and order situation is not good. These risks cannot be excluded while deciding on comparability and therefore have to be adjusted while deciding a CUP. Since the assessee has not considered the risk element in the CUP method adopted by it, therefore, the same cannot be accepted.

3.2 She submitted that the data of companies operating in different geographical locations would not provide a realistic measure because of differences in economic conditions and policies of the respective governments. She submitted that arm's length pricing has to take into account, the functions performed, the assets employed and the risks involved in the various transactions to determine the extent of profits accruing to the entity. A thumb rule analysis of equally distributing the profit and loss cannot be accepted as an appropriate method.

3.3 She submitted that the assessee in its transfer pricing study report had only tried to justify the CUP method. The assessee had considered the data of many companies which were not comparable with that of the assessee and further data of preceeding two years had also been considered which is not in conformity with Rule 10B(4). Challenging the contention of the arguments of the ld. counsel for the assessee that only data of comparables as available in public domain can be used for comparability analysis, the ld. D.R. submitted that Indian TP regulation nowhere refers to the requirement of availability of data in public domain. It is only the OECD guidelines which state that requirement. She submitted that the assessee being in a particular business activity is expected to be in the know of the profitability of that business at different points of time. In view of the above, she submitted that the transfer pricing adjustments made by the TPO should be confirmed.

4. The ld. Counsel for the assessee, on the other hand, strongly supported the order of the ld. CIT(A). Referring to page 113 to 118 of the paper book, he drew the attention of the Bench to the Agency Agreement between LEP International Management Ltd. UK and LEP International (India) Pvt. Ltd. and submitted that LEP is the old name of 'Agility'. Referring to the copy of agreement between UK based company and Indian company, the ld. counsel for the assessee drew the attention of the Bench to page 119 of the paper book and submitted that 50% of the difference between revenue and cost is payable by LEP UK to LEP (India) for consignments exported to India. Referring to page 120 of the paper book, he drew the attention of the Bench to the similar terms i.e. 50% of the difference between revenue and cost payable by LEP(India) to LEP, UK for consignment exported from India. Referring to page 266 of the paper book, he drew the attention of the Bench to the agency agreement for International Freight Forwarding between Geologistic Management Ltd. and Xpress Pak Logistics (Pvt.) Ltd. Referring to page 280 of the paper book, he drew the attention of the bench to the agreement between GeoLogistics Management Ltd. and Novo Cargo Services Ltd. Bangladesh. Referring to page

193 of the paper book, he drew the attention of the Bench to the copy of the agreement between LEP International Pvt. Ltd. and Freight International Pvt. Ltd., Sri Lanka.

4.1 The ld. counsel for the assessee submitted that the assessee does not own any transportation assets and they get it done through others. Referring to page 306 of the paper book, the ld. counsel for the assessee drew the attention of the Bench to the sample bill and submitted that the assessee company issues bill to the customers as agent. He submitted that this is the standard practice of business. The assessee has a consolidated agreement with IATA. Referring to page 307 of the paper book, he drew the attention of the Bench to the copy of bill of lading issued by Seaquest Line where the name of the assessee appears as an agent. He submitted that the assessee acts as an agent or intermediary. The assessee does not take consignment itself. He submitted that the TPO without valid reason and based on conjecture and surmise calculated the ALP. He submitted that the company does not own any transportation assets like trucks, ships or any other transport equipment of similar nature. It owns only infrastructure i.e office and computer etc. Referring to page 165 to 169 of the paper book, he drew the attention of the Bench to page 166 and submitted that Galaxy Blue Global, a member of the WWPC has stated that profit agreement is 50:50 ratio.

4.2 He submitted that the risk of bad debt is very minimal and as per the IATA Rules, the agent can sue the customer for the dues. Referring to the trend analysis of the bad debts incurred by the company for A.Y. 2002-03 to 2004-05, he submitted that the bad debt percentage to turnover is 0.08% for F/Y 2002-03, 0.06% for F/Y 2003-04 & 0.25% for F/Y 2004-05. He submitted that the bad debt mainly pertains to disputes with the customers for demurrage and other miscellaneous charges. As regards the inventory risk, he submitted that the assessee company enters into a contract with the shipping

line/airline for booking space on a ship/aircraft only upon receipt of confirmed orders from the customers and accordingly it does not assume any inventory risks in relation to the space on ship/airline. He submitted that the A.O. in A.Y. 2002-03 and 2003-04 has accepted the CUP (50:50) model. During the A.Y. 2004-05 the Id. CIT(A) has accepted the CUP method for which the Revenue is in appeal. So far as the marking expenses are concerned he submitted that such expenses are very nominal in the case of the assessee since the assessee is an agent of the airline and since it does not perform any of the activities itself. It gets the work done through others and is not liable for risk.

4.3 He submitted that the assessee considers the rate of 50:50 at which GeoUKmgt and the network members split their net revenues as a CUP and therefore considered CUP method as the most appropriate method for the purpose of bench marking the international transactions. He submitted that 50:50 split is a practice widely followed/accepted by the players in the logistic industry. For this proposition he referred to the third party details filed in the paper book. Referring to the allegation of the Id. D.R. that the 50:50 profit represents a profit split and cannot be considered as a CUP, he submitted that it does not split gross profit in a 50:50 ratio with its AE. It splits only the net revenue i.e. the difference between the total freight charges collected from customers less payments due to third party service providers such as airlines, ocean lines etc. He submitted that the 'net revenue split' is a mechanism (pricing agreement) used to derive the remuneration due to each freight provider entity i.e. the assessee or its AE for the respective functions carried out by them in the origin and destination country. He submitted that the assessee applies 50:50 profits not only to the AEs but also to non-AEs. Referring to a series of decisions, he submitted that the CUP method has been adopted for bench marking international transactions pertaining to payment of

interest/royalty. He accordingly submitted that the order of the CIT(A) accepting the method used by the assessee be accepted.

5. We have considered the rival arguments made by both the sides, pursued the orders of the Assessing Officer and the CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before us. From the various submissions made by the assessee in the paper book as well as submissions before the Id. CIT(A), we find the assessee was regularly adopting the CUP method on its international transactions relating to freight expenses and receipts which has been examined by the TPO and accepted in A.Y. 2002-03 and 2003-04. We find the TPO did not follow the earlier order of his predecessor and rejected the CUP method used by the assessee for the impugned assessment year. He also rejected the OP/VAE as the PLI and instead used OP/TC as the PLI on the ground that companies are operating in different geographical regions and agreements with third parties are entered into on a profit split method and not on the basis of rate. While doing so, he used the data of some private limited companies, the detailed information of which are not available in public domain and rejected the search undertaken by the assessee in the TP study. He further used the single year data for the purpose of TNMM analysis as against multiple year data applied by the assessee. It is the submission of the learned counsel for the assessee that the assessee had considered the CUP method as the most appropriate method to determine the ALP of the international transaction. According to him, the assessee company only co-ordinates with third party service providers and does not own any transportation assets such as trucks, ships, air crafts or any other transportation assets of similar nature and it owns only office premises and computers. The above submission of the Id. counsel for the assessee could not be controverted by the Id. D.R. We find force in the submission of the Id. counsel for the assessee that both the origin company and the destination company assume comparable risks with the risk of bad debts being minimal

and that there is no inventory risk since the assessee company enters into a contract with the shipping line/air line for booking space on a ship/air craft only upon receipt of confirmed orders from the customers. From the various agency agreements between Geologistics group and unrelated parties produced by the assessee, we find the terms and conditions are substantially same. The profit split information contained in all the agreements is typical to the industry. We also find merit in the submission of the ld. counsel for the assessee that the TPO in his TP study report has considered certain companies which are not available in the public domain being private limited companies or they are not comparable to the assessee companies. From the various submissions made by the assessee and the detail submissions in the paper book, we find the four companies rejected by the TPO are functionally comparable to the assessee and therefore should have been retained in the comparable study.

5.1 From the various documents produced in the paper book, we find the assessee in the case of air business as well as ocean business merely acts as an agent of the air line or the sea line and the assessee issues bills to the customers as an agent of the air line or the sea line. The customer at all time is aware of the fact that the assessee is acting only as an agent and the consignment is being transported by air or ship or road through air craft or a vessel or a vehicle owned by different entity and not by the assessee. Under these circumstances we find merit in the submission of the ld. counsel for the assessee that unless the freight amount paid to the 3rd parties are taken out, it will be skewed. The above proposition of the ld. counsel for the assessee also finds support from clause 7.6 of OECD guidelines which read as under:-

“When an associated enterprise is acting only as an agent or intermediary in the provision of services, it is important in applying the cost-plus method that the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the service themselves. In such a case, it may not be appropriate to determine arm’s length pricing as a mark-up on the

cost of the services but rather on the costs of the agency function itself or alternatively, depending on the type of comparable data being used, the mark-up on the cost of services should be lower than would be appropriate for the performance of the services themselves. For example, an associated enterprises may incur the costs of renting advertising space on behalf of group members costs that the group members would have incurred directly had they been independent. In such a case, it may well be appropriate to pass on these costs to the group recipients without a mark up and to apply a mark-up only to the costs incurred by the intermediary in performing its agency function.

5.2 We further find the Delhi Bench of the Tribunal in the case of Schefenacker Motherson Ltd. vs. ITO reported in 2009-TIOL-376-ITAT-DEL while considering the facts of the tax payer interpreted “net profit” for the application of the TNMM to mean “cash profits” i.e excluding depreciation. The relevant observation of the order of the Tribunal (at para 19 of the order) reads as under:-

“...There is no formula which would be applicable universally and in all circumstances. “Net profit” used in Rule 10B can be taken to mean commercial profit as held by the TPO and confirmed on appeal by the Id. CIT(A). But depreciation in such profit on commercial principles has to be the “actual” amount by which the assets of business got depleted between the two dates separated by a year. It cannot be depreciation under tax or companies rules or as per policy of the company. In the case in hand, revenue authorities went wrong in disregarding the context and purpose for which the “net profit” was to be computed. Depreciation, which can have varied basis and is allowed at different rates is not such an expenditure which must be deducted in all situations. It has no direct connection or bearing on price, cost or profit margin of the international transactions. Principles emphasized in the case of Bangalore Clothing by Bombay High Court are attracted here. Object and purpose of the transfer pricing to compare like with the like, and to eliminate differences, if any, by suitable adjustment is to be seen. Therefore, there was justification on the part of the taxpayer in pleading that profits be taken without deduction of depreciation as depreciation was leading to large differences in margins for various reasons.”

5.3 We find the OECD in the revised T.P. guidelines of 2010 has recognized the use of different measures of profit under the profit split method. The relevant para of the guideline reads as under:-

“2.131 Generally, the combined profits to be split in a transactional profit split method are operating profits. Applying the transactional profit split in this manner ensures that both income and expenses of the MNE are attributed to the relevant associated enterprise on a consistent basis. However, occasionally, it may be appropriate to carry out a split of gross profits and then deduct the expenses incurred in or attributable to each relevant enterprise (and excluding expenses taken into account in computing gross profits). In such cases, where different analyses are being applied to divide the gross income and the deductions of the MNE among associated enterprises, care must be taken to ensure that the expenses incurred in or attributable to each enterprise are consistent with the activities and risks undertaken there, and that the allocation of gross profits is likewise consistent with the placement of activities and risks. For example, in the case of an MNE that engages in highly integrated worldwide trading operations, involving various types of property, it may be possible to determine the enterprises in which expenses are incurred (or attributed), but not to accurately determine the particular trading activities to which those expenses relate. In such a case, it may be appropriate to split the gross profits from each trading activity and then deduct from the resulting overall gross profits the expenses incurred in or attributable to each enterprise, bearing in mind the caution noted above”.

5.4 From the various submissions made by the assessee it is also clear that the geographical difference is not material so far as it applies to the logistics industry. From the various agreements we find there is splitting of gross profit equally at 50:50 even in Pakistan, Bangladesh and Sri Lanka which fall under the same geographical region. In view of the above and in view of the detailed

reasoning given by the ld. CIT(A) we do not find any infirmity in the CUP method (50:50 module) adopted by the assessee. Accordingly, the order of the ld. CIT(A) on this issue is upheld and the ground raised by the Revenue is dismissed.

ITA No. 6004/Mum/2010 for A.Y. 2005-06(By the Revenue)

6. Ground No. 1 by the Revenue reads as under:-

“On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in deleting the disallowance made by the Assessing Officer on account of Petty cash expenses amounting to ₹ 20,00,000/- without appreciating the facts and circumstances of the case and in law.”

7. Facts of the case in brief are that the assessee has incurred expenses in cash amounting to ₹ 4,42,63,776/-. During the course of assessment proceedings, the A.O. noted that many of the petty cash expenses were not supported by invoices/bills. Further, cash vouchers for Mumbai location amounting to ₹ 81,56,486/- were not produced as the same were damaged on account of fire on 10.4.2006 in the assessee's godown situated at Bhiwandi. To substantiate the fire at the godown, the assessee produced police station diary register, panchnama dtd. 11.4.2008 and the report of firebrigade. The A.O. noted that while vouchers of Bombay office could not be produced at all, the vouchers for other stations, although produced, but did not have supporting invoices/bills. The amount involved in individual vouchers which were not supported by invoices is less than ₹ 500/- in many cases. However, the number of such missing invoices is fairly large. Since the exact amount in respect of which the invoices are missing are not available and considering the amount of cash expenditure incurred by the assessee, the A.O. made addition of ₹ 20 lacs on adhoc basis in order to prevent leakage of revenue on this account.

7.1 Before the Id. CIT(A), it was submitted that by their very nature itself, petty cash expenses are petty expenses. Due to the nature of expense, no corresponding invoices are issued for the amount paid as petty cash expenses such as loading and unloading charges at ports, conveyance expenses, amount paid to sweepers or gardeners or to a local electrician called upon for rectifying a small defect etc. This cannot lead to a conclusion that there is likely to be leakage of revenue. It was further submitted that the amount of petty cash expenses incurred during the year is ₹ 5,42,69,498/- and not ₹ 4,42,63,776/- as mentioned by the A.O. It was submitted that the above amount is merely 1.82% of the income from operations of ₹ 297.76 crores. It was submitted that it may not be always possible to support each and every petty cash expense with invoices and the allowability of expenses in such cases should be looked into objectively as to its fairness, reasonableness and whether it is commensurate with business of the assessee. Various case decisions were also cited before the Id. CIT(A) to the proposition that in absence of any defect pointed out by the A.O. in the audited books of account where the auditors have not given any adverse comments on the petty cash expenses no adhoc disallowance can be made.

7.2 Based on the arguments advanced before him, the Id. CIT(A) deleted the addition. While doing so he observed that the assessee has duly produced the vouchers for A.O's verification during the assessment proceedings. The A.O. has not given any cogent reasons for making an adhoc disallowance. He has not arrived at any conclusive finding with respect to leakage of revenue. He has not even pointed out any specific defects with respect to the adhoc disallowance. No specific defects have been pointed out by the A.O. from the vouchers produced for his verification. He further noted that it is always not possible to support each and every expense with invoices and the auditors have not pointed out any defect. He accordingly deleted the adhoc disallowance of ₹ 20 lacs made by the A.O. Aggrieved with such order of the Id. CIT(A), the Revenue is in appeal before us.

8. We have considered the rival arguments made by both the sides, pursued the orders of the Assessing Officer and the CIT(A) and the paper book filed on behalf of the assessee. We have also considered the various decisions cited before the Id. CIT(A) and reiterated before us. There is no dispute to the fact that most of the petty cash expense vouchers produced before the A.O. were not supported with bills and vouchers. It is also a fact that due to fire at godown at Bhiwandi the petty cash expenses vouchers of Bombay office were not produced before the A.O. It is the settled proposition of law that for claiming any expenditure as genuine business expenditure the onus is always on the assessee to satisfy the A.O. with evidence to his satisfaction to substantiate that the expenditure has been incurred wholly and exclusively for the purpose of business. Merely because the total expenditure of ₹ 5,42,69,498/- is 1.82% of the total operations at 297.76 crores, it cannot be a ground for accepting the whole of the expenses as genuine. Further, the finding of the Id. CIT(A) that the A.O. has not arrived at any conclusive finding with respect to leakage of revenue is also not correct since the A.O. has given a categorical finding that the petty cash expense vouchers were either not supported with proper bills and vouchers or are missing. It is also not correct on the part of the CIT(A) to say that it is not possible to see each and every expense with vouchers. It may be true in case of few items but where petty cash expenditure is of the magnitude of ₹ 5.43 crores and vouchers were not available for most of the small items, it cannot be said that the entire amount has been incurred wholly and exclusively for the purpose of business. The various decisions relied on by the Id. counsel for the assessee are distinguishable and not applicable to the facts of the present case. In those decisions it was held that where the A.O. has not pointed out any particular expense or without pointing out any specific defect in the books no adhoc disallowance can be made. However, in the instant case, assessee has admitted that vouchers are not possible for expenses such as loading and unloading charges, conveyance expenses, payment made to gardeners, sweepers,

electricians etc. Further, vouchers for Bombay office were not at all produced due to destruction of the vouchers due to fire. Under these circumstances, the case decisions relied on by the ld. counsel for the assessee are of no use. Further, allowance of the whole of the expenses in absence of proper vouchers is at the cost of an honest assessee who meticulously maintains all vouchers irrespective of the nature and amount involved. However, the disallowance of ₹ 20 lacs in our opinion appears to be on higher side. Considering the totality of the facts of the case, adhoc disallowance of an amount of ₹ 10 lacs Ten lakhs only), in our opinion, will meet the ends of justice. We hold and direct accordingly. Ground of appeal No. 1 by the Revenue is partly allowed.

9. Ground of appeal No. 2 by the Revenue reads as under:-

“On the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in deleting the adjustment u/s 92CA(3) of the I.T. Act, 1961, of freight related receipts and expenses amounting to ₹ 14,62,12,134/- made by the Transfer Pricing Officer & the Assessing Officer, as per the Arms Length Price by a sum of ₹ 27,54,34,623/-.”

9.1 After hearing both the sides we find the above ground is identical to ground No. 1 by the Revenue in ITA No. 2000/M/10. We have already decided the issue and the ground raised by the Revenue has been dismissed. Following the same ratio, this ground by the Revenue is dismissed.

ITA No. 8146/M/2010 for A.Y. 2006-07 (By assessee)

10. Ground of appeal No. 1 is general in nature and therefore the same is dismissed.

11. In ground of appeal No. 2, the assessee has challenged the order of the DRP in confirming the addition of ₹ 15,92,19,381/- to the income of the assessee by holding that its international transaction of freight receipts and expenses does not satisfy the arm's length principle envisaged under the Act by rejecting the CUP method followed by the assessee.

12. After hearing both the sides we find that the assessee during the impugned assessment year has entered into the following international transactions with its Associated Enterprises ('AE's') :-

- a) Provision of Logistics Services:
 - Freight receipts; and
 - Freight expenses.
- b) Professional Services fees
- c) Reimbursement of marketing expenses

12.1 We find the T.P. study in respect of international transactions undertaken by the assessee was rejected by the TPO who made addition of ₹.15,92,19,381/- to the freight receipts and expenses of the assessee. We find the DRP upheld the action of the AO on the ground that the transactions between the AE's and non AE's are not fully comparable because the nature of service rendered and quantum of business conducted with the AE's is substantial as compared to the Non AE's. Therefore, the DRP held that the AO was right in rejecting the TP method followed by the assessee. Further the DRP was of the view that TNMM method has correctly been applied by the AO by taking PLI on the basis of OP / OC. We find the various submissions made by the assessee before the DRP show that the same have been completely brushed aside and ignored without giving proper and adequate opportunity to the assessee. Most of the relevant points raised on behalf of the assessee on important issues even do not find mention in the order of the DRP. We find in the case of Gap International Sourcing India (P) Ltd. vs. DCIT 113 TTJ (Del.) 627, the coordinate bench of this Tribunal came across a similar situation wherein voluminous submissions made by the assessee were found to be brushed aside by the DRP without even a whisper in the order. The order passed by the DRP, therefore, was held to be laconic by the Tribunal and the matter was remitted back to the DRP to consider the same again and to pass a proper and speaking order. A similar situation arose in the case of Vodafone

Essar Ltd. vs. DRP 196 Taxman 423 (Del.) wherein the order passed by the DRP was quashed by the Hon'ble Delhi High Court and the matter was remanded for fresh adjudication observing that when a quasi judicial authority deals with a case, it is obligatory on its part to ascribe cogent and germane reasons as the same is the heart and soul of the matter. The Hon'ble Delhi High Court further observed that a well reasoned and well discussed order also facilitates appreciation when the same is called in question before the superior forum. Keeping in view the decision of the Hon'ble Delhi High Court in the case of Vodafone Essar Ltd. (supra) as well as that of the coordinate bench of this Tribunal in the case of Gap International Sourcing India (P) Ltd. (supra) and having regard to the fact that the DRP has passed the order giving directions to the AO u/s.144C without giving proper consideration to the elaborate submissions made on behalf of the assessee on the main preliminary issue, we set aside the said issue and remit the matter to the file of the DRP with a direction to consider the objections of the assessee on this issue as well as the other issues once again and pass a proper and speaking order giving direction u/s.144C. Further, the assessee has also not furnished fresh data of preceding year or current year for which the order for A.Y. 2004-05 and 2005-06 in our opinion cannot be applied to this year. In view of the above, we deem it proper to restore the issue to the DRP for fresh adjudication of the issue in accordance with law and after giving due opportunity of being heard to the assessee. We hold and direct accordingly. The ground raised by the assessee is accordingly allowed for statistical purpose.

13. In ground No. 3, the assessee has challenged the order of the Id. DRP in not allowing the employees' contribution to PF amounting to ₹ 7,18,085/-.

13.1 After hearing both the sides we find the amount of ₹ 7,18,085/- being employees' contribution to PF was disallowed by the DRP since the same was not paid before the due date but paid before the grace period. Since admittedly the contributions have been paid before the grace period, therefore, in view of

the consistent decisions of the co-ordinate Benches of the Tribunal that amounts paid within the grace period has to be allowed as deduction, the amount cannot be disallowed. Accordingly, the A.O. is directed to allow the claim of ₹ 7,18,085/- being employees' contribution to PF paid within the grace period.

14. Grounds of appeal No. 4 & 5 are as under:-

“Ground No. 4: On the facts and circumstances of the case, the learned DRP has erred in law in not disposing the objection raised by the assessee against the proposed addition of unexplained receipts of ₹ 21,42,582/-.

Ground No. 5 : On the facts and circumstances of the case, the learned A.O. has erred in law in confirming the proposed addition of unexplained receipts of ₹ 21,42,582/-.”

14.1 After hearing both the sides, we find the above two grounds have not been adjudicated by the DRP. Accordingly, the above two grounds are restored to the file of DRP for adjudication of the same in accordance with law and after giving due opportunity of being heard to the assessee. The above grounds are accordingly allowed for statistical purpose.

15. Ground No. 6 by the assessee reads as under:-

“The learned Assessing Officer for the purpose of computing the demand for the year under consideration has erred in considering the refund withdrawn for A.Y. 2007-08 of ₹ 2,91,29,970/- and thereby also erred in levying interest under section 234D of ₹ 24,76,047/-.”

15.1 After hearing both the sides, we find this ground by the assessee is consequential in nature. Accordingly the same is restored to the file of the A.O. for calculation of interest in accordance with law. This ground is accordingly allowed for statistical purpose.

16. In the result, appeal filed by the Revenue in ITA No. 2000/M/10 for A.Y. 2004-05 is dismissed, appeal in ITA No. 6004/M/10 for A.Y. 2005-06 is partly allowed and appeal filed by the assessee in ITA No. 8146/M/10 for A.Y. 2006-07 is partly allowed for statistical purpose.

Order pronounced on 25.01.2012.

Sd/-
(D. MANMOHAN)
VICE PRESIDENT

sd/-
(R.K. PANDA)
ACCOUNTANT MEMBER

Mumbai, dated 25.01.2012.

RK

Copy to...

1. The appellant
2. The Respondent
3. The CIT(A) – Concerned, Mumbai
4. The CIT – Concerned, Mumbai
5. The DR Bench, “A”
6. Master File

// Tue copy//

BY ORDER

DY/ASSTT. REGISTRAR
ITAT, MUMBAI

FIT FOR PUBLICATION

J.M.

A.M.