IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: "I" NEW DELHI

BEFORE SMT. DIVA SINGH, JUDICIAL MEMBER
AND
SHRI B.C.MEENA, ACCOUNTANT MEMBER

I.T.A .No.-5354/Del/2012
(ASSESSMENT YEAR-2008-09)

BMW India Pvt. Ltd.,	vs	Addl. CIT,
7th Floor, Tower-B,		Range-I,
Building No-8, DLF Cyber City,		Gurgaon.
Phase-II, Gurgaon.		
PAN-AABCB7140C		
(APPELLANT)		**(RESPONDENT)**

Appellant by: Sh. Rahul Mitra, CA & Sh. Amitava Sen, CA
& Sh. Samritra Kr. Chakraborty
Respondent by: Sh. Peeyush Jain, CIT(DR) TP

ORDER

PER DIVA SINGH, JM

This is an appeal filed by the assessee against the Assessment Order dated 18.10.2012 passed u/s 144C/143(3) pertaining to 2008-09 assessment year on the following grounds :-

"1. The Learned Dispute Resolution Panel ('Ld. DRP') and the Ld. Additional Commissioner of Income-tax('Ld AO') (following the directions of the Ld. DRP), erred on facts and in law, in enhancing the income of the appellant by Rs.48,65,29,622 by making a transfer pricing ('TP') adjustment by holding that the appellant should have received reimbursement of Advertising and Marketing Promotion ('AMP') expenses from the Associated Enterprises ('AEs') for allegedly incurring excess amount of expense in this regard as compared to other comparable companies.

2. The Ld. DRP and consequently the LD. AO (following the directions of the Ld. DRP) erred on facts and in law in upholding that the appellant has rendered services to the AEs by incurring the AMP expenses and by holding that a mark-up has to be earned by the appellant in respect of the "alleged excessive" AMP expenses and applying a mark-up of 15% in respect of the appellant's "alleged excessive" AMP expenses, without any basis for the same whatsoever.

3. The Ld. DRP and consequently the Ld. AO (following the directions of the Ld. DRP) erred on facts and in law in misinterpreting or placing incorrect reliance on the international guidance in relation to the 'marketing intangibles' and 'bright line *test' from Organization for Economic Co-operation and Development ('OECD'), US TP Regulations and Australian Tax Office ('ATO') and relying on several erroneous/factually incorrect and contradictory statements/observations in the TP order, which are not relevant to the instant case, only in order to justify an otherwise inappropriate and unwarranted TP adjustment.*

4. The Ld. DRP and consequently the Ld. AO (following the directions of the Ld. DRP) erred on facts and in law in ignoring the fact that the AMP expenses incurred by the appellant were in respect of its own business requirements/considerations/purposes and that all and any benefit resulting from such expenditure are to its own account (in the form of increased sales and market share) and benefit, if any, to the overseas AEs, was purely incidental.

5. The LD. DRP and consequently the Ld. AO (following the directions of the Ld. DRP) erred on facts and in law in disregarding that the appellant's international transactions are demonstrated to be at arm's length after application of Resale Price Method ("RPM") and corroborated by Transactional Net Margin Method ("TNMM") as the most appropriate method and also the fact that premium profits earned by the appellant had actually more than compensated the appellant for the extra functions, if any, represented by the allegedly excessive AMP spends, incurred by it.

6. The Ld. DRP and consequently the Ld. AO (following the directions of the Ld. DRP) erred on facts and in law in selecting inappropriate comparable set for the computation of the "alleged excessive" AMP spend based on "bright line limit" application of which in itself is inappropriate, being based in erroneous or inappropriate reasoning."

2. The assessee in the year under consideration declared an income of Rs.83,80,71,485/- by way of E-filing its return which was subsequently revised on 15.12.2009 at an income of Rs.99,89,99,667/-.

2.1. A perusal of the record shows that the assessee company was incorporated in 1997 as private limited company and is a wholly owned subsidiary of BMW Holding B.V, Netherlands. The ultimate holding company is BMW, AG, Germany, BMW India is engaged in manufacturing, training, marketing and distribution of motor vehicles and related spare parts and accessories. During the year, total income from sale of manufactured goods and traded goods had been shown at Rs.816.23 crores as against Rs.75.43 crores last year. Net profit had been shown at 13% as against net loss of 23% in the previous year.

2.2 The return was processed u/s 143(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act" or the "IT Act") and subsequently by way of issuance of notice u/s 143(2) and 142(1) along with detailed questionnaire etc. was subjected to scrutiny assessment.

2.3. The Transfer Pricing Officer (hereinafter referred to as the "TPO") on receipt of the reference made u/s 292CA(i) from the Assessing Officer (hereinafter referred to as the "AO") for determining the Arm's Length Price (hereinafter referred to as the "ALP") in respect of international transaction entered into by the assessee during the financial year 2007-08 relevant to assessment year 2008-09 passed an order dated 17.10.11 u/s 92CA(iii) of the Act.

2.4. A perusal of the same shows that the TPO took note of the fact that the BMW Group has global operations in 3 segments namely Automobiles, Motorcycles and Financial Services. The parent company of the group is BMW AG i.e the associated enterprise (hereinafter referred to as the "AE") which is headquartered in Munich, Germany and is primarily engaged in the manufacturing of automobiles and motorcycles. The major car brands manufactured by BMW AG are stated to be BMW, Mini and Rolls-Royce. The TPO takes note of the fact that the assessee had undertaken the following international transactions :-

S.N.	Description of transaction	Value (in Rs.)	Method
1.	Purchase of raw material	167,051,934	TNMM
2.	Purchase of traded vehicle	535,438,461	RPM
3.	Purchase of spare parts	18,057,016	RPM
4.	Purchase of fixed assets	175,346,819	CUP
5.	Purchase of software	78,880,000	CUP
6.	Receipt of technical support service	29,449,506	CUP
7.	Receipt of IT support services	2,739,917	CUP
8.	Market survey expenses	11,711,690	CUP
9.	Reimbursement of personal cost	17,252,074	CUP
10.	Reimbursement of expenses	12,270,724	CUP
11.	Interest of loan	12,9773,291	CUP

2.5. Referring to the Transfer Pricing Study of the assessee, the TPO observed that the assessee described its activities as that of a distributor. The TPO referred to the Importation Agreement between the parent company BMW AG and the assessee and observed that the same had been entered into w.e.f 01.01.2006 and it stated that the assessee had the following duties in regard to marketing and promotion of the products of the parent company:

> ***"2.2. Responsibility in the Contract Territory***
> *BMW India represents the interest of BMW AG in the Contract Territory. It is responsible for the sale promotion and the full utilization of the market potential for the Contract Goods in the Contract Territory.*
> *It is further responsible for ensuring the provision of the best possible customer service and adequate stocks of original BMW parts in the Contract Territory.*
> *Furthermore, BMW India undertakes the following functions in the Contract Territory in accordance with the laws of the contracting territory:*
> *- establishment and supervision of an efficient BMW distribution network.*
> *- Performance of an adequate advertisement and sales promotion as well as public and media relations.*
> *- Collection, evaluation and communication of market information to BMW AG.*
> ***3. Scope of the Activity of BMW India***
> *3.1 BMW India will meet its responsibility for the promotion of sales and the full utilization of the market potential for the Contract Goods by applying its best efforts and adequate resources toward effective sales promotion and advertising for the Contract Goods including available optional equipment and accessories."*

2.6. The TPO further observed that the TP study on page 5 para 1.2.4 and para 4.5.3 also the following positions :-

> *"4.1. The transfer pricing study, on page 5, para 1.2.4 states that, "based on an analysis of the functions performed and risks assumed by BMW Group and BMW India, the development of the arm's length price in this analysis recognizes that BMW Group owns valuable intellectual property rights (know-how, copy rights, patents etc.) and other commercial or marketing intangibles (brands, trademarks etc.) and is involved in complex product development, manufacturing of products and brand development operations. BMW India, on the other hand, can be characterized as a distributor, also performing low value and added assembly of automobiles, utilizing the intangibles developed and owned by the BMW Group. BMW India undertakes all the routine functions and assumes all the risks associated with such business activities."*
> *Further, the TP study also states, "Para 4.5.3 BMW India does not own non-routine intangibles and does not undertake any research and development on its own account that leads to the development of non-routine intangibles. BMW India uses the brand name, trademarks, processes technical know-how/data, operating/quality standards etc. developed/owned by BMW Group. Accordingly BMW India does not own any non-routine intangibles."*

2.7. Considering the TP Study documentation of the assessee, the TPO show caused the assessee that why it had not been compensated by its AE for its brand promotion activities which resulted in creating marketing intangibles for its AE as admittedly the brand ownership vested with the AE.

2.8. Advertising, Marketing and Promotion (hereinafter referred to as the "AMP"), the explanation of the assessee that the Amp expenses calculation included expenditure like after sales support costs etc. which needed to be corrected; that IPH (International Power House) is the organizational unit of BMW and as such it is responsible for marketing and development consequently the assessee had no role to develop campaigns etc; that the five year trend calculation of AMP expenses/sales showed that there was a decline in the percentage; that the bright line test had no application in the face of high profit margin shown in RPM/TNMM; that the comparables should be those who had similar intensity of functions; that there was no international transaction in incurring AMP expenditures were all not agreed to by the TPO who was of the view that judicial mandate was that "form" should prevail over "substance"; and that the fact remains that by incurring the expenditure over and above the bright line the assessee has incurred expenses which were non-routine expenditure far beyond the requirements of a normal distributor that this had resulted in the brand promotion of the AE who was the legal owner of the brand; and that consequently the brand had gained value. Accordingly for the services rendered by the assessee, it should have been compensated and a mark-up on the costs incurred should also have been received. The said view and conclusion was supported by the TPO relying upon para 6.3 and 6.4 as well as paras 6.36 to 6.38 of OECD's "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" edition 2010 reproduced in para 6.7 to 6.9 at pages 8-10 of his order. Reliance was also placed on the position under the Transfer Pricing Legislation and Australian Guidance and the judgement of the Hon'ble Delhi High Court in Maruti Suzuki's case. Accordingly the TPO was of the view that international practices and jurisprudence all hold that bright line is an internationally accepted economic tool which is applied to determine and ascertain the expenditure which a routine distributor would incur to market and promote the products which it is dealing with. As such for the expenditure beyond the bright line in the hands of a person who is not the legal owner of the brand, the TPO was of the view that in such a situation re-imbursement from the legal owner of the brand must flow. The TPO further referred to the advertisements from the company's website and the print media observed that it showed that the assessee had advertised the product of the AE along with "BMW logo" which did not bear the name "BMW India" and the "BMW India" logo. The argument that the assessee had no role in the level of publicity was also not accepted as assessee had purchased brochures worth Rs.7.68 crores and other advertising/marketing materials from its AE. The TPO referring to the international practices and the article titled "The significance of Intangibles Property Rights in Transfer Pricing" by Gregory J. Ossi specific paras 60, 55 relied upon by the assessee in its submissions dated 04.10.2011 extracted in the TPO's order at page 21-23 of his order, concluded that the tenure of the assessee is quiet tenuous and could be snapped anytime which could leave the assessee without any benefit for the hard work put by it as such he concluded that the compensation should have been received alongwith a mark-up.

2.9. The reliance paced on Nestle India Ltd. Vs DCIT (111 TTJ 53) by the assessee was held to be not relevant as it was not in the context of transfer pricing for determining the ALP of the AMP expenditure. The argument of the assessee that high margins earned by the assessee when compared to its comparables was also considered to be not relevant as margins were considered to be dependent on many factors like economics of scale, low over heads and such other factors like low end assembly etc.

2.9.1. The TPO considering the five comparables of the assessee excluded Concorde Automobiles Ltd. and TV Sundaram Iyengar & Sons Ltd. Concorde was excluded as it was found that being fully owned by Tata Motors promoted Tata brand, it was not an uncontrolled comparable and TV Sundaram Iyengar & Sons was also excluded as it was a tainted comparable as it owned TV Sundaram and Lucas brand. The average AMP sales ratio of the remaining three companies which worked out to

0.52% accordingly was taken as the bright line and accepting the expenditure of Rs.4,30,91,936/- as routine expenditure considered the amount of Rs.54,48,86,304/- out of total AMP expenses of Rs.58,79,782,410/- as expenditure exceeding the bright line the TPO required the assessee to explain as to why the said amount not be added as a non-routine expenditure.

2.9.2. The assessee in reply before the TPO referred to a fresh search of comparables addressing the intensity of the distribution functions comparable to the assessee. The said search was accepted by the TPO who considered the excess average AMP/sales as 1.99% after including the ……… comparables, retained from the original set of comparables on which he included a mark-up of 15%. The comparables referred to by the assessee and accepted by the TPO in the fresh search based on similarity in intensity of functions are extracted from the order hereunder for ready-reference :-

> ***"10.5 Response of the assessee:*** *The assessee; vide its reply dated 04.10.2011, has raised objections regarding the proposal to only use three out of the five comparables taken by it in its TP study.*
> *It has carried out a fresh search to come up with another set which it claims is closer to the distribution function of the AE. The set is as under:*

Name of the company	*Database*	*GP/Sales*	*OP/Sales*	*A&M/Sales*	*VAE/Sales*
Pebco Motors Ltd.	*P*	*6.62%*	*-3.84%*	*1.20%*	*10.46%*
Popular Vehicles & Services Ltd.	*P*	*11.72%*	*1.16%*	*4.10%*	*10.56%*
Shree Sancheti Motors Pvt. Ltd.	*P*	*12.15%*	*0.95%*	*1.61%*	*11.20%*
Machino Techno Sales Ltd.	*P*	*12.69%*	*1.07%*	*4.42%*	*11.62%*
Eastman Industries Ltd.	*P*	*16.22%*	*3.80%*	*1.25%*	*12.42%*
Bharat Power Corpn. Pvt. Ltd.	*P*	*24.79%*	*10.82%*	*0.87%*	*13.96%*
MGF Automobiles Ltd.	*P*	*15.90%*	*0.45%*	*6.31%*	*15.45%*
Lucas Indian Services Ltd.	*P*	*20.13%*	*4.16%*	*0.88%*	*15.97%*
Sri Ramadas Motor Transport Ltd.	*P*	*18.92%*	*2.19%*	*1.66%*	*16.73%*
Mean		***15.46%***	***2.31%***	***2.48%***	***13.15%***
BMW India		***27.36%***	***13.52%***	***2.69%***	***13.84%***

> *This set will be used along with the comparables already proposed in the show cause notice to be used from the original set taken under TP study. The average AMP/Sales works out to 1.99%."*

2.9.3. Accordingly, the TPO proposed the addition of Rs.48,65,29,022/- in the following manner :-

*"**10.8. Determination of arm's length price of receipt of subsidy :** The computation of arm's length price of the international transaction of receipt of special purpose subsidy is done as under :-*

Particulars	***Formula***	***Amount in Rs.***
Total Revenue of the assessee	*A*	*8,286,910,876*
Arm's length % of AMP Expenditure	*B*	*1.99%*
Arm's length AMP expenditure	*C=(A*B)*	*164,909,526*
Expenditure incurred by the assessee on AMP	*D*	*587,978,241*
Expenditure incurred for developing the intangibles	*E=D-C*	*423,068,715*
Add Markup @ 15%	*F*	*63,460,307*
Arm's length return for AMP expenditure	*G=E+F*	*486,529,022*
Reimbursement received from the AE	*H*	*NIL*
Amount by which income is to be enhanced	*I=G-H*	*486,529,022*

3. Aggrieved by this the assessee moved the Dispute Resolution Panel (hereinafter referred to as the "DRP"). The DRP concurred with the findings of the TPO on the conclusion that the AE had benefited by the promotional activities of the assessee as the legal ownership vested with the AE. The DRP also concurred with the applicability of bright line test as an accepted tool of quantifying the non-routine expenditure in the case of assessee's in whose case according to the DRP, there was nothing to show that the AE had any long term obligation towards the assessee. However the DRP directed the TPO to exclude from the AMP calculation, the amounts pertaining to the after sales support costs and salesman bonus etc. from the AMP cost bundle.

4. Consequent to the order of the DRP, the AO passed the assessment order u/s 144C/143(3) on 18.10.2012 observed that the DRP vide its order dated 24.09.2012 directed the TPO to exclude few items from the AMP cost bundles like after sales support, sales bonus which have no connection with AMP and re-compute the ALP however since the TPO passed his order dated 17.10.2012 and kept the transfer pricing adjustment unchanged, accordingly the AO confirmed the addition made in the draft assessment order and passed the impugned order.

4.1. Aggrieved by this, the assessee is in appeal before the Tribunal. The hearing in the present case took place on four different occasions. On 18.02.2013, both the sides put forth their arguments, subsequently the case was fixed for clarification and the Ld. AR filed a synopsis and re-joinder to the arguments advanced by the CIT DR. Ld. CIT DR on the next date made oral submissions on the submissions of the Ld. AR and the time was given to the Ld. CIT DR to sum up his arguments.

5. Before addressing the detailed arguments on the merits of the claims of the respective parties qua the grounds raised, we first propose to consider the preliminary issues addressed by the parties before the Bench.

5.1. On 18.02.2013, Ld. AR referring to the affidavit filed before us and the order of the Special Bench which is in public domain stated that the assessee sought permission to become an intervener in L.G' Electronics' case. However when during the hearing on 2.11.2012, the Members of the Special Bench clarified that the Special Bench would adjudicate only on the facts emanating from L.G. Electronics India Pvt. Ltd. i.e. the principal appellant and would not discuss the facts of any other case and since the principal appellant was "a licensed manufacturer" and the assessee in the present case being "a distributor", the Ld. AR sought permission to be allowed to withdraw as an intervener. It was stated by Sh. Rahul K. Mitra referring to the affidavit filed by him dated 14.02.2013 that the permission was granted and consequently the name of the assessee does not appear in the list of interveners before the Special Bench. It was stated that no separate order in writing was passed. Accordingly it was his submission that the order of the Special Bench proceeds entirely on different facts would not have any applicability to the assessee's case as the facts are entirely distinguishable, since the assessee predominantly is a distributor of automobiles with insignificant or low value added assembly functions. It was elaborated that when the Special Bench made it clear that it would not lay down any principle addressing the facts of a distributor accordingly a written request was made praying that the assessee may be permitted to withdraw as an intervener from the Special Bench. It was submitted that the said request was made in writing before the Special Bench (copy attached) supported by an affidavit asserting these facts and these submissions are further fortified by the fact that the order does not mention the name of the assessee as an intervener in this background it was sought to be submitted that the said decision may not be considered as a binding precedent as arguments addressing the facts of a distributor have not been considered. It was requested that these facts addressing the background may be considered in the correct perspective as the facts of L.G. Electronics case and assessee are different and both the cases proceed on different facts and the assessee did not have the opportunity to address arguments on the facts and the decision of the larger Bench would not apply to the assessee who is a distributor.

5.1.1. The Ld. CIT DR stated that though it is correct that the assessee's name does not appear in the list of interveners and the order of the Special Bench in L.G. Electronics has considered the facts of L.G. Electronics however according to him the Special Bench has laid down the law on the various aspects of transfer pricing on the nature of AMP spend holding it to be an international transaction and upholding the bright line concept as a tool for calculating the arm's length price and has considered while restoring the issue not only the aspects which would apply to a licensed manufacturer but also to distributors. As such it was submitted that the department would be heavily relying on the order of the Special Bench which has decided all the legal issued in favour of the Revenue. It was his stand that the order of the Special Bench would bind the assessee as the principles laid therein are applicable to the AMP expenses as such the argument that the said order would apply only to a license manufactured cannot be accepted. It was also his stand that the order shows that the assessee is not an intervener, as such the contents of the affidavit of the Ld. AR to the said extent are correct as the record shows that the assessee sought to implead itself as an intervener and thereafter sought permission to withdraw as an intervener from the hearing in LG Electronics case and the order available in the public domain shows that the assessee has not been named as an intervener. As such to that extent, the Ld. CIT DR was in agreement with the submissions of the Ld. AR.

5.1.2. On considering the stand of the parties before the Bench, we hold that the assessee was not an intervener in the proceedings before the Special Bench in the case of L.G. Electronics as its name does not find a mention in the list of interveners and the affidavit dated 14.02.2013 of the Ld. AR Sh. Rahul Mitra addresses the background as to how after seeking permission to be impleaded as an intervener, the permission to withdraw was moved. Accordingly, we hold that the assessee is not precluded from advancing arguments on facts and law which were either not addressed before the Special Bench by the intervener/parties nor considered consequently by the Special Bench. Having thus held, we clarify that it does not necessarily follow that the ruling of the Special Bench would not apply to the assessee wherever facts and law so demand. As such, the departmental stand that the said ruling is binding has to be upheld with the caveat to the extent facts and law support it.

5.2. The next preliminary issue which we need to address is the petition for admission of additional ground moved on behalf of the assessee. On the first date of hearing i.e 18.02.2013, Ld. AR invited attention to the petition dated 09.11.2011. Relying on the judgement of the Apex Court in the case of NTPC vs CIT 229 ITR 383(SC), it was submitted that the following additional grounds may be admitted:-

> *"7. The Ld. Additional Commissioner of Income-tax ('Ld. AO'), erred on facts and in law by not giving effect to the Directions issued by the Ld. Dispute Resolution Panel ('DRP') u/s 144C of the Income-tax Act, 1961, for exclusion of certain components of cost from the computation of Advertising and Marketing Promotion ('AMP') expenses, while incorporating the TP adjustment in the final assessment order despite the necessary details being filed before the Ld. Transfer Pricing Officer, following the Directions by the Ld. DRP."*

5.2.1. Ld. CIT DR did not pose any serious objection to the admission of the same as a perusal of the order of the Dispute Resolution Panel shows that the said ground was raised by the assessee. It is also seen that pursuant to the said ground being raised before the DRP convinced with the arguments, directions were issued by the

DRP u/s 144C(5) of the Income Tax Act, 1961 directing the TPO to grant necessary relief. It is seen that these directions have not been carried on to the said approach is neither expected nor accepted. If such an attitude is allowed to be continued then what to talk of judicial discipline the justice dispensing system would loose its sanctity and purpose. It is incumbent upon the TPO to follow and comply with the directions of a higher forum, the DRP definitely is a higher forum for a TPO whom he is statutorily and mandatorily bound to follow. It is not open and should not be open to anyone to thumb his nose on the statutorily supported directions of a higher forum and it is for the CBDT to look into this malaise which appears to have crept in the functioning of the department. As such it is seen that the issue arises from the material available on record. In the afore-mentioned peculiar facts and circumstances, we are of the view that the additional ground raised by the assessee deserves to be admitted as the said ground emanates from the impugned order.

5.3. Having disposed the preliminary issues, we now proceed to address the arguments of the parties before the Bench on merits.

5.3.1. The Ld. AR inviting attention to the synopsis filed before the Bench contended that the assessee BMW India is engaged in the import and sale of premium segment cars in India and operates as a normal risk distributor in India. It was his submission that it would be his endeavour to address the facts of the present case as opposed to facts of the case considered by the Special Bench where the Special Bench was considering the facts of a licensed manufacturer. It was his submission that the FAR analysis of the assessee i.e the functions performed, the assets employed and risks assumed by a distributor would be very different from the FAR analysis of a licensed manufacturer, where the assessee assumes higher risk as it also functions as an entrepreneur qua his manufacturing activity. Addressing the facts on record, it was submitted that the FAR analysis of the assessee describes the assessee as a normal risk distributor and the year under consideration it was submitted was the first full-fledged year of operation which fact it was submitted is borne out from page 2 of the DRP's order itself where the profile of the assessee is discussed.

5.3.2. Referring to the same, it was submitted that the BMW India was mainly engaged in the import and resale of completely built units ("CBU") of the 6-Series, 7-Series, X3, X5 models of cars from the BMW Group for resale in the Indian market. In addition to the distribution activity, it was submitted the assessee also carried out low value-added assembling of completely knocked down ("CKD") kits for BMW 3 and 5 series from its assembly facility in Chennai. The kits it was stated are imported in a fully manufactured and painted state and are simply assembled together using "screw driver" technology. As such the assessee carried out very low value addition during the course of the assembly.

5.3.3. In this background, it was his submission that in the TP assessment proceedings, the TPO alleged that the BMW India had incurred excessive Advertising, Marketing and Promotional ("AMP") expenses of 7.09 as a percentage to sales which was held to be excessive vis-à-vis the comparable companies who had incurred according to the TPO, an AMP expenditure of 1.99%. The same has been extracted from the TPO's order in the Synopsis filed on behalf of the assessee. For ready-reference it is reproduced hereunder :-

Name of the company	GP/Sales	GP/Sales	A&M/Sales	Remark
Pebco Motors Ltd.	6.62%	-3.84%	1.20%	Proposed by Appellant vide submission dated October 4, 2011
Popular Vehicles & Services Ltd.	11.72%	1.16%	4.10%	
Shree Sancheti Motors Pvt. Ltd.	12.15%	0.95%	1.61%	
Machino Techno Sales Ltd.	12.69%	1.07%	4.42%	
Eastman Industries Ltd.	16.22%	3.80%	1.25%	
Bharat Power Corpn. Pvt. Ltd.	24.79%	10.82%	0.87%	
MGF Automobiles Ltd.	15.90%	0.45%	6.31%	
Lucas Indian Service Ltd.	20.13%	4.16%	0.88%	
Sri Ramadas Motor Transport Ltd.	18.92%	2.19%	1.66%	
AVG Motors Ltd.	8.96%	1.85%	0.31%	TP Documentation Companies
Competent Automobiles Co Ltd.	5.91%	-0.04%	0.20%	

Sai Service Station Ltd.	9.82%	2.80%	1.06%	
Mean	**13.65%**	**2.11%**	**1.99%**	

5.3.4. In the context of the above facts it was submitted that solely based on this comparison of AMP/sales ratio of BMW India vis-à-vis the comparable companies, the TPO has alleged that the assessee should have been reimbursed by the BMW Group for the excessive AMP spend and has also over and above this held that the assessee has rendered services to its overseas BMW Group by incurring additional expenses and as such applied a mark-up of 15% on the incremental AMP spend vis-à-vis the comparables. It was his submission that the TP adjustment incorporated in the draft assessment order u/s 144C(i) on challenge by the assessee was upheld by the DRP. It was submitted that the DRP upheld the TPO's approach in holding that the assessee has incurred extraordinary AMP expenses for the promotion and development of BMW brand and also upheld that the assessee has contributed in creation of the marketing intangibles in India apart from that the other arguments on facts and law addressed by the objections of the assessee were also not accepted by the DRP except the direction to exclude certain items from the AMP calculation. The final assessment order, it was submitted though makes a reference to the directions of the DRP however does not give effort to the DRP's directions as TPO incorporates all the TP adjustments proposed originally and the AO was bound by the TPO's order passed pursuant to the directions of the DRP.

5.3.5. Addressing the transfer pricing documentation, it was submitted that the primary international transactions of BMW India were import of CBU and CKD units of different category of vehicles. In its annual TP documentation, it was submitted that the assessee had applied resale price method (RPM) as the primary method and transactional net margin method (TNMM) as the secondary method to establish the arms' length nature of its international transactions. It was submitted that it would be pertinent to note that under the RPM, BMW India's gross margin, i.e gross profit/sales was 27.36% as compared to the gross margins of the comparables which was 13.65%. Similarly, under the TNMM, the assessee's net margin (operating profit/sales was 13.52% as compared to the comparables net margin of 2.11%). Accordingly, it was his submission that these facts clearly demonstrate that even while considering the comparables accepted by the TPO, BMW India's earning was much higher than the arms' length return, both at gross profit and net profit return. It was his submission that during the TP proceedings the TPO has accepted the comparables selected by the assessee in its TP documentation as well as the fresh search proposed during the course of transfer pricing assessment proceedings and as such acknowledged the premium profit earned by the assessee at the gross level as well as the net level vis-a-vis its comparables. It was his submission that it has been argued before the DRP that the fact that the assessee has earned premium profit more than required goes to address the fact that no compensation was required to be received as the premium profits have already been earned due to the pricing benefits which the AE has ensured. It was his submission that the DRP did not dispute these facts was pleased to note them and observed that *"on the face of it, the arguments looks convincing"*. However, instead of carrying the same to its logical conclusion they concluded on suspicious in holding that there are certain basic flaws in the same. It was submitted that what was the flaw apart from suspicious was not addressed the assessee's argument on facts demonstrates the fact that compensation already stood received was discarded on the reasoning that the assessee is trying to place the arguments, which it had preferred in sub-ground 2.1 again through the back door. It was questioned how can such a decision be considered a reasoned finding. The said stand by the DRP according to the Ld. AR ignores the fact that the OECD Transfer Pricing Guidelines itself supports such adjustments.

5.3.6. It was re-iterated that the assessee had empirically demonstrated that additional remuneration has already been recovered by the assessee through premium profits both at gross level as well as net level as such there was no occasion to hold that compensation was still due to the assessee from the AE. It was submitted that before the TPO and the DRP also the assessee had addressed these arguments. Ld. AR elaborated that for evaluating whether any TP adjustment was necessitated at all reliance had been placed on OECD Transfer Pricing Guidelines and Australian Tax Office Guidelines on Marketing Intangibles. For ready-reference, we reproduce from pages 4-6 of the synopsis filed on behalf of the assessee:-

International guidance on the subject

"1.19 In order to evaluate whether the facts and circumstances of the Appellant would necessitate a TP adjustment on account of purported excessive AMP spend for creation of local marketing intangibles, the Appellant would pray for reference to the following international statutory guidance:

OECD Transfer Pricing Guidelines

1.20 The OECD Transfer Pricing Guidelines5 has discussed the issue of marketing activities undertaken by enterprises not owning trademark or trade names (please refer pages 129 to 130 of Compendium). The OECD TP Guidelines clarifies that it is necessary to determine how the distributor/marketer should be compensated for such marketing activities and whether the distributor/marketer should be compensated as a service provider that is providing promotional services or whether there can be a case in which the marketer should share in any additional return attributable to the marketing intangibles.

1.21 The OECD TP Guidelines state that in arm's length transactions, the ability of the party that is not the legal owner of a marketing intangible to obtain the future benefits of marketing activities that increase the value of that intangible will depend principally on the substance of the rights of the party. For example, the distributor may have long term commercial benefits from its investments in marketing activities or may derive additional return through decreasing purchase price of the product or a reduction in royalty rate.

1.22 Thus, the OECD TP Guidelines has clearly recognized the importance of evaluating the contractual rights and actual conduct along with the remuneration model of the distributor/marketer who is incurring excessive AMP spend so as to see whether the distributor/marketer is earning sufficient profits in the immediate and long term.

OECD's Discussion Draft on Intangibles (Chapter VI of the OECD Guidelines)

1.23 OECD's Discussion Draft on Intangibles (please refer pages 131 to 192 of Compendium) has also dealt in further detail on the issue of arm's length compensation for functions performed by Associated Enterprise related to the development, enhancement, maintenance or protection of intangibles6 (please refer pages 146 to 148 of Compendium). The Discussion Draft states that where the distributor bears the cost of its marketing activities, the issue is the extent to which the distributor is able to share in the potential benefits deriving from its functions, assets, risks and costs currently or in the future. As also stated in the OECD TP Guidelines, the Discussion Draft also states that in arm's length transactions the ability of a party that is not the registered or legal owner of trademarks and related intangibles to obtain the benefits of marketing activities that increase the value of those intangibles will depend principally on the substance of rights of that party.

1.24 The Discussion Draft also provides illustrative examples which demonstrate how a marketer/ distributor which is bearing the costs and risks of its marketing activities would be compensated under arm's length conditions. In one of the examples7 (please refer pages 174 to 175 of Compendium), it is explained that if a distributor is incurring marketing expenditure substantially in excess of the levels of independent distributors in comparable situation, and at the same time is not earning sufficient profits as compared to third parties, it should get an additional remuneration either

(a) by reducing the import price, or

(b) by applying a residual profit split method, or

(c) by getting a direct reimbursement of the excess expenditure from the owner of the intangible.

1.25 This, in the humble observation of the Appellant, is an extremely important determination for evaluating the issue of excessive AMP spend in relation to local marketing intangibles. The Discussion Draft clarifies that the level of AMP expenses and profitability of the distributor/marketer entity are indeed closely linked factors and cannot be detached or treated separately for the evaluating the issue of excessive AMP spend.

ATO's Guidelines related to Marketing Intangibles

1.26 The ATO Guidelines on Marketing Intangibles8 (please refer pages 193 to 203 of Compendium) also provide similar guidance and illustrative examples in line with the OECD TP Guidelines and Discussion Draft as stated above.

1.27 The ATO Guidelines on Marketing Intangibles includes Example 3 (please refer page 200 of Compendium) which illustrates a renewable long-term royalty-free contractual arrangement (with exclusive right), where the marketer/distributor ("B") bears the costs and risks of developing the market and incurs marketing expenses far beyond those of comparable independent enterprises on behalf of its AE ("A"). The relevant extract from the ATO Guidelines explaining the two approaches for remunerating "B" for its excessive marketing expenses has been given below:

"(a) Reducing the price paid by B for the Rist watches purchased from A. One way of effecting such an adjustment might be to apply a resale price method or transactional net margin method using available data about the profits made by comparable independent marketers and distributors during the corresponding years of similar long-term marketing and distribution agreements. An alternative might be to apply a residual profit split method. This method would split the combined profits from sales of the branded watches by first giving B and A a basic return for the functions they perform and then splitting the residual profit on a basis that takes into account the intangible assets owned by B and A 11 and the relative contributions of both B and A to the value of the trade name Rist.

(b) Directly compensating B for the excess marketing expenditure it has incurred over and above that incurred by comparable independent enterprises. This may be appropriate, for instance, if independent enterprises might be expected to have agreed to B receiving a fee and a reimbursement of expenditure incurred in excess of a specified amount (based on what a distributor purchasing for the agreed price might be expected to spend on its own account). It is expected that such a fee would include an appropriate profit element."

Based on the above, it can be concluded that a marketer/ distributor undertaking excessive marketing activities on behalf of the owner of the brand can be remunerated either by way of a reduction in the purchase price or by way of a separate remuneration. The facts and circumstances of the Appellant's case are

> *identical to the first remuneration methodology as enumerated by the ATO Guidelines. In the present case the Ld. TPO IDRP himself has accepted the benchmarking undertaken by the Appellant following RPM/TNMM whereby the facts clearly demonstrate that the Appellant has been already remunerated by BMW Group for the alleged "excessive" AMP spend by way of a higher gross margin as well as net margin vis-a-vis the comparable companies."*

5.3.7. It was emphasized that the assessee is "a normal risk taking distributor" as opposed to "a low risk distributor" who would perform only routine distribution functions at the behest of the parent and whose inventory and debtor risks consequently would not be significant and they would necessarily be remunerated though an assured/guaranteed return on overall operating costs. Normally a low distributor would not take independent decision on AMP spend and conventional marketing intangibles issue would not arise as its compensation model would take care of AMP spend. For a Normal Risk Distributor like the assessee two factors would determine whether or not a marketing intangible issue is created. The first factor it was submitted is the level of AMP spend and the second factor is the remuneration model for such distributors. If the level of AMP is similar to that of comparables then typically marketing intangible issue will not arise but if the AMP spend is higher then that of comparables then the distributor is admittedly carrying a higher level of function for which he would normally deserve a higher remuneration as compared to comparable normal distributor as clarified in the OECD and ATO Guidelines which is where the second factor of remuneration model comes into play. The remuneration model it was submitted may be higher gross or net margin either through reduction in price of goods or higher net margin through application of residual profit split methodology (RSPM) or re-imbursement of excess AMP spend alongwith a mark-up. The methodologies, it was submitted are alternatives available to a taxpayer who should have the flexibility to apply any of the options. It was submitted that if the taxpayer has adopted a particular methodology and demonstrated the fact that it has earned additional remuneration beyond what comparables have earned the marketing intangible issue would have no relevance. It was his submission that marketing intangible issue would typically arise in case of normal distributors who are incurring excess AMP expenditure and at the same time not earning higher remuneration as compared to comparable normal distributors. Accordingly it was argued that it can be demonstrated that marketing intangibles should not arise in the case of the assessee as BMW India has long-term distribution rights. Attention was invited to the Importation Agreement between the assessee and BMW AG. For ready-reference, we reproduce para 1.37 to 1.41 from the synopsis filed by the assessee :-

> "***(i) BMW India has long term distribution rights***
>
> *1.37 The Ld. DRP has alleged that BMW India does not have any long term contract for the distribution of the products manufactured by the parent and other group entities. In the Ld. DRP's view, in case the contract of distribution of goods is terminated by the parent, the Appellant would not have any rights over the brand promoted by it over a period of years. On the other hand, the parent would enjoy the fruits of the efforts put in by the Appellant for promoting the brand.*
>
> *1.38 It is pertinent to note here that the Importation Agreement between the Appellant and BMW AG (please refer pages 239 to 243 of Paperbook) provides the Appellant the right to import and distribute BMW CBUs and CKDs and original BMW parts and accessories in India (clause 1.1). BMW India is responsible for the sales promotion and full utilization of the market potential for the said goods for which it could perform necessary function for establishment of an efficient distribution network and performance of adequate advertisement and sales promotion activities (clause 2.2). Further, clause 5.1 states that the agreement shall enter into force from 1st January 2006 and shall remain in force until terminated by other party after giving due written notice.*
>
> *1.39 It is clearly mandated in international guidance such as the OECD TP guidelines and the UN TP Manual10 that if no written term exists the contractual relationships of the parties must be deduced from their conduct and economical principles that generally govern the relationships between independent enterprises. In the present case, in the humble view of the Appellant, there is no provision in the importation agreement that would imply that the Appellant does not have a long term distribution right. Though the parties have a right to terminate the contract after due notice, one should not contemplate that such a clause would necessarily transform the agreement into a short term contract. There can be multiple examples of third party contracts where despite long term contractual rights, parties are allowed to protect their own legal interest and terminate the contract after due notice period.*
>
> *1.40 The Appellant, similar to any independent party having long term distribution rights, would have incurred sufficient AMP spend to build and protect its market share in India. This is also evident from the terms of the Importation Agreement which casts reasonable responsibility on the Appellant to perform adequate advertisement and sales promotion activities. One would not have any prima facie doubt from BMW India's commercial conduct that it does not enjoy long term distribution rights since the company has established itself established as the leading seller of premium category cars in India.*

1.41 Further, even if the parties prematurely terminate the agreement, the question of compensating the Appellant for any loss is suffered due to excess AMP spend would arise only at the time of such premature termination and not during the pendency of the agreement. Thus, disallowance of AMP spend on the mere assumption that BMW AG may terminate the agreement in the future is not sustainable in fact or law. A taxpayer cannot be penalised on the presumption of a future event (which may not even occur) while ignoring the present facts and circumstances."

5.3.8. It was also submitted that another reason which operates in assess's favour for not making adjustment for marketing intangibles is that premium profits have been earned by the assessee. It was his submission that facts available on record would demonstrate that BMW India is adequately compensated by premium return for the excess AMP spend through the BMW Group's pricing policy for the excess AMP spend. We reproduce paras 1.42 to 1.48 form the synopsis available on record:-

"*1.42 As mentioned above, BMW India operates as a* ***Normal Risk Distributor****, remunerated through gross returns on sales. Further, without admitting but even if one assumes for the sake of discussion, that BMW India performs higher functions as compared to the comparable companies, it derives its additional returns through premium profits it earns at both gross as well as net level. The level of profits earned by BMW India during AY 2008-09, vis-a-vis that of com parables selected by the Ld. TPO in the TPO Order, as shown in the table below:*

Particulars	*BMW India*	*TPO Order Comparables' Arm's Length Result*
GP/Sales	*27.36%*	*13.65%*
OP/Sales	*13.52%*	*2.11%*

1.43 As discussed above, since at both gross as well as net level BMW India has earned much higher than the arm's length return, this amply evidences that even if it has spent excessively (as alleged by the Ld. TPO) on brand promotion, it is more than adequately compensated by higher return in India, and BMW India does not have any motives to shift profit outside Indian and that the international related party transactions are at arm's length.

1.44 ***The premium profit of BMW India in absolute terms compensates it for the AMP spends (i.e difference of 11.41% between BMW India's OP/Sales and Arm's length OP/Sales amounts to Rs. 106.85 which is greater than the AMP spend of Rs. 33.93).***

1.45 This clearly explains an adequate application of international guidance in the Appellant's case, even if it is presumed that the Appellant has incurred AMP spend to develop the Indian market, that it is compensated by BMW AG with higher gross and net level returns by virtue of operating as an entrepreneur distributor in India.

1.46 Based on the above, BMW India have got 13.71 % higher gross margin and 11.41 % higher net margin as compared to 5.10% excess AMP spend (by spending

7.09% on AMP expenses vis-a-vis 1.99% of that of the comparable companies), as alleged by the Ld. TPO.

1.47 Further as discussed above in para 1.7 the total AMP expenses as per the audited financials amounts to Rs. 58.80, however this includes the aftersales support costs and salesmen bonus amounting to Rs. 3.94 and Rs. 20.93 respectively (please refer pages 87 to 120 of the Paperbook), which have no connection with the AMP activity, warranting no compensating payment and therefore should be excluded for computation of AMP spend. Therefore, BMW India incurred only Rs. 33.93 on account of AMP expense, which amounts to 3.62% of the turnover. Accordingly, ***the actual excess AMP spend is 1.63% i.e. the difference of 3.62% vis-a-vis 1.99% of that of the comparable companies as selected by the Ld. TPO.***

1.48 In this regard it is worth mentioning at this stage that the in the directions issued by the Ld. DRP for the immediate previous year i.e. AY 2008-09 has also appreciated such contention on the excessive profitability earned by the Appellant, stating that" .... the arguments look convincing".

5.3.9. It was his submission that although the stand of the assessee is that it does not carry out the brand promotion activities for the AE but even if it is assumed for the sake of an argument that the assessee does perform the functions even then it cannot be ignored that the GP/Sales and OP/sales margin of 27.36% and 13.52% earned respectively is significantly higher than the gross and net margins earned by the comparables selected by the TPO himself i.e 13.71% and 11.41%. It was submitted that the following facts indicate the assessee's position. We reproduce from the synopsis filed on behalf of the assessee:-

"1.50 Even assuming but not admitting that the Appellant is undertaking all the entrepreneurial functions relating to the marketing and advertising function, then the point to note is that the GP/Sales and OP/Sales margin of 27.36% and 13.52% earned by the Appellant respectively, is significantly higher than the margins earned by the comparables selected by the Ld. TPO himself, i.e. 13.71% and 11.41 % at the gross and net level respectively. The following example vindicates our point:

(Figures in Rs. crores)

Particulars	*GP Sales*	*OP Sales*
Margin earned by the Appellant (A)	*27.36%*	*13.52%*
Arm's Length Margin using AY 2008-09 data (B)	*13.65%*	*2.11%*
Excess Profit earned by the Appellant (C = A- B) [in %]	*13.71%*	*11.41%*
Sales of the Appellant in crores (D)	*936.68*	*936.68*
*Excess profit earned by the Appellant (E = D*C) [in Actuals]*	*128.42*	*106.85*
Excess AMP Expense of the Appellant as alleged by the Ld. TPO 12 (F)	*42.31*	*42.31*
Actual AMP Expense incurred by the Appellant'13(G)		*33.93*

	33.93	

1.51 Based on the above, BMW India in actual terms has earned excess profits of Rs. 128.42 croes at the gross level and Rs. 106.85 crores at the net level. Considering the excess AMP expense as alleged by the Ld. TPO in the TPO Order, the premium profits in both the scenario considering AMP expense as alleged by the Ld. TPO i.e. Rs. 58.79 crores (resulting in excess AMP of Rs. 42.31 croes) or actual AMP expense as argued by the Appellant i.e. Rs. 33.93 crores (resulting in excess AMP of Rs. 15.29 croes) the Appellant has earned much higher returns.

1.52 Now taking the argument of the Ld. TPO that the Appellant should not only be compensated for the excessive AMP spend but it should also earn a mark-up the on same. The additional AMP spend as contended by the Ld. TPO in the impugned TPO Order works out to Rs. 42.31 crores and after providing for a 15% markup on the same the total compensation to be received by the Appellant comes to Rs. 48.65 crores. Now the excessive profit of 13.71 % at gross level and 11.41 % at net level earned by the Appellant by following a discounted transfer price works out to Rs. 128.42 at gross level and Rs. 106.85 crores at net level, which compensates the Appellant for the additional compensation to be received by the Appellant for undertaking AMP activities. Thus, it can be concluded that the Appellant has already been compensated by the AE for any excessive AMP spend and therefore not further compensation is required to be earned by the Appellant.

1.53 The above discussion clearly demonstrates that the Appellant has retained more than adequate profits in India as a Normal Risk Distributor and it has not siphoned off the same by way not getting adequate remuneration for its functions.

1.54 Further, it is submitted that a separate reimbursement, as contended by the Ld. TPO is merely one of the ways whereby such "excessive" AMP expenses can be remunerated. Alternatively, the BMW Group can also compensate the Appellant for the AMP expenses by charging a discounted transfer price for the products supplied to the latter. Where such a discounted transfer price is already being charged, there is no need for any separate compensation for the AMP cost. This is aspect is explained in further detail in the following section:

Incorrect reliance on international and Indian cases

5.3.10. The decisions relied upon by the DRP it was submitted have no applicability. Whereas the judgement of the Hon'ble High Court in Maruti Suzuki's case, it was submitted was on entirely different set of facts and the Hon'ble Supreme Court has negated the judgment; the international decision relied upon in the case of Glaxosmithkline Holding (Americas) V Commissioner, T.C. No. 6959-05, it was submitted was an out of court settlement and no decision was publicly pronounced as such reliance on the same has no purpose. The decision in the case of DHL Corporation, it was stated was not correctly applied. The basis of inapplicability of the said decision as addressed in the Synopsis filed is extracted from the synopsis itself :-

"1.57 Furthermore, the Ld. DRP placed reliance on the case of DHL Incorporated. In DHL's case, DHL Corporation ('DHL'), US had entered into a long term agreement with Document Handling Limited, International ('DHLI'), Hong Kong, the group entity responsible for DHL operations outside US. As per the agreement, DHL had exclusive right to use and sublicense 'DHL' trademark in US while DHLI had corresponding rights overseas. The agreement did not require DHLI to pay any royalty to DHL for the use of the 'DHL' trademark. An important issue in the case, inter alia, was whether DHLI was required to pay any royalty to DHL for use of the 'DHL' trademark. The Court of Appeals held that since DHLI was the 'developer' of the 'DHL' trademark outside the US, it was not required to pay any royalty to DHL. The Court applied the four factor test for a 'developer' under the 1968 US Transfer Pricing Regulations i.e. (1) greatest weight is to be given to the relative amounts of all the direct and indirect costs of development and the corresponding risks of development borne by the members of a group, (2) the location of the development activity, (3) which entity is better suited to carry out advertising and marketing independently and (4) who exercises greater, if not exclusive, control over the advertising and development of the trademarks. On the facts of the case it was held that DHLI satisfied all the four conditions and qualified as 'developer'. (Please refer pages 284 to 309 of Compendium)."

5.3.11. It was also contended that the said decision was decided under the 1968 US Treasury Resolutions that are no longer applicable now. Apart from that the submission made was that even the said decision does not support the disallowance of AMP spend of the assessee and on the contrary it allows undertaking of marketing and advertisement expenditure if there is an exclusive and long term distribution agreement. In fact it was urged that the said decision supports the assessee's case. The following arguments reproduced from the synopsis address the issue:-

"1.59 Moreover, without prejudice to the above, the facts and decision in the DHL case, do not support disallowance of AMP spend of the Appellant. On the contrary, the DHL case allows undertaking of marketing and advertisement expenditure if there is an exclusive and long term distribution agreement. As in DHL's case, BMW India also has entered a long term agreement with BMW AG for distribution of premium cars. Accordingly, there is no contradiction between the DHL ruling and the facts in the case of BMW India as in both cases:

(i) the licensee had entered into a long term agreement for the use of the trademark;

(ii) the licensee may have developed the local intangible by way of advertisement and marketing spends; and

(iii) in accordance with the arm's length principle, BMW India has earned and is expected to earn a suitable return for its marketing activities, over a period of time given the long term nature of the licensing agreement.

1.60 To summarize, where the licensing agreement is exclusive and long term and healthy margins are being earned by the licensee (as in case of BMW India), marketing and advertisement expenditure should be considered to be perfectly legitimate and in conformity with the arm's length principle.

Advertising. Marketing and Promotional ('AMP') spend incurred by the Appellant

1.61 The AMP expenditure was incurred by BMW India for its own benefit (in the form of increased sales and profits), and therefore borne by it. Benefit, if any, arising to the overseas AEs is nothing more than indirect / incidental.

1.62 As already mentioned above, AY 2008-09 is only the second year (and first full year) of operations accordingly the AMP spend was imperative due to the initial phase of operations. Since then, the trend has declined over the years. Also keeping the initial phase of operations, the AMP expenditure may not reflect the true position, ideally a multiple year data trend should considered.

1.63 Accordingly the weighted average AMP/Sales works out to 2.69% should be considered for the current analysis, since for a start-up company to incur high AMP expenses in the initial years of operations is a very common practice. This is explained in the following chart:

(Amount in INR Crores)

Particulars as per the PYL account	*FY 2006-07*	*FY 2007-08*	*FY 2008-09*	*FY 2009-10*	*FY 2010-11*
Advertising	*1.42*	*12.86*	*15.06*	*19.02*	*24.54.*
Marketing and Sales Promotional	*2.57*	*45.94*	*77.16*	*88.78*	*24.03*
Sub total	*3.99*	*58.80*	*92.22*	*107.80*	*48.57*
Less: Expenses not relevant to brand promotion activities	*0.74*	*24.87*	*58.17*	*68.21*	*4.04*
AMP expenses	*3.25*	*33.93*	*34.06*	*39.59*	*44.53*
Sales	*81.36*	*936.68*	*1086.76*	*1408.68*	*2267.06*
Net AMP/Sales	*4%*	*3.62%*	*3.13%*	*2.81%*	*1.96%*
Weighted Average over 5 years			*2.69%*		

1.64 Further, it is worth mentioning here that the profitability of BMW India at both gross as well as net level is much higher than the arm's length return, this amply <u>evidences that even if it has spent excessively (as alleged by the Ld. TPO) on brand promotion, it is more than adequately compensated by higher return in India through premium profits retained in India.</u>

1.65 As mentioned above, BMW India applied RPM as the primary method and TNMM as the secondary method, and the economic analysis was not challenged by the Ld. TPO neither during the course of proceedings nor while applying the test of purported excessive AMP spend.
1.66 In this regard, it is reiterated that any and all of the AMP expenses with respect of the local operations undertaken by the Appellant are solely for its own business. Accordingly, the Ld. TPO's action of considering it as a service provided by the Appellant to the AEs and seeking to recover the same by way of a "reimbursement" from the AEs along with a mark-up is erroneous and not in line with the basic TP principles.
1.67 Since, the AMP expenses undertaken by BMW India are solely for its own business, the Ld. TPO's action of considering it as a service provided and seeking to recover the same as a "reimbursement" along with a mark-up is erroneous and not in line with the basic TP principles."

5.3.12. Addressing the facts of the case, it was submitted that in the comparables taken the assessee has placed a fresh search before the TPO which has been accepted based on the similar intensity functions. Relying on the comparables accepted by the TPO in para 10.5 of the TPO's order reproduced hereunder:-

Name of the company	Database	GP/Sales	OP/Sales	A&M/Sales	VAE/Sales
Pebco Motors Ltd.	P	6.62%	-3.84%	1.20%	10.46%
Popular Vehicles & Services Ltd.	P	11.72%	1.16%	4.10%	10.56%
Shree Sancheti Motors Pvt. Ltd.	P	12.15%	0.95%	1.61%	11.20%
Machino Techno Sales Ltd.	P	12.69%	1.07%	4.42%	11.62%
Eastman Industries Ltd.	P	16.22%	3.80%	1.25%	12.42%
Bharat Power Corpn. Pvt. Ltd.	P	24.79%	10.82%	0.87%	13.96%
MGF Automobiles Ltd.	P	15.90%	0.45%	6.31%	15.45%
Lucas Indian Services Ltd.	P	20.13%	4.16%	0.88%	15.97%
Sri Ramadas Motor Transport Ltd.	P	18.92%	2.19%	1.66%	16.73%
Mean		**15.46%**	**2.31%**	**2.48%**	**13.15%**
BMW India		**27.36%**	**13.52%**	**2.69%**	**13.84%**

5.3.13. Reference was made to page 185 to 186 of the paper book addressing the dynamics of the competitive Indian market at the relevant point of time. For ready-reference, we reproduce para 3.5 to 3.10 of the letter addressed to the TPO:-

3.5. It may be noted here that the above companies did not form part or finally got selected in the TP documentation of the Company for FY 2007-08 due to non *availability of relevant data (i.e data non-availability of two out of three years) at the time of Documentation and in case of Lucas India Services Ltd. Due to difference in product profile i.e it operates as automobile electrical parts distributor.*

Analysis of AMP spend of international auto brands in India

3.6. *At this stage, the Company would like to introduce certain passenger car companies operating in India, which are otherwise not comparable to BMW India in terms of functions but in case a comparison of AMP spend is to be drawn, such passenger car companies' AMP spend would be most ideal to be compared since they would have identical product and market characteristics viz. product/brand profile, brand equity, market/customer base, features, life cycle, quality, etc. similar to BMW India.*

3.7. *Therefore, the Company has provided below the details of such passenger car companies that, otherwise are incomparable for undertaking profitability testing/analysis under TNMM, but are leading multinational players in the passenger car industry having similar product/brand profile (in terms of quality, recognition/brand equity, market/customer base, etc.) to be compared from the viewpoint of AMP spend. These companies are operating in same/similar industry dynamics and market forces. Moreover, the brands advertised/marketed by these companies are also legally owned by their overseas group companies just as is the case with BMW India. The advertising and marketing expenses of these companies are not controlled transactions. Therefore, in order to have a true and fair benchmark of the industry average advertising and marketing expenses, the ratios of these companies have to be necessarily taken into account.*

3.8. *A trend of the AMP spend of the following companies operating in Indian passenger car market would therefore be more appropriate to be compared with BMW India's AMP spend as depicted in the table below:-*

Name of the company	***FY 2005-06***	***FY 2006-07***	***FY2007-08***	***FY 2008-09***	***FY 2009-10***
General Motors India Pvt. Ltd.	*5.28%*	*6.53%*	*7.09%*	*6.41%*	*3.92%*
Honda Siel Cars India Ltd.	*0.95%*	*1.07%*	*1.73%*	*2.30%*	*2.11%*
Hyundai Motor India Ltd.	*2.79%*	*3.54%*	*3.48%*	*4.19%*	*4.98%*
Maruti Suzuki India Ltd.	*1.65%*	*2.08%*	*1.88%*	*1.90%*	*1.52%*
Mean	***2.67%***	***3.31%***	***3.54%***	***3.70%***	***3.13%***
BMW India	***2.69%***				

3.9. *From the above, it is evident that the AMP spend of BMW India vis-à-vis the comparable companies is similar during the year under consideration. Therefore, the Company resiliently states that purely of comparison of AMP spend of the Company, appropriate comparable companies should be selected by your good self.*

1.39 *The Company further provides the details of year of incorporation and the weighted average AMP/Sales for the FY 2005-06 to FY 2009-10 of the above mentioned companies, in the following table:-*

S.No.	**Company Name**	**Year of Incorporation**	**Weighted Average AMP**
1.	General Motors India Pvt. Ltd.	1994	5.84%
2.	Honda Siel Cars India Ltd.	1995	1.67%

3.	Hyundai Motor India Ltd.	1996	4.04%
4.	Maruti Suzuki India Ltd.	1981	1.78%
	Mean		**3.33%**
	BMW India		**2.69%**

3.10. *From the above, it is evident that the weighted average AMP spend of BMW India vis-à-vis the comparable companies is higher, despite the fact that these companies were incorporated much before BMW India."*

5.3.14. Specific attention was invited to paper book page no-239 to 243 which contains the copy of the Importation Agreement entered into by the assessee with BMW AG addressing the fact that pricing is done in such a manner that the prices charged for the contract goods is "adequate to ensure recovery of total cost of the contract goods supplied plus representative profits".

5.3.15. Arguments were also addressed on the aspect that the L.G. Electronics case refers to an assessee who was a licensed manufacturer and the assessee being a distributor its FAR analysis as such is distinguishable. Accordingly it was submitted necessarily it is the facts of the assessee which need to be considered for deciding the issue and the facts of the case it was submitted on examination would show that the assessee has already been compensated by way of pricing as a result of which it has shown higher profits both at the gross as well as the net level and once the computation of the AMP expenses is corrected following the directions of the DRP which are supported by identical directions given in L.G. Electronics case, it would show that no addition as a result of ALP adjustment need be done.

5.4. The Ld. CIT DR relying upon the order of the DRP and the order of the TPO contended that on facts ALP adjustment has correctly been made barring the relief which may be due consequent to the directions of the DRP not implemented by the TPO which principle on facts has been upheld by L.G>Electronics case. Accordingly it was the vehement stand of the Ld. CIT DR that the issue is covered in favour of the Revenue by virtue of the order of the L.G. Electronics case rendered by the Special Bench. It was his stand that the principles laid down therein are fully applicable to the AMP expenses as such the argument that it would apply only to the facts of a licensed manufacturer it was submitted cannot be accepted and is strongly opposed.

5.4.1. Referring to the said order it was submitted that no doubt the said order does not reflect the name of the assessee as an intervener but the fact remains the Larger Bench has considered while adjudicating various parameters which can be examined while considering the AMP expenses and one of those is subsidy given to meet the specific AMP expenses or price adjustments etc but these facts it was his submission the assessee has to demonstrate. It was also vehemently submitted that even though the assessee did not participate as an intervener however arguments on behalf of other interveners some of whom were distributors have been considered and the Special Bench has as such considered the position of the distributors also.

5.4.2. It was his submission that in transfer pricing it is well-settled that if the assessee wants to claim the benefit of some fact then the onus necessarily and primarily is on the assessee to demonstrate the fact by evidences. The fact remains that in none of the cases the assessee's had disclosed the specific AMP expense as an international transaction as such the occasion to benefit by hindsight in making a reference to the guidelines laid down by the Special Bench are of no benefit. In the facts of the present case also it was submitted the assessee has not disclosed the AMP expense as an international transaction and the issue is covered against the assessee by the order of the Larger Bench.

5.4.3. It was also submitted that the application of the bright line as a tool for considering the issue has also been considered and discussed and held as an acceptable tool for calculating the AMP spend by the Special Bench wherein the action of the TPO and DRP has been upheld as such the said issue also is in favour of the Revenue.

5.4.4. It was also his argument that the reliance placed on OECD Guidelines is misplaced as the issue has to be decided on the basis of Indian Laws and judgements and India is not a signatory as far as OECD Guidelines are concerned as the concerns and the interests of a developing country like India are very different from the concerns of developed countries.

5.4.5. The Delhi Benches of the ITAT it was submitted has recently held in Knorr-Bremse India Pvt. Ltd. that Indian Transfer Pricing Laws mandate the use of transaction by transaction approach for evaluating arm's length nature of international transaction.

5.4.6. It was also submitted that the argument that the assessee has earned higher level of margins in profit both at gross levels and net levels is an irrelevant argument as there could be various reasons for those results like economics of scales the low end assembly cost etc., the specific nature of the product and the trends in the market and all these stand considered and decided by the DRP.

5.4.7. Addressing the Importation Agreement placed in the paper book, it was submitted that the duration of the agreement would show that the assessee's position is very tenuous as merely by a notice of six months or so, the Agreement can be terminated and the benefits of the brand building would be available to the AE at no cost wherein the assessee does not receive any compensation thus eroding the tax base of the country. The fact remains it was urged that the assessee has incurred high AMP expenses as compared to its comparables and these have contributed to building brand recognition and marketing intangibles for the AE as the ownership admittedly of the brand vests with the AE as such placing heavy reliance on the order of the TPO and DRP which have had an occasion to consider the various arguments of the assessee and which have been approved by the Special Bench, the said orders, it was submitted deserve to be upheld.

5.4.8. IN all fairness it was submitted that incurring of expenditure not related to the AMP expense in regard to which directions have been given by the DRP and the Special bench also has held that such expenses are not relatable to the AMP expenditure and are part of sales expenditure of the assessee they may be excluded, however it was submitted that it is not a concession on his part but recognition of judicial discipline that orders of higher forums have to be followed.

5.4.9. It was his submission that the Importation Agreement of the assessee with its AE clearly shows that the assessee has rendered services of brand building to its AE and by the efforts of the assessee benefit has accrued to the AE by virtue of greater brand recognition for the AE and brand building has been done at the cost of the profits of the Indian entity as such adjustment made are correct and appropriate as such should be sustained.

5.5. In reply the Ld. AR submitted that the principle laid down in Knorr-Bremse India Pvt. Ltd. is not disputed by the assessee and it was earnestly requested that the FAR analysis of a license manufacturer and a distributor are completely different as such in principle the decision which is considering the facts of a licensed manufacturer cannot be made applicable to a distributor. It was also stated that no doubt the principle of applying bright line test as a methodology has been decided in the Revenue's favour however the distinction in the FAR analysis of a licensed manufacturer and a distributor is not prohibited. It was his submission that if the transaction of imports and marketing (brand building) is accepted and it is so held that they must be treated separate transactions for TP analysis then the department can very well argue looking at the functions performed by the assessee that storage, warehousing, promotion, advertising, marketing, distribution should all be treated as international transactions.

5.5.1. The arguments that the assessee's rights can be terminated at any time and at that time the assessee would not be compensated for such consequential loss it was submitted as a justification for making ALP adjustment is based on the happening of an event in future and there is nothing in the present to suggest the possibility that the agreement is likely to be terminated. It was submitted that the very fact that it is a possible eventuality can give rise to the eventuality that such an even may never occur and on the remote possibility of such an event occurring it was submitted the Revenue cannot presume to conclude that the assessee is performing functions for the benefit of the AE as there is no reason to ignore the basic fact that the assessee exists and functions primarily to make profits. Infact the record would show it was submitted that in order to use the brand name of the AE, the assessee is paying no royalty and is utilizing the same in order to sell the product of the AE. The efforts of the assessee, it was submitted have been assisted by the AE by creating favourable pricing policies so that the assessee earns a comfortable profit as such it was submitted the Revenue's argument that over and above earning premium profits the assessee should be compensated with a mark-up is against the accepted international tax Jurisprudence. It was his vehement argument that Transfer Pricing is not a subject of legal interpretation and it necessarily requires on the other hand consideration of keeping the nature of business and the FAR analysis in mind. For ready-reference we reproduce para 7 from the synopsis submitted after the case was fixed for clarification on 26.04.2013 addressing the assessee's stand:-

> "*7. TP is not a subject of legal interpretation where a particular section would be interpreted and applied uniformly, irrespective of whether the taxpayer belongs to pharmaceutical industry or to FMCG industry or to automotive industry or to software industry. Any dictum in TP would depend upon the characterisation made by the taxpayer and the manner of its representation before the judicial authority. For instance, Infosys and IBM are commonly known players operating in the software sector. However, when Infosys and IBM sell software products to their foreign related parties, the principles and methods of TP to be applied to each one of them would been entirely different. IBM, being a captive service provider in India, working for its parent company, IBM US, would need to be compensated under a cost plus / TNMM, while Infosys being a gigantic entrepreneur in India, selling software to its overseas distributors for on-sale to customers in the foreign market, would need to apply a resale minus methodology for framing its' TP policy, whereby the distribution/ profit margin of the overseas distributor would need to be tested and compared with similar distributor in the foreign territory.*

5.5.2. Emphasizing the functions of a distributor, it was submitted that the entire gamut of marketing and selling functions are subsumed thereunder. For ready-reference, we reproduce the relevant arguments in Ld. AR's own language as submitted in the above mentioned synopsis submitted during clarification on which Ld. DR has also had occasions to address:-

> ***"Transaction -by-transaction approach***
>
> *8. An overall TNMM in the case of a licensed manufacturer can never justify the arm's length prices of the several and numerous individual transactions with related parties, which are not linked with each other. This is what the Special Bench had*

ruled. It is a different matter altogether that the Special Bench might not had even adjudicated the merits in the case of LG India, by holding that since the entire characterisation and TP methodology was wrong, the same needed to be first corrected by the taxpayer and then brought up the before the Tribunal. However, one would need to respectfully abide by the logic and rationale adopted by the Special Bench in disposing the said case of LG India, with the obvious and automatic corollary that its dictum has to be restricted in the manner of characterization of the taxpayer and application of an erroneous overall TNMM to the said case; and that the said principles cannot and should not apply to the facts of any other taxpayer, which are significantly different from those of LG India, for example, BMW India, which is predominantly a distributor and the principles of TP applicable in its case being entirely different to those applicable to a licensed manufacturer, like LG India, a fact even admitted the Special Bench during the course of the hearing, as encapsulated both in letter filed by BMW dated 6th November2012whilewithdrawingitsapplication for intervention for the proceedings before the Special Bench and also in the affidavit sworn in by the authorised representative as above.

9. *As represented during course of the oral arguments and also in the written submission filed earlier, there is no denying the fact that BMW India is predominantly a distributor of cars manufactured and supplied by BMW AG, for distribution and marketing in India. The act of distribution is akin to a service performed by the distributor in favour of the principal manufacturer of products. Distributors only function is to provide a supply chain service to the manufacturer; and in the process performs necessary marketing and selling functions. The entire gamut of marketing and selling functions is an integral and non-detachable part of the distributor's (here BMW India's) functions; and the profits from the respective sub-functions are subsumed in the overall profits of the distributors. BMW India is responsible for importing and selling the vehicles and for that purpose performs necessary selling and marketing service, which are interlinked. This fact is substantiated by* ***clause 1*** *(importation and distribution rights) and* ***clause 3*** *(scope of activity of BMW India) of the importation agreement entered into BMW India and BMW AG [****Refer pages 240 and 241 of the paper book****].*
10. *It may be noted that BMW India had not applied an overall TNMM approach, by throwing in all possible transactions entered into with its foreign related parties into the cauldron of TNMM at an entity level. On the other hand, BMW India had actually applied a transaction-by-transaction approach, for the different transactions entered into with its foreign related parties, as borne out from page 2 of the TPO's order. It would be evident that for the main transaction of purchase of vehicles and spare parts for distribution, BMW India had applied a resale price method (RPM), by testing its gross margins against comparable distributors of auto motives in India. For the purchase of raw material, being complete knock-down (CKD) units, BMW India had applied TNMM only for the relevant segment of assembly of such CKDs into finished cars; the assembly function incidentally constituted only 5% of the cost of the finished vehicle, as brought out in the TP documentation study prepared for BMW India and submitted before the TPO (refer page 29 of the paper book).When such finished vehicles were ultimately sold by BMW India, the same were again tested under the RPM. There were several other transactions entered into by BMW India with its foreign related parties, in the form of purchase of fixed assets, purchase of software, receipt of technical support services, receipt of IT support services, market*

survey expenses, reimbursement of personnel costs, reimbursement of expenses and interest on loan, which had no connection whatsoever with the main function of distribution of vehicles carried out by BMW India. It may be noted, as accepted by the TPO in his order (page 2 of the TPO order), BMW India had tested each and every such transaction separately by applying the CUP method; and did not engulf all of them under an overall TNMM, which was the bane in the case of LG India before the Special Bench and a factor to be looked down with distain and apathy in the context of classical and cardinal principles of TP, which was also endorsed by the ruling highlighted by the Ld. DR in the case of Knorr Bremse (supra).

11. *It has been submitted earlier that the issue of marketing intangibles/ bright-line in the context of the level of AMP spent needs to be properly addressed by applying international best practices, as there are no codified guidelines embodied in the Indian Income-tax Act, 1961orIncome-taxRules,1962inthis regard. It has been explained before the Hon'ble Tribunal, by referring to the OECD draft guidelines on intangibles office (refer page 174 and 175 of the Compendium) and also by the guidelines of the Australian Tax office (refer page 200 of the Compendium) if the taxpayer distributor carries out significantly higher functions in the context of AMP, as compared to comparable distributors, then the taxpayer distributor would admittedly deserve higher remuneration from its foreign principle as compared to comparable distributors in the market. The said higher remuneration can be imputed by either of the following methods-*
    i. *Reducing the price of the goods, i.e. by allowing a higher gross margin; or*
    ii.. *Reimbursement of the excess AMP spent; or*
    iii. *Applying a residual profit split method.*

The TPO has not applied a residual profit split method and therefore one need not dwell further on the same. It has been explained earlier before the TPO, DRP and the Hon'ble Tribunal that BMW India had been more than adequately compensated for its incremental AMP spent by BMW AG through an adjustment to its import prices.

12. *Thus, as opposed to a meagre 5.10% excess AMP spent made by BMW India as compared to the comparable companies, the gross margin earned by BMW India was 13.71% more than the same comparable companies chosen and accepted by the TPO in testing the distribution profits of BMW India. The corresponding net margins of BMW India and the comparablecompanieswere13.52and 2.11% respectively, signifying an excess net margin of 11.41%earnedbyBMWIndiaoverthe comparable companies.*

13. *The analysis is tabulated below:*

Particulars	***BMW India***	***TPO Order Comparables' Arm's Length Result***
GP/Sales	*27.36%*	*13.65%*
OP/Sales	*13.52%*	*2.11%*

14. *Thus, as per both the OECD guidelines and the ATO guidelines, BMW India was sufficiently and adequately remunerated for the extra functions performed by it on account of advertisement and marketing through earning higher gross margins, being one of the accepted modes of receiving remuneration by a distributor for performing extra functions.*

15. *The TPO cannot take its stand that reimbursement of such expenses is the only manner of receiving remuneration for such extra function since the flexibility in the manner of conducting business needs to be the prerogative of the taxpayer and not the revenue, as explained by the OECD and the ATO guidelines. The DR had made a*

comment during the course of the hearing that there was no evidence to suggest that BMW AG had given a discount or made an adjustment to the vehicles to compensate BMW India for extra functions relating to advertisement and marketing. It is submitted that there was no question of granting any such additional discount or adjustment since the gross margin of the vehicles were already fixed a much higher price so as to adequately and necessarily compensate BMW India for the intensity of distribution functions, as explained earlier.

16. *In case the additional gross margin earned by BMW India was less than the incremental AMP spent of BMW India as compared to the comparable distributors, then a question of making a TP adjustment either with reference to lowering the import price of the goods and there by giving the extra gross margin to BMW India or receiving a reimbursement of such incremental AMP expenses would have arisen, in line with both the OECD guidelines and ATO Guidelines. However, when such incremental AMP expenses was already built in the commensurately higher gross margin of BMW India as compared to the comparable distributors, there was no question of separately documenting any discount or adjustment to the import price of the vehicles, as alleged to the contrary by the Ld. DR."*

5.5.3. The arguments of the Ld. CIT DR that the Guidelines of the OECD and ATO are not binding on the Tribunal it was submitted is not disputed but it may be pointed out that the DRP has itself liberally made references to the OECD Guidelines. It was also submitted that where there are no suitable aids or guidelines in the Indian Act or jurisprudence then there is a long standing practice to refer to International jurisprudence/guidelines. Support was derived from the judgement of the Hon'ble Apex Court in the case of Azadi Bachao Andolan [263 ITR 706, 741 (SC)] and Graphite India Ltd. V DCIT [86 ITD 384 (KOL)]. It was submitted that wherever the Indian Tax Laws on the subject deviate from the OECD Guidelines the Indian Laws shall prevail like in the use of single year data as against the use of multiple year data and the use of arithmetic mean embodied in the Income Tax Act and Rules as against inter-quartile range. This position it was submitted has been confirmed by the Hon'ble Delhi High Court in the case of Mentor Graphics Pvt. Ltd. (TS-86-HC-2013 (Del)-TP).

5.5.4. It was reiterated that emphasis by the department that the distribution rights can be terminated at any time it was submitted is an academic hypothesis as there is nothing on record to suggest that such an event will occur.

5.5.5. Addressing the observations of the department that some of the interveners were distributors as such the argument on behalf of the assessee that Special Bench was only applicable to a licensed manufacturer it was submitted was advanced in the context of the observation of the Special Bench itself that it was referring to the facts of the assessee who was a licensed manufacturer however the assessee's case it was submitted was that the FAR analysis is very different and the principles applicable in the licensed manufacturer's case consequently would not apply ipsi dixit and infact the Special Bench specifically takes note of this fact when they observe that there can be no "straitjacket formula for giving weight to each of the factors/questions highlighted in para 17.4.

5.5.6. It was submitted that on behalf of the assessee arguments have been made relying on international best practices that compensation for higher AMP can be in different ways and the department cannot deny flexibility to the assessee as to how compensation is to made, whether by subsidy or pricing adjustments or any other manner and in the facts of assessee's case the resultant premium profits vis-a-vis the comparables demonstrate this fact that compensation has already been factored in. The additional gross margin earned by BMW India it was submitted was higher than the incremental AMP spent of BMW India as compared to the comparables. Had it been less than the occasion to make transfer pricing adjustments would have arisen. However when such incremental AMP expenses were already built in the commensurately higher gross margin of BMW India as compared to the comparable distributors it was submitted there was no question of separately documenting any discount or adjustment to the import price of the vehicle. The BMW India's gross margin it was emphasized was 12.67% (i.e 27.26%-13.65%) and net margin was 11.41% (i.e 13.52% -2.11%) higher than those of the comparables. It was his submission that in the facts of the present case, the adjustments proposed deserve to be deleted.

6. Having decided the preliminary issues in regard to the admission of additional ground and also holding that the assessee was not an intervener before the Special Bench as evident from the order of the L.G. Electronics, we now proceed to address the grounds raised by the assessee on the basis of the arguments advanced before the Bench on four different dates.

6.1. Both the Ld. AR, Sh. Rahul Kumar Mitra and the Ld. CIT DR Sh. Peeyush Jain have very patiently but very vehemently advanced various arguments in support of their respective claims and positions. Ld. AR, Sh. Rahul Kumar Mitra was placed with a formidable task of distinguishing his case from that of an "adverse binding precedent" in L.G. Electronics case as referred to and heavily relied upon by the Ld. CIT DR. Undisputedly the onus of the argument was on the Ld. AR to make a distinction in order to set up his own case. Judicial rulings on the law are conditional on the strengths and persuasiveness of the arguments advanced on facts. By detailed careful arguments, the Ld. AR elaborated and addressed the facts so as to distinguish how L.G. Electronics case is distinguishable and not an adverse binding precedent and thereafter on the principles of transfer pricing and their application to the present case has to be decided independently.

6.2. On a consideration of the entire gamut of the arguments, submissions in the context of decisions and judgements, it would be necessary to address the settled legal precedents which have been judicially settled as binding for the Courts and Tribunals. It is a settled legal position that a precedent is an authority for what it actually decides and not what may remotely or even logically follow from it; similarly a question which has not been argued cannot be treated as a covered issue by the precedent. It is also an accepted and recognized legal position that the language used in the judgement is to be interpreted plainly and unambiguously and artificial construction is to be avoided. Similarly it is equally well-settled that in case there is a doubt about the decision then the entire judgement has to be considered and a stray sentence or a casual remark cannot be treated as a binding precedent in the decision as a case is a precedent for what it actually decides and nothing more.

6.3. It is equally well-settled that for considering the applicability of rules of interpretation to the words used in the judgements and decisions vis-à-vis the Acts of Parliament, the words used by the Judges are not to be read as if they are words used in an Act of the Parliament. Statutes lay down rules "in fixed verbal form" precedents do not. The particular words are not necessarily used by precedent Courts after weighting the pros and cons of all conceivable situations that may arise, they constitute just the reasoning of the judges in the particular case, tailored to a given set of facts and circumstances, and only the proposition of law which constitutes ratio decidendi that is binding on the same set of facts. The Acts of Parliament on the other hand on account of the careful drafting-presumably with reference to analogous statutes; the multiple readings to which it is subjected in the legislature and the discussions which go behind the making of a statute inject a degree of sanctity and defiteness to the meaning of the words used by the Legislature. The same cannot necessarily be always said of a decision which deals with a certain given set of facts for answering the specific question posed to the Judges. The Judges while deciding the same may dwell on various possibilities without the benefit of the facts in those cases on which they may deliberate and at times without the benefit of specific arguments on those facts as such observations made in passing in these deliberations do not form the ratio decidendi. As such it would be too much to ascribe and read precise meaning to words in a decision which the judges who wrote them may not have had in mind. We may refer to CWT vs Dr. Karan Singh and Others. (1993) 200 ITR 614 (SC); CIT vs K. Ramakrishnan (1993) 202 ITR 997 (Kerala) and KTMTM Adbul Kayoom & another vs. CIT (1962) 44 ITR 689. Reference may also specifically be made to the celebrated judgement of the Hon'ble Apex Court in the case of CIT vs. Sun Engineering Works Pvt. Ltd. (1992) 198 ITR 297 (SC) that it is neither desirable nor permissible to pick out a word or a sentence from the judgement of the Hon'ble Supreme Court divorced from the context of the question under consideration and treat it to be the complete law declared.

6.4. We may also quote the observations as quoted in CIT vs K. Ramakrishnan (1993) 202 ITR 997 (Ker.) and state of Orris vs Sudhansu Shekhar Misra and others AIR 1968 SC 647 of Lord Halsbury LC from Quinn v. Leathem [1901] AC 495 (HL), at page 506:

> *"….there are two observations of a general character which I wish to make, and one is to repeat what I have very often said before, that every judgement must be read as applicable to the particular facts proved, or assumed to be proved, since the generality of the expression which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such expressions are to be found. The other is that a case is only an authority for what it actually decides. I entirely deny that it can be quoted for a proposition that may seem to follow logically from it. Such a mode of reasoning assumes that the law is necessarily a logical code, whereas every lawyer must acknowledge that the law is not always logical at all.*

6.5. Similar views have been expressed by Sabhyasachi Mukharji J., stated in Goodyear India Ltd. v. State of Haryana [1991] 188 ITR 402, 424; AIR 1990 SC 781, 793:-

> *"…. A precedent is an authority only for what it actually decides and not for what may remotely or even logically follow from it."*

6.6. Accordingly, as we understand the correct approach is that a judgement or a decision considered to be a binding precedent necessarily has to be read as a whole and the ratio decidendi of the ruling expressly or impliedly given by a Court or Tribunal is sufficient to settle a point of law put in issue by the arguments of the parties in a case, being a point on which a ruling was necessary to justify the decision in that particular case in the light of the question which was before the Court. A decision of the Court and that equally applies to the Tribunal also takes its colour from the questions posed in the case in which it is rendered and while applying the decision to a later case, it is necessary for the Courts to ascertain the true principle laid down by the Court. Similar would necessarily be the position considering the decision of a Co-ordinate Bench or the Special bench in which case the Special Bench being a larger Bench has greater precedent value in the context of the question posed to it. The transfer pricing litigation and adjudication being fact based necessarily requires consideration of the business model of the assessee and the contractual terms entered into with the AE along with a detailed FAR analysis so as to characterize the transactions and the business model and after charactering the taxpayer on the basis of FAR analysis, a selection of comparable companies has to made where functional similarity qua the transaction on the basis of the FAR analysis of the comparable companies is necessarily required to be done. In order to decide the applicability of any section, rule or principle underlying the decision or judgement which would be binding as a precedent in a case, an appraisal of facts of the case in which the decision has been rendered is necessary since "the scope and authority of a precedent should never be expanded unnecessarily beyond the needs of a given situation' as held by the Hon'ble Supreme Court in P.A.Shah vs. State of Gujarat AIR 1986 SC 468. More so in the case of transfer pricing the detailed analysis cannot be over looked as only thereafter the applicability of the decision to the facts of a case to which it is sought to be applied can be considered.

6.7. The need in the facts of the present case is more so, as transfer pricing legislation mandates that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to specific characteristics of the property transferred or services provided in transactions/functions performed taking into account the assets employed or to be employed and the risks assumed by the respective parties to the transactions; the contractual terms whether or not such terms are formally put in writing or are orally agreed which lay down explicitly or implicitly how the responsibilities and evidences the risks and benefits to be divided between the respective parties to the transactions how the parties have actually acted; and conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical locations and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition in the sector and whether the markets are wholesale or retail.

6.8. Consideration of these facts is mandatorily required under Rule 10B(2) made u/s 92C of the Income Tax Act, 1961. For ready-reference, we reproduce Rule 10B(2) of the Indian Income Tax Rules 1962:-

"Determination of arm's length price under section 92C 10B (1)

10B(1) (a) ……………………………..
(b) ……………………………..
(c) ……………………………..
(d) ……………………………..
(e) ……………………………..
(f) ……………………………..

(2) For the purposes of sub-rule(1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely-

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account asset employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail."

6.9. On a consideration of the arguments and consideration of the material available on record, we are of the view that the orders and judgements of Co-ordinate Division Benches or Special Benches of the Tribunal consisting of 3 Members as in L.G.Electronics case or the Hon'ble High Cour and Hon'ble Apex Court specially in Transfer Pricing adjudication cannot necessarily always be taken as a binding precedent "unless facts and circumstances are in pari material in a case cited before the Court" as held in Ramesh Singh vs. State of A.P 2004 (2) Supreme 749. One may also refer to Rudrappa Ramoppa Vs. State of Karnatka AIR 2004 SC 4148 and Abdul Kayoom's case (cited supra). The applicability of the decisions and orders in transfer pricing adjudication can only come after it has been established that relevant facts are identical Tranfer Pricing issues, being fact driven the need and necessity to carefully examine the facts in order to cull out the relevant facts is thus imperative. Rules 10B framed under section 92C of the Income Tax Act, 1961 mandates that the comparability of an international transaction with an uncontrolled transaction in order to determine the arm's length price of the product or service etc. shall then be judged with reference to the specific characteristics of the property transferred or services provided in either transactions; functions performed taking into account the assets employed or to be employed and the risks assumed by the respective parties to the transactions; the contractual terms whether or not such terms are formal or in writing of the transactions contemplated and in fact undertaken which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions; and conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical locations and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail. This entire enquiry is fact strewn and driven and the change or nuanced change in the facts of a case, for instance the terms of the contract may significantly vary or it may be borne out from the terms of the contract evidenced by the conduct of the parties despite similarity of contracts that the actual reality borne out from the conduct of the parties may lead to different conclusions qua the functions performed vis-à-vis the functions assumed.

6.10. Accordingly in the light of the above legal principles, we consider it necessary to address the facts available on record and cull out the relevant facts in order to adjudicate upon the issue which we are called upon to decide. In the facts of the present case, there is no dispute that the assessee is a 100% subsidiary of its AE and has entered into an **Importation Agreement** placed at paper book page no-239-243 between BMG AG (Bayerische Motoren Werke Aktiengesellschaft, Petuelring 130, 80788 Munchen, Germany) and BMW India Pvt. Ltd, DLF Cyber City Phase-II, Tower B, Building No.-8, Gurgaon, Haryana-122002. The opening preamble of the said agreement sets out the following facts :-

> *"(A) BMW India is a hundred percent subsidiary of BMW Group.*
>
> *(B) The Parties endeavor, through their co-operation in production, distribution and maintenance of Contract Goods products, to satisfy in every way the expectations of the customers.*
>
> *(C) The objective is to ensure that the global standards of product quality and awareness of, or satisfaction or service to customers in India of BMW cars are achieved at par with the global standards in India;*
>
> *(D) **BMW AG is willing to provide such contract goods to BMW India in return for payment of appropriate consideration by BMW India**; and*
>
> *(E) The parties have agreed to the terms and conditions hereinafter contained and are desirous of recording the same as set out hereinafter."*
>
> ***(highlighted for emphasis by the Bench)***

6.10.1. **Clause 1** of the said **Importation Agreement** addresses the following aspect **"Importation Distribution Rights"** to the assessee :-

> ***"1. Importation and Distribution Rights***
>
> *1.1. Distribution Rights for Contract Goods*
>
> *"BMW AG hereby grants BMW India the right and BMW India undertakes the corresponding duty to import and distribute BMW completely built units (CBUs), completely knocked down (CKD) kits and original BMW parts/accessories (hereinafter referred to as "Contract Goods") according to the provisions of this Agreement.*
>
> *Original BMW parts are all parts, components, re-built parts and accessories, which BMW AG offers in its current sales program for original BMW AG parts, irrespective of whether these parts are manufactured by BMW AG or supplied to BMW AG by third parties."*

6.10.2. **Clause 1.2** addresses **"Independence of BMW India'** and states that the assessee operates its business "in its own name, on its account and at its own risk and it has no authority or power to legally bind" the AE.

6.10.3. **Clause 2** addresses the **Contract Territory** and has the following responsibilities in the **Contract Territory**:-

"2. Contract Territory

2.1 Description of the Contract Territory

The Contract Territory of BMW India shall be:

-INDIA-

2.2. Responsibility in the Contract Territory

"BMW India represents the interests of BMW Ag in the Contract Territory. It is responsible for the sales promotion and the full utilization of the market potential for the Contract Goods in the Contract Territory.

It is further responsible for ensuring the provision of the best possible customer service and adequate stocks of original BMW parts in the Contract Territory.

Furthermore, BMW India undertakes the following functions in the Contract Territory in accordance with the laws of the contracting territory:

- ***establishment and supervision of an efficient BMW distribution network.***
- ***Performance of an adequate advertisement and sales promotion as well as public and media relations.***
- *Collection, evaluation and communication of market information to BMW AG."*

(highlighted for emphasis by the Bench)

6.10.4. The scope of the activity of the assessee is addressed in **Clause 3** which reads as under :-

"3.1 Responsibilities for Sales and Advertising

BMW India will meet its responsibility for the promotion of sales and the full utilization of the market potential for the Contract Goods by applying its best efforts and adequate resources toward effective sales promotion and advertising for the Contract Goods including available optional equipment and accessories.

3.2. Inventory

BMW India will maintain an inventory of Contract Goods that is adequate in view of its business volume.

3.3. Pricing

The price charged for the Contract Goods is adequate to ensure recovery of total costs of the Contract Goods supplied plus representative profits.

BMW AG, in order to arrive at the price of Contract Goods supplied to BMW India, adds to the cost of manufacture (CBU and CKD kits) or procurement (parts/accessories) as the case may be certain costs, including but not limited to:-

- *indirect cost (which includes costs like administrative, marketing and other overhead costs) of the Contract Goods; and*
- *profit computed as percentage of the total costs, which is representative of BMW AG's overall profit attributable to the Contract Goods.*

BMW AG will inform BMW India of all price changes beforehand in writing and will provide BMW India with a sufficient number of price lists.

3.4. Supply of Original BMW Parts
BMW India will maintain and offer to customers a supply of original BMW parts, which corresponds to customer expectations and to the requirements of BMW AG.

3.5. Customer Service
BMW India will provide customer service pursuant to the provisions of the current customer service regulation, the regulations for warranty and good-will as well as the information material published by BMW AG from time to time."

(highlighted for emphasis by the Bench)

6.10.5. **Clause 4** addresses **sales to the assessee** and sets out the terms and conditions of the supply of contract goods ordering of the same and assumptions of the warranty and payments etc.

6.10.6. **Clause 5** addresses **duration of the contract** as under :-

"5. Duration and Termination

5.1. Duration

"The parties agree that this agreement shall enter into force as of 1st January 2006 and shall remain in force until terminated by either party.

This Agreement may be terminated by either Party at any time upon 6 months prior written notice or as agreed between the Parties."

6.11. A perusal of the TP study of the assessee shows that the intangible assets are held by the AE and the assessee being a 100% subsidiary undertakes distribution responsibilities of the contract goods. The Importation Agreement, Clause 2, specifically, addresses the fact that responsibility for the sales promotion and the full utilization of the market potential for the contract goods, in unambiguous terms, rests with the assessee. Similarly it is seen that the assessee is responsible for providing the best possible customers service and is also required to establish efficient distribution network by establishment and supervision and perform adequate advertisements and sales promotion as well as establish public and media relations. Clause 1.2 addresses the independence of the assessee also and in unambiguous terms it sets out the fact that the business is operated by the assessee in its own name, on its own account, at its own risk and as such the functions performed of advertising and sales promotion is stated to be at its own discretion.

6.12. The fact that the independence of a taxpayer who is 100% subsidiary company of its holding company wherein because of the economic control and overall control necessarily lies with the holding company who has the right to appoint all or most of the directors, the independence of the directors appointed by the AE can become questionable notwithstanding claims to the contrary in the Agreement. As the interests of the AE cannot be easily ignored by them as such we are of the view that assertions in addressing their independence of decision may be required to be looked into if the situation so warrants. As such the sanctity which generally operates in favour of the terms of the agreement can be called upon to be explained in transfer pricing as such may be open to question. However in order to adjudicate the issue in the present proceedings the facts of the present case to our minds, do not warrant such an examination and it would not be of much relevance as without looking into the independable of the directors it is seen that as per the Importation Agreement itself assessee has agreed to perform greater intensity of functions to carry out sales promotion and achieve "optimum utilization of the market potential in the luxury automobile segment" to which it belongs as such service to the AE is accepted in the Agreement itself. This acceptance on the part of the assessee to perform the functions as a distributor is further elaborated in Clause 3 of the Importation Agreement. A perusal of the same shows that the assessee assumes the responsibility for sales and advertising and agrees "to apply its best efforts" and "adequate resources" towards "effective sales promotion and advertising" for the contract goods. These terms and conditions borne out from the Importation Agreement show that the assessee as a distributor agrees to perform the functions of advertising and sales promotion thereby doing greater service to market the goods by advertising marketing and promotion. As such in the TP study of the assessee itself the assessee has characterized itself as "a normal distributor" as opposed to a distributor who is a "low end distributor".

6.13. It is also seen that the assessee before the TPO has addressed that uncontrolled comparables be considered for comparison on the basis of near identical intensity of functions performed and the TPO has accepted comparables of the assessee. Accordingly it is seen that there is no denying that the assessee has assumed greater role and responsibility vis-a-vis the comparables as the record shows that applying the bright-line test the AMP expenditure of the assessee exceeds the AMP/sales ratio of the comparables. Thus it is seen that the assessee has performed non-routine advertising marketing functions and the Importation Agreement also shows that the assessee has agreed to perform the functions. Even otherwise, on going through the TP study of the assessee it is seen that the assessee is described as normal distributor who is required to set up the distributorship network by appointing dealers including ensuring availability of warehousing, creating a distribution of dealership network, sales promotion, maintaining adequate advertisement, maintaining public and media relations etc. are the functions which the assessee has been tasked with and has undertaken to perform and the record shows that these functions have been performed. The fact that they far exceed the functions of a routine distributor stands demonstrated and is found in confirmation with the terms of the contract. As such, it is evident that the assessee has conducted its affairs by performing non-routine functions which it agreed to do so.

6.14. The TP study of the assessee also addresses the global overview of the automobile sector as well as the India overview of the sector. A perusal of the same shows that whereas the sales are stated to be stagnant in the last three years in the Western Europe and America, the growing markets are identified as China and India. In India due to the change in the policy and vision of the Government from 1970's to 1984 and change of the role of the Government from a regulator to "an enabler" as per the TP study resulting in restructuring of the tariff structure, changes in the import policy, FDI and reducing the Quantitative Restrictions on imports etc. which have all contributed to creating the ground realities where major International players have entered in the Indian market contributing to the movement of market expectations from compact car segment to luxury car segment. The domestic market is stated to have the presence of almost all the global players represented in India as a consequence of improved infrastructure and policies as a result of which the market is described as competitive and consequently driven by price and technology which necessitates greater efforts in capturing the market share. The TP study also addresses the fact that whereas in the past, the choice of a customer was limited to a few options today it is stated that there are about 150 models and variants available by way of customer option. The purpose of mentioning these facts and figures in the TP study is presumably to address the prevalent competition in the market necessitating aggressive marketing and sales promotion exercises. The following review of the trend in the performance of the passenger car industry over the 5 year period for 2003-08 has also been given:-

Sales Trend-Passenger Cars

Year	Units Sold	% change
2003-04	1,031,387	32.27%
2004-05	1,227,703	19.03%
2005-06	1,318,809	7.42%
2006-07	1,578,176	19.67%
2007-08	1,766,403	11.93%

6.15. The above facts and figures in order to establish a trend for computing the ALP issue is of no relevance as the Rules under the Statue specifically mandate the use of current year financials however sector performance addressed in the TP study to address decline in sales across the segment again presumably to justify advertising, marketing and promotion expenses needs a mention. However in the facts of the present case the assumption of greater role and performance of functions have been assumed by the assessee itself as incorporated in the Importation Agreement as such the mention in the TP study presumable to address sector overview and competitiveness in the market as such cannot be ignored.

6.16. The TP study further states that the Indian passenger car segment shows an increasing trend of fragmentation of the market into sub-segments, reflecting the increasing sophistication and developing tastes of the Indian consumers. For ready-reference, we quote from the TP study itself :-

> *"3.5.10. The intense competition in the market has given rise to a scenario where the margins of automobile manufacturers are under pressure, primarily on account of increasing cost of upgrading manufacturing systems as well as parts to conform to stiff environmental regulations and the need to offer promotions and discounts to push products in the market. Moreover automobile makers do not enjoy the luxury of increasing their prices commensurate to the rise in the backdrop of a sluggish market scenario.*
>
> *3.5.11. With the launch of new models, the market for Multi Utility Vehicles (MUVs) has also been redefined in India, especially at the high-end. Currently, Sports Utility Vehicles (SUVs), occupy a niche in the urban market. With the success of SUVs, the line of distinction between passenger cars and MUVs in the Indian market is getting blurred."*

6.17. The assessee in the TP study has addressed that the key drivers of the Indian passenger car industry are changing technology necessitated by rising fuel costs, rising per capita income, the change in government policy in regard to import duty, excise duty and modern practices like vendor tiering, adoption of JIT (Just in Time technique) which has helped in reducing inventory carrying costs, creation of Special Economic Zones, tax holdings/incentives like sales tax relaxation, providing land at subsidized rates and liberalized FII norms and spending on infrastructure in roads, airports etc. are stated to be some of the reasons which have driven automobile industry in the country.

6.18. The rising incomes have been stated to be the cause of reducing the average holding period of a car from 7-8 years to 3-4 years in India, projecting that model may be frequently upgraded either to another model from the same or a higher segment and thus being the possible cause of increasing trend of a need for a second car stated to be on the rise in urban areas. According to the TP study, it is mentioned that the small compact car owners accordingly are likely to upgrade to mid sized segment and as per estimates the proposed growth in the world car market is expected to come from Asian Countries which has created a very competitive environment.

6.19. Thus on a consideration of the market conditions and the terms of the contract entered into in the Importation Agreement by the assessee with the AE, it necessarily leads us to the conclusion that the assessee has performed the function of sales promotion and advertisement in order to make a dent in the market while performing the functions of a distributor with greater intensity as opposed to a routine distributor. Accordingly, we hold that the assessee has performed greater intensity of service than a normal distributor and has incurred expenditure for advertising marketing and promoting the brand of its AE.

6.20. In the context of the above finding, we are now required to examine the claim of the assessee whether on account of rendering of non-routine service was the assessee entitled to receive compensation with a mark-up from its AE. Arguments have been addressed on behalf of the assessee that the FAR analysis of a licensed manufacturer differs from the FAR analysis of a distributor. It is seen that the assessee evidently is not a low end distributor and infact is a distributor having greater intensity of functions. The remuneration model of a distributor generally is low risk as the rewards are guaranteed by the entity for whom a tax payer becomes the distributor. The manufacturer or for that matter a licensed manufacturer necessarily employs greater assets and is exposed to a higher risk vis-à-vis a distributor and has a higher potential of profit/loss consequently higher risks than a distributor whose rewards are guaranteed upto an extent. The licensed manufacturer may or may not pay fee/royalty for the license but for its manufacturing activities it functions as an entrepreneur and the rewards are not guaranteed. A distributor on the other hand operates on a lesser risk and the remuneration model is reward-based and it also may or may not pay royalty/fee for the use of Brand-logo etc. On behalf of the assessee, it has been argued that whereas the low end distributor would not undertake higher functions and would limit itself to the basic distribution function and the rewards are guaranteed but low as compared to the distributor who undertakes to perform higher functions and undertakes to establish distributorship network, advertise, promote and market the brand the remuneration/compensation/rewards of distributorship herein is also guaranteed however they ought to exceed the rewards vis-à-vis a low end distributor. Relying upon contemporaneous Guidelines/jurisprudence, it has been canvassed that for a distributor the rewards are inbuilt in the pricing itself and can also be directly compensated and international tax jurisprudence best practices contemplate that profit split method can also be resorted to in order to work out the compensation due apart from the other two methods. On consideration, we find merit in the argument and as such convinced that generally the remuneration model of a manufacturer or a licensed manufacturer can be the results of acting as an entrepreneur in its own capacity and exposing itself to all the risks and rewards which an entrepreneur is exposed to the argument appears to have merit, however for the purposes of the present proceedings, we need not examine the correctness of the same as what is relevant for our consideration is the remuneration model of a distributor. On examination of contemporary Guidelines/jurisprudence on the subject, we are of the view that a distributor is rewarded by the entity for whom the distributor works and the rewards are guaranteed upto an extent and the risk component vis-à-vis a manufacturer is necessarily very less. The rewards can be and generally are based on pricing adjustments and can also be compensated over and above that if greater services are rendered and pricing adjustments have not covered the cost of routine services rendered. Generally speaking the remuneration model for a distributor is reward-based and rewards are based on the quantity of sales. The rewards are guaranteed for a distributor on the performance of all the functions of a distributor which as per the Importation Agreement in the present case, the assessee has been tasked with "full utilization of the market potential of the contract goods by applying its best efforts and adequate resources towards effective sales promotion and advertising for the contract goods". Accordingly we on consideration of the TP study and the terms of the contract affirm our conclusion and hold that the assessee has performed the functions of advertisement while carrying out the activities of a distributor which have contributed to the brand building for its AE. Accordingly, the alternative arguments of the assessee namely that as a distributor it is necessarily required to incur expenditure for warehousing, sales promotion and even advertisement as such is accepted. However the arguments that the incurring of

AMP expenses though a function of a distributor, is not an international transaction is not accepted in view of the precedent value of the order of the Special Bench which is binding on the issue as such is decided against the assessee. The argument that the assessee was not required to show it as a separate transaction as it was a function within the bundle of functions performed as a distributor which includes costs of warehousing etc. also is not agreed with in view of the binding precedental value of the decision of the Special Bench in L.G. Electronics case.

6.21. No doubt the remuneration model of a distributor is different from the remuneration model of a manufacturer as is borne out from the Importation Agreement on which we shall deliberate subsequently however the fact remains that it was not only a transaction but an international transaction which benefited the foreign AE and in terms of the bright-line test considered by the Special Bench was an expenditure which cannot be called to be a routine expenditure for which remuneration has to be considered. The claim advanced on behalf of the assessee which is to be examined is that has the remuneration already been factored in the pricing which as per the Importation Agreement ensures that after the costs of the assessee are met the assessee is left with representative profits which are much more than those of a routine distributor as such no further remuneration is necessary or is compensation still to be received from the AE. For examining this contention, we need to go back again to the Importation Agreement of the assessee with its AE and the facts on record.

6.22. A perusal of the Importation Agreement shows that as per Clause 3, the price charged for the contract goods is stated to be "adequate to ensure" "recovery of total costs" of the contract goods supplied plus "representative profits". The argument on behalf of the assessee has been that the function performed by a distributor necessitated the incurring of AMP spend and the cost of performing this function has been factored in the pricing arrangement consequent to which the assessee has shown high profits at the net level as well as the gross margin levels vis-à-vis the comparables of the TPO. It is seen that the comparables based on the intensity of functions performed by comparing the functionally comparable untainted companies had been provided by the assessee before the TPO the comparables have been accepted by the TPO at para 10.5 of his order. Considering these fresh comparables alongwith the 3 comparables retained by the TPO from the original 5 comparables, the TPO calculated the bright-line as AMP/sales of the comparables at 1.99%. The same is depicted from the original synopsis filed by the assessee on 18th February 2013:-

> *"1.4 During the TP assessment proceedings the Learned ('Ld. ') Transfer Pricing Officer (TPO'), alleged that BMW India has incurred excessive Advertising, Marketing and Promotional ('AMP') expenses of 7.09% as a percentage to sales. The Ld. TPO alleged that the AMP/Sales ratio that BMW India had incurred is excessive vis-a-vis its comparable companies which was determined by the Ld. TPO at 1.99% as depicted below:*

<u>Ld. TPO's Calculation for AMP spend</u>

Name of the company	*GP/Sales*	*OP/Sales*	*A&M/Sales*	*Remarks*
Pebco Motors Ltd.	*6.62%*	*-3.84%*	*1.20%*	*Proposed by Appellant vide submission dated October 4, 2011*
Popular Vehicles & Services Ltd.	*11.72% .*	*1.16%*	*4.10%*	
Shree Sancheti Motors Pvt. Ltd	*12.15%*	*0.95%*	*1.61%*	
Machino Techno Sales Ltd	*12.69%*	*1.07%*	*4.42%*	
Eastman Industries Ltd	*16.22%*	*3.80%*	*1.25%*	
Bharat Power Corpn. Pvt. Ltd.	*24.79%*	*10.82%*	*0.87%*	
M G F Automobiles Ltd	*15.90%*	*0.45%*	*6.31%*	
Lucas Indian Service Ltd	*20.13%*	*4.16%*	*0.88%*	
Sri Ramadas Motor Transport Ltd.	*18.92%*	*2.19%*	*1.66%*	
AVG Motors Ltd.	*8.96%*	*1.85%*	*0.31%*	
Competent Automobiles Co Ltd	*5.91%*	*-0.04%*	*0.20%*	*TP Documentation Companies*
Sai Service Station Ltd	*9.82%*	*2.80%*	*1.06%*	
<u>Mean</u>	*13.65%*	*2.11%*	*1.99%*	

6.23. It is seen that the use of bright-line as a tool for calculating the non-routine AMP spend has been upheld by the L.G. Electronics decision and even if the assessee was not an intervener before the Special Bench, the said principle is binding and as opposed to applying arbitrary estimation is a well accepted methodology in Transfer pricing and is an accepted tool for calculating non-routine expenditure for marketing intangibles where the brand ownership rests with the foreign AE. The said tool is accepted in both developing and developed countries alike in international tax jurisprudence and the applicability of the same has already been upheld in the present proceedings. The arguments that OECD Guidelines as international tax best practices and jurisprudence have no role to play shall be dealt with separately subsequently however the fact remains that international jurisprudence or for that matter OECD Guidelines are and have been frequently resorted to either by the department or by the assessee in order to canvass their respective stands and wherever it is found that in the absence of any guidelines by way of rules under the legislation or absence of judicial interpretation the international jurisprudence is accepted and frequently resorted to by Courts and Tribunals and has a persuasive value.

6.24. In the facts of the present case holding that bright-line is an accepted method for calculating, we now proceed to consider the position on facts whether in the case of a distributor whose remuneration model is based on rewards as set out in the Importation Agreement was the assessee still required to be reimbursed following the L.G. Electronics decision.

6.25. For the said purpose, we have referred to the Importation Agreement which clearly sets out that the assessee shall be charged such a price which shall ensure adequate recovery of total costs of the contract goods "plus" representative profits. In the facts of the present case, it has been submitted on behalf of the assessee before the TPO as well as the DRP and also before us that the GP/sales ratio of the assessee is 27.36% as compared to the similar ratio of the comparables considered by the TPO which is 13.65%. Even the OP/sales ratio of the assessee vis-à-vis the comparable is higher namely 13.52% in the case of assessee as opposed to 2.11% in the case of the comparable companies. The AMP/sales ratio of the assessee is 7.09% as compared to the mean of the similar ratio of the comparables which is 1.99%. It may necessary be kept in mind that these ratios are calculated on the basis of the amounts mentioned in the assessment order where AMP bundle includes the expenditure pertaining to sales promotion and bonus of salesman and dealers. The record would also show that these directions of the DRP for reasons best known to himself have not been carried out by the TPO. It has already been addressed in the earlier part of this order that the said approach/attitude of the TPO is strongly disapproved by us and has already been addressed in the earlier part of this order. To revert back to the issue under consideration, it is seen that once the said expenditure is reduced from the AMP bundle in compliance to the direction of the DRP by the TPO which has also been so directed in para 18.3 by the Special Bench in L.G. Electronics case the resultant figure of AMP would be Rs.33.93 crore odd [Rs.58,79,78,241/- (AMP as per the assessment order) to be subtracted by Rs.3.94 crore odd and Rs.20.93 crore (constituting after sales support costs and salesman bonus respectively)= Rs.3.93 crore odd]. These assertions are found made in para 1.47 of the synopsis filed in February 2013 and despite fixing the case for clarification and hearing the parties at length and almost requiring an addressal on facts de novo the calculations and statements have not been refuted by the department. Accordingly reverting back to para 1.47 of the Synopsis the resultant figure of Rs.33.93 crore odd amounts to 3.62% of the turnover. Thus the "excess' AMP spend ratio of the assessee would be 3.62% as opposed to 7.09 calculated by the TPO once the directions of the DRP are given effect to. It is seen that 1.99% is considered as the bright-line calculated by the TPO, the excess AMP/sales ratio after arithmetic corrections are carried out would be 1.63% i.e (3.62%-1.99%=1.63%). The claim as per the Synopsis dated 18.02.2013 states that putting the things in the perspective would show that the assessee has got as compared to its comparables 13.71% higher gross margin (27.36%-13.65%) and 11.41% higher net margin (13.52%-2.11%) as compared to 5.10% (7.09%-1.99%) excess AMP if figures without carrying out the corrections directed by the DRP are considered and 1.63% (3.62%-1.99%), if corrected figure are taken. In absolute terms the assessee vide para 1.44 of synopsis dated 18.02.2013 claims that it has already been compensated to the tune of Rs.106.85 crore (difference between 11.41% between BMW India OP/sales and Arm's Length OP/sales) which is greater than AMP spend of Rs.33.93 crore from which routine expenses are to be allowed. These figures have not been disputed by the department. In the said background rejecting the main ground of the assessee that no services were rendered by the assessee to its AE for which compensation was to be calculated and remunerated, we hold on a detailed reading of the terms of the Importation Agreement and perusing the facts and figures addressing the AMP spend vis-à-vis the comparables and upholding the application of the bright-line application as an accepted tool, we conclude that services over and above the routine services as a distributor have been rendered by the assessee which has resulted in brand building for the AE for which compensation has to be computed which has been done. Also on consideration of the terms of the Importation Agreement and the facts and figures addressing the incurring of expenditure and the resultant profits of the assessee vis-à-vis the comparable both at the net level and the gross level, we hold that in the facts of the present case the assessee has demonstrated that the compensation for the higher services was embedded in the pricing arrangement of the contract goods itself. Not only Clause 3.3 ensures that price charged would be adequate to ensure recovery of total costs but also earning of representative profits which has been done. It is seen that the comparables identified by the assessee and accepted by the TPO as having similar intensity functions have earned profit at the gross and net levels far below the profits both at gross and net levels as achieved by the assessee. In the circumstances as evidenced from record, we are inclined to agree with the submissions advanced on behalf of the assessee that no further compensation was required to be made by the AE as the same has already been received.

6.26. In support of the remuneration model of the assessee who is a distributor rewarded by way of price adjustments to ensure profitability upto mutually accepted terms is a well-recognized and well-accepted method for compensating a distributor. In support of the said methodology of compensation, reliance on behalf of the assessee has been placed on the OECD Guidelines (copy of the discussion draft on TP aspects of Intangibles issued by OECD Chapter V1 placed at pages 131-192 of the paper book and Australian Tax Guidelines (copy of the Australian Tax Officer

"ATO") Guidelines on Marketing Intangibles placed at pages 193-203 of the paper book title "Compendium of Statutory and Judicial Rulings Guidelines"). Addressing the examples illustrating the position in the OECD Guidelines, Ld. AR has canvassed that a distributor can be remunerated for the services/functions performed either by adjusting the pricing or by compensating the entity directly for excess marketing advertisement expenditure or by applying residual profit split method. In the facts of the assessee's case the adjustment has been based on the pricing so as to ensure adequate representative profits earned after meeting the cost of the goods sold. Similar view has been taken by the Australian Guidelines which has also been relied upon by the Ld. AR. Specific attention was invited to example 3 at page 200 of the paper book so to submit that price adjustment; direct compensation for the excess spend or resale price method are the ways in which a distributor can be remunerated for the functions which may be performed over and above what routine function a normal distributor would have performed. In the facts of the present case, it has been emphasized that for exploiting the brand logo etc, no royalty has been paid by the assessee to its foreign AE. It is also necessary to note the fact that the AE has provided the assessee with a loan at a rate better than the external bench-mark, the average PLR as per the assessee's TP study is 13.30% and the BMW India's effective Rupee cost on the loan is 7.43%. This fact is borne out from the para 5.12.7 at page 54 whereas the projected financial information for 2008-09 to 2010-11 addressing marketing cost is placed at page 69.

6.27. We on considerations of the contemporaneous international jurisprudence which supports the claim of the assessee are of the view that even if considering the arguments of the Ld. CIT DR for a moment, the contemporaneous international jurisprudence is ignored even then the claim of the assessee has merit as the assessee with the AE can agree to be rewarded/remunerated by price adjustments to earn profits which include the cost of rendering services with profit. The department cannot insist in the absence of any provision under the Act that the mode of compensation to the assessee by the foreign AE necessarily has to be direct compensation and pricing adjustment is not accepted. In the absence of any such Rule or provision in the Act barring such mode, the assessee is free to adjust and apply any method which it finds most suitable to manage its affairs. Had it been specifically required by the Statute and the Rules thereunder that the remuneration/compensation for the performance of non-routine functions of a distributor has to necessarily be remitted/reimbursed separately with a cost plus the occasion to refer and rely on the terms of the Importation Agreement would have not arisen as the mandate of the Statute necessarily prevails on the terms of the Agreement entered into between the parties. Similarly reliance on OECD TP Guidelines etc. would then have no relevance. In the absence of any such bar in the Statute and the provision, we do not see any infirmity if in the terms of the Importation Agreement, the assessee for its functions performed beyond the routine functions as calculated by applying the bright-line test has been compensated by the AE by making pricing adjustments so as to ensure that the assessee is left with representative profits after meeting it costs. The fact that assessee's profits vis-à-vis the comparables with similar intensity functions far exceeds the mean margin of the comparable stands established. The contemporaneous international jurisprudence supports this and even the Special Bench leaves the issue open by accepting its limitations while giving voice to the diverse nature of facts, business models and peculiar terms and conditions of different assessee by observing that there cannot be any 'straight-jacket' formula.

6.28. Accordingly after a detailed analysis of the relevant provisions of the Act, the FAR analysis of the assessee, the terms of the Importation Agreement entered into by the assessee with its AE, the orders and judgements relied upon and considered by us in order to decide the issues and weigh the merits and relevance of the comprehensive arguments made at length by both the sides juxta posed with the facts and figures of the assessee in the year under consideration and the comparables as addressed in the orders and referred to by the parties before the Bench, we hold that in the facts of the present case there was no occasion for the AE to further compensate the assessee for the services rendered towards building the brand of the AE as the same already stood factored in the pricing adjustment of the contract goods. As such the occasion to consider the applicability of mark-up does not arise. We further find support form the decision of the Special bench in L.G. Electronics case which considers a deviance from the view taken in the case of an assessee who incurred higher AMP vis-à-vis the comparables in the initial years. As discussed in the earlier part of this order, the DRP specifically notes that this is the first full year of assessee's functioning. The TP study referred to by us in the earlier part of this order addresses the prevalent competition in the market and the fact that the sector is highly competitive becomes more so for a new entrant where there is a declining trend seen in the automobile sale market coupled with entrenched position of early entrants in the sector.

6.29. Before parting, we would briefly address certain other issues on which arguments have been addressed. One of the issues is that date of termination has not been mentioned which according to the Revenue is a detrimental facts and makes the agreement tenuous as with a mere notice of 6 months as per the terms of the Importation Agreement, the contract can be terminated and the assessee would be deprived of its efforts of the brand building of the AE and the benefits are capable of being exploited by the AE at no cost. In the facts of the present case, duration of contract has no relevance as it is an argument taken to justify that compensation should be received. In the facts of the present case, we have agreed with the Revenue's stand that for the non-routine services compensation from the AE is required and on considering the terms of the contract and the facts of the case have held that it has already been factored in the pricing adjustment by the AE. As such where compensation has already been received more than adequately as vis-à-vis the comparable doing similar intensity of functions the finding that assessee's claim is tenuous on account of duration does not need to be gone into in the present proceeding. Since compensation has been received, the worries and apprehension of the Revenue that assessee has rendered services for brand building reducing its domestic profit eroding the tax base does not arise as the tax base has not been eroded.

6.30. It may also not be out of place to mention here that a perusal of the decision of the Special Bench in the case of LG Electronics shows that while considering the specific facts of the assessee therein who admittedly was a license manufacturer, the Special Bench after referring to the vast ranges of possible arrangements which the AE in different business models may enter in para 17.3 attempts to formulate "some of the relevant questions" whose answers have a considerable bearing on the determination of the issue. Reference may specifically be made to Question No-1 which gives recognition to the fact that it is important to determine whether the Indian AE is a distributor or is holding a manufacturing license from its foreign AE. Similarly Question No-12 whether the year under consideration is the entry level of the foreign AE in India or is it a case of established brand in India. Admittedly this is the first full year of functioning of the assessee in India and admittedly as per record the competition in the market is intense and in the presence of global players in the market with entrenched presence is a matter of record. We have also taken into consideration the order dated 28.2.2013 which for want of specific arguments the Co-ordinate Bench had restored to the AO in RayBan Sun Optics India Ltd.

6.31. Before parting, we would also want to address the role of OECD Guidelines and ATO Guidelines etc. for interpreting and adjudicating on the issues arising in transfer pricing issues on which the parties have addressed at length invoking at times strong and patriotic sentiments. On a consideration of the issues and the orders and judgements on the issue, we are of the view that there can be no dispute with the principle that to the extent OECD Guidelines are repugnant to the Indian Income Tax provisions, the same have no role to play. As such if the provisions of the Statute and the Rules framed thereunder lay down a specific criteria which is to be met then there is no doubt that the provisions of the India Income Tax Act shall prevail whatever may be said to the contrary in the OECD TP Guidelines or the ATO Guidelines or any other International Legislation or decision thereunder. For instance where the Indian Statute and the Rules framed there under mandate the use of single year data or consideration of arithmetic mean, the use of multiple year data and use of inter-quartile range recommended in OECD TP Guidelines have no role to play. However wherever there is no conflict with the Indian Income Tax Act and the Rules thereunder specially where issues which may arise in a constantly developing law as far as India is concerned, in the absence of any guidelines in the Indian Income Tax Act and the Rules thereunder we are of the view that there is no bar and there can be no bar to refer to OECD TP Guideline and International Tax Practices Jurisprudence. To our minds there can be no judgement or order which would lay down the proposition that OECD TP Guidelines or any international Jurisprudence per se be ignored where the situations warrant on the issues which are not addressed in the Indian Transfer Pricing Laws contained in the Income Tax Act & Rules. Similarly there cannot be a blanket ban to considering/referring to judgements and orders rendered by the Courts and Tribunals in different tax jurisdictions as they definitely have a persuasive value. Similarly the OECD/ Australian Tax Office/UN Model Guideline definitely have a persuasive value and a decision rendered ignoring the same to our minds would be denying the concerned Authority with the benefit of contemporaneous and relevant literature on the constantly evolving issues. There is no brilliance in trying to re-invent the wheel, intelligence lies in utilizing the benefits of search and research which are already available and to proceed therefrom. The benefits of knowledge on evolving issues which has been internationally debated and discussed by academicians experts and various stake-holders is not to be ignored with contempt and should not be treated lightly and discarded without considering. Accordingly we hold that OECD TP Guidelines/ATO Guidelines and International Tax Jurisprudence to the extent, they do not run foul of the Indian Income Tax Act and Rules thereunder have a very important role to play and if one can say that they should be disregarded then such a decision may suffer from deliberate ignorance which could have been ideally avoided. The selective stand of the department to “trash” these arguments if one can so use the word for want of a better and more appropriate word, which may be 'de-bunk" the arguments on behalf of the assessee wherever reliance is placed on OECD TP Guidelines or International tax jurisprudence is worth commenting. It may not be out of place to mention that that "bright-line test" does not from part of Indian Income Tax Legislation and has been borrowed from the US Legislation. Section 1.482-4 of US-1RC incorporates Bright-Line Test within the US Legislation and the Revenue heavily relies on it to calculate the non-routine AMP spend. Similarly for valuation of AMP spend resulting in intangible benefits to the AE by building/promoting their brand OECD TP Guidelines are frequently resorted to by the Revenue to address that they have a value for which compensation should be computed then how and why a discussion on the possible and acceptable methods by which remuneration for the services rendered should be ignored on the arguments that the OECD Guidelines ventilate the view of developed economies and do not reflect the view of the developing economies is surprising.

7. Accordingly for the detailed reasons given hereinabove, Ground no-3,4 & 6 of the assessee are rejected and in view of the finding in Ground No-1 and additional Ground no-7, Ground No-2 becomes infructuous. Ground no-5 in view of the specific terms of the Importation Agreement borne out by the facts of the case for the detailed reasons given hereinabove is allowed. The TPO is directed to verify the calculations and give effect to the order.

8. In the result, the appeal of the assessee is partly allowed.

The order was pronounced in the open Court on 16 of August 2013.

Sd/-	**Sd/-**
(B.C.MEENA)	**(DIVA SINGH)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Dated: 16/08/2013
Amit Kumar

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI