`आयकर अपीलीय अधिकरण "के" न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K", MUMBAI

श्री डि. करुनाकर राव, लेखा सदस्य एवं श्री विवेक वर्मा, न्यायिक सदस्य के समक्ष।
BEFORE SHRI D. KARUNAKARA RAO, ACCOUNTANT MEMBER AND SHRI VIVEK VARMA, JUDICIAL MEMBER

आयकर अपील सं. : 7408/मुम/2010
निर्धारण वर्ष A.Y. 2002-2003
ITA No. : 7408/Mum/2010
(Assessment year: 2002-2003)

M/s. Cadbury India Ltd, Cadbury House, 19, B Desai Road, Mumbai 400 026	Vs	Addl Commissioner of Income Tax, Range -5(1), Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)

आयकर अपील सं. : 7641/मुम/2010
निर्धारण वर्ष A.Y. 2002-2003
ITA No. : 7641/Mum/2010
(Assessment year: 2002-2003)

Addl Commissioner of Income Tax, Range -5(1), Mumbai	Vs	M/s. Cadbury India Ltd, Mumbai 400 026 स्थयी लेखा सं.:PAN: **AAACC 0460 H**
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
Appellant-assessee by	:	Shri J.D. Mistry Shri Nishant Thakkar
Respondent-revenue by	:	Shri Ajeet Kumar Jain Shri O.P. Singh

सुनवाई की तारीख /Date of Hearing : 22-10-2013
घोषणा की तारीख /Date of Pronouncement : 13-11-2013

आ दे श
O R D E R

श्रि विवेक वर्मा, न्या स:
PER VIVEK VARMA, JM:

The Cross Appeals have been filed by the department and the assessee against the order of CIT(A) 15, Mumbai, dated 25.08.2010. For the sake of brevity and convenience, we passing a common and consolidated order.

ITA No. 7641/Mum/2010: (Appeal filed by the department):

2. The department has raised the following grounds of appeal:

"1. Whether on the facts and in the circumstances of the case and in Law, was the Ld. CIT(A) justified in concluding that M/s. Cadbury India Limited has received several benefits on account of payment of Technical Knowhow Royalty and whether the Ld. CIT(A) was justified in concluding that Royalty for Trademark at 1% and Technical Knowhow at 1.25% for ht entire FY 2001-02 is at Arm's Length.

2. Whether on the facts and in the circumstances of the case and in Law, was the Ld. CIT(A) justified in treating 50% the expenses incurred on Architect & Interior Design amounting to Rs. 21.94 Lacs and expenses incurred on Supply & Installation of Electrical Items amounting to Rs. 14.44 Lacs as Revenue"?

3. The facts in brief are that the assessee is in the business of manufacture, distribution and marketing of malted food drinks, cocoa powder, chocolates, toffees, drinking chocolates and sugar confectionaries. The assessee, having its head office at Mumbai, is having its factories at Thane, Induri and Malanpur and marketing offices located at Delhi, Chennai, Kolkata and Mumbai.

4. The assessee is a subsidiary of M/s Cadbury Schewepps PLC, U.K. Cadbury group has presence in more then 200 countries and it enjoys the distinction of being world's third largest soft drinks company in sales volume and is among the fourth largest confectionary company in the world.

5. Cadbury India Ltd., the assessee entered into certain international transactions with its Associated Enterprises (AEs), which are as follows:

S No.	*Name of the Associated Enterprise (AEs)*	*Country of tax residence of AEs*	*Nature of relationship*	*Description of transaction with AEs*	*Amount Received/receivable paid/payable as per books of accounts (Rs)*
(1)	***(2)***	***(3)***	***(4)***	***(5)***	***(6)***
1	*M/s Cadbury International Limited*	*U.K.*	*92A(2)(b)*	*(i) Purchase of CDM Flavor oils* *(ii) Cocoa buying service charges*	*277,238* *3,460,441*
2	*M/s Cadbury Schweppes Pty Limited, Australia*	*Australia*	*92A(2)(b)*	*Purchase of Cocoa beans*	*1,243,244*
3	*M/s Cadbury confectionery,*	*Malaysia*	*92A(2)(b)*	*Purchase of chocolates*	*10,110,412*

	Malaysis Sdn. Bhd, Malaysia				
4	*M/s Cadbury (Pty) Limited, South Africa*	*South Africa*	*92A(2)(b)*	*Purchase of Chocolates*	*1,047,364*
5	*M/s Cadbury Middle East FZE, Dubai, United Arab Emirates*	*United Arab Emirates*	*92A(2)(b)*	*Sale of Chocolates and malted food drinks*	*4,343,153*
6	*M/s Cadbury Schweppes Overseas Limited, UK*	*U.K.*	*92A(2)(a)*	*(i) Royalty for the use of Trade Mark* *(ii) Royalty for technical know-how*	*63,668,247* *56,624,003*
7	*M/s Cadbury Schweppes Plc., UK*	*U.K.*	*92A(1)(a)*	*Payment of ERP license and maintenance fees*	*3,601,240*

The issue of ALP was referred to the TPO u/s 92CA with regard to transactions relating to Royalty for the use of trademarks at Rs. 6,36,68,247/- and Royalty for technical knowhow at Rs. 5,66,24,003/-

6. With regard to Royalty on technical knowhow, it was found that the assessee had entered into an agreement with its parent AE on 09.03.1993, with the approval(s) of SIA, Government of India, which were granted at various points of time.

7. According to the agreement, the assessee shall pay Royalty at 1.25% of internal sales and exports (Net sales), against which the parent AE shall supply and disclose and make available to CIL (Indian Co.) all knowhow, advice and assistance at all such time that may be mutually agreed between the parties.

8. The TPO, gathering information from other Cadbury units across the globe required the assessee to submit a reply, as to why 1% of gross sales be not taken to be at arm's length instead of 1.25% taken by the assessee in the case of technical knowhow.

9. Looking into the facts of the case, the TPO found out that the assessee has used TNMM for computing ALP of the International transactions by comparing the net margin of the company at entity level, with that of companies engaged in food products, beverages and tobacco business. According to the TPO transactions pertaining to

payment of Royalty is not separately and independently benchmarked. He further noted that companies identified by the assessee company i.e. DFM Foods Ltd., Bakeman Industries Ltd., Modern Food Industries (India) Ltd., Parrys Confectionary Ltd and Ravalgaon Sugar Farm Ltd., did not pay any technical fee/royalty. According to him, these companies could not be used in the analysis for benchmarking the royalty payments. Since the total sales of the company is at Rs. 645 crores and international transactions pertaining to this segment is only 14.50 crores, being only 2.24% would not effect the profitability, if the ALP is to be determined at TNMM at entity level. According to the TPO, the most appropriate method, therefore, would be CUP because all other comparables, as supplied by the assessee, either developed their own technology, or they had acquired the technology long back and are no more paying for the transfer of technology. This, in the case of the assessee is not the case, because, the assessee company, i.e. Cadbury India Ltd., is required to pay royalty to its parent AE, CSDL, for the continuous upgradation of technology.

10. The TPO, therefore, concluded that in the case of royalty on technical knowhow the ALP should be computed at 1% of sales, which comes to Rs. 4,52,99,207/- against 1.25% taken by the assessee at Rs. 5,66,24,003/-.

11. Similarly, the TPO computed royalty paid on trademarks, at Rs. 5,03,31,678/- in place of Rs. 6,36,68,247/- taken by the assessee.

12. Before the TPO, it was submitted this was the first year for the payment of royalty on trademark use, because, earlier, the payment was banned under FERA Rules.

13. After the prohibition was lifted, the assessee in the Board meeting held on 24.04.2001 authorized the company to pay the royalty on use of trademark at 1% of the net sales value, w.e. from April 2001.

After getting the approval from the Reserve Bank of India (RBI) an agreement was entered into between Cadbury Limited, Trebor Bassett Limited, Cadbury Scheweppes Overseas Ltd. and Cadbury India Ltd., on 12.02.2002, according to which Cadbury and Trebor granted Cadbury overseas the exclusive rights to distribute its products and use the trademarks and technical information throughout the territory. The said agreement provided *"that Cadbury Overseas hereby grants to company and the Company hereby accepts the exclusive non transferable licence to manufacture, market and sell the products under the Cadbury Trade Marks and Trebor Trade Marks in the territory in accordance with the technical information and specifications".* Herein territory meant India, Nepal, Bangladesh, Bhutan and Sri Lanka.

14. According to the TPO, the agreements seemed to be overlapping, therefore, he asked the assessee to submit the information regarding payments received by CSOL from all group companies. The company vide its letter dated 04.02.2005 submitted the copy of email sent to it from CSOL, which is as under:

S No.	*Overseas Company*	*Territory*	*Royalty rate/ Fee Net Basis*	*Type of Agreement*
(1)	***(2)***	***(3)***	***(4)***	***(5)***
1	*Cadbury Adams Canada Inc.*	*Canada & Export Territory*	*2.50%*	*Trade mark licence- Exclusive & transferable*
2	*Cadbury Food Co. Ltd., China*	*Not specified but excludes exports*	*3.5%*	*Trademark licence sole non-transferable rights*
3	*Cadbury Egypt S.A.E.*	*Republic of Egypt Export territories listed*	*2%*	*Trade mark licence exclusive*
4	*Cadbury France*	*France and such other territories*	*2.00%*	*Trade mark licence*
5	*Cadbury Ghana Limited*	*Ghana*	*2.00%*	*Combined technical services & trademark user agreement*
6	*PT Cipta Rasa Primatama*	*The Republic of Indonesia*	*2.50%*	*Trade mark licence – Exclusive & non-transferable*
7	*Cadbury Kenya Limited*	*Kenya, Uganda and Tanzania and any other territories*	*2.00%*	*Trade mark licence*
8	*Cadbury Confectionery Malaysia SDN BHD*	*East & West Malaysia & Brunei & such other territories*	*2.00%*	*Royalty technical information and trade mark licence agreement – exclusive & non-transferable*
9	*Cadbury Nigeria plc*	*Nigeria*	*2.00%*	*Trade mark licence*
(1)	***(2)***	***(3)***	***(4)***	***(5)***
10	*Cadbury Poland Sp zo.o*	*Poland*	*2.5%*	*Trademark licence-*

				exclusive and non-transferable
11	*Dlrol Cadbury LLC*	*Russia plus named export territories*	*3% for confectionery ***	*Trade mark licence exclusive and non-transferable*
12	*Cadbury Dulciora SA*	*Spain and such other countries*	*3.00%*	*Trademark licence and non-transferable*
13	*Crystal Candy (PVT) Limited*	*Zimbawe and such other territories*	*2.00%*	*Trade mark licence exclusive & non-transferable*
14	*Cadbury Nigeria plc*	*Nigeria*	*2.00%*	*Technical Service Agreement*

15. From the chart, the TPO inferred that royalty on trademarks usage is 2% but the assessee company is paying the royalty between 1 to 2.5% and the average on the above comes to 2.32%. The issue was put to the assessee who replied,

> *"The company contended that, "Technical Assistance and Royalty Agreement was approved by Govt. of India, Ministry of Industry, vide letter dated 14.09.2000. The rate of royalty payable as per approval letter was authorized at 1.25%. The comparability of international transaction of payment towards technical assistance can also be judged with reference to the laws and government orders In force [Rule 10B(2)(d)]. Accordingly, under the facts of the case, the payment towards technical assistance to SQL can be said to comply with the Arm's Length Princiole."*
> *The company submitted the copy of application dated 30.04.2001. addressed to the General Manager, Reserve Bank of India, Exchange Control Department, Regional Office, Mumbai, for automatic approval for payment of royalty towards trademarks to Cadbury Schweppes Overseas Limited, U.K. In the application, it is mentioned that "the trademarks belonging to Cadbury Schweppes Overseas Limited, U.K. In the application, it is mentioned that "the trademarks CADBURY and several other trademarks belonging to CSOL are used by us on our chocolate, drinking chocolate, malted foods and sugar confectionery products which are being manufactured and sold by our company in India and certain other countries. It requested to issue the automatic approval effective 01.04.2001". The Reserve Bank of India, Exchange Control Department, vide letter dated 25.06.2001, has given the approval to enter into Technical Collaboration for manufacture/use of trademarks. The Press Note No.9 (2000 series), of the Government of India, Ministry of Commerce & Industry, Department of Industrial Policy & Promotion (SIA) allowed payment of royalty upto 2% for exports and 1% for domestic sales under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer.*
> *From the above, it is seen that the approval was sought by the company and granted by the Reserve Bank of India, under the Exchange Control Policy of the Government of India. The branding fee payment, as a general rule is allowed by a Press Note No.9 issued by Ministry of Commerce and Industry. This approval indicates that such payments are not prevented or blocked by the Government, considering the present Exchange Control Policy. There is no intervention from the Government for such payments considering the Exchange Control Policy, but such transaction satisfies the principles of Arm's Length or not is not the concern or within the jurisdiction of the Reserve Bank of India. This requires to be decided as per the provisions of Income Tax Act, 1961. The payment should satisfy the provisions of the Act, separately and independently, irrespective of the allowability of payment as per Exchange Control Policy. Similar is the view of Tax Administration of most of the countries. The Guidelines of Tax Administration of France, on the issue, refers to "please note, finally, that, although the authorization given by the Ministry of Industries or by any other technical department, with respect to the rate of a royalty or of the amount*

which may be transferred abroad, is not binding on the tax administration, the Inspector, nevertheless have regard to it (source IBFD Publications)'

The company also cited CBDT Circular No.6-P, dated 06.07.1968 and the decision of Pune ITAT, in the case of Kinetic Honda Motor Limited vs. Jt. CIT [77 ITD 396), in support of Its contentions. The Board's Circular and the decision are gone through. The circular as well as the decision of ITAT, Pune, deals with payments covered u/s.40A(2)(b) of the I.T. Rules, 1962 Hon'ble Tribunal referred to the Circular No.6-P, dated 06.07.1968 and observed that, when payments are approved by one wing of the Government, there is no question of such payments being treated s excessive or unreasonable having regard to legitimate business needs. The Tribunal's decision deals with the remuneration of director of a company approved by Company Law Board. In the present case, as discussed above, the approval by the Reserve Bank of India cannot be considered as an approval for making payments at Arm's Length. The approvals from the Foreign Investment Promotion Board/SIA/RBI, are for the purpose of satisfying the requirements of Foreign Exchange Regulations. In all the applications, the companies were required to justify the payments in Foreign Exchange, by indicating, how the country will be benefiting by the Net Foreign Exchange earning in the arrangements. These approvals are for checking the effect of agreements on the Foreign Exchange Reserve of the country.

Due to this, the contention of the company that, the agreement is approved by the Reserve Bank of India, on its own, does not support the Arm's Length nature of the payment, accordingly, rejected.

(ii) It further contended that, "The Transfer Pricing Regulations introduced in India requires complying with Arm's Length Principle by testing the controlled transactions with that of comparable uncontrolled transactions. In other words, it is respectfully submitted that transactions entered into inter-se between associated enterprises-controlled transactions cannot be applied to test the compliance with Arm's Length principle".

16. The TPO rejected the reply of the assessee, observing that controlled transactions cannot be used for computing ALP, as per OECD guidelines in para 1.70, which classified,

"... that evidence from enterprises engaged in controlled transactions with associated enterprise may be useful in understanding the transactions with associated enterprise may be useful in understanding the transaction under review or as a pointer to further investigation. The dealings between associated enterprises, for comparison, can also be used in the cases of last resort where:

(i) There is sufficient data available to demonstrate their reliability.

(ii) Related party comparable data provides the most reliable available data upon which to determine or estimate an Arm's Length outcome.

(iii) In the FMCG Sector, most of the big companies in India, are part of Multi-National Enterprises, and their transactions would certainly be the controlled transactions. There would be very few companies, in the FMCG Sector other than MNCs, wherein, any royalty is paid by them to unrelated parties. The details regarding any such company could not be found on the website of SIA/RBI "www.siadipp.nic.in/publicat/newsltr" meaning thereby in FMCG sector, such royalty payments are not approved".

Considering the above and as the information regarding payment of royalty by the Cadbury Group entities to CSOL is available, the same is used as a bench mark to decide the Arm's Length rate of royalty and the contention of the company is rejected".

"The company, itself, vide letter dated 20.01.2005 submitted the meaning of the term "Trademark" in the commercial parlance, the same is reproduced below

"a market place device by which consumers identify good and services and their source. In the context of trademark nomenclature, it is that the consumers will make future purchase of the same goods and services."

"Trademark recognition develops from years of customer service, consistent packaging, and quality control. Depending on the strength of a trademark, the

maintenance of the desired consumer awareness level generally requires significant, continuing advertising investment."

In the case of company, Cadbury India is investing huge amounts in Advertising Campaigns; therefore, It is Cadbury India, who is building the brand value, without commensurate compensation from CSOL. Due to these reasons, it would be more appropriate, to club the payments made for two agreements and compare the same with the payments made by other affiliated companies.

(iv) Cadbury India argued that, "the company in conformity with the regulations and the guidelines, benchmarked the payment of brand fees by application of TNMM. The TNMM method was applied by comparing the margin earned by comparables independent enterprises. As per the said analysis, the net profit margin of the company is within the range of the margins earned by comparable companies. Accordingly, under the facts of the case, the payment towards technical assistance can be said to comply with the Arm's Length Principles/'

The assessee has used Transactional Net Margin Method for computing the Arm's Length Price of the International Transactions by comparing the Net Profit Margin of the company :at entity level with that of other companies engaged in Food Products1 Beverages and Tobacco Business. The transaction pertaining to payment of Royalty is not separately and independently benchmarked. The company has identified DFM Foods Ltd., Bakemans Industries Ltd., Modern Food Inds. (India) Ltd., Parrys Confectionery Ltd. and Ravalgaon Sugar Farm Ltd. From the Prowess/Capitaline Database, it is seen that none of these companies are paying any technical fees/royalty. Therefore, these companies cannot be used in the analysis for benchmarking the royalty payments. The total sales of Cadbury India Ltd. is nearly Rs.645 crores and all international transactions, are of value of 14.50 crores, which is only 2.24% of the turnover. The use of Transactional Net Margin Method, at entity level, for benchmarking such a small transaction, will not be the most appropriate method, because, such a transaction does not in a big way affect the profitability of the company. In the present case, the data regarding comparable, though controlled transactions are available, and therefore, Comparable Uncontrolled Price method is the most appropriate method".

"The total royalty worked out by the company is Rs.63,668,246/-. The company was asked to submit the working of royalty as per Press Note No.1 (2002 Series), issued by Secretariat for Industrial Assistance, Government of India. As per this Press Note, the formula for calculation of royalty for the use of trademark and brand name is:

"Royalty on brand name/trade mark shall be paid as a percentage of net sales, viz., gross sales less agents/dealers' commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts, components imports from the foreign I/censor or its subsidiary/affiliated company."

The company submitted the working for the same in Annexure 4 of the letter dated 11.02.2005. The revised royalty payment works out to Rs.61,840,438/-

Tax Deduction:

The chronological events leading to payments of this royalty are

(i) Date : 26.04.2001 - Cadbury Board passes the resolution for payment of royalty w.e.f. 01.04.200 1.

(ii) Date : 30.04.2001 - Application made to RBI for approval of royalty payment.

(iii) Date : 25.06.2001 - Date of approval of Exchange Control Department of Reserve Bank of India, providing approval to enter into technical collaboration, for use of trademarks. As per the approval, the duration of agreement will be 10 years from the date of agreement or 7 years from the date of commencement of commercial production whichever is earlier.

(iv) Date : 12.02.2002 - Trademark License Agreement made, though commencement date Is mentioned at 01.04.2001.

The royalty could not have been paid without the approval of RBI, therefore, the company was asked to submit objection to the intention of this office to compute the royalty for Tax Deduction purpose, for the period of 25.06.2001 to 31.03.2002 only. The company submitted that, the Reserve Bank of India, after considering the application of the company, approved payment of trademark royalty from 01.04.2001. The application of the company made to RB! is gone through, wherein, the company requested to issue automatic approval effective 01.04.2001 so that the payment can commence from that date. The approval of

RBI, does not refer to effective date of payment, therefore, the royalty for the period of July, 2001 to March, 2002 only, is allowable as Tax Deduction for the year. For these months, the Brand Royalty is computed at Rs. 51,819,324/- and the same worked out as per the computation provided in Press Note No.1 amounts to Rs. 5O,331,678/-".

He, therefore, computed the royalty payment on trademark usage at Rs. 5,03,31,678/-.

17. The TPO, therefore, suggested a net adjustment of Rs. 2,46,61,370/- on payment of both kinds of royalties, i.e. royalty on technical knowhow and royalty on trademarks as:

S. No.	***Transaction***	***As per books***	***ALP as per TPO***	***Difference***
1.	*Royalty on tech. knowhow*	*5,66,24,003*	*4,52,99,202*	*1,13,24,801*
2	*Royalty on trade marks*	*6,36,68,247*	*50,33,678*	*1,33,36,569*
	Total	***12,02,92,250***	***9,56,30,880***	***2,46,61,370***

18. The AO, in accordance with the above, made addition to the tune of Rs. 2,46,61,370/- to the income of the assessee.

19. The assessee approached the CIT(A), before whom the assessee reiterated its submissions made before the TPO/AO. The CIT(A) on examining the submissions, made proposal for enhancement for disallowing the entire payment of royalty on trademark usage technical knowhow at 1.25%, as the same were not wholly and exclusively incurred for the purpose of the appellant's business.

20. On receipt of the show cause notice for enhancement, the assessee gave a detailed reply with regard to the genuineness and correctness of royalty payments on both counts. The CIT(A), on receipt of the detailed submission from the assessee held,

> "Based on the submissions filed on record, explanations provided from time to time, documents evidencing provision of technical know-how, I am satisfied that the Appellant has received several benefits on account of payment of technical know-how royalty and the same have been evidenced by supporting documents"

21. On observations with regard to brand ownership, the CIT(A) held,

> *"5.7 The Appellant, has submitted that the Overseas AEs have merely granted the Appellant, the rights to use the trademarks and all the rights with regard to decision making on licensing / exploitation / sa1e of trademarks,*

maintaining the trademarks, protecting the trademarks etc continues to lie with the Overseas AEs.

Extracts from The Report on the Attribution of Profits to Permanent Establishments dated 17 July 2008 issued by the OECD were brought to my attention that defines, economic ownership' in the context of Article 7, as under:

"The economic ownership over an intangible asset relates to the ongoing contribution and investment in the property to maintain the development and value of the intangible. This is generally evidenced by marketing expenditure but is not limited to this. It also relates to the exertion of practical control over the intellectual property and hence decision making with respect to the use and exploitation of the asset. In respect of trademarks for example, while expenditure for promotions and advertising may be contributing to the value of the asset through promotion of the brand this may not be sufficient of itself to demonstrate economic ownership of the asset."

In this regard, the Appellant submitted that the economic ownership over an intangible asset could relate to the ongoing significant contribution and investment in the intellectual property to maintain and .develop the value of .the intangible. Thus, the economic owner must have the rights to use and exploit the asset in the first instance. Thereafter the extent to which the exploitation and economic control over the intellectual property is possible subject to the legal contractual relationship between the two parties which governs the terms and conditions.

The Appellant explained that Overseas AE is the intellectual property owner of the trademarks and without access to this trademarks, the Appellant would be unable to exploit the intellectual property in the Indian market. With respect to the exploitation of the intellectual property, it was submitted that the Appellant has merely been granted the right to use the trademarks on the licensed products manufactured in accordance with the prescribed specifications. The Appellant thereafter undertakes marketing and selling of the products using the brand "Cadbury".

It was further explained that economic and commercial value of, a 'brand' is typically driven by the income-stream it generates. However, the Appellant has merely contributed approximately 1% of the total sales of CSOL over the years from 2001-2008. This clearly indicates the Appellant has hardly contributed to the total group turnover and hence it cannot be termed as the economic owner of the 'Cadbury' brand. In fact, it is because of the global brand that it represents that the Appellant has been able to capture approximately 75% of the market share. It was also stated that while Cadbury has been in India from 1948, the brand per-se has been in existence since 1824 and it was a well developed brand even before it was introduced in India.

5.8 Advertisement expenses incurred by the Appellant

With respect to the advertisement expenditure incurred by the Appellant, it was submitted that marketing expenditure in itself is insufficient for a claim to economic ownership over an asset.

The Appellant has contended that it is in the business of manufacturing and distribution of chocolates, sugar confectionery and malted food drinks in India based on the technology licensed by Overseas AEs, and in this regard, it incurs various business related expenses inter-alia for undertaking advertisements for the creation of "product" awareness of new products and recall value of existing product portfolio in the minds of its customers.

It was further stated the advertising expenditure is typically incurred by the Appellant for the purposes of;

a) Increasing sales of existing products by continuously reminding the customers of its products especially in case of a end in sales or when competitors launches new products / advertisement campaigns such as Kit Kat, Munch, Eclairs etc

b) Counte ring competition / acting as entry barriers for new players eg. Lindt, Mars etc

c) Informing consumers of its new product launches such as Bournville, Cadbury Silk, etc

d) Creating awareness of discounts offered on various products at a particular point of time

e) Creating a recall value of chocolates (as an alternative to Indian sweets) on festive occasions such as Diwali, New Year, Holi etc

f) Reaching out to rural markets for its low cost products
g) Marketing its health drinks/ nutraceutical products (Bournvita)
The Appellant has also placed on record sample copies of the advertisement mandates provided to the advertising agencies which evidence the objective and desired outcome of the advertising to be achieved.
It has been contended that advertisements are largely undertaken to create "product recall", "popularize products in the market" "counter competition" etc. It was reemphasized based on the advertising mandated filed by the Appellant, that creating "brand" awareness was not the objective of the advertisements since "Cadbury" brand is already well known respected in India.
It has been submitted that the Overseas AEs provide strict brand guidelines so as to ensure that the overall strategy and vision associated with the brand is adhered to by the Appellant in India. The appellant has also submitted the copy of branding guidelines before me to corroborate the above.
It has also been highlighted by the Appellant that while the increased sales may have benefited the. Overseas AEs by way of increased royalty at 1% on the incremental sales, the same is insignificant as compared to the incremental quantum of profits earned by the Appellant on the increased sales and the taxes paid thereon to the Indian Government Treasury.
The Appellant has contended that the correct way of looking at royalty payment is to see the turnover achieved by the Appellant as a result of the license. It has been contended that the payment of Rs 635.68 lakhs to achieve a turnover of Rs 63,606.53 lakhs and to realize the net profit of Rs 8,892.88 lakhs is certainly reasonable and at arm's length.
Further the Appellant has also highlighted that that the advertisement and marketing efforts undertaken by the Appellant, for promoting the sales of its products in India, does not benefit the Overseas AEs directly, as they are not involved in the business of manufacture/ trading of such products in India either on its own or through any of its other subsidiaries. Hence, the entire advertisement and marketing expenses incurred are purely for its own, benefit and no direct benefit accrues to Overseas AEs as such.

5.9. With respect to points raised by me during the appellate proceedings on the ruling of the AAR in case of Fosters Australia Ltd, the Appellant submitted that even the AAR and the Revenue department, in the case of Fosters Australia Limited had accepted that the owner of the trademark and the technology was Fosters Australia, overseas company and that the Indian company was only licensed the trademark and technology for its usage. Accordingly, it is submitted that considering the decision of the AAR in the case of Fosters Australia, the Appellant cannot be considered as the economic owner of the trademark Cadbury".

22. The CIT(A) also took into consideration the AA Ruling in the case of Fosters Australia Ltd., where Fosters Australia was the owner of the trademark and technology and the Indian company was the licensed user. In the decision, it was held that the applicant cannot be considered as the economic user of the trademark. Before the CIT(A) the assessee also relied on certain third party agreements and other group companies, wherein terms and conditions, assigned in the agreements were similar. The assessee placed the copy of agreement with Harshey Food Corp. US, who had been given right to produce, market, advertise, promote, sell and distribute Cadbury licensed products under the trademark of Cadbury UK. It was also argued that the group companies and third parties to whom license has been

granted are legally obliged to incur marketing/advertising expenditure while paying Royalty to the licensor and none of these partners' had faced any TP adjustment on the issue of royalty payment to the overseas AE, while undergoing TP audits.

23. The CIT(A), while examining the detailed arguments held,

6.5. The appellant had benchmarked its Royalty for trade mark and technical know how under the TNMM. Its operating margin on operating revenue came to 13.28% whereas those of its comparables in confectionary industry came to 2.17% only. TNMM is a profit based method. A royalty rate for the related party is determined indirectly by selecting a royalty rate that would give the licensee post royalty operating profits that are similar to what an unrelated party would earn by using the intangibles.

The theoretical basis of the TNMM takes the stance that, if intangible property is contributing to an entity nature, the entity will earn profits in excess of what could be observed in the absence of such intangible property. Applied to the facts of this case, the appellants 13.28% margin vis a vis average margin of comparables at 2.17% clearly establishes that the intangible property (Trademark and Technical Know How) has contributed to its excess profits. The TPO has no objection to the selection of comparable companies for benchmarking but has taken the stand that since they (comparables) are not paying trademark royalty and technical know how fees, hence cannot be used for benchmarking this transaction lacks force. In fact what distinguishes the appellant (Cadbury) from its competitors in the chocolate & confectionary market is its valuable brand name backed by the high quality products and it is this crucial factor that gives it a tremendous competitive advantage translating into an operating margin of 13.28% despite huge turnover. In the absence of such intangible property the comparables average is languishing at 2.17% only. This huge gap justifies the 2.25% payment by the appellant to its AE. There is a direct co-relation between Cadbury's "intangible capital" and its performance.

6.6. As regard the issue of period of royalty payment based on the submissions filed before me and the explanations provided, and reviewing the chain of events, I am of considered view that the Appellant always intended to pay brandname royalty from 1 April 2001 and the same was accordingly stated in its application to the RBI. The payment of brandname royalty was approved by the RBI and RBI has not raised any question on the effective date of royalty payments. It is merely that the Appellant received the RBI approval at a subsequent date. This would however not change the effective date of payment, approved by the RBI and hence the same is allowed.

6.7. To sum up the appellant has demonstrated that the royalty payment for trade mark and know how meets the Arms Length test under TNMM. It has backed it with CUP method including third party comparables like HERSHEY, unrelated third parties in Asia to whom license has been granted. It also demonstrated that its advertisement, marketing and promotion expenses are at par with other in the same line of business. Hence, for reasons recorded as aforesaid and after taking into account all facts and circumstances the royalty for trademark at 1% and technical knowhow 1.25% for the entire F.Y. 2001-02 is considered to be at Arms Length. The consequent addition of Rs. 11,13,24,801/- for technical know how and Rs. 1,33,36,564/- for Trade marks so made is deleted".

24. The CIT(A), not only dropped the enhancement proceedings, he deleted the addition made on account of TP adjustment.

25. Against this decision, the department has filed the appeal before the ITAT.

26. Before us, the DR submitted that the revenue authorities picked up two of the other international transactions, which really pertained to Royalty payment for technical knowhow and use of trademarks. It has been submitted that royalty on technical knowhow was being paid by the assessee company to its parent AE since the signing of the agreement dated 19.03.1993 which was valid upto 08.03.2000, which was extended by SIA vide approval upto 08.03.2000, which was extended by SIA vide approval upto 14.09.2000. He further submitted that since agreement dated 20.12.2000 upto present date, the assessee company has been paying royalty on technical knowhow at the rate of 1.25%. This is being in accordance with the agreements signed on various dates.

27. He further submitted that the assessee started to pay royalty on use of trademark after taking approval of the Board of Directors on 26.04.2001 and consequential approval by the RBI. It was submitted that the assessee had been paying royalty from 12.02.2002 to its parent AE.

28. The DR, advancing the objection made by the TPO submitted that the agreements entered into by group companies in other parts of the world had been paying composite royalty, which came to 2%, whereas, the assessee had been paying royalty ranging between 1% to 1.25% and that the agreements entered into by the assessee company and its parent AE have overlapping clauses, pertaining to the payment of royalty on technical knowhow and trademark usage.

29. Besides this objection, the DR submitted that in the course of proceedings before TPO, the TPO raised the issue of payment of AMP, which had been left without any comments, in respect of computation of ALP.

30. The DR also submitted that CUP method would be most suitable method, as there are no segment wise data available. The DR further submitted that the assessee brought on record fresh agreements, which have not been seen by the AO/TPO along with AMP issue and for this reason, the issue deserves to be restored to the AO who shall reexamine the issue afresh.

31. The Senior Counsel appearing on behalf of the assessee responded that in so far as the royalty on technical knowhow is concerned, 2% has been accepted in the case of the assessee over the years. He further pointed out that as per the data placed before the TPO and then before the CIT(A) the average royalty received by the parent AE from global entities is coming to 2.32% (as recorded by the revenue authorities in their orders). According to the Senior Counsel, even the guidelines issued by OECD is at a higher percentage at 2.25%, therefore, the royalty paid to the parent AE is well within the prescribed limits and therefore, no AL adjustment is called for. Similarly, the royalty payment on trademark usage, at 1% is well within the arms length and has been continued from the preceding year.

32. On the issue of AMP issue, the Senior Counsel submitted that since the issue was never before the TPO, the enhancement proceedings as initiated by the CIT(A) were dropped, after being fully satisfied.

33. The Senior Counsel placed reliance on the decision of Lumax Industries Ltd. vs ACIT, in ITA No. 4456/Del/2012, wherein the coordinate Bench at Delhi has accepted TNMM on royalty payments. He submitted that the case law relied upon by the DR, wherein the ITAT rejected TNMM and restored the issue to the file of the AO, does not have any relevance, when a definite finding from the coordinate Bench is there.

34. He further relied on the decision in the case of ITO vs Industrial Roadways, reported in 112 ITD 293, wherein the coordinate Bench at Mumbai held, "*that if additional evidence furnished by the assessee before the first appellate authority is in nature of a clinching evidence, leaving no further room for doubt or controversy, in such a case no useful purpose would be served by following evidence/ material to AO to obtain report and in such exceptional circumstances, said requirement may be dispensed with"*. He therefore, submitted that there is no occasion for restoring the TP issue to the file of the AO to look into the issue of AMP, which is not impugned before us.

35. The Senior Counsel, therefore, submitted that the CIT(A) was correct in holding that the payments made under both the types of royalties were at arms length and no adjustment addition needs to be made.

36. The DR in the rejoinder submitted that the in the interests of justice the issue needs to be restored to the file of the TPO.

37. We have heard the detailed arguments from both the sides. The basic issue is the correctness of ALP on the royalty payments made by the assessee company to its parent AE on account of technical knowhow and trademark usage.

38. From the arguments of the DR, made on behalf of the TPO, the agreement for paying royalty on technical know how at 1.25% and trademark usage at 1.25%, were overlapping and thus, TNMM method used by the assessee was incorrect. According to the TPO, the best method to ascertain ALP in the interest case was CUP, as the transactions were controlled. This was reasonable, as no data was available from independent source to benchmark the transactions.

39. On going through the records and the orders of the revenue authorities, we find that in so far as the payment of royalty on technical knowhow concerned, the assessee has been paying to its

parent AE right from 1993, as, other group companies are paying across the globe. It has been accepted by the TPO that the payment does not effect the profitability of the assessee, if we are to examine the issue from that angle as well. In any case the payment of royalty on technical knowhow is at par with the similar payments from the group companies in other countries & region. Besides this, the payment is made as per the approval given by the RBI and SIA, Government of India. Hence there cannot be any scope of doubt that the royalty payment on technical knowhow is not at arms length.

40. Coming to the issue of royalty payment on trademark usage, we find that the assessee, in fact is paying a lesser amount, if the payments are compared with the payments towards trademark usage, by the other group companies using the Brand Cadbury in other parts of the world. On the other hand, if we examine the argument taken by the TPO with regard to OECD guidelines. On this point the assessee's payment is coming to a lesser figure, as discussed in detail by the CIT(A).

41. We are not going into the arguments advanced by the DR/TPO on geographical differences, and payments made to Harshey, as these arguments gets merged in the interpretation and details available in the table supplied by the assessee and taken note of by the TPO and the CIT(A).

42. We are also not referring to the case of Maruti Suzuki Ltd. as we find that in so far as the instant case is concerned, there is really no relevance.

43. On the basis of the above observations, we are of the opinion that the royalty payment on trademark usage is within the arms' length and does not call for any adjustment.

44. We, therefore, sustain the order of the CIT(A) and reject the grounds as claimed by the department.

45. Ground no. 1 as raised by the department is rejected.

46. Ground no. 2 pertains to domestic issue, wherein the CIT(A) allowed the 50% of expenses incurred on renovation of office complex and other expenses pertaining to electric installation, treating the same to be revenue.

47. The facts are that the assessee undertook refurbishing of the Cadbury House and claimed an aggregate expense of Rs. 2,39,38,000/-, which is as under:

Party Name	***Description***	***Amount (Rs.)***
Dalal Consultants	*Upgradation of Cadbury House*	*21,73,793*
Dalal Consultants	*Upgradation of Cadbury House*	*5,73,924*
Nitin Parulekar Architects	*Architects, interior design work*	*88,860*
Hitesh Shah & Associates	*Plumbing/removing window frams/debris, etc.*	*30,160*
Hitesh Shah & Associates	*Plumbing/removing window frams/debris, etc.*	*30,160*
Hitesh Shah & Associates	*Fixing Ms Steel support/bamboo scaffolding*	*29,040*
Roshan Electrical Contractor	*Supply & Installation of electrical items*	*14,44,694*
Interscape	*Civil, Exterior and Plumbing works*	*1,60,63,652*
S.R. Network	*UTP CAT 5 cable/connectors/cords/cabling work*	*10,45,103*
Geeta Network	*Repairing with upholstery work Board rooms chairs*	*34,240*
Geeta Network	*Repairing with upholstery work /Dir Chairs/Meeting room chairs/staff chairs*	*99,720*
Neutron Electronics	*Reinstallation charges NEC-M-100*	*50,000*
	TOTAL	***2,39,38,000***

48. The assessee in its submissions before the AO claimed that in fact the repairs, renovation, refurbishing, plumbing expenses and architects fee was much higher and much more. The assessee had *suo moto* capitalized all the expenses, which were in the nature of capital.

49. The AO disallowed the entire expenditure, claimed as revenue by the assessee. The AO observed in the assessment order that *"the whole exercise has resulted into the additional utilizable space and long term increase in the value and strength of the building. The items claimed as revenue expenditure are part and parcel of the total expenses incurred on renovation and therefore, only a part cannot be said as capital*

expenses and remaining as revenue expenditure, therefore, the entire expenditure is disallowed as capital expenditure and 10% depreciation is allowed". He, therefore, added back Rs. 2,15,44,200/- (Rs. 2,39,38,000 0 Rs. 23,93,800/-).

50. The assessee approached the CIT(A), before whom the assessee reiterated its submissions. The CIT(A) taking into consideration the submissions placed before him, along with the evidence and details, pertaining to the issues of various renovation jobs, allowed benefit to the extent of 50% on the interior designs work at Rs. 21,94,800/- and supply and installation of electrical items at Rs. 14,44,694/-.

51. Against these allowances, the department is in appeal before the ITAT.

52. Before us, the DR submitted that the view taken by the AO was correct because the nature of renovation work is of enduring benefit and falls squarely within the capital field. On the basis of these arguments, the DR submitted that even the allowance of 50% by the CIT(A) was unjustified.

53. The AR on the other hand pleaded that the expenses incurred by the assessee are purely in the nature of repairs and maintenance and are allowable as revenue.

54. We have heard the arguments of the parties before us and area of dispute for our consideration is very limited, i.e. 50% allowance on the payment made to Nitin Parulekar Architects for interior design works at Rs. 21,984,800/- and payment made to Roshan Electric Contractors at Rs. 14,44,694/-.

55. The CIT(A) has allowed only 50%, though, on adhoc basis, the impugned expense, which according to us are quite reasonable.

56. We, therefore, sustain the order of the CIT(A) and reject the ground of appeal, as filed by the department.

57. Ground no. 2 is therefore, rejected.

58. In the result, appeal filed by the department is dismissed.

ITA No. 7408/Mum/2010: (Assessee appeal):

59. The following grounds have been raised:

"GROUND NO. 1- Expenditure incurred on rural development Rs. 1,07,891/-.

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the Additional Commissioner of Income Tax, Range 5(1), Mumbai ("the AO") of disallowing Rs. 1,07,891/-, being expenditure incurred on rural development in villages near the Appellant's factory, on the alleged ground that the said expenditure has no nexus with the business carried out by the Appellant without considering the fact that such expenditure incurred out of commercial expediency, it enhances the corporate image of the Appellant Company and also promote its business.

GROUND NO. 2: 8OHHC - Miscellaneous Income and Trade Discount Rs. 9944,920/- and Rs. 5,13,72,467/-

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the AO of treating miscellaneous income and trade discount as part of the total turnover for the purpose of computing deduction u/s. 8OHHC of the Act.

GROND NO. 3 : 8OHHC — Interest Rs. 6,47,94,044/-

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the AO of reducing 90% of the gross interest received while computing deduction u/s. 8OHHC of the Act on the alleged ground that there is no nexus between the two without netting off the same against interest paid.

GROUND NO. 4: Payment to Third Party Manufacturer Rs. 22,64,396/-

On the facts and in the circumstances of the case and in law the CIT(A) erred in not considering and directing the AO to allow the deduction of Rs 22,64,396/- being actual payment made to the Third Party Manufacturer on account of contractual obligation

GROUND NO.5: General

The Appellant craves leave to add, to alter and/or amend all or any of the foregoing grounds of appeal.

60. Ground no. 1 pertains to disallowance of Rs. 1,07,891/- on account of rural development.

61. The CIT(A) sustained the disallowance, following the order of his predecessor in the preceding year(s). We also find that the addition has been sustained by the coordinate Bench in the assessee's own case in assessment year 2001-02 in ITA No. 975/Mum/2005.

62. In the impugned order, we find that the assessee has placed reliance on the decision of CIT vs Madras Refineries Ltd., reported in

266 ITR 170 (Mad). This case has not been considered by the CIT(A), rather, the CIT(A) followed his predecessor's order. As a correct judicial propriety, the issue should be held against the assessee, following the order of the coordinate Bench in the preceding year, but the fact that the assessee factory is located in the village belts at Induri, near Mumbai and Malana, in Madhya Pradesh. The upliftment of these areas, though not directly relatable to the business of the assessee but is certainly a matter of good corporate governance through corporate citizen, which is encouraged by the government. This is what has been held in the case of Madras Refineries Ltd. (*supra*). It may not be out of place to mention, that in the case of Indian Rayon & Industries Ltd. (now known as Aditya Birla Nuvo Ltd.), (where one of us was a party to the decision), in ITA No. 5421/Mum/2005 have allowed a similar expense.

63. In these circumstances, in the interest of justice and the current need for being a better corporate citizen, the issue is restored to the file of the AO, who shall reexamine the nature of expense in the light of Madras Refineries Ltd. (*supra*) and Aditya Birla Nuvo Ltd. ITA No. 5421/Mum/2005 (*supra*) and allow the expense, if the assessee has incurred expenditure for upliftment of local village community, as a good corporate citizen.

64. Issues raised in Grounds No. 2 to 4 are dealt with and are covered by the various orders of the coordinate Benches of the ITAT, in the case of the assessee. Since the grounds are covered on identical issues, we for the sake of brevity are not deviating from the inferences drawn by the coordinate Benches.

65. Ground no. 2 pertains to Miscellaneous income and trade discounts amounting to Rs. 99,44,920/- and Rs. 5,13,72,467/-.

66. At the time of hearing, the AR pointed out that the issue is covered by the order of the coordinate Bench in ITA No.

957/Mum/2005 in assessment year 2001-02 in assessee's own case, wherein in para 6.1, it has been held,

> *"6.1 After hearing both parties, we find that this issue is covered by the decision of the Tribunal in assessee's own case in assessment year 1995-96 in ITA No.1641/M/2003 dated 8.10.2010. The Tribunal in the said year noted that the miscellaneous income which included trade discounts, miscellaneous sales, sales tax, excise duty etc. had to be included in the total turnover except the sales tax and excise duty which did not contain an element of turnover in view of the judgment of the Hon'ble Supreme Court in the case of CIT vs. Lakshmi Machine Works (290 ITR 667). The facts this year are identical. Therefore, we confirm the order of CIT(A) except in relation to sales tax and excise duty which will be excluded from the total turnover.*
>
> *7. The sixth dispute is regarding reduction of 90% of interest from profit of business as per Explanation (baa) while computing deduction under section 80 HHC. Assessee had received interest on FDRs, ICDs and others aggregating to Rs.5,21,04,545/-. The AO excluded 90% of the same from the profit of the business while computing deduction under section 80 HHC which in appeal was confirmed by CIT(A). Assessee has disputed the decision of authorities below to exclude 90% of the gross interest and not net interest income.*
>
> *7.1 We have heard both the parties, perused the records and considered the matter carefully. Earlier the Hon'ble High Court of Bombay in case of CIT vs. Asian Star Co. Ltd. (326 ITR 56) had held that 90% of gross interest has to be reduced from the profit of business as per Explanation (baa). However the said decision of the Hon'ble High Court has not been up held by the Hon'ble Supreme Court who in the case of ACG Associated Capsules Ltd. (343 ITR 89), have recently held that 90% of net receipts have to be reduced as per Explanation (baa). We, therefore, set aside the order of CIT(A) and hold that 90% of net interest income is required to be reduced after deducting expenses incurred having nexus with earning of interest income. The issue is thus restored to AO for working out 90% of net interest income after allowing opportunity of hearing to the assessee".*

67. The DR placed reliance on the orders of the revenue authorities.

68. We have gone through the orders of the revenue authorities and have also perused the order in ITA No. 975/Mum/2005 (*supra*). We find the issue is covered and we do not find any reason to deviate from the order in the assessee's own case. We hold accordingly.

69. Ground no. 2 is therefore allowed.

70. Ground no. 3 pertains to reduction of gross interest from the computation of deduction u/s 80HHC.

71. At the time of hearing, the AR pointed out that the issue is covered by the order in ITA No. 975/Mum/2005 in paras no. 7 and 7.1, which reads as under

> *7. The sixth dispute is regarding reduction of 90% of interest from profit of business as per Explanation (baa) while computing deduction under section 80 HHC. Assessee had received interest on FDRs, ICDs and others aggregating to Rs.5,21,04,545/-. The AO excluded 90% of the same from the profit of the business while computing deduction under section 80 HHC which in appeal*

was confirmed by CIT(A). Assessee has disputed the decision of authorities below to exclude 90% of the gross interest and not net interest income.

7.1 We have heard both the parties, perused the records and considered the matter carefully. Earlier the Hon'ble High Court of Bombay in case of CIT vs. Asian Star Co. Ltd. (326 ITR 56) had held that 90% of gross interest has to be reduced from the profit of business as per Explanation (baa). However the said decision of the Hon'ble High Court has not been up held by the Hon'ble Supreme Court who in the case of ACG Associated Capsules Ltd. (343 ITR 89), have recently held that 90% of net receipts have to be reduced as per Explanation (baa). We, therefore, set aside the order of CIT(A) and hold that 90% of net interest income is required to be reduced after deducting expenses incurred having nexus with earning of interest income. The issue is thus restored to AO for working out 90% of net interest income after allowing opportunity of hearing to the assessee".

72. On going through the order of the revenue authorities and the order of the Coordinate Bench in assessee's own case in assessment year 2001-02, we are of the opinion that for the sake of continuity and consistency the issue be restored to the file of the AO.

73. Ground no. 3 is allowed for statistical purposes.

74. Ground no. 4 pertains to payments of Rs. 22,64,396/- made to third party manufacturers.

75. The CIT(A) has followed the decision taken by his predecessor. In the order of the ITAT in ITA No. 975/Mum/2005, in the preceding year, the addition has been sustained, wherein it has been held in paras no. 3 and 3.1,

"3. The second dispute is regarding disallowance of provision for contractual liability towards 3rd party manufacturers/ convertors in relation to excise duty payable amounting to Rs.61,44,628/-. The assessee was is engaged in the business of manufacturing and sale of malted foods, cocoa based products including confectionary which were being manufactured at its own factory as well as under agreement with third party manufacturers/converters at their factories. In respect of products manufactured at company's own factory, excise duty is paid on the basis of company's wholesale trade price less permissible deductions in the nature of post manufacturing expenses (PME) incurred by the company on freight, octroi, additional sales tax etc. The third party manufacturers converters were initially paying excise duty on the products manufactured for Cadbury on the basis of cost of raw material, packing material and conversion charges which included third party manufacturers/converters' margin of profit. However, the excise authorities disputed the said basis of valuation and claimed that excise duty on products manufactured by third party manufacturers/converters is payable on the basis of Cadbury's whole sale trade price less PME. Accordingly, the excise department issued a show cause cum demand notice and directed the manufacturers/converters to pay excise duty on the basis of normal price worked out from the prices charged by the assessee company to their wholesale dealers. The said third party manufacturers/converters disputed the basis adopted by the Excise authorities for levy of excise duty and the said dispute became the subject matter of appeal before the Excise Duty Appellate Authorities. Although the primary liability to pay the excise duty was that of the third party

manufacturers/converters, the said excise duty liability was to be paid by the assessee company as per the agreements as and when was payable. Since the said dispute was not settled in the year under consideration, the assessee company retained the liability in respect of the disputed amount to the extent of Rs.61,44,628/- in view of its contractual obligations towards the third party manufacturers/ converters by reducing its sales to that extent and crediting the accounts of the third party manufacturers/converters. In the result, the sales were shown less to that extent in the Profit & Loss Account and in effect, deduction was claimed on account of provision for liability towards contractual obligation to the third party manufacturers/ converters in computing the total income which was disallowed by the AO following decision in earlier year. In appeal the CIT(A) has confirmed the disallowance following the appellate order in the earlier year, aggrieved by which the assessee is in appeal before the Tribunal.

3.1 After hearing both the parties, we find that this issue had been adjudicated by the Tribunal in assessment year 1994-95 in ITA No.282/M/00. In the said year, the Tribunal noted that the assessee was following mercantile system of accounting as per which contractual liability accrued on the date of its ascertainment and was allowable in the year of ascertainment. In this case, the liability was pending in dispute and therefore, the same had not been incurred during the year. Facts this year are identical and, therefore, respectfully following the decision of the Tribunal in the year 1994-95 (supra), we confirm the order of CIT(A)disallowing the claim".

76. As the facts are identical and the reasoning given by the ITAT is one the similar basis, we, therefore, following the order of the coordinate Bench in the preceding assessment year, confirm the disallowance.

77. Ground no. 4 is rejected.

In the result, appeal filed by the assessee is partly allowed.

To sum up:

Assessee's appeal in ITA 7408 of 2010 stands partly allowed

Revenue's appeal in ITA 7641 of 2010 stands dismissed.

Order pronounced in the open Court on 13th November, 2013.

Sd/-	**Sd/-**
(डि. करुनाकर राव)	**(विवेक वर्मा)**
लेखा सदस्य	**न्याईक सदस्य**
(D. KARUNAKARA RAO)	**(VIVEK VARMA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

मुमबई Mumbai, दिनाक Date: **13th November, 2013**

प्रति/Copy to:-

1) अपीलार्थी /The Appellant.
2) प्रत्यर्थी /The Respondent.
3) आयकर आयुक्त(अपील) -15, Mumbai / The CIT (A)-15, Mumbai.
4) The CIT-5,/Concerned _____, Mumbai,
5) विभागीय प्रतिनिधि "के" , आयकर अपीलीय अधिकरण, मुंबई/
   The D.R. "K" Bench, Mumbai.
6) गार्ड फाईल
   Copy to Guard File.

आदेशानुसार/By Order

/ / True Copy / /

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण, मुंबई
Dy./Asstt. Registrar
I.T.A.T., Mumbai

*चव्हान व.नि.स
*Chavan, Sr. PS

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

BEFORE SHRI G.D. AGRAWAL, HON'BLE VICE PRESIDENT
AND
SHRI A.D. JAIN, JUDICIAL MEMBER

ITA No.4456/Del/2012
Assessment Year : 2008-09

Lumax Industrues Ltd., B-85/86, Mayapuri Industrial Area, Phase-I, New Delhi.	Vs.	ACIT, Circle-4(1), New Delhi.

PAN : AAACL1126D

(Appellant) (Respondent)

Assessee by	:	Shri Pradeep Dinodia, Shri R.K. Kapoor and Ms Pallavi Dinodia.
Revenue by	:	Shri Peeyush Jain, Sr. DR

ORDER

PER A.D. JAIN, JUDICIAL MEMBER

This is Assessee's appeal for Assessment Year 2008-09 against the order dated 17.07.2012 passed by the Assessing Officer, taking the following grounds:-

> "1. That the learned Assessing Officer has erred in law and on facts in making an addition of Rs.8,03,58,167/- on wholly illegal, erroneous and untenable grounds.
>
> 2. The order of assessment is bad in law.
>
> 3. That the ld. A.O. has erred in law, on facts and in the circumstances of the case in making addition on account of arm's length price under section 92CA(3) of the Income Tax Act amounting to Rs.5,32,07,016/- on wholly illegal, erroneous and untenable grounds.

4. The learned A.O's order based on the findings of the learned Transfer Pricing Officer and the directions of the learned Dispute Resolution Panel u/s 144C(5) of the Income-tax, is erroneous, untenable in law and on facts for the various reasons and not limited to the following:-

a) The TPO as well as the DRP and consequently the A.O. has passed in law and on facts and in the circumstances of the case in erroneously determining the ALP of the transaction on account of payment of royalty to the AE of the appellant as NIL.

b) The TPO as well as the DRP and consequently the A.O. has erred in law and on facts and in the circumstances of the case in erroneously holding that the appellant has not been able to show that it derived economic benefit from the know how received from the AE.

c) The TPO and DRP and consequently the A.O failed to appreciate that royalty was one of the two elements of cost and sales and could have been evaluated under same overall method as had been correctly done by the assessee under TNMM method and royalty payment is not independent of sales and could not be examined on stand alone basis.

d) The TPO as well as the DRP and consequently the A.O. has erred in law and on facts and in the circumstances of the case in erroneously exceeding their jurisdiction by judging the royalty payments made by the assessee through a benefit test, which is not based on not any of the method prescribed as per Section 92C of the IT Act.

5. The DRP as well as the A.O. has erred in law and facts and circumstances of case and made additions amounting to Rs.84,48,000/- on account of disallowance of provisions for warranty u/s 37(1) of the IT Act.

6. The DRP as well as A.O. has erred in law and facts and circumstances of the case and made additions amounting to Rs.1,75,26,309/- on account of disallowance of provisions for leave encashment u/s 43B of the IT Act.

7. The DRP and consequently A.O. has erred in law and facts and circumstances of the case and made additions amounting to Rs.11,26,737/- on account of disallowance u/s 14A of the IT Act r.w. Rule 8D of I Tax Rules.

8. That the adjustment made by the A.O. of Rs.50,105/- to the total income of the assessee on the ground of disallowance of depreciation on computer's peripherals @ 60% were erroneous,

factually incorrect, and not maintainable in law and is prayed not to be confirmed.

9. The DRP and consequently the A.O. have erred in law, on the facts and in the circumstances of the case in charging interest under section 234-B of Rs.1,30,70,415/- of the Income Tax Act, 1961 on wholly erroneous, illegal and untenable grounds.

10.The DRP and consequently the A.O. have erred in law, on the facts and in the circumstances of the case in charging interest under section 234C of Rs.13,68,438/- of the Income Tax Act, 1961 on wholly erroneous, illegal and untenable grounds.

11.The DRP and consequently the A.O. have erred in law, on the facts and in the circumstances of the case in charging interest under section 234D of Rs.1,08,400/- of the Income Tax Act, 1961 on wholly erroneous, illegal and untenable grounds."

2. As per the record, the business profile of the assessee company is as follows:-

"The appellant is a Public Limited and a listed Company incorporated under the Companies Act. The appellant had been engaged in the business of manufacturing and trading of lighting products for the automotive industries. The business of the appellant was set up in 1945 and expanded in 1957. Initially it was a partnership firm which was converted into a Pvt. Ltd. company in 1981 by the name of Lumax Industries Pvt. Ltd. The company was later on converted into a Public Ltd. company when it went public in 1984 and is now listed on both the NSE & BSE.

In 1984, the appellant entered into a technical collaboration agreement with Stanley Electric Co. of Japan, a global market leader in the same industry. The appellant had been manufacturing some of its products under the brand name of STANLEY for which it had been paying royalty after seeking necessary approval from SIA & RBI as was required at the relevant point of time. The approval accorded by RBI is continuing and is being renewed by RBI on a year to year basis. The royalty was initially being paid @ 4% on the sale of some of the products produced under the brand name of Stanley which later on was reduced to 3%.

Sometime in 1994, Stanley, Japan, acquired small equity stake in the appellant company and in the financial year 2003-04 (relevant to Asstt. Year 2004-05) this stake amounted to 19.41% of the total paid up capital of the appellant company. Stanley Japan also appointed an Executive Director on the Governing

> Board of appellant and therefore by virtue of Section 92A (2) (e), it became an AE of the appellant. Similarly, the other 100% subsidiaries of Stanley Japan also became AE's of the appellant as per the definition of "associate enterprise" as contained in Section 92A (2) read with its various clauses."

3. Ground Nos.1 and 2 are general.

4. Apropos Ground No.3, the facts are that the assessee company filed its return for the year under consideration, declaring income of ₹ 17,81,88,750/-. This return was processed u/s 143 (1), on 12.09.2009. A draft assessment order u/s 144C of the IT Act was served on the assessee. The assessee filed its objections before the DRP on 26.12.2011. The said objections were disposed of by the DRP vide Order dated 14.06.2012. The final assessment order was passed on 17.07.2012. The present appeal has been preferred thereagainst.

5. The TPO, vide Order dated 30.10.2011, passed u/s 92CA (3) of the Act, suggested upward assessment of assessee's income by ₹5,32,07,016/-, observing as follows:-

> " In the present case the taxpayer has benchmarked the transaction related to payment of royalty under CUP. Hence, the CUP taken by the taxpayer is not acceptable for the reasons discussed above. But as discussed in the preceding paras, the taxpayer has failed to furnish certain vital information like how the royalty rate was determined along with basis thereof, what cost benefit analysis was done, what is the royalty rate paid by other AEs or independent persons, what is the industry rate, what is the cost incurred by the AE for developing the intangible, what was the expected benefit from the use of the intangible, etc. Such information was essential to benchmark the transaction. As held by the ITAT in the case of Aztech Software (supra) it is the duty of taxpayer to furnish complete information not only about the transactions entered into by it with the AE, but also about the comparable cases, as the assessee is in that field and has knowledge about the comparables also. The ITAT further held that if the taxpayer does not furnish such information, the TPO would be justified in determining the arm's length price on the basis of the information available with him. For some of the questions, the taxpayer has simply stated that it is not privy to the information related to the AE. As held by the ITAT, Mumbai in the case of UCB India (2009-TII-02-ITAT-Mum-TP), it is

the duty of the AE to furnish requisite information to the taxpayer, if it wants to help the assessee in its tax matters. If the AE does not provide the relevant information, then it is not for the revenue to conclude in the subsidiary's favour. On the question of benefit derived from the use of the intangible, the taxpayer could have at least done the analysis by following the income approach viz. discounted cash flow method to show as to what was the excepted benefit from the use of the intangible. The taxpayer has not taken pains to do the aforesaid.

I am therefore, left with no other alternative but to benchmark the transaction by applying the 'benefit test' which is an internationally accepted method. Under this test it is to be seen as to whether the taxpayer has received any tangible benefit from the use of the intangible which would help it in earning greater economic benefit. In arm's length situation a person would pay royalty only if the use of the technology will give him greater economic benefit. In the present case, as discussed above, despite the use of the intangible the margin of the assessee is lower than the comparables. This clearly shows that the technology has not provided any benefit to the assessee. No independent person in such a situation will pay any royalty. This view is also supported by the ITAT, Delhi's decision in the case of Abhishek Auto (2010-TII-54-ITAT-DEL-TP) wherein the ITAT held as under:-

> "If the tested party without the use of imported technology and imported raw material can make additional margins, then it would be case the international transactions have demonstratively boosted the profits of the appellant."

In view of the above discussion and particularly keeping in view of the fact that the assessee has neither benchmarked this transaction property by applying the most appropriate method and nor has it furnished the requisite information I am constrained to determine the arm's length price of this transaction at NIL under CUP method. No independent person in similar circumstances would pay any such royalty.

I am aware of the ITAT, Delhi's decision in the case of Ekla Appliances (2011-TII-37-ITAT-DEL-TP). However, the aforesaid decision is not applicable as in that case it was found that the technology had helped the taxpayer in reducing its losses significantly. It was also found that there were peculiar reasons for incurring the losses. Thus, the aforesaid decision is of no help. Similarly, the decision of ITAT, Hyderabad in the case of LG Polymers is of no help as in that case the transaction was treated as sham and the matter was restored to the file of the AO/TPO for fresh determination of the ALP.

Thus, the arm's length price of royalty is determined at Rs. NIL.

a. Payment of Royalty	Rs.5,32,07,016/-
b. Arm's length price under CUP	Rs.NIL
c. Adjustment u/s 92CA	Rs.5,32,07,016/-

> The above amount of Rs.5,32,07,016/- is treated as adjustments under section 92CA as the value of royalty transactions in uncontrolled conditions is treated as Rs. NIL under CUP and the absence of any substantiation to show that substantial benefit is accrued to the taxpayer."

6. The assessee made detailed submissions before the Assessing Officer. The Assessing Officer, however, did not find the same to be acceptable and an addition of ₹ 532,07,016/- was made to the total income of the assessee. While doing so, it was observed as follows:-

> "The proposed enhancement of Rs.5,32,07,016/- was brought to the notice of the assessee vide order sheet entry dated 08.11.2011. The submissions of the assessee company have been duly examined, considered and however, not found acceptable. On the basis of TPO's order under section 92CA(3) dated 30.10.2011, an addition of Rs.5,32,07,016/- is made to the total income of the assessee. The order passed by the Transfer Pricing Officer under section 92CA(3) is annexed herewith and made a part of this assessment order.
>
> The assessee filed its objections before the Hon'ble Dispute Resolution Panel – I, New Delhi. The Hon'ble Dispute Resolution Panel – I, New Delhi vide order dated 14.06.2012 held that the conclusion of the TPO was correct and declined to interfere with the proposed adjustments.
>
> I am satisfied that the assessee filed inaccurate particulars of its income and thereby concealed its income to the tune of Rs.5,32,07,016/-. Penalty proceedings under section 271(1)(c) are initiated separately for furnishing inaccurate particulars of income."

7. Before us, it has been contended on behalf of the assessee that the ALP of the transaction of the assessee on account of payment of royalty to its AE has wrongly been determined by the authorities below; that it has wrongly been held that the assessee was not able to show that it had derived economic benefit from the know-how received by it from its AE; that it has not been appreciated that the royalty was one of the two elements of cost and sales and could have been evaluated under the same overall method, as correctly done by the assessee under the TNMM; that it has not been appreciated that the royalty payment was not independent of sales and could not have

been examined on a standalone basis; that it was not correct to judge the royalty payment on the yardstick of the benefit test, the same not being based on any of the methods prescribed u/s 92C of the IT Act; that it has wrongly not been taken into consideration that it was since 1984, that the assessee was in association with Stanley Electric, Japan; that the assessee's relationship with Stanley Electric, Japan turned into that of an AE in 1994; that it has not been appreciated that royalty payment was being made by the assessee to Stanley Electric, Japan, right from 1984 and this continued even after Stanley Electric, Japan acquired the status of an AE of the assessee; that it has not been appreciated that in 1984, the assessee was a small company, having a turnover of just about ₹ 2 crores, whereas in the year under consideration, it had evolved into a company having a turnover of ₹ 600 crores; that no justification has been given as to how the arm's length price has been determined at nil under the CUP method, as against that of ₹ 5.32 crores claimed by the assessee, notwithstanding the fact that the TPO himself noted that the royalty had been paid by the assessee to its AE @ 3%; that 3% stands accepted as the rate of payment of royalty in the cases of the following companies:-

1. Sona Okegawa Precision Forgings Ltd.
2. Federal Mogul TPR India Ltd.
3. Climate Systems India Ltd.
4. Eicher Motors Ltd.
5. Swaraj Engines Ltd.
6. Praga Tools Ltd.

7.1 That the decisions in this regard are as follows:-

1. 'Sona Okegawa Precision Forgings Ltd. vs. ACIT' (ITA No.4781/Del/2010)

2. ‘ACIT vs. Sona Okegawa Precision Forgings Ltd.’ (ITA No.260/Del/2010.
3. ‘CIT vs. Federal Mogul TPR India Ltd.’ (ITA No.398/2012)
4. ‘Climate Systems India Ltd. vs. CIT’ (2009) 319 ITR 113 (Delhi)
5. ‘CIT vs. Eicher Motors Ltd.’ (2007) 293 ITR 464 (MP)
6. ‘Praga Tools Ltd. vs. CIT’ (1980) 123 ITR 773 (A&P);

that the assessee also being an auto ancillary and, therefore, part of the automotive industry, is clearly comparable in its payment of royalty to the royalty paid, as accepted to be at arm’s length, in the aforesaid cases @ 3%; that in all the aforesaid cases, the royalty is related to transfer of technical assistance and know how in the automotive industry; that the technical collaboration agreement of the assessee (copy at APB-I, pages 340-359), which is duly approved by the Government of India, has not been taken into consideration by the authorities below; that the AE of the assessee is paying 40% tax in Japan and so, the observation of the TPO to the effect that there is siphoning off profit from India with minimum incidence of tax, is wrong; that the assessee is paying 30% tax in India; that in the balance sheet for the years ended on 31.03.2008 and 31.03.2007 of assessee’s AE (copy at APB-I, page 403), royalty income has been shown; that in the assessee’s AE’s Note to Consolidated Financial Statements (APB-I, page 412), the expenditure for the year under consideration has been shown at 47 million US $, whereas the income is of 10 million US $, i.e., much less; that this goes to show that if the assessee’s AE had filed a return on the royalty under consideration in India, there would have been a loss; that this aspect of the matter has also not been taken into consideration; that further, it is wrong to state that no economic benefit accrued to the assessee vis-a-vis the payment of royalty, since the royalty was paid only in respect of the Japanese customer, i.e., on

43% sale; that as available from APB-I, page 385, i.e., the total of royalty paid by the assessee to its AE, for the period from 1.4.07 to 31.3.08, the royalty is about 2.43% of the net sales of ₹ 2180871964.63; and that the TPO did not deem it fit to do any benchmarking qua the issue of royalty, i.e., no comparable was brought. Besides the case laws mentioned hereinabove, the ld. counsel for the assessee has sought to place reliance on 'KHS Machinery (P) Ltd. vs. ITO', 53 SOT 100 (Ahm.), wherein, it has been, *inter alia*, held that where the Assessing Officer had not brought on record the ordinary profits which could be earned in the type of business carried on by the assessee, the finding of the Assessing Officer in considering royalty charges as nil as ALP, could not be accepted and that therefore, the payment of royalty was not hit by the provisions of Section 92-C of the Act.

8. On the other hand, the Ld. DR has strongly supported the orders of the authorities below. It has been contended that just because the assessee and its AE are public listed companies, the requirement of establishment of arm's length price cannot be left uncomplied; and that apropos the RBI approval of 3% to 4% of payment of royalty, the assessee did not benchmark its payment of royalty. The Ld. DR has placed reliance on the following case laws:-

8.1 Order dated 30.3.2012 passed by the Mumbai Bench of the Tribunal in ITA No.5979/Mum/2010 and CO No.130/Mum/2011 for Assessment Year 2005-06, in the case of CMA CGM Global India (P) Ltd., wherein, according to the Ld. DR, earlier payment made to the same party, i.e., when the party was not an AE of the assessee, was not allowed. The Ld. DR has submitted that therefore, for payment made to an AE, there *has* to be a separate benchmarking, even if earlier payments had been made to the same party. The Ld. DR has further contended that there is no CUP available for royalty payments and that the CUP method has been applied by the assessee relying on the RBI approval granted to it, which is of no value, since the RBI approval is for the purposes of FEMA/FERA and not a deterrent debarring the taxing authorities from going into the transaction of payment of royalty. The following case laws have been relied on:-

a) 'Delloite Consulting'
b) 'Nestle India', 337 ITR 102 (Del)
c) 'Interra'
d) 'Aztec' (107 ITD 141)
e) 'Knorr Bremse'
f) 'CMA CGM Global India Pvt. Ltd.'

9. The Ld. DR has further contended that the assessee's contention regarding allowance of the payment u/s 37 of the Act is not at all maintainable, since the Assessing Officer and the TPO were in entirely different situations; that Section 37 of the Act and the Proviso to Section 92 thereof operate in entirely different fields. Reliance has again been sought to be placed on 'Deloitte' (supra).

10. The Ld. DR has further contended that the propositions of law sought to be raised by the assessee are not maintainable before the Tribunal, since they impinge upon the aspect of constitutionality. The decision in 'Interra' (supra) has been relied on.

11. So far as regards the commercial expediency aspect, the Ld. DR has stated that it is true that the Income-tax Authorities cannot dictate to the assessee as to how its business is to be carried on, but he facts in the present case are in *pari materia* with 'Knorr Bremse' (supra), wherein also, the assessee had incurred losses.

12. Addressing the issue as to whether nil ALP could have been allowable, the Ld. DR has submitted that there may be a benefit, but it cannot be a passive and incidental benefit – it has to be a tangible benefit. Here, he places reliance on 'Knorr Bremse' (supra) and 'Delloite' (supra).

13. On the issue of consistency, the Ld. DR has contended that it is well settled that a mistake cannot be allowed to be perpetuated; that if in the earlier years, a claim had been mishappenly accepted, such a mistake cannot bind the Department forever; that moreover, in the earlier cases, the payment was considered u/s 37 of the Act and not u/s 92C thereof. Reliance has been sought to be placed on CBDT Circular No.12 of 23.08.2001 (copy placed on record).

14. The Ld. DR has further contended that even otherwise, the royalty should be separately benchmarked, as there is a chance of cross-subsidisation. He further contended that in the present case, there is no intangible involved and the assessee sells products under the brand name 'Lumax' and not 'Stanley.'

15. We have heard both the parties on this ground and have examined the material placed on record with regard thereto. The issue is as to whether the addition of ₹ 532,07,016/- on account of arm's length price, has correctly been made concerning the payment of royalty by the assessee to its AE.

16. The TPO proposed the enhancement of ₹ 532,07,016/- to the total income of the assessee company on the basis that the assessee had failed to furnish information as to how the rate of royalty payment was determined, the basis thereof, the cost benefit analysis done by

the assessee, the royalty rate paid by other AEs or independent persons, the industry rate of payment of royalty, the cost incurred by the AE for developing the intangible, the expected benefit from the use of the intangible, etc. The TPO observed that such information was essential to benchmark the transaction. It was also observed that regarding the issue of benefit derived from the use of the intangible, the assessee did not show as to what was such expected benefit and that therefore, the transaction *had to be* benchmarked by applying the benefit test; that in the assessee's case, in spite of the use of the intangible, the margin of the assessee was lower than the comparables, which clearly showed that the technology had not provided any benefit to the assessee; and that no independent person in such a situation would pay any royalty.

17. The Assessing Officer made the addition on the basis of the aforesaid findings of the TPO. The DRP declined to interfere with the said proposed adjustment.

18. Therefore, the main reason, rather the only reason recorded by the authorities below for disallowing the royalty payment is that of the alleged inability of the assessee to satisfy the 'benefit test'. In other words, the royalty payment made by the assessee company was disallowed for the alleged inability of the assessee to quantify the benefit which it had obtained from such payment of royalty.

19. In this regard, it is seen that during the year, royalty was paid by the Assessee to its AE on sales made using the trade mark of 'Stanley'; that the assessee is a widely held listed company, a market leader. The payment of royalty was for trade mark, patent and technology. The contract, i.e., the Technical Collaboration Agreement, between the assessee and its AE stood approved by the Government since 1984.

Ever since, the assessee had been carrying out the manufacture of some of its products under the brand name of ‘Stanley.’ For this, the assessee had been paying royalty. Approval in this regard had been pre-obtained from SIA, as required. The RBI had also granted its approval, which was being renewed yearly. Initially, the royalty had been paid @ 4% on the sale of some of the products produced under the brand name ‘Stanley.’ Later, it was reduced to 3%. In F.Y. 2003-04, Stanley Electric Company of Japan acquired the status of the AE of the assessee. Thus, it was right from 1984, that technical assistance got started being given by Stanley Electric Company, Japan to the assessee, with regard to the manufacture of automotive lighting equipment. As available from para 1.4 of the agreement in the year under consideration (copy at APB-I, 340-359, relevant portion at page 342), a non-exclusive licence had been granted by Stanley, Japan to the assessee, only for India. As per the conditions thereof, the assessee was to pay royalty on its net sales, after deduction from the net sale price of the licensed products sold by Lumax in India. The basis of calculation of payment of royalty, as agreed to, is contained in Article 4 of the Agreement (APB-I, page 345). Such payment was to be @ 4% on the net sales. However, during the year, royalty was paid @ 2.43% on the sale of licensed products, amounting to ₹ 218.08 crores, as available at APB-I, page 385. This was so, since the cost of standard imported components, standard local components and certain other deductions had been deducted from the net sales of ₹ 218.08 crores.

20. The Ld. DR has contended that just because the assessee and its AE are publicly listed companies, this is no reason for the requirements of ALP to be flouted. However, the assessee’s contention regarding both the entities being listed companies, it is seen, is not at all to support any violation of the ALP provisions. This argument, in fact, has

been taken to bolster the assertion regarding benefits of the transactions and the genuineness thereof.

21. The next contention of the Department has been that the RBI approval sought to be relied on by the assessee is only for the purposes of FEMA/FERA and it does not stop the transaction from being looked into by the Income-tax Authorities for the purpose of the Income-tax Act. Here again, it is seen that this argument has been taken by the Assessee only to stress that the agreement between the assessee and Stanley was not merely a paper transaction, rather it was approved by the RBI as well, besides other governmental authorities. It has not been shown by the Department to be otherwise.

22. The Ld. DR then contended that the royalty in question was not benchmarked by the assessee, as held by the TPO and that it has not been shown that the payment of royalty was an arm's length transaction. Since the average PLI of the comparables taken by him resulting in 7.05% - OP/sales was within the (+)/(-) 5% range of the assessee's PLI worked out by him at 4.09%, the range between 2.05% to 12.05%, as per the proviso to Section 92C (2) (2A) of the Act.

23. The Ld. DR has further contended that the assessee did not apply the CUP method properly, since such method has been supported by the assessee, based on the approval by the RBI. In this regard, we find that as noted above, the argument regarding the RBI approval was raised by the assessee to buttress the claim of genuineness of its transaction. In the TPO's order, there is not even as much as a mention about RBI. So far as regards the DR's objection that the plea of earlier payment to the same party, when it was not the assessee's AE, has not been allowed, is not maintainable, it is to be reiterated here, as above, that the assessee *did* benchmark its

transaction by two methods, i.e., CUP and TNMM and this was taken note of by the TPO himself. Apropos the reliance by the Department on 'CGM Global' (supra), it is correct that therein, the internal CUP was held to be not applicable, since the transaction was with an AE having related party transactions and it was held that there was no external CUP for making any comparison in the relevant year, as the earlier Agency Agreement with the third party had expired and rates applicable in the earlier years could not be made applicable during the relevant year. However, this decision does not have any adverse effect on the case of the assessee. The facts herein are entirely at variance with those of 'CGM Global'. Herein, as opposed to the facts in 'CGM Global', the same Royalty Agreement and the same licence has been in continuance from 1984 till the year under consideration, the licence being renewed from year to year, albeit on the same terms and conditions. Moreover, the following decisions are instances of the external CUP having been employed and this has not been disputed by the Department:-

1. 'Sona Okegawa Precision Forgings Ltd. vs. ACIT' (ITA No.4781/Del/2010)
2. 'ACIT vs. Sona Okegawa Precision Forgings Ltd.' (ITA No.260/Del/2010.
3. 'CIT vs. Federal Mogul TPR India Ltd.' (ITA No.398/2012)
4. 'Climate Systems India Ltd. vs. CIT' (2009) 319 ITR 113 (Delhi)
5. 'CIT vs. Eicher Motors Ltd.' (2007) 293 ITR 464 (MP)
6. 'Praga Tools Ltd. vs. CIT' (1980) 123 ITR 773 (A&P)
7. 'Ekla Appliances (2012-TII-01-HC-DEL-TP)
8. 'Ericsson India Pvt. Ltd. vs. DCIT' (2012-TII-48-ITAT-Del-TP)

24. In ‘‘Sona Okegawa Precision Forgings Ltd.’ (supra), it has been held that since the royalty paid by the Indian company was 3% of net sales and it falls within the range of @ 8% on export sales and 5% on domestic sales as per directions of the RBI, therefore, the payment stands justified under the CUP method.

25. This view was accepted by the Tribunal in ‘Sona Okegawa’s case for Assessment Year 2004-05 also, as well as in ‘Climate Systems’ (supra), ‘Swaraj Engines Ltd.’ (supra) and ‘Eicher Motors’ (supra).

26. In ‘Federal Mogul’ (supra), payment of royalty @3% on the sale price, on transfer of technical knowledge and information, was accepted.

27. In ‘Climate Systems India Ltd.’ (supra), again, payment of royalty @ 3% on the sale price on transfer of technical knowledge and information was accepted.

28. All the above companies, like the assessee, were in the auto ancillary industry.

29. In ‘Praga Tools Ltd.’ (supra), which was also in an auto ancillary industry, payment of royalty @ 5% on the sale price, on transfer of technical know how and assistance was accepted.

30. The royalty payment by the above companies is directly comparable with that made by the assessee company. The assessee, as observed, is also an auto ancillary, manufacturing automotive parts for OEMs. In all these cases, as in that of the assessee, the payment of royalty was related to transfer of technical assistance and know-how in

the automotive industry. That being so, the CUP method *is* available apropos the issue of arm's length price *qua* the payment of royalty.

31. So far as regards other case laws relied on by the Department, the same are also distinguishable on facts, being on general propositions of law relevant to the specific facts present in those cases. In the present case, an ALP analysis *had* been done by the assessee, as above. The assessee applied the CUP method and the TNMM. The TPO, however, despite being legally bound to do so, did not apply any method.

32. Apropos the decision of the Delhi Bench of the Tribunal in the case of 'Interra Information Technology (I) Pvt. Ltd. vs. DCIT', 2012-TIOL-142-ITAT-DEL-TP (supra), it is seen that here also, the facts are at a complete variance with those of the assessee's case, wherein payment of royalty for supply of technology and knowhow to manufacture licensed products was held to be for the benefit of the assessee and the same rate of royalty payment was allowed as allowed in the years when the parties were not in an AE relationship, but were having identical transactions as those in the year under consideration before the Tribunal. It was held that the royalty payment was a revenue expenditure incurred wholly and exclusively for the benefit of the assessee. The part of the payment disallowed as capital expenditure was held by the Hon'ble Delhi High Court to be revenue expenditure. It is as such that the invocation of the rule of consistency has been sought on behalf of the assessee and, in our considered opinion correctly so, contending that since the circumstances before and after the coming into existence of the AE relationship between the assessee and Stanley are identical *inter se,* it cannot at all be said that though in the earlier years, the royalty payment was for the benefit of the assessee, since the inception of the AE relationship, it ceased to be

so, due to which, the application of the benefit test by the TPO is entirely uncalled for. Payment of royalty was being claimed and allowed right from 1984 to Assessment Year 2003-04, as business expenditure of the assessee and no new circumstance has been pointed out by either of the authorities below to hold that in the years thereafter, the benefit accrued to the assessee by the payment of such royalty has dried up. Therefore, we find that the reliance by the Department on 'Interra' (supra), to support the contention that the rule of consistency should not be applied, is wholly misplaced. It cannot be gainsaid that a judgement has to be, in its entirety, considered in the backdrop of and with reference to the peculiar facts and circumstances doing the rounds therein. In 'Interra' (supra), the assessee raised an argument that transfer pricing adjustment at best cannot exceed the amount of the margin retained by the assessee as well as the AE. This argument did not find favour with the Tribunal. It was also contended that the TPO had not made any adjustment in the earlier years and as such, no adjustment was called for in the year before the Tribunal as well, on the principle of consistency. The Tribunal observed that the assessee had not been able to demonstrate as to which particular conclusion of the previous TPO or Assessing Officer had been reviewed in an opposite manner by the current TPO and that it was a case of non-application of mind by the previous TPO on some issues. It was therefore, that the Tribunal rejected this argument raised by the assessee. This is the background for the Tribunal not having allowed the principle of consistency to be invoked in that case. In the present case, however, it is patent on record that the facts remain identical pre-AE relationship and thereafter, as also that the related payment has been consistently allowed by the department itself in the numerous earlier years, where the arguments were at an exactly similar, nay identical footing.

33. The TPO has made the disallowance in question mainly on the basis of the benefit test. In this regard, it is seen that the payment of royalty cannot be examined divorced from the production and sales. Royalty is inextricably linked with these activities. In the absence of production and sale of products, there would be no question arising regarding payment of any royalty. Rule 10A(d) of the ITAT Rules defines 'transaction' as a number of closely linked transactions. Royalty, then, is a transaction closely linked with production and sales. It cannot be segregated from these activities of an enterprise, being embedded therein. That being so, royalty cannot be considered and examined in isolation on a standalone basis. Royalty is to be calculated on a specified agreed basis, on determining the net sales which, in the present case, are required to be determined after excluding the amounts of standard bought out components, etc., since such net sales do not stand recorded by the assessee in its books of account. Therefore, it is our considered opinion that the assessee was correct in employing an overall TNMM for examining the royalty. The TPO worked out the difference in the PLI of the outside party (the assessee) at 4.09% and the comparables at 7.05%. This has not been shown to fall outside the permissible range.

34. The decision of the Tribunal in 'Ekla Appliances', 2012-TII-01-HC-Del-TP, has been sought to be distinguished by the TPO, observing that the facts in that case are not in *pari materia* with those of the assessee's case. However, therein also, the benefit test had been applied by the TPO, as in the present case. The matter was carried in appeal before the Hon'ble High Court. The Hon'ble Delhi High Court has held that the so-called benefit test cannot be applied to determine the ALP of royalty payment at nil and that the TPO could apply only one of the methods prescribed under the law. A similar view has been

taken in 'Sona Okegawa Precision Forgings Ltd.' (supra) and in 'KHS Machinery Pvt. Ltd. vs. ITO', 53 SOT 100 (Ahm) (URO).

35. It is, thus, seen that the royalty payment @ 3% by the assessee is at arm's length. The Technical Collaboration Agreement stands approved by the Government of India. The royalty payment has been accepted by the department as having been made by the assessee wholly and exclusively for its business purposes. For Assessment Years 2004-05 and 2005-06, such payment of royalty has been allowed by the CIT (A). As per the FEMA Regulations, royalty can be paid on net sales @ 5% on domestic sales and @ 8% on export sales. The royalty payment by the assessee falls within these limits. It also falls within the limits of payment of royalty in the automobile sector, as per the market trend. This payment of royalty is at the same percentage as that paid by other auto ancillaries in the automotive industry. Then, in 'Ekla Appliances' (supra) and in 'Ericsson India Pvt. Ltd. vs. DCIT', 2012-TII-48-ITAT-Del-TP, it has been held that royalty payment cannot be disallowed on the basis of the so-called benefit test and the domain of the TPO is only to examine as to whether the payment based on the agreement adheres to the arm's length principle or not. That being so, the action of the TPO in the present case, to make the disallowance mainly on the ground of the benefit test, is unsustainable in law.

36. Keeping in view all the above factors, the disallowance made on account of royalty is found to be totally uncalled for and it is deleted as such. Accordingly, ground Nos.3 and 4 raised by the assessee are accepted.

37. Coming to ground No.5, the assessee contends that addition of ₹ 84,48,000/- on account of disallowance of provisions of warranty u/s 37(1) of the Act has wrongly been made and confirmed. The Assessing

Officer noted from Form No.3CD that the assessee had made provision for warranty. The assessee was asked to show cause as to why the same be not disallowed, as it was a contingent liability. The assessee submitted that during the year, it had worked out the amount of net warranty liability by applying a multiplying factor on the total sales made during the year on the basis of past results and had made provisions in its books; that since the provision had been made based on the past factor of actual expenses incurred towards warranty liability, deduction claimed with regard thereto u/s 37(1) of the Act was an allowable expenditure. Reliance was placed on the Tribunal decision in the case of 'DCIT, Circle 4 (1) vs. LG Electronics (I) Ltd.' and the Hon'ble Supreme Court decision in the case of 'Rotork Controls India Pvt. Ltd. vs. CIT', 314 ITR 62 (SC), beside other case laws. The Assessing Officer, however, observed that in the case laws referred to by the assessee, the crucial findings were that the claim of the assessee should be on a scientific basis and the assessee should have been regularly following this system of accounting for warranty; that however, in the assessee's case this system of accounting for warranty had been introduced only in F.Y. 2005-06; that thus, it could not be said that the assessee had been regularly employing this method over a number of financial years; and that further, the multiplying factor determined by the assessee for working out the warranty provision could not be said to be a scientific method for determination of the provision of warranty, being based on a single year data base. The Assessing Officer held that the provision for warranty amounting to ₹ 1,61,61,410/- was liable to be disallowed, but an amount of ₹ 77,73,410/- stood disallowed in the earlier years and, therefore, a net amount of ₹ 84,48,000/- was being disallowed and added back to the total income of the assessee company. The DRP upheld this action of the Assessing Officer.

38. Challenging the action of the Assessing Officer, the ld. counsel for the assessee has contended before us that while wrongly making the disallowance, the Assessing Officer has failed to take into consideration the fact that the provision was made by the assessee on a highly scientific basis, based on actual warranty expenses incurred by the assessee for the unexpired warranty period. Reliance has been placed on 'Rotork Controls India Pvt. Ltd.' (supra) and 'CIT vs. Becton Dickinson', 2012-TIOL-962-HC-Del-IT. It has been contended that similar provisions for warranty have not been disallowed in the earlier years, upto Assessment Year 2005-06. A chart in this regard has been filed.

39. The Ld. DR, on the other hand, has placed strong reliance on the impugned order in this regard.

40. In this regard, it is seen that the Assessing Officer made the disallowance on the basis that the provision for warranty was a contingent liability, having no scientific basis. Indeed, undisputedly, the assessee was making the provisions on actual warranty basis for the unexpired warranty period, providing warranty of one year on the products which it was selling. It created provision for warranty for the unexpired period of warranty as at the end of the year, on a percentage of the actual warranty expenses during the immediately prior period, on the sales made. It has not been shown as to how this basis of making provision for warranty is not scientific. Moreover, similar provision for warranty was not disallowed in the earlier years, upto Assessment Year 2005-06. This position is also supported by the Hon'ble Supreme Court's decision in 'Rotork Controls India Pvt. Ltd.' (supra) and the Hon'ble Delhi High Court decision in 'Becton Dickinson' (supra). Accordingly, this addition is deleted and ground No.5 is allowed.

41. Apropos ground No.6, the assessee has challenged the addition of ₹ 1,75,26,309/- made on account of disallowance of provisions for leave encashment u/s 43B of the Act.

42. The Assessing Officer observed that the assessee's provisions for leave encashment had increased to ₹ 3,27,47,739/-. The assessee had maintained that the deduction had been claimed in view of the decision of the Hon'ble Calcutta High Court in the case of 'Exide Industries vs. UOI', 292 ITR 470 (Cal). The Assessing Officer asked the assessee to show cause as to why the amount be not disallowed and added back to the assessee's total income, since the decision in 'Exide Industries' (supra) had been stayed by the Hon'ble Supreme Court. The assessee submitted that during the year, it had made provision for leave encashment amounting to ₹ 1,75,26,309/- as per the actuarial valuation, in compliance of AS-15 of the ICAI and had claimed it as a business expenditure. The Assessing Officer, however, made the disallowance. The DRP upheld the Assessing Officer's action.

43. The assessee's challenge to the action of the Assessing Officer has been on the stated basis that there has been a double addition, since the assessee had itself made the disallowance and the amount had not been taken to the Profit & Loss Account at all. It has been pointed out that the Tribunal also, in the Stay Order granted in favour of the assessee, has observed that there has been a double addition in this regard.

44. The Ld. DR, on the other hand, has placed strong reliance on the impugned order.

45. As to whether there has indeed been a double addition, needs to be verified by the Assessing Officer by confirming as to whether or not the assessee had made the disallowance itself and the amount had not been carried to the Profit & Loss Account. For this purpose, the matter is remitted to the file of the Assessing Officer, to be decided afresh in accordance with the law, on affording adequate and due opportunity to the assessee. Ground No.6 is, as such, treated as allowed, for statistical purposes.

46. Ground No.7 states that the addition of ₹ 11,26,737/- on account of disallowance u/s 14A of the Act read with Rule 8D of the IT Rules has wrongly been made.

47. The assessee was found to have made investment, income wherefrom, according to the Assessing Officer, did not form part of the assessee's taxable income. The disallowance was made, observing that separate bank accounts had not been maintained by the assessee in respect of investments and other activities; that there was a common pool of funds and it could not be ascertained whether the investments had been made out of internal accruals or from borrowed funds; that had the assessee company not made the investments, its total borrowings would have been lower, leading to reduction in interest costs; that the assessee had not attributed any administrative expenses towards the earning of exempt income; that the interest expenses of ₹ 4,92,95,768/- were not directly attributable to any particular income or receipt; and that by maintaining such investments and other investment related activities, administrative expenses were attributable to them. Accordingly, the Assessing Officer made the following disallowance u/s 14A of the Act read with Rule 8D of the IT Rules:-

S.No.	Disallowance	Amount (Rs.)
1.	The amount of expenditure directly relating to income which does not form part of total income	0
2.	In a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula – AXB/C Where A = amount of expenditure by way of interest other than the amount of interest included in clause (1) incurred during the previous year. B = the average of value of investment, income from which does not or shall not form part of the total income appearing in the balance sheet of the assessee, on the last day and the last day of the previous year. C = the average value of total assets as appearing in the balance sheet of the assessee on the first day and the last day of the previous year.	A=4,92,95,768/- B=25,22,01,525/- C=345,18,91,509/- Hence, disallowance = 36,01,639/-
3.	An amount equal to on-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year	1/2 % of average investment of Rs.25,22,01,525/- = 12,61,008/-
	Total disallowance Less disallowance made by the assessee in computation of income Balance net disallowance	Rs.48,62,647/- Rs.12,61,008/- Rs.36,01,639/-

48. Thus, an amount of ₹ 36,01,639/- was proposed to be disallowed. However, the DRP held that the interest of ₹ 3,38,74,081/- was to be excluded while calculating the disallowance. As such, the disallowance was recomputed as follows:-

S.No.	Disallowance	Amount (Rs.)
1.	The amount of expenditure directly relating to income which does not form part of total income	0
2.	In a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula – AXB/C Where A = amount of expenditure by way of interest other than the amount of interest included in clause (1) incurred during the previous year. B = the average of value of investment, income from which does not or shall not form part of the total income appearing in the balance sheet of the assessee, on the last day and the last day of the previous year. C = the average value of total assets as appearing in the balance sheet of the assessee on the first day and the last day of the previous year.	A=4,92,95,768/- minus Rs.3,38,74,081/- (as per the directions of the Hon'ble DRP) = Rs.1,54,21,687/- B=25,22,01,525/- C=345,18,91,509/- Hence, disallowance = 11,26,737/-
3.	An amount equal to on-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year	½ % of average investment of Rs.25,22,01,525/- = 12,61,008/-
	Total disallowance Less disallowance made by the assessee in computation of income Balance net disallowance	Rs.48,62,647/- Rs.12,61,008/- Rs.11,26,737/-

49. As such, the disallowance u/s 14A of the Act read with Rule 8D of the Rules came to ₹ 11,26,737/-, which amount was added back to the total income of the assessee company.

50. The ld. counsel for the assessee has contended before us that the assessee had itself worked out a disallowance of ₹ 12,61,008/-; that however, neither the Assessing Officer, nor the DRP adjudicated on the aspect as to how such disallowance made by the assessee itself was

incorrect or not acceptable; that the assessee is a manufacturing concern and its entire infrastructure is meant for manufacturing activities; that the assessee company has a turnover of about ₹ 508 crores from its manufacturing operations; that the Assessing Officer attributed interest cost under Rule 8D of the Rules, overlooking the fact that the assessee was having huge funds of its own and investments were made out of these funds only; that it was also overlooked that the borrowings had been made for specific purposes of working capital and other business operations, due to which, no interest cost was attributable to the earning of dividend income; that it had been specifically stated before the DRP also, that investment of ₹ 43.72 crores during the year had been made out of capital receipt of ₹ 56 crores. Reference in this regard has been made to page 478 of the assessee's paper book. Attention has also been drawn to the assessee's balance sheet (APB-31) to show that the assessee's investments went up to ₹ 46.99 crores from ₹ 3.44 crores and its capital and reserves increased to ₹ 143.35 crores from ₹ 81.46 crores; and that the loan refunds had decreased from ₹ 97.38 crores to ₹ 82.84 crores, establishing that no borrowed funds had been utilized.

51. The Ld. DR has placed strong reliance on the impugned order.

52. Here also, we find that the matter needs verification by the Assessing Officer, for which purpose, it is remitted to the file of the Assessing Officer. The Assessing Officer shall re-adjudicate the matter in accordance with law on affording adequate opportunity to the assessee, particularly verifying the aforesaid averments made by the assessee.

53. As per ground No.8, the adjustment made by the Assessing Officer, of ₹ 50,105/- to the total income of the assessee on the ground

of disallowance of depreciation on computer peripherals @ 60%, is erroneous.

54. The Assessing Officer, it is seen, restricted the depreciation on computer peripherals to 15% as against @ 60%, as claimed by the assessee. The matter, as rightly contended, is covered in favour of the assessee by 'BSES Yamuna Power Ltd.', 2010-TIOL-636-HC-Del. No decision to the contrary has been brought to our notice. Therefore, in view of this decision of the jurisdictional High Court, this issue is decided in favour of the assessee, accepting ground No.8.

55. Ground Nos. 9-11 concern charging of interest under sections 234B to 234D of the IT Act, amounting to ₹ 1,30,70,415, ₹ 13,68,438/- and ₹ 1,08,400/-, respectively. These issues are consequential in nature.

56. In the result, the appeal of the assessee is partly allowed, as indicated.

The order pronounced in the open court on 31.05.2013.

Sd/-	Sd/-
[G.D. AGRAWAL]	[A.D. JAIN]
VICE PRESIDENT	JUDICIAL MEMBER

Dated, 31.05.2012.

dk

Copy forwarded to: -

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

TRUE COPY

By Order,

Deputy Registrar,
ITAT, Delhi Benches