IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, BANGALORE

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER
and
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

IT(TP)A No.29/Bang/2014
(Assessment year: 2009-10)
and
IT(TP)A No.227/Bang/2015
(Assessment year: 2010-11)

M/s.Essilor India Pvt.Ltd.
No.71/1, Brigade Plaza, 6th floor,
S C Road, Gandhinagar,
Bangalore-9. … Appellant
PAN:AAACE 4623 J

Vs.

Deputy Commissioner of Income-tax,
Circle 11(3),
Bangalore. … Respondent

Appellant by : Shri S.Ramasubramanyam, CA
Respondent by : Smt. Neera Malhotra, CIT(DR)

Date of hearing : 08/12/2015
Date of pronouncement : 05/02/2016

<u>O R D E R</u>

Per INTURI RAMA RAO, AM :

These appeals by the assessee-company are directed against assessment orders passed u/s 143(3) r.w.s. 144C of the Income-tax Act,1961 ['the Act' for short] pursuant to the directions of the Disputes Resolution Panel (DRP) for assessment years 2009-10 and 2010-11. The appeal in IT(TP)A No.29/Bang/2014 is directed against the assessment order dated 29/11/2013 passed u/s 143(3) r.w.s. 144C of the Act for the assessment year 2009-10 and appeal in IT(TP)A

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No.227/Bang/2015 is directed against the assessment order dated 30/12/2014 passed u/s 143(3) r.w.s.144C of the Act for the assessment year 2010-11.

2. Since common issues are involved in both the appeals, we dispose of the same by this common and consolidated order for the sake of convenience.

3. The grounds of appeal raised for the assessment year 2009-10 are as follows:

1) That the order of the learned lower authorities in so far it is prejudicial to the interest of the appellant is bad and erroneous in law and against the facts and circumstances of the case.

2) That the learned lower authorities erred in law and on facts in holding that the appellant promoted the brand of the associated enterprise merely on the ground that the AMP expenses incurred by the appellant are more than the AMP expenses incurred by the comparable entities.

3) That the learned lower authorities erred in law and on facts in presuming that the transaction of brand promotion has taken place without bringing on record any tangible and reliable evidences and such a finding of the learned lower authorities is perverse as being not supported by any materials on record.

4) That the learned TPO erred in law and on facts in determining the arm's length price of an alleged transaction which has not been referred to him even though he has no jurisdiction to go beyond the reference made by the learned assessing officer.

5) That the learned lower authority erred in law and on facts in holding that the appellant had incurred expenses in earning the dividends without bringing on record any material to prove the same and disallowing the sum of Rs. 60,98,481 u/s 14A of the Act.

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6) That the learned Commissioner of Income Tax(Appeals) erred in law and on facts in holding that S. 14A is attracted even though the Assessing Officer has not recorded any satisfaction as to why the claim of the appellant that no expenditure has been incurred is not correct.

7) Without prejudice to above grounds, the learned lower authorities erred in law and on facts in disallowing a sum of Rs. 60,98,343/- even though the actual dividend received is only Rs. 49,30,000/-.

8) That the learned assessing officer erred in law and on facts in levying the interest u/s 234C of the Act at Rs. 8,14,41I/-.

   Each of the above grounds is without prejudice to one another and the appellant craves leave of the learned Hon'ble Income Tax Appellate Tribunal, Bangalore, to add, delete, amend or otherwise modify one or more of the above grounds either before or at the time of hearing of this appeal.

4. For the sake of convenience and clarity, the facts in appeal IT(TP)A No.29/Bang/2014 for the assessment year 2009-10 are stated herein.

5. Briefly, facts of the case are that the assessee is a company duly incorporated under the provisions of the Companies Act, 1956. It is engaged in the business of trading in finished, semi-finished opthalmic lenses, optical meters and processing of semi-finished ophthalmic lenses. It is wholly owned subsidiary of Essilor International SA, France [hereinafter referred to as 'AE']. The license to use quoting technology is granted by AE. In consideration for granting the right to use the technology, the assessee-company is charged a royalty of 0.60 cents of USD

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per lens, for an anti glare coating and 0.30 cents of USD per lens for a hard coating lens produced and sold by the assessee-company. The assessee-company purchases ophthalmic lenses from the AE and sells them after some processing.

6. The assessee-company had filed its return of income for the assessment year 2009-10 on 30/09/2009 declaring a total income of Rs.13,48,74,129/-. The assessee-company reported the following international transactions as per its report in 3CEB:

International transaction	Amount (Rs.)
Lens imported	28,27,86,616/-
Purchase returns lenses	4,51,584/-
Instruments imported	1,34,90,411/-
Export of lens	20,82,645/-
Import of consumables	2,61,70,268/-
Purchase returns – Consumables	5,80,277/-
Import of spares and others	1,13,30,904/-
Purchase returns – spares and others	3,63,832/-
Import of fixed assets	56,75,339/-
Royalty expenses	62,43,766/-
Commission received	44,45,256/-
Services – received (training costs, web ordering)	5,19,313/-
Cost sharing – paid or payable – BWS clone renting and application running costs	9,55,913/-
Cost sharing – received or receivable	1,08,74,428/-
Reimbursement of expenses – received or receivable	5,84,221/-
Reimbursement of expenses paid or payable	51,757/-
Project grant received	51,76,000/-
Expenditure incurred for project	39,94,765/-
Sample lenses	1,67,994/-
Compensation received for obsolete lenses	20,160/-

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7. During the previous year relevant to assessment year 2009-10 assessee-company paid the above amount to its AE. The assessee-company sought to justify the consideration paid for the international transactions entered into with the AE to be at ALP. The assessee-company submitted a transfer pricing report adopting operating profit margin to the turnover as the Profit Level Indicator ('PLI') for the transfer pricing studies. The assessee-company applied the Transactional Net Margin Method (TNMM) which was considered to be the most appropriate method for the purposes of benchmarking the international transaction. The assessee-company's operating profit margin (i.e. operating profit/total turnover) was computed at 13.45% and the assessee-company claimed that the same was comparable with other companies engaged in the similar line of business. For the purposes of the transfer pricing study, the assessee-company chose two comparable entities viz. GKB Opticals Ltd., and Techtran Polylenses and the arithmetic average of the operating profit margins of the said comparables was computed at (-)3.31%. Therefore, according to the assessee-company, since its PLI was more than the average PLI of the comparables, it was claimed that these transactions with its AE are at arm's length price (ALP).

8. AO referred the matter to TPO. The TPO, by an order dated 11/1/2013 passed u/s 92CA(3) of the Act, computed the TP adjustment at Rs.10,65,96,361/-. While doing so, the TPO held

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that the assessee-company incurred expenditure on account of sales promotion and advertisement (AMP) more than 3.33% of the turnover. The TPO observed that the assessee-company incurred expenditure on account of sales promotion and advertisement to the tune of Rs.16,24,01,249/- which is 14.2% of the total revenue. The TPO noticed that in the case of comparable companies chosen by the assessee-company viz., GKP Opticals and Techtran Polylenses Ltd., the average expenditure on those items worked out to only 3.3% of the turnover. Therefore, the TPO adopted 3.3% of the turnover to bench mark the transaction of the AMP with its AE. The TPO had also worked out the operating margin on the total operating cost at 20.22% after excluding the additional expenditure incurred on AMP of Rs.8,86,67,743/- from the total operating cost. He has also applied the mark up on the AMP expenditure at 20.22% and finally, ALP was computed as under:

Particulars	**Amount (Rs.)**
Operating Revenue Services (excluding other income)	114,31,94,600
Operating Cost (excluding additional advertisement expenses of Rs.8,86,67,743/-)	95,08,53,928
Profit	19,23,40,672
OP/OC	20.22%
Additional advertisement expenses incurred for promotion of brand on behalf of the AE	8,86,67,743
Arm's Length Price	NIL
Reimbursement received for advertisement expenses incurred for brand promotion of AE's products	

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(i) Adjustment u/s 92CA	8,86,67,743
(ii) Adjustment u/s 92CA on account of mark up	1,79,28,618
Total adjustment u/s 92CA [i + ii])	10,65,96,361

9. Therefore, the TPO proposed adjustment of Rs.10,65,96,361/- u/s 92CA on account of AMP expenditure. However, the TPO held that other international taxations entered into by the assessee-company with its AE are to be at arm's length and therefore, not proposed any addition.

10. Pursuant to the TPO order, draft assessment order dated 31/1/2013 was passed by the AO, wherein the following disallowances were proposed

- (i) adjustment on account of transfer pricing of Rs.10,65,96,361/-,
- (ii) bad debts of Rs.76,98,072/-,
- (iii) software expenses of Rs.38,60,822/-,
- (iv) warranty expenses of Rs.7,38,953/-,
- (v) warranty replacement of Rs.60,53,621/- and
- (vi) new product launch expenses of Rs.42,15,017/-.

11. Being aggrieved by the draft assessment order, the assessee-company filed objections before the Dispute Resolution Panel (DRP) contesting all the additions. It was contended by the assessee-company before the DRP, *inter alia* that

(i) in the absence of agreement between the assessee-company and its AE, the question of promotion of brand or sharing the advertisement expenditure does not arise.

(ii) It cannot be presumed that there is an international transaction within the meaning of sec.92B of the Act.

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(iii)The burden of proof lies on the TPO to prove the existence of international transaction and not on the assessee-company.

Without prejudice to the above, it was claimed that the entire expenditure incurred on the advertisement and sales promotion cannot be added as transfer pricing adjustment. It is only the expenditure beyond 3.34% of the revenue that can be treated as excess expenditure and even for the purpose of calculating mark up and AMP expenditure, it was claimed that depreciation should be treated as operating cost in which event, profit on the operating cost will work out to 11.47%. The same percentage should be adopted for the purpose of applying mark up on AMP expenditure.

12. The ld. DRP, after considering the above submissions of the assessee-company, had set aside the issue to the file of the TPO to examine the case in the light of the decision of the Special Bench of ITAT in the case of *LG Electronics India Pvt. Ltd.,* 140 ITD 41)(Del)(SB) and determine the cost of services provided by the assessee-company to its AE in the form of AMP expenditure incurred for promoting the brands of AE after determining the cost of the services so provided, to determine the margin on these services by applying the cost plus method, as prescribed by the Special Bench of ITAT in the above-mentioned case.

13. On the issue of bad debts, the issue was restored to the file of the AO to examine whether the debtors accounts have been

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credited which have been claimed as bad debts and if it is found so, to allow the same as deduction. On the issue of software expenditure, the ld.DRP found favour with the submission of the assessee-company and directed the AO to allow the same. The ground relating to warranty expenditure was allowed by the ld.DRP following the decision of the Hon'ble Apex Court in the case of *Rotork Controls P. Ltd*. reported in 314 ITR 62. On the issue of product launch expenditure, the DRP held that the expenditure was in the nature of revenue and directed the AO to allow the same. On the issue of disallowance u/s 14A of Rs.60,98,834/-, the disallowance was confirmed by the DRP on the ground that the assessee-company had failed to maintain separate accounts in respect of tax exempt income.

14. Being aggrieved, the assessee-company is before us with the present appeals. It is contended that international transactions cannot be presumed on incurring AMP expenditure in absence of tangible material to show that the two parties 'acted in concert'. The AMP expenditure was incurred by the assessee-company only to promote the sales of the products of the company. It was further contended that the expenses such as convention expenses, loyalty programme expenses and merchandising expenditure should not be treated as advertisement marketing expenditure. It was further submitted that these expenses only incurred in connection with the sales.

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Therefore, it should be treated as selling expenses. On the issue of disallowance u/s 14A of the Act, it was contended that no expenditure was incurred to earn the dividend income and without rendering finding as to the correctness of the claim of the assessee-company, the disallowance should not have been made.

15. On the other hand, ld.CIT(DR) vehemently contested the submissions of the ld. AR and submitted that on the issue of transfer pricing adjustment on AMP, the matter may be restored to the file of the TPO for fresh adjudication in the light of the law laid down by the Hon'ble Delhi High Court in the case of *Sony Ericsson Mobile Communication India (P) Ltd. Vs. CIT* (374 ITR 118)(Del) and on the issue of disallowance u/s 14A, he submitted that new issue was raised for the first time before the Tribunal that dividends were earned from the subsidiary company and the investments were made in the subsidiary company in the business interests of the assessee-company and out of commercial expediency. Therefore, the disallowance should be confirmed.

16. We have heard the rival submissions and perused the material on record. We shall now deal with grounds relating to TP adjustments made by the TPO/AO as confirmed by the ld.DRP on AMP expenditure. The issue that arises for consideration is whether the advertisement, marketing and promotion expenses

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incurred by the assessee can be said to be incurred not only for the benefit of the assessee-company but also by way of rendering services of promoting the brand of foreign AE viz. Essilor International SA, France. The case of the assessee-company is that the expenditure was incurred only for increasing the sales of its product and no benefit accrued to its foreign AE and there is no international transaction on AMP expenditure as envisaged within the meaning of sec.92B of the Act. The ld.DRP confirmed the existence of international transaction on AMP expenditure following the law laid down by the Special bench of Tribunal in the case of *LG Electronics India (P) Ltd. & others* (sura). However, ld.DRP remitted the matter to the file of TPO for determination of ALP in the light of law laid down therein. The correctness of the decision of the Special bench of the Tribunal in the case of *LG Electronics India (P) Ltd.,* (supra) was considered by the Hon'ble Delhi High Court in the case of *Sony Ericsson Mobile Communication India (P) Ltd.*(supra). The following questions were addressed by the Hon'ble Delhi High Court:

> "(i) Whether the additions suggested by the Transfer Pricing Officer on account of Advertising/Marketing and Promotion Expenses (AMP Expenses' for short) was beyond jurisdiction and bad in law as no specific reference was made by the Assessing Officer, having regard to retrospective amendment to Section 92CA of the Income Tax Act, 1961 by Finance Act, 2012.
>
> (ii)Whether AMP Expenses incurred by the assessee in India can be treated and categorized as an international transaction under Section 92B of the Income Tax Act, 1961?

(iii) Whether under Chapter X of the Income Tax Act, 1961, a transfer pricing adjustment can be made by the Transfer Pricing Officer/ Assessing Officer in respect of expenditure treated as AMP Expenses and if so in which circumstances?

(iv) If answer to question Nos.2 and 3 is in favour of the Revenue, whether the Income Tax Appellate Tribunal was right in holding that transfer pricing adjustment in respect of AMP Expenses should be computed by applying Cost Plus Method.

(v) Whether the Income Tax Appellate Tribunal was right in directing that fresh bench marking/comparability analysis should be undertaken by the Transfer Pricing Officer by applying the parameters specified in paragraph 17.4 of the order dated 23.01.2013 passed by the Special Bench in the case of LG Electronics India (P) Ltd.?"

17. The conclusions of the Division Bench in Sony Ericsson (supra) are as under:

(i) The Court concurred with the majority of the Special Bench of the ITAT in the LG Electronics case qua the applicability of 92CA(2B) and how it cured the defect inherent in 92CA(2A). The issue concerning retrospective insertion of 92CA(2B) was decided in favour of the Revenue.

(ii) AMP expenses were held to be international transaction as this was not denied as such by the assessees.

(iii) Chapter X and Section 37(1) of the Act operated independently. The former dealt with the ALP of an international transaction whereas the latter deals with the allowability/disallowability of business expenditure. Also, once the conditions for applicability of Chapter X were satisfied nothing shall impede the law contained therein to come into play.
(iv) Chapter X dealt with ALP adjustment whereas Section 40A(2)(b) dealt with the reasonability of quantum of expenditure.

(v) TNMM applied with equal force on single transaction as well as multiple transactions as per

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the scheme of Chapter X and the TP Rules. Thus, the word 'transaction' would include a series of closely linked transactions.

(vi) The TPO/AO could overrule the method adopted by the Assessee for determining the ALP and select the most appropriate method. The reasons for selecting or adopting a particular method would depend upon functional analysis comparison, which required availability of data of comparables performing of similar or suitable functional tasks in a comparable business. When suitable comparables relating to a particular method were not available and functional analysis or adjustment was not possible, it would be advisable to adopt and apply another method.

(vii) Once the AO /TPO accepted and adopted the TNMM, but chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would lead to unusual and incongruous results as AMP expenses was the cost or expense and was not diverse. It was factored in the net profit of the inter-linked transaction. The TNMM proceeded on the assumption that functions, assets and risks being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible.

(viii) The Bright Line Test was judicial legislation. By validating the Bright Line Test the Special Bench in LG Electronics Case (supra) went beyond Chapter X of the Act. Even international tax jurisprudence and commentaries do not recognise BLT for bifurcation of routine and non-routine expenses.

(ix) Segregation of aggregated transactions requires detailed scrutiny without which there shall be no segregation of a bundled transaction. Set off of transactions segregated as a single transaction is just and equitable and not prohibited by Section

92(3). Set-off is also recognized by international tax experts and commentaries.
(x) Segregation of bundled transactions shall be done only if exceptions laid down in CIT v. EKL Appliances Ltd. [2012] 345 ITR 241 (Del) are justified. Re-categorisation and segregation of transactions are different exercises; former would require separate comparables and functional analysis.

(xi) Economic ownership of a brand would only arise in cases of longterm contracts and where there is no negative stipulation denying economic ownership. Economic ownership of a brand or a trade mark when pleaded can be accepted if it is proved by the Assessee. The burden is on the Assessee. It cannot be assumed.

(xii) After the order of the Supreme Court in the Maruti Suzuki case, the judgment of the Delhi High Court does not continue to bind the parties. This position was misunderstood by the majority of the Special Bench in the LG Electronics Case.

(xiii) The RP Method loses its accuracy and reliability where the reseller adds substantially to the value of the product or the goods are further processed or incorporated into a more sophisticated product or when the product/service is transformed. RP Method may require fewer adjustments on account of product differences in comparison to the CUP Method because minor product differences are less likely to have material effect on the profit margins as they do on the price.

(xiv) Determination of cost or expense can cause difficulties in applying cost plus (CP) Method. Careful consideration should be given to what would constitute cost i.e. what should be included or excluded from cost. A studied scrutiny of CP Method would indicate that when the said Method is applied by treating AMP expenses as an independent transaction, it would not make any difference whether the same are routine or non-routine, once functional comparability with or without adjustment is accepted.

(xv) The task of arm's length pricing in the case of tested party may become difficult when a number of transactions are interconnected and compensated

but a transaction is bifurcated and segregated. CP Method, when applied to the segregated transaction, must pass the criteria of most appropriate method. If and when such determination of gross profit with reference to AMP transaction is required, it must be undertaken in a fair, objective and reasonable manner.

(xvi) The marketing or selling expenses like trade discounts, volume discounts, etc. offered to sub-distributors or retailers are not in the nature and character of brand promotion. They are not directly or immediately related to brand building exercise, but have a live link and direct connect with marketing and increased volume of sales or turnover. The brand building connect is too remote and faint. To include and treat the direct marketing expenses like trade or volume discount or incentive as brand building exercise would be contrary to common sense and would be highly exaggerated. Direct marketing and sale related expenses or discounts/concessions would not form part of the AMP expenses.

(xvii) The prime lending rate cannot be the basis for computing markup under Rule 10B(1)(c) of the Rules, as the case set up by the Revenue pertains to mark-up on AMP expenses as an international transaction. Mark up as per sub-clause (ii) to Rule 10B(1)(c) would be comparable gross profit on the cost or expenses incurred as AMP. The mark-up has to be benchmarked with comparable uncontrolled transactions or transactions for providing similar service/product.

(xviii) The exceptions laid down in EKL Appliances Case (supra) were neither invoked in the present case nor were the conditions satisfied.

(xix) An order of remand to the ITAT for de novo consideration would be appropriate because the legal standards or ratio accepted and applied by the ITAT was erroneous. On the basis of the legal ratio expounded in this decision, facts have to be ascertained and applied. If required and necessary, the assessed and the Revenue should be asked to furnish details or tables. The ITAT, in the first instance, would try and dispose of the appeals, rather than passing an order of remand to the AO /TPO. An endeavour should be to ascertain and

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> satisfy whether the gross/net profit margin would duly account for AMP expenses. When figures and calculations as per the TNM or RP Method adopted and applied show that the net/gross margins are adequate and acceptable, the appeal of the assessed should be accepted. Where there is a doubt or the other view is plausible, an order of remand for re-examination by the AO/TPO would be justified. A practical approach is required and the ITAT has sufficient discretion and flexibility to reach a fair and just conclusion on the ALP. Impugned order of the ITAT 21. The Assessee then filed appeals being ITA Nos. ITA No. 3861/Del/2010, 4924/Del/2011, 6580/Del/2013 and 6382/Del/2012 for the said four AYs in question. The above four appeals were disposed of by the common impugned order dated 23rd May 2014 by the ITAT.

18. It is important to note that in the cases dealt by the Hon'ble Delhi High Court along with *Sony Ericsson Mobile Communication India (P) Ltd.*(supra), the assessees were distributors of products manufactured by the foreign AE. The said assessees themselves were not manufacturers. More over none of the said assesses appears to have questioned the very existence of international transaction with foreign AE. It was also not disputed that the said international transaction of incurring AMP expenditure could be subject matter of TP adjustments in terms of sec.92 of the Act.

19. In the present case, the assessee-company imports the lens from its foreign AE and after some processing, sells the products on its own. However, the amount of value addition on account of processing in terms of total revenue is not clear from the material on record. That apart, the assessee-company has

been throughout contesting before all the authorities the very existence of international transaction on account of incurring AMP expenditure between assessee-company and its AE and therefore, the contentions that the law laid down by the Hon'ble Delhi High Court in *Sony Ericsson Mobile Communication India (P) Ltd.* (supra) should be applied to the case on hand, is not correct. Therefore, the submission of the learned Departmental Representative that the matter be remanded to the file of TPOD for fresh decision in the light of law laid down by the Hon'ble Delhi High Court in the case of *Sony Ericsson Mobile Communication India (P) Ltd.*(supra), cannot be acceded to.

20. Subsequent to the decision in the case of *Sony Ericsson Mobile Communication India (P) Ltd.*(supra), the Hon'ble Delhi High Court had rendered five decisions on the same issue. Those decisions are:

(i) Maruti Suzuki India Ltd. Vs. CIT (282 CTR 1),
(ii) CIT vs. Whirlpool of India Ltd. (129 DTR (169),
(iii) Bausch & Lomb Eyecare (India) (P) Ltd. Vs. Addl.CIT (129 DTR 201) and
(iv) Yum Restaurants (India) Pvt. Ltd. Vs. ITO (ITA No.349/2015 dated 13/01/2016) and
(v) Honda SeilProducts

In the above-mentioned decisions, the issue of the very existence of international transaction on incurring AMP expenditure and the method of determination of ALP was the subject matter of appeal before the Hon'ble Delhi High Court. The Hon'ble Delhi High Court had categorically held that in the absence of agreement

between Indian entity and foreign AE whereby the Indian entity was obliged to incur AMP expenditure of a certain level for foreign entity for the purpose of promoting the brand value of the products of the foreign entity, no international transaction can be presumed. It was further held that the fact that there was an incidental benefit to the foreign AE, it cannot be said that AMP expenditure incurred by an Indian entity was for promoting brand of foreign AE. One more aspect highlighted by the Hon'ble High Court is that in the absence of machinery provisions, bringing an imagined transaction to tax was not possible. While coming to this conclusion, the Hon'ble High Court had placed reliance on the decisions of the Hon'ble Apex Court in the cases of *CIT vs. B.C.Srinivasa Setty* (128 ITR 294) and *PNB Finance Ltd. Vs. CIT* (307 ITR 75). The Hon'ble Delhi High Court after referring to its earlier decision in the case of *Maruti Suzuki India Ltd* (supra) *and Whirlpool of India (P) Ltd.,*(supra) had considered the question of existence of the international transaction and computation of ALP thereon in the case of *Bausch & Lomb Eyecare (India) (P) Ltd.*(supra) vide para 51 to 65 as under:

> *"51. The central issue concerning the existence of an international transaction regarding AMP expenses requires the interpretation of provisions of Chapter X of the Act, and to determine whether the Revenue has been able to show prima facie the existence of international transaction involving AMP between the Assessee and its AE.*
>
> *52. At the outset, it must be pointed out that these cases were heard together with another batch of cases, two of which have already been decided by this Court. The two decisions are the judgement dated 11th*

December 2015 in ITA No. 110/2014 (Maruti Suzuki India Ltd. v. Commissioner of Income Tax) and the judgment dated 22nd December 2015 in ITA No. 610 of 2014 (The Commissioner of Income Tax-LTU v. Whirlpool of India Ltd.) and many of the points urged by the counsel in these appeals have been considered in these two judgments.

53. A reading of the heading of Chapter X ["Computation of income from international transactions having regard to arm's length price"] and Section 92 (1) which states that any income arising from an international transaction shall be computed having regard to the ALP and Section 92C (1) which sets out the different methods of determining the ALP, makes it clear that the transfer pricing adjustment is made by substituting the ALP for the price of the transaction. To begin with there has to be an international transaction with a certain disclosed price. The transfer pricing adjustment envisages the substitution of the price of such international transaction with the ALP.

54. Under Sections 92B to 92F, the pre-requisite for commencing the TP exercise is to show the existence of an international transaction. The next step is to determine the price of such transaction. The third step would be to determine the ALP by applying one of the five price discovery methods specified in Section 92C. The fourth step would be to compare the price of the transaction that is shown to exist with that of the ALP and make the TP adjustment by substituting the ALP for the contract price.

55. Section 92B defines 'international transaction' as under:

"Meaning of international transaction. 92B.(1) For the purposes of this section and sections 92, 92C , 92D and 92E , "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or

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facility provided or to be provided to any one or more of such enterprises. (2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise."

56. Thus, under Section 92B(1) an 'international transaction' means- (a) a transaction between two or more AEs, either or both of whom are non-resident (b) the transaction is in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, incomes or losses of such enterprises, and (c) shall include a mutual agreement or arrangement between two or more AEs for allocation or apportionment or contribution to the any cost or expenses incurred or to be incurred in connection with the benefit, service or facility provided or to be provided to one or more of such enterprises.

57. Clauses (b) and (c) above cannot be read disjunctively. Even if resort is had to the residuary part of clause (b) to contend that the AMP spend of BLI is "any other transaction having a bearing" on its "profits, incomes or losses", for a 'transaction' there has to be two parties. Therefore for the purposes of the 'means' part of clause (b) and the 'includes' part of clause (c), the Revenue has to show that there exists an 'agreement' or 'arrangement' or 'understanding' between BLI and B&L, USA whereby BLI is obliged to spend excessively on AMP in order to promote the brand of B&L, USA. As far as the legislative intent is concerned, it is seen that certain transactions listed in the Explanation under clauses (i) (a) to (e) to Section 92B are described as an 'international transaction'. This might be only an illustrative list, but significantly it does not list AMP spending as one such transaction.

58. In Maruti Suzuki India Ltd. (supra) one of the submissions of the Revenue was: "The mere fact that the service or benefit has been provided by one party to the other would by itself constitute a transaction irrespective of whether the consideration for the same

has been paid or remains payable or there is a mutual agreement to not charge any compensation for the service or benefit." This was negatived by the Court by pointing out: "Even if the word 'transaction' is given its widest connotation, and need not involve any transfer of money or a written agreement as suggested by the Revenue, and even if resort is had to Section 92F (v) which defines 'transaction' to include 'arrangement', 'understanding' or 'action in concert', 'whether formal or in writing', it is still incumbent on the Revenue to show the existence of an 'understanding' or an 'arrangement' or 'action in concert' between MSIL and SMC as regards AMP spend for brand promotion. In other words, for both the 'means' part and the 'includes' part of Section 92B (1) what has to be definitely shown is the existence of transaction whereby MSIL has been obliged to incur AMP of a certain level for SMC for the purposes of promoting the brand of SMC."

59. In Whirlpool of India Ltd. (supra), the Court interpreted the expression "acted in concert" and in that context referred to the decision of the Supreme Court in Daiichi Sankyo Company Ltd. v. Jayaram Chigurupati 2010(6) MANU/SC/0454/2010, which arose in the context of acquisition of shares of Zenotech Laboratory Ltd. by the Ranbaxy Group. The question that was examined was whether at the relevant time the Appellant, i.e., Daiichi Sankyo Company and Ranbaxy were "acting in concert" within the meaning of Regulation 20(4) (b) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. In para 44, it was observed as under:

"The other limb of the concept requires two or more persons joining together with the shared common objective and purpose of substantial acquisition of shares etc. of a certain target company. There can be no "persons acting in concert" unless there is a shared common objective or purpose between two or more persons of substantial acquisition of shares etc. of the target company. For, de hors the element of the shared common objective or purpose the idea of "person acting in concert" is as meaningless as criminal conspiracy without any agreement to commit a criminal offence. The idea of "persons acting in concert" is not about a fortuitous relationship coming into existence by accident or chance. The relationship can come into being only by design, by meeting of minds between two

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or more persons leading to the shared common objective or purpose of acquisition of substantial acquisition of shares etc. of the target company. It is another matter that the common objective or purpose may be in pursuance of an agreement or an understanding, formal or informal; the acquisition of shares etc. may be direct or indirect or the persons acting in concert may cooperate in actual acquisition of shares etc. or they may agree to cooperate in such acquisition. Nonetheless, the element of the shared common objective or purpose is the sine qua non for the relationship of "persons acting in concert" to come into being."

60. The transfer pricing adjustment is not expected to be made by deducing from the difference between the 'excessive' AMP expenditure incurred by the Assessee and the AMP expenditure of a comparable entity that an international transaction exists and then proceeding to make the adjustment of the difference in order to determine the value of such AMP expenditure incurred for the AE. In any event, after the decision in Sony Ericsson (supra), the question of applying the BLT to determine the existence of an international transaction involving AMP expenditure does not arise.

61. There is merit in the contention of the Assessee that a distinction is required to be drawn between a 'function' and a 'transaction' and that every expenditure forming part of the function cannot be construed as a 'transaction'. Further, the Revenue's attempt at re-characterising the AMP expenditure incurred as a transaction by itself when it has neither been identified as such by the Assessee or legislatively recognised in the Explanation to Section 92 B runs counter to legal position explained in CIT v. EKL Appliances Ltd. (supra) which required a TPO "to examine the 'international transaction' as he actually finds the same."

62. In the present case, the mere fact that B&L, USA through B&L, South Asia, Inc holds 99.9% of the share of the Assessee will not ipso facto lead to the conclusion that the mere increasing of AMP expenditure by the Assessee involves an international transaction in that regard, with B&L, USA. A similar contention by the Revenue, namely, that even if there is no explicit arrangement, the fact that the benefit of such AMP expenses would also enure to the AE is itself sufficient to infer the existence of an international transaction has

been negatived by the Court in Maruti Suzuki India Ltd. (supra) as under:

"68. The above submissions proceed purely on surmises and conjectures and if accepted as such will lead to sending the tax authorities themselves on a wild-goose chase of what can at best be described as a 'mirage'. First of all, there has to be a clear statutory mandate for such an exercise. The Court is unable to find one. To the question whether there is any 'machinery' provision for determining the existence of an international transaction involving AMP expenses, Mr. Srivastava only referred to Section 92F (ii) which defines ALP to mean a price "which is applied or proposed to be applied in a transaction between persons other than AEs in uncontrolled conditions". Since the reference is to 'price' and to 'uncontrolled conditions' it implicitly brings into play the BLT. In other words, it emphasises that where the price is something other than what would be paid or charged by one entity from another in uncontrolled situations then that would be the ALP. The Court does not see this as a machinery provision particularly in light of the fact that the BLT has been expressly negatived by the Court in Sony Ericsson. Therefore, the existence of an international transaction will have to be established de hors the BLT.
....
70. What is clear is that it is the 'price' of an international transaction which is required to be adjusted. The very existence of an international transaction cannot be presumed by assigning some price to it and then deducing that since it is not an ALP, an 'adjustment' has to be made. The burden is on the Revenue to first show the existence of an international transaction. Next, to ascertain the disclosed 'price' of such transaction and thereafter ask whether it is an ALP. If the answer to that is in the negative the TP adjustment should follow. The objective of Chapter X is to make adjustments to the price of an international transaction which the AEs involved may seek to shift from one jurisdiction to another. An 'assumed' price cannot form the reason for making an ALP adjustment."
71. Since a quantitative adjustment is not permissible for the purposes of a TP adjustment under Chapter X, equally it cannot be permitted in respect of AMP expenses either. As already noticed hereinbefore, what the Revenue has sought to do in the present case is to resort to a quantitative adjustment by first determining whether the AMP spend of the Assessee on application of the BLT, is excessive, thereby evidencing the

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existence of an international transaction involving the AE. The quantitative determination forms the very basis for the entire TP exercise in the present case.

....

74. The problem with the Revenue's approach is that it wants every instance of an AMP spend by an Indian entity which happens to use the brand of a foreign AE to be presumed to involve an international transaction. And this, notwithstanding that this is not one of the deemed international transactions listed under the Explanation to Section 92B of the Act. The problem does not stop here. Even if a transaction involving an AMP spend for a foreign AE is able to be located in some agreement, written (for e.g., the sample agreements produced before the Court by the Revenue) or otherwise, how should a TPO proceed to benchmark the portion of such AMP spend that the Indian entity should be compensated for?

63. Further, in Maruti Suzuki India Ltd. (supra) the Court further explained the absence of a 'machinery provision qua AMP expenses by the following analogy:

"75. As an analogy, and for no other purpose, in the context of a domestic transaction involving two or more related parties, reference may be made to Section 40 A (2) (a) under which certain types of expenditure incurred by way of payment to related parties is not deductible where the AO "is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods." In such event, "so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction." The AO in such an instance deploys the 'best judgment' assessment as a device to disallow what he considers to be an excessive expenditure. There is no corresponding 'machinery' provision in Chapter X which enables an AO to determine what should be the fair 'compensation' an Indian entity would be entitled to if it is found that there is an international transaction in that regard. In practical terms, absent a clear statutory guidance, this may encounter further difficulties. The strength of a brand, which could be product specific, may be impacted by numerous other imponderables not limited to the nature of the industry, the geographical peculiarities, economic trends both international and domestic, the consumption patterns, market behaviour and so on. A simplistic approach using one of the modes similar to the ones contemplated by Section 92C may not only be

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legally impermissible but will lend itself to arbitrariness. What is then needed is a clear statutory scheme encapsulating the legislative policy and mandate which provides the necessary checks against arbitrariness while at the same time addressing the apprehension of tax avoidance."

64. In the absence of any machinery provision, bringing an imagined transaction to tax is not possible. The decisions in CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294 (SC) and PNB Finance Ltd. v. CIT (2008) 307 ITR 75 (SC) make this position explicit. Therefore, where the existence of an international transaction involving AMP expense with an ascertainable price is unable to be shown to exist, even if such price is nil, Chapter X provisions cannot be invoked to undertake a TP adjustment exercise.

65. As already mentioned, merely because there is an incidental benefit to the foreign AE, it cannot be said that the AMP expenses incurred by the Indian entity was for promoting the brand of the foreign AE. As mentioned in Sassoon J David (supra) "the fact that somebody other than the Assessee is also benefitted by the expenditure should not come in the way of an expenditure being allowed by way of a deduction under Section 10 (2) (xv) of the Act (Indian Income Tax Act, 1922) if it satisfies otherwise the tests laid down by the law".

21. Respectfully following the ratio of the decision of the Hon'ble Delhi High Court in the above cases, we hold that no TP adjustment can be made by deducing from the difference between AMP expenditure incurred by assessee-company and AMP expenditure of comparable entity, if there is no explicit arrangement between the assessee-company and its foreign AE for incurring such expenditure. The fact that the benefit of such AMP expenditure would also enure to its foreign AE is not sufficient to infer existence of international transaction. The onus lies on the revenue to prove the existence of international

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transaction involving AMP expenditure between the assessee-company and its foreign AE. We also hold that that in the absence of machinery provisions to ascertain the price incurred by the assessee-company to promote the brand values of the products of the foreign entity, no TP adjustment can be made by invoking the provisions of Chapter X of the Act.

22. Applying the above legal position to the facts of the present case, it is not a case of revenue that there existed an arrangement and agreement between the assessee-company and its foreign AE to incur AMP expenditure to promote brand value of its products on behalf of the foreign AE, merely because the assessee-company incurred more expenditure on AMP compared to the expenditure incurred by comparable companies, it cannot be inferred that there existed international transaction between assessee-company and its foreign AE. Therefore, the question of determination of ALP on such transaction does not arise. However, the transaction of expenditure on AMP should be treated as a part of aggregate of bundle of transactions on which TNMM should be applied in order to determine the ALP of its transactions with its AE. In other words, the transaction of expenditure on AMP cannot be treated as a separate transaction. In the present case, we find from the TP study that the operating profit cost to the total operating cost was adopted as Profit Level Indicator which means that the AMP expenditure was not

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considered as a part of the operating cost. This goes to show that the AMP expenditure was not subsumed in the operating profitability of the assessee-company. Therefore, in order to determine the ALP of international transaction with its AE, it is *sine qua non* that the AMP expenditure should be considered as a part of the operating cost. Therefore, we restore the issue of determination of ALP, on the above lines, to the file of the AO/TPO. The grounds of appeal raised by the assessee-company on this issue are partly allowed.

23. Now, we advert to the grounds of appeal challenging the addition made u/s 14A of the Act. The ld.DRP had directed the AO to proceed with disallowance u/s 14A only after giving a finding that expenditure was incurred to earn the exempt income. From the assessment order, it is noticed that the AO had invoked the provisions of rule 8D to make disallowance in respect of indirect expenditure incurred to earn exempt income. But it appears that the direction of the ld. DRP has not been followed in true spirit by the AO. Therefore, we are of the considered opinion that interest of justice would be met if this issue is restored to the file of the AO for *de novo* consideration in the light of the direction of the ld.DRP.

24. Since the facts and circumstances and the grounds of appeal raised in the appeal for the assessment year 2010-11 are

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similar with that of the appeal for the assessment year 2009-10, the appeal is disposed of on the same lines.

24. In the result, the both the appeals are treated as partly allowed.

Order pronounced in the open court on this 5th day of February, 2016

sd/-	sd/-
(VIJAY PAL RAO)	**(INTURI RAMA RAO)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Place : Bangalore
D a t e d : 05/02/2016

srinivasulu, sps

Copy to :

1. Appellant
2. Respondent
3. CIT(A)-II Bangalore
4. CIT
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore

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