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

Reserved on :21st September 2015
Decided on: 22nd December 2015

\+ **ITA 610/2014**

THE COMMISSIONER OF INCOME TAX-LTU ..... Appellant
Through: Mr. G. C. Srivastava and Mr. D. S. Bhardwaj Advocates.

versus

WHIRLPOOL OF INDIA LTD. ..... Respondent
Through: Mr Ajay Vohra, Senior Advocate with Ms. Kavita Jha, Mr. Neeraj Jain and Mr Aditya Vohra, Advocates.

AND

\+ **ITA 228/2015 & CM No.5751/2015**

WHIRLPOOL OF INDIA LTD. ..... Appellant
Through: Mr Ajay Vohra, Senior Advocate with Ms. Kavita Jha, Mr. Neeraj Jain and Mr Aditya Vohra, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME-TAX .....Respondent
Through: Mr. G. C. Srivastava and Mr. D. S. Bhardwaj, Advocates.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

J U D G M E N T

% 22.12.2015

Dr. S. Muralidhar, J.:

1. These two appeals, one by the Revenue and the other by the Assessee, under Section 260 A of the Income Tax Act 1961 ('Act') are directed against the common order dated 13th January 2014 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No. 426/Del/2013 for the Assessment Year ('AY') 2008-09.

The issue

2. These appeals concern the issue of transfer pricing ('TP') adjustment in relation to the incurring of advertisement, marketing and sales promotion ('AMP') expenses by the Indian entities involved in international transactions with their respective foreign associated enterprises ('AEs'). The case of the Revenue is that the arm's length price ('ALP') of the AMP expenses incurred by the Indian entity i.e the Assessee is required to be determined since it has been using, for marketing and promotion or otherwise the brand of its foreign AE and that the incurring of such AMP expenses, while enuring to the benefit of the Assessee, is also benefiting the brand of the foreign AE. The attempt by the revenue is to attribute some part of the AMP expenses incurred as having been incurred for the foreign AE for which the Assessee is to be compensated or reimbursed by the foreign AE.

The ITAT's decision in LG Electronics

3. Before discussing the facts of the present case it requires to be noticed that the issue of making of TP adjustments to AMP expenses was

considered by the Special Bench of the ITAT in a batch of cases. By a majority of 2:1, the Special Bench of the ITAT in ***LG Electronics India Pvt. Ltd. v. ACIT (2013) 140 ITD 41 (Del)***, *inter alia* decided:

> (i) A TP adjustment in relation to AMP expenses incurred by the Assessee for creating and improving the marketing intangibles for its foreign AE was permissible.
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> (ii) Earning the mark up from the AE in respect of AMP expenses incurred by the foreign AE was also allowed.

4. The majority of the ITAT adopted the Bright Line Test ('BLT') for determining the existence of an international transaction involving AMP expenses as well as for determining its ALP. If the expense incurred by the Assessee on AMP was higher than what was incurred by an independent entity behaving in a commercially rational manner, then the Transfer Pricing Officer (TPO) would determine whether the said transaction required re-characterisation. If the Assessee failed to supply the details of the value of such international transaction, the onus was on the TPO to determine its ALP on some rational basis by identifying the comparable domestic cases. It was further held that the initial burden to show that the international transaction with the AE was at ALP was on the Assessee.

The decision of this Court in Sony Ericsson

5. The correctness of the decision of the Special Bench of the ITAT in ***LG Electronics*** (*supra*) was considered by this Court in ***Sony Ericsson Mobile Communications India P. Ltd. v. Commissioner of Income Tax (2015)***

374 ITR 118 (Del). This Court heard a batch of appeals in the aforementioned decision and disposed of in particular the appeals concerning the Indian entities who were distributers of products manufactured by their respective foreign AEs including Sony Ericsson Mobile Communications India Pvt. Ltd, Discovery Communications India, Daikin Air-conditioning (India) Pvt. Ltd., Reebok India Company and Canon India Pvt. Ltd. The Court explained the features particular to three of the said Assessees i.e Sony Mobile Communications India Pvt. Ltd., Reebok India Company and Canon India Pvt. Ltd. In the case of Sony Mobile Communications India Pvt. Ltd., TNMM had been followed. In respect of Reebok India, the TNMM had been followed for the sourcing of goods and exports from India, the CUP method had been followed in respect of the royalty paid by the Indian entity to the foreign AE and for import of apparels and footwear for re-sale, the re-sale price (‘RP’) method had been followed. In the case of Cannon India, the RP method was adopted for import of finished goods for resale.

6. The following questions were addressed by the Division Bench in ***Sony Ericsson*** (*supra*):

> “(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.?"

7. The summary of the conclusions of the Division Bench in ***Sony Ericsson*** (*supra*) was 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 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*** 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 the ***EKL Appliances Case*** 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 long-term 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 mark-up 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*** 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 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.

Relevant Facts

8. As far as the present appeals are concerned the Assessee, Whirlpool of India Ltd (‘WOIL’), is a subsidiary of Whirlpool Corporation, USA (‘Whirlpool USA') and is engaged in production, sales and distribution of whirlpool appliances. The company’s product portfolio includes washing machines, refrigerators, microwave ovens and air conditioners. There was a technical assistance and transfer agreement entered into between WOIL and Whirlpool USA on 12thMay 2005/13th December 2005 and a trade mark and trade name licence agreement (‘TLA’) on 1st April 2005/13th December 2005. WOIL has been allowed to use the trademarks owned by the AE i.e. Whirlpool USA. WOIL pays brand assistance fees/royalty to the AE for grant of licences to use trademarks belonging to it. These transactions have been benchmarked separately.

9. During the financial year (‘FY’) 2007-08, the international transactions entered into by WOIL were as follows:

Name of International transaction	Method selected	Value of international transaction (INR)
Sale of finished goods	TNMM	1,263,245,853
Sale of spares		30,117,767
Purchase of raw material components and spares for export manufacturing		50,236,010
Purchase of raw material, Components and	CPM	230,094,932

spares for domestic manufacturing		
Purchase of finished goods and spares of resale	TNMM	112,707,323
Contract R&D services		253,406,000
GIS Services		83,723,000
IPO Services		7,329,000
Technical and brand assistance fee	CUP	179,832,400
Payment of interest on ECB loan		22,160,415
Cost recharge		233,216,947

10. Noticing that the Assessee had incurred "extremely high level" of AMP expenses, a reference was made by the Assessing Officer (AO) i.e., the Assistant Commissioner of Income Tax ('ACIT') to the TPO under Section 92CA (1) of the Act for determination of the ALP of the international transactions undertaken by WOIL. The documents prescribed under Rule 10D of the Income Tax Rules, 1962 ('Rules') and other details sought by the TPO were submitted by WOIL. The Assessee also submitted a transfer pricing study ('TP study') dated 24th September 2008 for the FY 2007-08.

The order of the TPO

11. By an order dated 20th October 2011, the TPO determined that the extent of AMP expenditure incurred by the Assessee was to expand the reach of the

AE's brand in India. The Assessee was, therefore, held to be creating "marketing intangibles" in favour of the AE. In particular a reference was made to the expenses incurred in the immediate three earlier AYs as well as the AYs in question in relation to the sales as under:

	AY 2008-09	AY 2007-08	AY 2006-07	AY 2005-06
Sales (Rs. in lakhs)	193,261	159,187	134,561	102,194
Advertisement Exp (Rs. in lakhs)	5,270	4,246	3,844	3,965

12. WOIL contended that it alone was benefiting from the use and exploitation of the whirlpool trade name (which was a very strong name in the global consumer durables industry) and that the AMP expenses incurred by it was for furthering "its own business and commercial interests". It further contended that all the marketing related decisions were taken by WOIL and not by Whirlpool USA. However, the TPO concluded that the increased sales would come up "only when you are able to so position your brand in the market that it will have such powerful recall value that the customer will choose it over your competitors. This is the benefit that is accruing to the brand which is the end result of the increased level of AMP expenses incurred by you". Further, since admittedly it had required concerted effort on the part of the WOIL to ensure proper brand recognition in the Indian Market, the TPO concluded that "it is your company that has established the "'Whirlpool' brand in the Indian market." The TPO proceeded to split up the AMP expenses at Rs. 52.7 crores towards advertisement and Rs. 1,433,626,136 towards discounts and incentives which aggregated to the total of Rs. 1,960,626,136. When compared to the total sales, the ratio of AMP sales worked out to 11.12%. The TPO then

compared this with other consumer goods manufacturers in India in whose case the average advertising plus marketing/sales ratio worked out to 3.78%. It was accordingly concluded that:

> "by achieving this increased level of sales, you have promoted the brand of your AE. It has already been discussed that all the benefit that has come about in this process will inure to your AE. Under these circumstances, it is a fact that you have created marketing intangible in favour of your AE. The creation of this marketing intangible is an international transaction which calls for benchmarking. You should have received compensation for the same. This compensation should at least be the amount spent by you towards the creation of that marketing intangible. That amount is calculated as below.
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> |---|---|
> | Total sales made by you | : Rs.17,622,456,000 |
> | Arm's length level of AMP exp (3. 78% of sale) | : Rs. 666,128,836 |
> | Amount actually spent on AMP exp. | :Rs.1,960,626,136 |
> | Amount spent on creation of marketing intangible | :Rs. 1,294,497,300" |

13. The TPO did not stop at determining the reimbursable amount at Rs. 1,294,497,300. Since the brand building exercise also involved an amount of service, the TPO held that it called for a mark-up which was taken to equal to the prime lending rate of the State Bank of India which for the FY 2007-08 was 12.5%. This worked out to Rs. 161,812,162. However, considering the Assessee's proposition to reduce the ALP of the transactions related to the payment of technical and brand assistance fee to 'nil', that sum was increased as mark up that could have been charged as AMP expenses. As a result, the amount that the Assessee ought to have received from the

AE for the AMP expenses was worked out at Rs. 1,294,497,300. Ultimately, the TPO determined the amount paid on the market intangibles at Rs. 1,807,310,769 being the difference between the actual AMP expense incurred and the ALP calculated at 0.87% of the sales. This sum was, therefore, directed to be added to the income of the Assessee.

The orders of the AO

14. The AO drew a draft assessment order on 15th December 2011 on the basis of the above order of the TPO. The Assessee then took the matter before the Dispute Resolution Panel ('DRP') which by its order dated 28th September 2012, affirmed the order of the TPO. Significantly, as far as DRP is concerned, it decided that there should be a mark-up for the services rendered by the Assessee to an extent of 12.5%. As a result, the TPO again passed an order dated 10th October 2012 by re-computing the ALP with the mark-up of 12.5% proposing an adjustment of Rs. 2,033,224,615 under Section 92CA of the Act.

15. On the basis of the above orders, the AO passed the final order on 23rd November 2012 under Section 143 read with Section 144C of the Act, making the above TP adjustment to the AMP under Section 92CA of the Act.

Impugned order of the ITAT

16. Aggrieved by the above order, WOIL filed ITA No. 426/2013 before the ITAT. In the impugned order dated 13th January 2014, the ITAT followed its judgment in ***LG Electronics*** (*supra*). The ITAT noted that there is a general proposition that if an expenditure is deductible under Section 37(1) of the

Act as having been incurred "wholly and exclusively for the business purpose, the same has to be allowed in entirety notwithstanding the fact that some third party (being the foreign AE in the present case) also got some advantage by such expenditure."

17. However, the ITAT pointed out that this proposition underwent a change because of Chapter X of the Act, which requires the computation of income from international transactions having regard to ALP. Accordingly, it was held that once there was an international transaction then the TP provision shall prevail over other relevant provisions and the amount spent by the Assessee in relation to an international transaction of building brand for its foreign AE could not be considered as a case of disallowance under Section 37 (1) of the Act, since Section 37(1) and Section 92 of the Act operated in different fields.

18. Therefore, according to the ITAT, what was required to be done in terms of the judgment of the Special Bench of the ITAT in ***LG Electronics*** (*supra*) was that overall AMP expenses had to be processed to find out what portion of it was spent on brand building for the foreign AE and then disallowance should be made for such amount with the proper mark-up by way of TP adjustment. The remaining amount had to be considered as incurred by the Assessee for its own business purposes liable for deduction subject to relevant provisions of the Act. It was noted that if the amount of AMP expenses were to be disallowed both under Sections 37 and 92 of the Act "it will result in double addition to the extent of the original amount incurred for the promotion of the brand of the foreign AE *de hors* the mark-up". It

was, accordingly held that the AO was not justified in observing alternatively that a sum of Rs.180 crores was not allowable under Section 37(1) of the Act. The matter was accordingly remitted to the AO/TPO for re-working the TP adjustment on account of the AMP expenses in the light of the decision of the Special Bench of the ITAT in ***LG Electronics*** (supra).

Questions urged by the Revenue

19. In the appeal filed by the Revenue against the impugned order of the ITAT the following five questions have been urged for consideration:

> "(i) Whether the ITAT erred in directing the TPO to consider the combined effect of fourteen factors of determining the cost value of the international transaction which will make the whole process of comparability impractical and ineffective and not in accordance with Rule 1OB(3) of the Rules and other provisions of Chapter X of the Act?
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> (ii) Whether the ITAT erred in directing the TPO to exclude the expenses incurred in connection with sales from AMP expenses by treating them as expenses not adding to the value of marketing intangible legally owned by the AE by drawing analogy from Section 37 (3A) once present in the Act without giving any reasons for the same?
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> (iii) Whether the ITAT erred in directing the TPO/AO to exclude the expenses incurred in connection with sales from AMP expenses when similar expenses have not been excluded by the TPO from the AMP expenses of comparables for the reasons that such expenses lead to benefit to the AE?
>
> (iv) Whether the ITAT erred in deleting the addition of Rs. 1,80,73,10,769/- made by AO/TPO on account of advertising and marketing promotion under Section 37 of the Act?

(v) Whether the ITAT erred in directing the AO/TPO that no addition is called for i.e. amount of Rs. 1,80,73,10,769 under section 37 of the Act?"

Questions urged in the Assessee's appeal

20. As far as the Assessee is concerned, it also filed an appeal ITA No. 228 of 2015. The Assessee urged the following questions:

"(a) Whether on the facts and in the circumstances of the case, the ITAT erred in law in upholding, in principle, transfer pricing adjustment made by the assessing officer/TPO in respect of expenditure incurred on AMP expenses?

(b) Whether on the facts and in the circumstances of the case, the ITAT erred in law in not appreciating that the AMP expenses, etc., unilaterally incurred by the appellant in India could not be characterized as an international transaction as per Section 92B, in the absence of any proved understanding/ arrangement between the Assessee and the AE so as to invoke Section 92 of the Act?

(c) Whether on the facts and in the circumstances of the case, the ITAT erred in law in holding that expenditure incurred by the Assessee which incidentally, if at all, resulted in brand building for the foreign AE, was a transaction of creating and improving marketing intangibles for and on behalf of its foreign AE and further that such a transaction was in the nature of provision of service by the Assessee to the AE?

(d) Whether on the facts and in the circumstances of the case, the ITAT erred in law in not appreciating that such a TP adjustment could not at all be made in respect of AMP expenses which were found to constitute legitimate, *bona fide* and deductible business expenditure and the Assessee was the economic owner of the benefit of such expenses?

(e) Whether on the facts and in the circumstances of the case, the ITAT erred in law in not quashing the adjustment made by the TPO using the “bright line test”, without following any of the prescribed methods for determination of the ALP?

(f) Whether on the facts and in the circumstances of the case, the ITAT erred in setting aside the order to the file of the assessing officer/ TPO for fresh benchmarking/ comparability analysis adopting only domestic comparable companies, not using foreign brand?”

Questions framed for consideration

21. As far as the above questions projected by the Revenue are concerned, Questions (ii) and (iii) stand answered by the decision in ***Sony Ericsson*** (*supra*) in favour of the Assessee and against the Revenue. In that decision, this Court held that the expenses in connection with sales and marketing are to be excluded for the purposes of determination of AMP expenses. Question (i) also stands answered by that decision inasmuch as it has been held that fourteen factors specified in para 17.4 of the decision of the ITAT in ***LG Electronics*** are not binding on the Assessee or the Revenue.

22. According the following question is framed for consideration as far as the Revenue’s appeal is concerned:

> Whether the ITAT erred in deleting the addition of Rs. 180,73,10,769 made by the AO/TPO on account of AMP expenses under Section 37 of the Act?

23. Turning to the Assessee’s appeal, question (e) does not survive after the decision of this Court in ***Sony Ericsson***, since it specifically overruled the decision of the majority of the Special Bench of the ITAT in ***L.G Electronics*** and held that the BLT could not be adopted for determining the ALP of an international transaction involving the AMP expenses.

24. The following questions are framed for consideration in the Assessee's appeal:

> (i) Was there an international transaction between WOIL and its AE involving the AMP expenses within the meaning of Section 92B of the Act read with Section 92F(v) of the Act?
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> (ii) If the answer to the above question is in affirmative, was the ITAT justified in remanding the matter to the AO/TPO for segregating the AMP expenses incurred into the extent attributable to promote the brand of the AE, and that that was wholly and exclusively for the business purposes of the Assessee, allowable under Section 37 of the Act?

Submissions of counsel for the Assessee

25. The submissions of Mr. Ajay Vohra, learned Senior counsel appearing for the Assessee, were as under:

> (i) The TP adjustment exercise could be undertaken only if in the first place, there was an international transaction between the Assessee and its AE as defined under Section 92B of the Act. In other words, there should be 'mutual agreement' or 'arrangement' or 'action in concert'.
>
> (ii) Such agreement, arrangement or understanding should be for the allocation or apportionment of or contribution to the cost or expenses incurred by the Assessee in connection with benefit, service or facility provided to the AE.

(iii) A unilateral action by one of the partners without any binding obligation on the other could not be termed as a transaction. There could not be an inference of the existence of such an ‘international transaction’. The onus is on the Revenue to demonstrate the existence of such transaction between the two parties.

(iv) The observations in ***Sony Ericsson*** about the existence of international transaction involving AMP expenses was limited to the distributors of products manufactured by foreign AEs, viz., Sony Ericsson, Canon India and Reebok India and not to the case in hand where the Assessee was also a manufacturer of household products under the trademark ‘Whirlpool’.

(v) In order to benchmark an expense under Chapter X of the Act, having regard to the ALP, the *sine quo non* is that the expense should arise under an international transaction with a foreign AE. Chapter X does not envisage the benchmarking of transactions between the Indian entity and third parties in India where there is no income arising to an Indian enterprise from the foreign AE.

(vi) The mere fact that the WOIL is a subsidiary of Whirlpool USA, does not mean that unilateral expense incurred on AMP by WOIL constitutes an international transaction involving WOIL and Whirlpool USA. The two are independent entities and the AMP expenses incurred by WOIL was wholly and exclusively for its own business. The benefit to Whirlpool USA was only incidental. On the strength of the decision of the Supreme Court in ***Sassoon J. David v. CIT (1979) 118 ITR 26,*** it was submitted that such expense incurred by WOIL wholly or exclusively for its business was allowable as such under Section 37 of the Act.

(vii) Once the BLT has been discarded as a valid methodology either for deducing the existence of an international transaction or for determining ALP, there has to be some other recognized method for first determining the international transaction involving AMP expense and thereafter ascertaining ALP for such transaction. The re-characterisation of a transaction is not permissible, as explained by this Court in ***CIT v. EKL Appliances Ltd. [2012] 345 ITR 241 (Del).*** A reference was made to the decision of this Court in ***Sony Ericsson*** (*supra*) which states that "Internally generated goodwill or brand is not treated as an asset in AS-26 because it is not an identifiable resource controlled by an enterprise, which can be reliably measured at cost. Its value can change due to a range of factors."

(viii) It was acknowledged in ***Sony Ericsson*** (*supra*) that even if marketing intangible is created as a consequence of non-routine AMP expenses incurred by the Indian entity, the economic ownership of such intangibles vested in the Indian entity, which could exploit the same for furthering its business interest. It cannot, therefore, be said that the marketing intangibles created by the WOIL was transferred to the AE only because the existing AMP expenses needed to be compensated.

(ix) Referring to paras 7.12 and 7.13 of the OECD guidelines it was submitted that the incidental benefit to the foreign AE on account of the AMP expenses incurred by WOIL cannot regarded as a provision of intra group services. The Revenue in other jurisdictions are not known to have undertaken any transfer pricing adjustment qua AMP expenses incurred by an entity in their respective jurisdiction as having been incurred on behalf of and/or for the benefit of entities in other jurisdiction. Otherwise it would be a virtual tug of war between the Revenue authorities in different jurisdictions. There is in fact no mutual arrangement between WOIL and Whirlpool USA for allocation or apportionment or contribution of AMP expenses.

Submissions of counsel for the Revenue

26. Mr. G.C. Srivastava, learned Special counsel for the Revenue, made an elaborate argument and also filed written submissions. He made an extensive reference to the TP study submitted by the Assessee which according to him shows that the Assessee is engaged both in manufacturing and distribution of products. It also imports some finished goods and spares from its AE which are sold in India. The Assessee distributes the manufactured products to neighbouring countries such as Nepal, Bangladesh, Sri Lanka, Maldives and African countries. The major sales of finished goods are to the AEs which constitutes an international transaction. Even in respect of such exports, the Assessee is undertaking marketing activities. It is submitted that the Assessee is not an independent manufacturer but is manufacturing "for the benefit of the group entities" and its status is akin to that of a contract manufacturer. Therefore the AMP activity is not for the sole benefit of the Assessee but for the group as a whole.

27. According to the Revenue, the TP report shows that the market risks with respect to the product including customer acceptance are borne by the Whirlpool Group. Therefore, it was "not open to urge that AMP functions of the appellant are solely for its own benefit". Considering the Assessee was paying brand fee @1% of the domestic and export sales to its AE and that the agreement leaves such crucial elements concerning the AMP for the development of the brand undefined, that mere fact "cannot lead to the inference that the activity of the Indian AE is unilateral or that it is entirely for its own benefit".

28. Analysing the trademark and trade name license agreement ('TLA') Mr. Srivastava submits that clause 3.2 thereof indicates that the Assessee has no rights in the trade name and that "the manner of the use of the trademark has to be approved" by Whirlpool USA; Clauses 6.1, 6.2 and 6.3 indicate that the contents of the advertisements for brand promotion also needs to be approved. It was seen that during the FY in consideration, the Assessee had received a grant of Rs.1.66 crores from its AE. In the earlier year, it received Rs. 4.22 crores. The nature of this grant had not been specified and this was also not shown as an international transaction in the TP report. This according to him was a clear indication that the Assessee was "getting certain amount of contribution from its AE towards the expenses incurred". This showed that the AE was sharing some part of the cost and "it would be a matter to be examined whether such contribution is at arm's length".

29. Mr. Srivastava submits that Clause 19.2 of the TLA indicates that the AE's primary objective in entering into this agreement was "further protection and enhancement of its uniquely valuable marks and name". Therefore, it could not be said that "AE is not concerned with what the appellant does or benefit is not intended or not arising to the AE." Clause 3.1 of the agreement states that the goodwill connected with the marks shall continue to inure to the benefit of the AE. Further the licensor i.e., Whirlpool USA has power to assign the rights to any other entity. In such circumstances, no licensee could ever undertake such AMP expenses if the benefits of such expenditure could be taken away by the AE at its own will.

Analysis of the relevant provisions

30. The discussion of the above submissions is required to be prefaced by analysis of the relevant provisions concerning the TP adjustment and determination of AMP international transaction.

31. At the outset, it requires to be noticed that 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 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."

32. 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.

33. A reading of the heading of Chapter X ["Special provisions relating to Avoidance of Tax "] and Section 92 (1) which states that any income arising from an international transaction shall be computed having regard to the ALP, 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 TP adjustment envisages the substitution of the price of such international transaction with the ALP.

34. The TP 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 proceed to make the adjustment of the difference in order to determine the value of such AMP expenditure incurred for the AE.

35. It is for the above reason that the BLT has been rejected as a valid method for either determining the existence of international transaction or for the determination of ALP of such transaction. Although, under Section 92B read with Section 92F (v), an international transaction could include an arrangement, understanding or action in concert, this cannot be a matter of inference. There has to be some tangible evidence on record to show that two parties have "acted in concert".

36. The expression "acted in concert" has been interpreted by 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 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."

37. The provisions under Chapter X do envisage a 'separate entity concept'. In other words, there cannot be a presumption that in the present case since WOIL is a subsidiary of Whirlpool USA, all the activities of WOIL are in fact dictated by Whirlpool USA. Merely because Whirlpool USA has a financial interest, it cannot be presumed that AMP expense incurred by the WOIL are at the instance or on behalf of Whirlpool USA. There is merit in the contention of the Assessee that the initial onus is on the Revenue to demonstrate through some tangible material that the two parties acted in concert and further that there was an agreement to enter into an international transaction concerning AMP expenses.

Absence of an international transaction involving AMP expense

38. The clauses of the TLA which had been referred to *in extenso* by Mr. Srivastava go to show that Whirlpool USA was protective of its brand. However, it is not discernible from the clauses of the said TLA that WOIL was under any obligation to incur an extent of AMP expense for building the brand or mark of Whirlpool USA. The Revenue has been unable to

explain why there should a presumption that as a result of the TLA, there must have been an understanding between Whirlpool USA and WOIL and that WOIL will spend ‘excessively’ on AMP in order to promote the ‘Whirlpool’ brand in India. In other words, it is not clear why a presumption should be drawn that since an incidental benefit might enure to the brand of Whirlpool USA, a proportion of the AMP expenses incurred must be attributed to it.

39. It is in this context that it is submitted, and rightly, by the Assessee that there must be a machinery provision in the Act to bring an international transaction involving AMP expense under the tax radar. In the absence of any clear statutory provision giving guidance as to how the existence of an international transaction involving AMP expense, in the absence of an express agreement in that behalf, should be ascertained and further how the ALP of such a transaction should be ascertained, it cannot be left entirely to surmises and conjectures of the TPO.

40. Mr. Srivastava submitted that 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 associated enterprises in uncontrolled conditions" could be construed as a machinery provision. But then that provision refers 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. BLT as a determinative tool has been expressly invalidated by the Court in ***Sony***

Ericsson (*supra*).Therefore, it is not possible to view this as a machinery provision. The existence of an international transaction will have to be established *de hors* the BLT. There is nothing in the Act which indicates how, in the absence of the BLT, one can discern the existence of an international transaction as far as AMP expenditure is concerned.

41. Recently this Court has in its decision dated 11th December 2014 in ITA No. 110 of 2014 (***Maruti Suzuki India Ltd. v. Commissioner of Income Tax***) while interpreting the provisions of Chapter X of the Act observed:

> "the only TP adjustment authorised and permitted by Chapter X is the substitution of the ALP for the transaction price or the contract price. It bears repetition that each of the methods specified in S.92C (1) is a price discovery method. S.92C (1) thus is explicit that the only manner of effecting a TP adjustment is to substitute the transaction price with the ALP so determined. The second proviso to Section 92C (2) provides a 'gateway' by stipulating that if the variation between the ALP and the transaction price does not exceed the specified percentage, no TP adjustment can at all be made. Both Section 92CA, which provides for making a reference to the TPO for computation of the ALP and the manner of the determination of the ALP by the TPO, and Section 92CB which provides for the "safe harbour" rules for determination of the ALP, can be applied only if the TP adjustment involves substitution of the transaction price with the ALP. Rules 10B, 10C and the new Rule 10AB only deal with the determination of the ALP. Thus for the purposes of Chapter X of the Act, what is envisaged is not a quantitative adjustment but only a substitution of the transaction price with the ALP."

42. Again in ***Maruti Suzuki India Ltd.*** (*supra*) the Court held:

> "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 step is to ascertain the disclosed 'price' of such a transaction and thereafter ask whether it is at 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."

43. As regards allowing the entire expenditure under Section 37 of the Act, there is an obvious contradiction which was attributed to be resolved by the ITAT in the impugned order by asking the TPO to rework the AMP expenses into that which was incurred for building the brand of the foreign AE and that which was incurred wholly or exclusively for the benefit of the WOIL. In ***Sony Ericsson*** (*supra)* this was sought to be explained by stating that Section 37 and Chapter X operate in different domains and merely because an expense was incurred wholly or exclusively for the Indian entity it would not mean that it is also not incurred for the foreign AE. The question then is to what extent the Indian entity should be compensated for the expenses incurred by it on behalf of the foreign AE. What will then be required to be benchmarked is not the AMP expenditure but the extent to which the Indian entity must be compensated.

44. Further in ***Maruti Suzuki India Ltd.*** (*supra*) this Court observed:

> "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 40A (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 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."

45. 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 it explicit that in the absence of any machinery provision, bringing an imagined transaction to tax is not possible. Here, 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.

46. As already mentioned, merely because there is an incidental benefit to Whirlpool USA, it cannot be said that the AMP expenses incurred by WOIL was for promoting the brand of Whirlpool USA. 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”.

Conclusion

47. For the aforementioned reasons, the Court is of the view that as far as the present appeals are concerned, the Revenue has been unable to demonstrate by some tangible material that there is an international transaction involving AMP expenses between WOIL and Whirlpool USA. In the absence of that first step, the question of determining the ALP of such a transaction does not arise. In any event, in the absence of a machinery provision it would be hazardous for any TPO to proceed to determine the ALP of such a transaction since BLT has been negatived by this Court as a valid method of determining the existence of an international transaction and thereafter its ALP.

48. Question (i) in the Assessee's appeal viz., "Was there an international transaction between WOIL and its AE involving the AMP expenses within the meaning of Section 92B of the Act read with Section 92F(v) of the Act?" is answered in the negative, i.e., in favour of the Assessee and against the Revenue. Consequently Question (ii) in the Assessee's appeal is not required to be answered. Further, the only question framed in the Revenue’s Appeal viz., "Whether the ITAT erred in deleting the addition of Rs. 180,73,10,769 made by the AO/TPO on account of AMP expenses under Section 37 of the Act?" is answered in the negative, i.e. in favour of

the Assessee and against the Revenue.

49. The impugned order of the ITAT and the corresponding orders of the DRP and the TPO, on the above issues are hereby set aside. The appeal of the Assessee, ITA No. 228 of 2015 is allowed and the appeal of the Revenue, ITA No. 610 of 2014 is dismissed in the above terms, but in the circumstances with no orders as to costs.

S. MURALIDHAR, J

VIBHU BAKHRU, J

December 22, 2015
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