Marketing Intangibles – Analysis of Recent Ruling of Special Bench of Income Tax Appellate Tribunal in the Case of LG Electronics India Private Limited

The Indian tax authorities have just concluded eight years of transfer pricing audits, since the transfer pricing provisions were introduced in 2001. Over the years, the amount of transfer pricing adjustments are increasing with the amount estimated to be USD 14 billion (estimates based on various sources) in the most recently completed eighth round of transfer pricing audits relevant to the financial year 2008-09. Further, with completion of each round of transfer pricing audits, the tax authorities are becoming more aggressive and complex transfer pricing issues relating to marketing intangibles, intra-group services, etc. are coming to fore for which there are limited judicial precedents available. The present article analyses the recent judgment of Special Bench of Delhi Tribunal ('Delhi ITAT') in the case of *L.G Electronics India Private Ltd. vs. Assistant Commissioner of Income Tax*[1] , which has explained concept of marketing intangibles under Indian transfer pricing provisions.

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Concept of Marketing Intangibles

• Meaning of phrase "Intangibles"

The term intangibles generally means assets like patents, know-how, designs, trademark etc. which provide its user some benefit and created through risky and costly research and development activities.

[1] *L.G Electronics India (P.) Ltd. v. Assistant Commissioner of Income Tax [2013] 29 taxmann.com 300 (Delhi ITAT)*

Delhi ITAT vide majority decision held that marketing intangibles is an international transaction under Indian TP provisions. However, one member has given dissenting judgment stating that excess AMP expenses incurred by LGI is not an international transaction under Indian TP provisions.

Para 6.2 of Chapter VI of the OECD Transfer Pricing Guidelines 2010 ('OECD TP Guidelines') defines the term "intangible property" as *"intangible property includes rights to use industrial assets such as patents, trademarks, trade names, designs or models. It also includes literary and artistic property rights, and intellectual property such as know-how and trade secrets."*

Further, OECD TP Guidelines defines the term commercial intangibles as *"Commercial intangibles include patents, know-how, designs, and models that are used for the production of a good or the provision of a service, as well as intangible rights that are themselves business assets transferred to customers or used in the operation of business (e.g. computer software)."*

• Meaning of phrase "Marketing Intangibles"

Marketing intangibles generally refers to the benefits like brand name, customer lists, unique symbols, logos, distribution/dealership network etc. which are not normally measured or recognised in the books of accounts. Marketing intangibles are created over a period of time through brand building, large scale marketing of product, distribution network etc.

• OECD TP Guidelines

Para 6.3 and 6.4 of Chapter VI of the OECD TP Guidelines defines the term marketing intangibles as a special type of commercial intangibles which include trademarks and trade names that aid in the commercial exploitation of a product or service, customer lists, distribution channels, and unique names, symbols, or pictures that have an important promotional value for the product concerned. Some marketing intangibles (e.g. trademarks) may be protected by the law of the country concerned and used only with the owner's permission for the relevant product or services.

The value of marketing intangibles depends upon many factors, including the reputation and credibility of the trade name or the trademark, quality of the goods and services provided under the name or the mark in

the past, the degree of quality control and ongoing R&D, distribution and availability of the goods or services being marketed, the extent and success of the promotional expenditures incurred for familiarizing potential customers with the goods or services.

• Issue

Transfer pricing issue arises when marketing activities are undertaken by an enterprise which does not own the trademarks or trade names it promotes. For e.g. distributor of branded goods would sell goods manufactured by its principal manufacturer and incur advertising and marketing expenses for selling those goods. However, being only distributor, the benefit, if any, arising due to popularity of brand would always accrue to the principal manufacturer being legal owner of the brand name. In such situations, the issue which arises for examination is whether any marketing intangibles are created by distributor on behalf of its principal manufacturer and if yes, whether distributor needs to be compensated for the same under Indian transfer pricing regulations.

• Previous Judicial Precedents

One of the earliest judgment of the above issue of 'marketing intangibles' was given by Hon'ble Delhi High Court in the case of *Maruti Suzuki*[2] , wherein Hon'ble Delhi High Court based on facts of the case held that as long as the advertising and marketing expenses of the company does not exceed the bright line test i.e. expenses incurred does not exceed expenses incurred by comparable independent domestic company, no compensation is required from the principal manufacturer.

After making the above observations, the matter was remitted back to the tax authorities for determining the arms length price based on the above principles. Post the above decision of Hon'ble Delhi High Court,

[2] 328 ITR 210

the taxpayer filed an appeal with the Hon'ble Supreme Court. Hon'ble Supreme Court[3] held that the tax authorities should determine the arms length price without considering the above observations of Hon'ble Delhi High Court.

Analysis of Special Bench Ruling of Delhi ITAT in Case of LG Electronics

Post the above decision of Hon'ble Supreme Court and Hon'ble Delhi High Court in the case of Maruti Suzuki, the issue of marketing intangibles pending at various ITAT were consolidated and a Special Bench was constituted in Delhi to hear all the cases and decide on the issue of marketing intangibles.

Facts:

- LG Electronics Inc., Korea ('LGK') is engaged in the manufacture, sale and distribution of electronics products and electronic appliances.
- LG Electronics India Pvt. Ltd. ('LGI') is a wholly owned subsidiary of LGK operating in India having the functions same as that of the parent company.
- LGI entered into a mutual agreement with LGK to use the technical know-how, designs, drawings and the industrial property rights for manufacturing, sale and services of the agreed products of LGK in exchange of payment of 1% of royalty to the licensor.
- The licensor ('LGK'), without any restriction, allowed the licensee (LGI), to use its brand name and trademarks to the products manufactured in India on a royalty-free basis.
- During the TP assessment proceedings, the TPO observed that the total advertising, marketing and promotion ('AMP') expenses were 3.85% of the total sales of the assessee. As against the same, the AMP expenses of comparable companies selected by TPO was 1.39% of sales. Accordingly, the TPO proposed to make an adjustment by alleging that the LGI had incurred excessive AMP expenses of 2.66% (3.85% - 1.39%) on sales for which its AE, i.e. LGK ought to have reimbursed to LGI.
- The TPO proposed the above adjustment based on the concept of Bright Line Test, as laid down by the US Tax Courts in the case of DHL Inc and Subsidiaries v. Commissioner.
- Aggrieved by the TPO's order, the assessee preferred an appeal to Dispute Resolution Panel ('DRP'). The DRP upheld the order of the TPO and additionally observed that LGI had undertaken brand promotion services of LGK resulting into increase in value of LGK's intangibles in India. Hence, LGI should have received some mark up on AMP expenses incurred on behalf of its AE, LGK. The DRP determined the mark-up to be 13% and held that LGI ought to have recovered 13% mark up on excess AMP expenses incurred by LGI.
- The assessee on being aggrieved by the DRP's order preferred an appeal to the Delhi ITAT which formed a Special Bench to examine the following issues:

ITAT accepted asssessee's contention and held that AMP expenses refers only to advertisement, marketing and publicity expenses. Hence, expenses in connection with the sales which do not lead to brand promotion cannot be brought within the ambit of "advertisement, marketing and promotion expenses" for determining the cost/value of the international transaction.

Issues raised before the tribunal:

- Whether transfer pricing adjustment in relation to the AMP expenses incurred by assessee was justified?
- Whether it was justified that the assessee should have earned a mark-up from its AE in respect of excess AMP expenses alleged to have been incurred for and on behalf of the AE?

Analysis of Ruling

D*elhi ITAT vide majority decision held that marketing intangibles is an international transaction under Indian TP provisions. However, one member has given dissenting judgment stating that excess AMP expenses incurred by LGI is not an international transaction under Indian TP provisions.* For the sake of convenience, we have analysed following key points of the majority decision given by Special Bench:

1. Whether excess AMP expenses incurred by assessee can be considered as an international transaction under Indian TP regulations?
2. If answer to the above question is yes, what is the cost / value of the above transaction?
3. What is the scope of AMP expenses?
4. Which method to be used for determining Arm's

[3] 335 ITR 121

length price ('ALP') of above international transaction?

5. Interplay between section 37(1), section 40A(2) and section 92 of the Act
6. What is the effect of Delhi High Court judgment in the case of Maruti Suzuki on the issue of marketing intangibles in facts of this case?

Question 1 - Whether excess AMP expenses incurred by assessee can be considered as an international transaction under Indian TP regulations?

Assessee's Contentions:

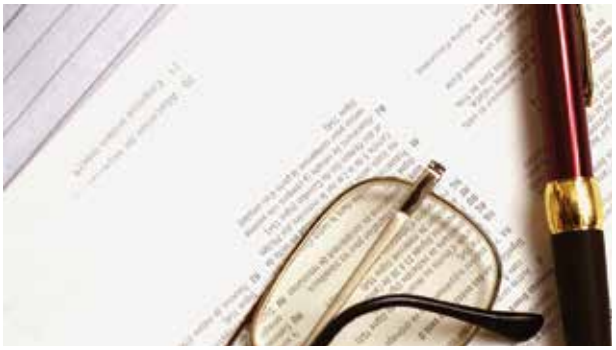
- The assessee contended that there is no such alleged transaction of creating marketing intangible in the nature of brand building by the assessee for its foreign AE, much less an international transaction. The assessee mentioned that it did not arrive at any understanding, oral or written, with its AE for promoting their brand.
- All the AMP expenses were incurred by assessee in India for advertising its own products and there was no question of spending anything exclusively towards brand building for its AE. Further, AMP expenses were incurred by the assessee without any interference from its AE.
- Further, assessee contended that there cannot be any brand building without product and hence, all AMP expenses even though exhibiting foreign brand were liable to be attributed only to the advertisement of its products. Thus, once assessee incurred AMP expenses for its business purpose, the tax department was not entitled to recharacterise this transaction by splitting it into two parts - first towards advertisement expenses for the assessee's business and second towards the brand building of its AE. In support of this contention, assessee relied on the judgment of the Hon'ble Delhi High Court in CIT v. EKL Appliances Ltd[4] .
- In absence of any agreement between AE and assessee, the presence of an agreement cannot be inferred.
- The assessee incurred advertisement expenses for which the payments were made to third parties unrelated to it in India. Such transactions got concluded on the incurring of advertisement expenses without any direct or indirect involvement of the AE. It was stated that a transaction with a third party or a part of such transaction cannot be called as transaction with the AE and hence, would not be an international transaction.
- Any incidental benefit resulting to the AE, out of the expenses incurred by the assessee in India, cannot be termed as international transaction. It was argued that the present so-called transaction of brand building for the foreign AE by the assessee is neither covered under sub-section (1) nor (2) of section 92B and hence the same cannot be recognized as an international transaction.
- As the economic ownership of the brand rested with the assessee itself, full AMP expenses are eligible for deduction in the hands of the assessee.
- Even if it is held that assessee is undertaking brand building on behalf of its AE, since the said transaction is not specifically included in definition of international transaction as defined under Explanation to section 92B of the Act as expanded by Finance Act, 2012, the said transaction cannot be construed as an international transaction under provisions of section 92B of the Act.

Department's Contentions:

- Existence of oral agreement in the facts and circumstances of the present case is absolutely visible as assessee has incurred AMP expenses of a magnitude which no businessman in a commercially rational manner incurs. This shows that there was a tacit understanding between the assessee and its AE for creating/improving the marketing intangible of the AE in India by incurring such excess AMP expenses, which is a transaction
- There can be advertisement only for brand and not for product or it can also be for a product coupled with brand or only for product and not for brand. It was, therefore, submitted that the assessee entered into agreement with its AE for advertising the brand of the later, which is nothing but an implied transaction.

ITAT held that the meaning of the term 'transaction' as given in rule 10A(d) provides that : *'transaction includes a number of closely linked transactions'*. Hence, only closely linked transactions can be benchmarked using one method. For example, if an Indian enterprise has sold goods to its AE and also made interest payment, the transaction of interest payment and sales would need to be separately benchmarked as they are not closely linked transactions.

[4] 345 ITR 241/209 Taxman 200



- Departmental Representative ('DR') argued that the United Nations Transfer Pricing Manual provides for the allocation of such cost of market penetration, marketing expansion and market maintenance strategies between a Multinational Enterprise and its subsidiaries under the Transfer Pricing Regulations.
- DR argued that the excess of the AMP expenses incurred by the Indian entity over what other comparable independent entities incur in similarly placed situation, means the exclusive benefit, service or facility to the foreign AE so as to constitute the value of international transaction of brand building for it.
- DR argued that international transaction is not AMP expenses incurred by assessee with third parties. The international transaction is restricted to the activity done by the Indian assessee in relation to its foreign AE for adding value to a brand (being an intangible property of the foreign AE), the payment for which made by the Indian assessee is included in the overall AMP expenses claimed as deduction by the assessee.

ITAT Ruling

- Section 92F of Income tax Act, 1961 ('Act') defines transaction inter alia to mean an arrangement or understanding "(A) *whether or not such arrangement, understanding or action is formal or in writing"*. Thus, the agreement between the two AEs can be either in writing or oral. When there is a formal or written agreement between two AEs, the answer to the question as to the existence of transaction becomes patent. If, however, there is an informal or an oral understanding, the existence of such agreement can be inferred from the attending facts and circumstances. Such inference can be drawn from the conduct of the parties.
- Also, if it is found that apart from advertising the products and the assessee's name, assessee has also simultaneously or independently advertised the brand or logo of the AE, then the initial doubt gets converted into a direct inference about some tacit understanding between the assessee and the AE on this point.

Thus, the judicial member in dissenting judgment held that incurring of AMP expenses by assessee is not a 'provision of service' and hence, does not fit in any part of the definition of an 'international transaction'. Hence, it held that the assessee has not created, improved or maintained the marketing intangible for its foreign AE and hence, question of any sort of compensation does not arise in this case.

- Also, incurring of proportionately more AMP expenses coupled with the advertisement of brand or logo of the foreign AE, gives strength to the inference of some informal or implied agreement in this regard.
- Also, for the purpose of the Act, the ITAT held that is only the legal ownership of the brand that is recognised and not its economic ownership.
- ITAT also relied on Article 20 of the agreement entered between assessee and AE which stated that assessee would incur AMP expenses not only for products manufactured by it but also for products manufactured by LGK. Accordingly, based on the said Article, ITAT observed that there is a 'transaction' between the assessee and the AE for the promotion of brand LG in India, which is legally owned by the latter.
- The ITAT held that while determining presence of an international transaction of marketing intangible, it is relevant to consider as to whether an independent enterprise behaving in a commercially rational manner would incur the expenses to the extent the assessee has incurred. If the answer to this question is in the affirmative, then the transaction cannot be recharacterised. If, however, the answer is in the negative, then the transaction needs to be probed further for determining as to whether its recharacterisation is required. Such recharacterisation can be done by making a comparison with what 'independent enterprises behaving in a commercially rational manner' would do, tied with the fact of the assessee also simultaneously advertising the brand of its foreign AE.
- The ITAT held that the expression 'international

transaction' as per clause (i) of the Explanation has been 'clarified' to 'include' five sub-clauses. Thus the meaning assigned to 'international transaction' as per clause (i) of the Explanation is simply inclusive and not exhaustive.

- Further, ITAT held that clause (i)(d) of Explanation to section 92B defining 'international transaction' includes 'provision of services, including provision of market research, market development, marketing management…..'. Further, Clause (ii) of the Explanation defining 'intangible property' includes through sub-clause (a): 'marketing related intangible assets, such as, trademarks, trade names, brand names, logos'.
- Thus, provision of services is defined in an inclusive manner and includes all the market related services including those specifically covered like market development, research and administration. Further, brand name and logos have been specifically considered as marketing intangibles. Hence, on a combined reading of both the above provisions, the ITAT held that brand building by the assessee for its AE is in the nature of 'provision of service' and thus, is an international transaction.
- The ITAT also held that the mere fact that no consideration moved between the AEs for a transaction is not a decisive factor to have influence over its nature. Further, it held that payment of consideration has not been made as a condition precedent for inclusion of any transaction within the ambit of section 92B.
- Thus, ITAT held that there is a transaction between the assessee and the AE under which the assessee incurred AMP expenses towards promotion of brand which is legally owned by the foreign entity.

With the passage of each transfer pricing audit, the determination of income from intangible transactions is going to be more complex and challenging due to increased focus from tax authorities. This decision of Special Bench is a landmark and first ruling on the contentious issue of marketing intangibles and as it is based on peculiar facts in the assessee's case, its implications on other assessees would need to be suitably evaluated. Further, the dissenting judgment given by judicial member may also need to be appropriately considered.

Question 2 - What is the cost / value of the above transaction?

Assessee's Contentions:

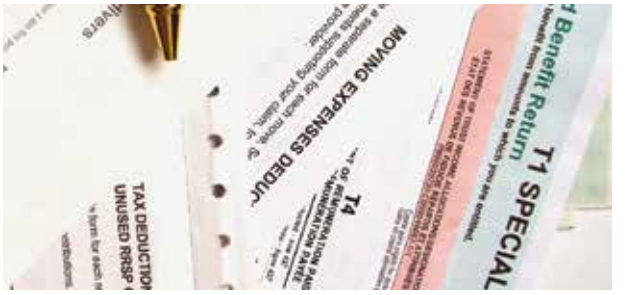
- The Bright Line Test applied by the TPO in determining the transfer pricing adjustment was not tenable as it is not a prescribed method under relevant provisions of the Act.
- Also, transfer pricing provisions laid in Chapter X of the Act is a complete code in itself and contains both substantive as well as machinery provisions. Hence, if machinery provisions fail, charge cannot be attracted under the substantive provisions. Since the Department's case hinges on the computation of ALP of AMP expenses on the basis of a bright line method which is not prescribed under section 92C of the Act, assessee contended that the entire exercise must fail.

Department's Contentions:

- It was stated that the Bright Line Test is simply a tool to ascertain the cost of the international transaction and it is wrong to contend that the ALP has been determined by applying the Bright Line Test, which is not a part of the Indian tax law.
- He argued that if there is an international transaction and the ALP cannot be determined by any of the prescribed methods, then there can be no fetters on the powers of the TPO to adopt any other method for determining ALP.

ITAT Ruling

- The ITAT held that Bright Line Test is only a way of finding out the cost/value of international transaction, and not for computing ALP of the international transaction. Hence, bright line test is not a method which has been adopted for computing ALP of the international transaction. It observed that bright line is a line drawn within the overall amount of AMP expense. The amount on one side of the bright line is the amount of AMP expense incurred for normal business of the assessee and the remaining amount on the other side is the cost/



value of the international transaction representing the amount of AMP expense incurred for and on behalf of the foreign AE towards creating or maintaining its marketing intangible.

- Thus, ITAT held that the amount of excess AMP expenses determined by tax department by applying the Bright Line Test, is the cost/value of the international transaction of brand building for the foreign AE.
- Also, ITAT observed that Bright Line Test in essence is only a 'cost plus method', being one of the method prescribed under Indian TP regulations wherein first the cost/value of service provided to the assessee is identified and thereafter adding mark-up. The mere fact that DRP did not specifically mention that Bright Line Test is a 'cost plus method', will not mean that it did not apply the cost plus method, when the essence of the working matches with the methodology provided in that method.

Question 3 – Scope of AMP expenses

Assessee's Contentions:

- It was contended that the TPO has included selling expenses in the total AMP expenses for the purposes of determining the ALP. It was submitted that selling expenses cannot constitute part of AMP expenses.
- It was contended that the TPO has simply gone by the comparable cases and failed to give any weight to other relevant factors such as the tenure of agreement with the foreign AE, payment of royalty and subsidy allowed by the foreign AE on the goods imported etc.
- It was also submitted that only such comparable cases should be chosen as are using the foreign brand.

ITAT Ruling

- ITAT accepted asssessee's contention and held that AMP expenses refers only to advertisement, marketing and publicity expenses. Hence, expenses in connection with the sales which do not lead to brand promotion cannot be brought within the ambit of "advertisement, marketing and promotion expenses" for determining the cost/value of the international transaction.
- The ITAT held that for the purpose of determining value of AMP expenses incurred by Indian entity on behalf of foreign AE, result of each of the following factors would need to be considered:

1. *Whether the Indian AE is simply a distributor or is a holding a manufacturing license from its foreign AE?*
2. *Where the Indian AE is not a full fledged manufacturer, is it selling the goods purchased from the foreign AE as such or is it making some value addition to the goods purchased from its foreign AE before selling it to customers ?*
3. *Whether the goods sold by the Indian AE bear the same brand name or logo which is that of its foreign AE?*
4. *Whether the goods sold bear logo only of foreign AE or a logo which is only of the Indian AE or is it a joint logo of both the Indian entity and its foreign counterpart?*
5. *Whether Indian AE, a manufacturer, is paying any royalty or any similar amount by whatever name called to its foreign AE as a consideration for the use of the brand/logo of its foreign AE?*
6. *Whether the payment made as royalty to the foreign AE is comparable with what other domestic entities pay to independent foreign parties in a similar situation.*
7. *Where the Indian AE has got a manufacturing license from the foreign AE, is it also using any technology or technical input or technical knowhow acquired from its foreign AE for the purposes of manufacturing such goods?*
8. *Where the Indian AE is using technical know-how received from the foreign AE and is paying any amount to the foreign AE, whether the payment is only towards fees for technical services or includes royalty part for the use of brand name or brand logo also?*
9. *Whether the foreign AE is compensating the Indian entity for the promotion of its brand in any form, such as subsidy on the goods sold to the Indian AE?*
10. *Where such subsidy is allowed by the foreign AE, whether the amount of subsidy is commensurate with the expenses incurred by the Indian entity on the promotion of brand for the foreign AE?*
11. *Whether the foreign AE has its presence in India only in one field or different fields? Where it is*

involved in different fields, then is there only one Indian entity looking after all the fields or there are different Indian AEs for different fields? If there are different entities in India, then what is the pattern of AMP expenses in the other Indian entities?

12. *Whether the year under consideration is the entry level of the foreign AE in India or is it a case of established brand in India?*
13. *Whether any new products are launched in India during the relevant period or is it continuation of the business with the existing range of products?*
14. *How the brand will be dealt with after the termination of agreement between AEs?*

- The ITAT held illustrated the benefit of the above my way of a simple example. If there is no subsidy in a comparable case but the assessee has received some amount of subsidy from its AE on imports or in any other manner, which fact otherwise needs to be specifically established by the assessee, then the initial amount so computed would require reduction to the extent of such subsidy or vice versa. Thus, the ITAT held that is the duty of the TPO to give due regard to above factors by making suitable plus or minus adjustments before finally determining the cost/value of the international transaction.
- The ITAT also rejected that assessee's contention that only foreign comparables should be chosen while determining AMP expenses. ITAT held that in case of foreign comparables, AMP expenses of Indian companies will also include contribution towards brand building of their respective foreign AEs and hence, they cannot be compared. The ITAT held that the correct way to make a meaningful comparison for AMP expenses is to choose comparable domestic companies which are not using any foreign brand.
- Thus, ITAT remanded the matter to TPO to determine AMP after considering various factors like indirect subsidy from parent AE, other benefits received from AE etc.

Question 4 – Which method to be used for determining ALP of above international transaction?

Assessee's Contentions:

- Assessee contended that when the overall net profit rate declared by the assessee is higher than other comparable cases, no disallowance can be made out of AMP expenses by benchmarking them separately.
- Assessee submitted that its overall higher net profit rate implies that, firstly, there was no advertisement by the assessee for the brand of its AE and secondly, if at all it was there, the same stood compensated by its AE in terms of sale of goods to the assessee at lower rates.

Department's Contentions:

- Department opposed assessee's plea and submitted that there is no requirement under law that if one transaction has been subjected to the transfer pricing provisions by applying the TNMM then no other international transaction can be separately considered.
- It was submitted that all the international transactions are required to be viewed independent of each other.

ITAT Ruling

- ITAT held that the meaning of the term 'transaction' as given in rule 10A(d) provides that: 'transaction includes a number of closely linked transactions'. Hence, only closely linked transactions can be benchmarked using one method. For example, if Indian enterprise has sold goods to its AE and also made interest payment, the transaction of interest payment and sales would need to be separately benchmarked as they are not closely linked transactions.
- Further, Section 92C of the Act provides that the ALP in relation to 'an' international transaction shall be determined by any of the prescribed methods. Also, Rule 10B(1)(e) also talks of the net profit margin realized by the enterprise from 'an' international transaction. Hence, when both the section as well as relevant rule apply for each transaction, the computation of ALP should be of an international transaction and not of an entity as a whole.
- Hence, ITAT held that each international transaction is required to be separately scrutinized under TP regulations and TNMM can be applied only on a transactional level and not on entity level. The correct approach under TNMM is to consider the operating profit from each international transaction in relation to the total cost or sales or capital employed etc. of such international transaction and not the net profit, total costs, sales, capital employed of the assessee as a whole on entity level.
- Thus, ITAT concluded that even when the overall net profit earned by the assessee is better than

others, each international transaction has to separately examined. Accordingly, it held that TP provisions on AMP expenses would need to be separately analysed and cannot be clubbed with overall TNMM at entity level.

- Further, ITAT also held that on a conjoint reading of sub-section (1) and sub-section (3) of section 92, it appears that if there are if there are two distinct international transactions, their ALP needs to be separately determined. Also, if determination of ALP in respect of the first transaction leads to an increase in total income as per sub-section (1) but no adjustment is called for in respect of the second transaction as per sub-section (3) because of the ALP on the negative side, then the ALP in respect of the first transaction shall be considered in computing the total income, but the ALP of the second transaction shall be ignored. There is no provision under the Act which permits set off of negative adjustment with the positive adjustment to the income on account of different international transactions. Hence, this substantiates that two or more international transactions are required to be separately processed under the TP provisions. Thus, the contention that if TNMM has been applied on one international transaction, then it would oust the jurisdiction of the TPO to process other international transactions under TP provisions, really does not stand in the scheme of the provisions.
- ITAT on merits also observed that it is possible to charge a 'mark up' on excess AMP expenses incurred by assessee on behalf of its AE while computing ALP of marketing intangibles. However, ITAT observed that 13% mark up determined by DRP was arbitrary as DRP did not show as to how much an independent comparable entity has earned from an international transaction similar to one which is under consideration.
- Accordingly, ITAT restored the matter to AO / TPO for determining the cost/value of international transaction in the first instance and thereafter determine, appropriate mark up to be charged in determining value of international transaction.

Question 5 – Interplay between section 37(1), section 40A(2) and section 92 of the Act

Assessee's Contentions:

- Assessee argued that the AMP expenses are fully deductible under section 37(1) of the Act and there is no question of finding any ALP of the international transaction in this regard.

Department's Contentions:

- Tax department submitted that section 92 has come to play for taking away a part of the AMP expenses towards brand building out of the ambit of section 37(1) together with the mark-up.

ITAT Ruling:

- ITAT held that it cannot be said that once entire amount is deductible under section 37(1) of the Act, no part of the same can be attributed to brand building of the AE even if the AE benefitted out of said expenses. ITAT observed that transfer pricing provisions are special provisions which have been inserted to curb tax avoidance. Hence, once there is an international transaction, transfer pricing provisions would prevail over other regular provisions. Thus, the exercise of separating the amount spent by the assessee in relation to international transaction of building brand for its AE for separately processing as per section 92 of the Act cannot be considered as a case of disallowance of AMP expenses under section 37(1) / section 40A(2) of the Act.

Question 6 – Effect of Hon'ble Delhi High Court judgment in the case of Maruti Suzuki on the issue of marketing intangibles

Assessee's Contentions:

- Assessee argued that the judgment of Hon'ble Delhi High Court in the case of Maruti Suzuki has been overruled by Hon'ble Supreme Court and hence, the AMP principles enunciated in the High Court judgment are no longer applicable

Department's Contentions:

- Tax department submitted that Hon'ble Supreme Court did not overrule the judgment of Hon'ble Delhi High Court as it did not make any observations of merits.

ITAT Ruling:

- ITAT held that the Hon'ble Supreme Court has directed the TPO to make a fresh determination of the ALP of the transaction of brand building for the foreign AE without considering the observations of Hon'ble Delhi High Court. Hence, ITAT held that in view of such direction, Hon'ble Supreme

Court has recognised that there is a transaction of brand building between the assessee and the foreign AE, which is an international transaction as per section 92B and the TPO has the jurisdiction to determine the ALP of such transaction.

Conclusion

Thus, as per majority decision of ITAT, it held that

i) The transfer pricing adjustment in relation to advertisement, marketing and sales promotion expenses incurred by the assessee for creating or improving the marketing intangible for and on behalf of the foreign AE is permissible; and

ii) Earning a mark-up from the AE in respect of AMP expenses incurred for and on behalf of the AE is also allowable.

However in so far as answering these two questions on the facts and circumstances of the present case is concerned, it restored the matter to the file of the TPO for fresh adjudication in the light of certain guidelines outlined above.

Dissenting Judgement

The judicial member of the Special Bench however delivered a separate ruling and held that excess AMP expenses incurred by LGI would not amount to an international transaction so as to be compensated under Indian TP provisions. The main observations of that ruling are as under:

- No written agreement has been found to exist between the assessee and its AE in relation to incurring of AMP expenses. Further, there is no evidence on record to suggest that there is any oral agreement between the parties.
- Further, in the majority order, a finding of fact has been reached that the 'comparables' are not really 'comparable-companies' with reference to FAR analysis. Hence, when the basis of comparison is struck down, then the finding of fact that assessee has incurred excess AMP expenses cannot also survive.
- AMP expenses, admittedly, were incurred in India and paid to an Indian tax-payer entity or entities who have undeniably paid their tax in the Indian jurisdiction. Hence, the alleged non-routine expenditure cannot be treated as a 'transaction' between the assessee and its foreign AE fitting in the definition of an 'international transaction' given in the Act. Hence, no adjustment is required to be made for such AMP expenses incurred by the assessee.
- Further, it held that any advertisement which is product-centric or brand-centric, will only enhance the sales of the products of that brand in India. Hence, the brand owner situated outside India will not be benefited from the same. Also, in case of wholly owned subsidiary, any benefit derived by the foreign company will directly and proportionately benefit the Indian company. Therefore, this is not a case of brand-building/promotion. Hence, it held that no such 'covert transaction' between the Indian entity and its foreign AE, can be been culled out and presumed or inferred by the TPO/AO in the given facts and the circumstances of this case.
- Further, it held that the primary beneficiary of the AMP activities is the Indian company and if foreign AE derives any benefit, the same is purely incidental and an unavoidable byproduct of advertisement activities undertaken aggressively by the Indian Company. Also, it relied on OECD guidelines on intra-group services, which stated that no compensation is required to be paid in such cases of incidental benefits.

Conclusion

Thus, the judicial member in dissenting judgment held that incurring of AMP expenses by assessee is not a 'provision of service' and hence, does not fit in any part of the definition of an 'international transaction'. Hence, it held that the assessee has not created, improved or maintained the marketing intangible for its foreign AE and hence, question of any sort of compensation does not arise in this case.

Way Forward

With the passage of each transfer pricing audit, the determination of income from intangible transactions is going to be more complex and challenging due to increased focus from tax authorities. This decision of Special Bench is landmark and first ruling on the contentious issue of marketing intangibles and as it is based on peculiar facts in the assessee's case, its implications on other assessees would need to be suitably evaluated. Further, the dissenting judgment given by judicial member may also need to be appropriately considered. Thus, all in all, based on the judgment of Special Bench in this case, it is unlikely that the issue of marketing intangibles would be settled soon.■