**IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'C'**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND
SHRI B.R.BASKARAN, ACCOUNTANT MEMBER**

IT(TP)A No.3071/Bang/2018
Assessment Year: 2014 – 15

M/s. The Himalaya Drug Company Makali, Tumkur Road Bengaluru-562162 **PAN NO :AADFT3025B**	**Vs.**	The Deputy Commissioner of Income tax, Circle 6(2)(1), Room No.317, 3rd Floor, B.M.T.C Building, 80 feet Road, 6th Block, Koramangala, Bengaluru - 560095
APPELLANT		**RESPONDENT**

Appellant by	:	Shri Padam Chand Khincha, & Sudheendra B., A.R.
Respondent by	:	Shri Pradeep Kumar, CIT-D.R.

Date of Hearing	:	03.12.2020
Date of Pronouncement	:	07.12.2020

O R D E R

PER B.R.BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed this appeal challenging the assessment order dated 14-09-2018 passed by the Assessing Officer for assessment year 2014-15 u/s 143(3) r.w.s.92CA r.w.s.144C(13) of the Income-tax Act,1961 ['the Act' for short] in pursuance of directions given by the ld. Dispute Resolution Panel (DRP).

2. The grounds of appeal filed by the assessee run into 28 pages. The Ld A.R submitted that they give rise to the following issues:

a. Disallowance of advertisement expenditure in the form of construction of swimming pool.

b. Disallowance of Depreciation & additional depreciation claimed

c. Disallowance of product promotion expenses incurred with Doctors

d. Transfer Pricing adjustment relating to sale of goods to associated enterprises.

e. Transfer Pricing adjustment relating to advertisement and market promotion expenses.

f. Transfer Pricing adjustment relating to royalty

Other issues urged by the assessee are either general in nature or consequential.

3. The facts relating to the case have been narrated as under by the Tribunal in its order passed for AY 2013-14 in ITA No.1385/Bang/2017:-

"3. The facts relating to the case are stated in brief. The assessee is a partnership firm engaged in the business of manufacture and sale of Ayurvedic medicament and preparations, consumer/personal care products and animal health care products. The partners of the assessee firm are

(a) M/s Himalaya Global Holdings Pvt Ltd., a foreign company registered in Cayman Islands and

(b) M/s Himalaya Drug Co. Pvt. Ltd.

These two partners respectively hold 88% and 12% share in the profits of the assessee firm. The TPO has also discussed ownership details of the above said two partner

companies. Mr. Meeraj Alim Manal, is holding 100% shares in M/s Himalaya Global Holdings Pvt. Ltd. He also holds entire shares except one share in M/s Himalaya Drug Co. Pvt. Ltd."

The assessee firm was started in 1930. Currently, the products manufactured by the assessee firm is classified broadly into three groups, viz., Pharmaceutical products, Personal care products and Animal Health products.

3.1 The assessee filed its return of income for the year under consideration on 29.11.2014 declaring a total income of Rs.91.69 crores. The AO referred the matter to the Transfer Pricing Officer (TPO) for determining ALP of international transactions entered with its Associated Enterprises. The TPO determined addition of Rs.179.09 crores on account of following Transfer pricing adjustments:-

Sale of finished goods	-	88.22 crores
Advertisement, Marketing	-	87.47 crores
Royalty on product registration	-	3.40 crores

Total TP adjustment	-	179.09 crores
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3.2 The assessing officer issued draft assessment order making addition of Transfer pricing adjustment of Rs.179.09 crores determined by the TPO. Besides the above, the AO also disallowed expenses relating to Gift to Doctors; expenditure incurred on swimming pool, depreciation/addl. Depreciation claimed on certain assets and donation to CM relief fund.

3.3 The assessee filed its objections before Ld DRP. The Ld Dispute Resolution Panel granted relief in respect of donation given

to CM relief fund and confirmed all the additions proposed by the AO in the draft assessment order. Accordingly, the AO passed the final assessment order. Aggrieved, the assessee has filed this appeal before us challenging the assessment order passed by the AO.

4. The first issue relates to disallowance of advertisement expenditure. The AO noticed that the assessee firm has contributed a sum of Rs.99.66 lakhs to a School named M/s Mallya Aditi International school, Yelahanka, Bangalore for the purpose of construction of a swimming pool in that school. The assessee claimed the above said payment as advertisement expenditure. In support of the said claim, it was submitted that the "name of the assessee company" is displayed near the swimming pool and hence the same would promote the brand of the assessee company. It was submitted that over 500 children study in that school. Apart from them, parents of the children also visit School and the alumini of the school hold events etc., who will happen to see the advertisement Board. Accordingly, it was submitted that the assessee's brand would get promoted in this process. Accordingly, it was claimed that the above said contribution is in the nature of advertisement expenditure only. The AO however, noticed that the children of Mr.Meeraj Alim Manal had studied in the school till 31-03-2011 and the children of Ms. Lubna Manal, daughter of Shri Meeraj Alim Manal (i.e., grand children of Mr. Meeraj Alim Manal) continue to study in this school. Hence, the AO took the view that the contribution for the construction of swimming pool was made by Mr. Meeraj Manal on account of his personal gestures only and hence it is clearly in the nature of personal expenditure. i.e., there is no commercial consideration involved in it. Accordingly, the AO disallowed the above said claim of Rs.99.66 lakhs. The Ld DRP

upheld the view so taken by the AO by following its decision rendered in AY 2013-14 on an identical issue. The relevant observations made by Ld DRP in AY 2013-14 are extracted below:-

> *"iii. As per Section 37 of the IT Act, any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income under the head business or profession. However, the onus is on the assessee to prove that expenses were laid out wholly and exclusively for the purposes of the business. In the case of the assessee, not only the conclusion of the AO that the expenses incurred in construction of the swimming pool for the school where the children of the assessee were studying is a personal expense remains uncontroverted but also the assessee could not establish that the said expenses were laid out wholly and exclusively for the purpose of its business. The Hon'ble High Court of Rajasthan in case of Jaipur Udyog Limited 140 taxman 703 has held that where maintenance of any garden by the assessee has nothing to do with business or profit from business, expenses incurred could not be allowed. The Hon'ble High Court of Allahabad in case of Saru Smelting & Refining Corpn.(P) Ltd., 116 ITR 766 has held that expenditure incurred on erection of a gate and statue of its founder Director in a Municipal garden is not deductible as revenue*

expenditure The Hon'ble Karnataka High Court in cases of Mac Exploiter (P.) Ltd. 155 taxman 247 has held that expenses incurred on education of son of the director is not allowable as a deduction in case of the assessee company. The Hon'ble High Court of Madras in case of R.K.K.R. Steels (P.) Ltd 131 taxman 830 has decided on similar lines confirming the disallowance of the claim of educational expenses for the son of the director of the assessee company.

In view of above facts and judicial position, the claim of the assessee of expenses incurred for construction of the swimming pool in the school of the children of the Chairman of the group as revenue expenditure cannot be allowed as the same is in the nature of personal expenses and also as the assessee could not establish that the expenses were wholly and exclusively laid out for the purposes of the business. The decision of the AO is upheld"

4.1 The Ld A.R submitted that an identical issue was examined by the co-ordinate bench of Tribunal in the assessee's own case in AY 2013-14 in IT(TP)A No.1385/Bang/2017 and the Tribunal, vide its order dated 14.07.2020, has decided the issue against the assessee. We heard Ld D.R on this issue. We notice that the co-ordinate bench has decided this issue in AY 2013-14 against the assessee with the following observations:-

"7. We have heard the rival submissions on this issue and perused the record. The admitted facts are that the

children and grand children of Mr. Meeraj Alim Manal, has studied/studies in the school in which the assessee has contributed for construction of swimming pool. It is the contention of the assessee that its name is displayed alongside of the swimming pool and hence the same will promote the brand name of the assessee. However, it is not the case of the assessee that it is making such type of contributions to other schools also as a strategy to promote its brand, meaning thereby, the assessee firm has made the contribution to the impugned school only for the reason that the children/grandchildren of Mr. Meeraj Alim Manal has studied/studies in this school. There should not be any dispute that Mr. Meeraj has full control over the assessee firm. Looking at these facts and the circumstances surrounding the contribution, we are of the view that there is merit in the contentions of Ld DR that the impugned contribution has been made on account of personal considerations only and not on commercial considerations. Hence, we are of the view that the main objective of making contribution could not be related to the business activity carried on by the assessee. Before us, the ld AR placed his reliance on the decision rendered by the Hon'ble Karnataka High Court in the case of Infosys Technologies Ltd. (supra). The facts available in the above said case are that the assessee before the Hon'ble High Court had incurred expenditure on installation of traffic signals at various parts of the city. It was mentioned that the purpose of incurring such expenditure was to secure free movement of employees so that they reach office in time. The Hon'ble High Court noticed that the absence of traffic signals or traffic police at important junctions would lead to congestion which is a regular phenomenon in the Bengaluru City. Accordingly, the Hon'ble High Court accepted the plea of the assessee that the expenditure incurred on erection of traffic signals would help the employees of the assessee to reach the office in time, which would in turn, facilitate the business of the assessee. Hence, it was held the said expenditure in installing traffic signal is allowable as deduction. It can be noticed that the assessee before Hon'ble Karnataka High Court could establish the commercial consideration

> in incurring expenses on the construction of traffic signals. On the contrary, we have noticed that the main objective of making contribution to the school was on account of personal consideration & gesture of the ultimate owner of the assessee firm and no commercial consideration relating to the assessee herein was attached thereto. Accordingly, we are of the view that the AO was justified in treating the expenditure as not related to the business activity carried on by the assessee. Accordingly, we confirm the disallowance made by the AO."

4.2 Since the facts relating to this identical in this year also, following the decision rendered in AY 2013-14, we confirm the impugned disallowance of advertisement expenses relating to construction of swimming pool made by the AO.

5.0 The next issue relates to disallowance of depreciation and additional depreciation claimed by the assessee.The AO noticed that the assessee has claimed depreciation at the rate of 15%, i.e., the rate applicable to plant & machinery and also claimed additional depreciation at the rate of 20% (again applicable to Plant & machinery) on certain new items of assets purchased during the year. The assessee has so claimed depreciation at the above said rates, by classifying those assets as "Plant & Machinery". The AO, however, took the view that the assets listed out in the table at pages 6 to 8 of the assessment order are in the nature of "Furniture and fixtures" only, i.e., they are not "Plant & Machinery" as claimed by the assessee. Accordingly, the AO held that the rate of depreciation applicable to Furniture & Fixtures is only 10% and further additional depreciation cannot be allowed on furniture. Accordingly, the AO allowed depreciation @ 10% applicable to Furniture and Fixtures and disallowed the excess claim. Since additional depreciation is not allowed in the respect of assets

classified as Furniture and Fixtures, the AO disallowed the claim of additional depreciation also. Accordingly, the assessing officer made disallowance of Rs.15,99,366/- out of depreciation claimed by the assessee.

5.1 The Ld A.R submitted that an identical issue was examined by the co-ordinate bench of Tribunal in the assessee's own case in AY 2013-14 in IT(TP)A No.1385/Bang/2017 and the Tribunal, vide its order dated 14.07.2020 has restored this issue to the file of the AO. We heard Ld D.R on this issue. We notice that the co-ordinate bench has restored this issue to the file of the AO in AY 2013-14 with the following observations:-

> "11. We have heard the rival contentions on this issue and perused the record. It can be noticed that the AO has listed out 46 items. According to AO, these items would fall under the category of 'Furniture and Fixture' and they have been classified as "Plant & Machinery" by the assessee. However, a perusal of the list of items of assets extracted above would show that there are certain items like pump sets, refrigerator, camera, telephone, pedestal fan etc., which should fall under the category of "Plant & Machinery", even if the purpose for which they are put to use are not considered. In respect of remaining items, the contention of the assessee is that these items are used in the factory/lab for the purpose of production or manufacture as part of "Plant & Machinery". In support of his contention, the ld. AR placed his reliance on the decision rendered by Pune Bench of the Tribunal in the case of Serum Institute of India Ltd., Vs Addl.CIT 147 TTJ 594 (Pune). In the above said case, the Tribunal considered the issue of depreciation allowable on stools, tables, stainless steel racks etc., which were used for laboratory purposes, i.e for the purpose of production or processing of chemical tests in the laboratory leading to the production. The Tribunal took the view that the functionality test of the assets has to be applied for

determining its category and in this regard, Pune Bench, in turn, relied upon the decision rendered by the Hon'ble Karnataka High Court in the case of Hindustan Aeronautical Ltd.,(HAL) Vs CIT 206 ITR 338, wherein it was held that for determining what constitutes "plant", the 'functional test' and not merely 'amenities test' has to be applied. It was also held by the Hon'ble Karnataka High Court that the bins, racks and shelves kept in workshop would constitute plant and machinery.

12. Before us, the ld. DR placed has placed reliance on the decision rendered by the Hon'ble Madras High Court in the case of Dinamalar Ltd.(supra). We have gone through the said case-law and notice that the assessee therein had claimed higher rate of depreciation applicable to computers in respect of peripherals used along with the computers. In that context, Hon'ble Madras High Court has taken the view that the peripherals cannot be classified as computers for claiming higher rate of depreciation as applicable to "Computers". In our view, the above said decision has been rendered in a different context, i.e., within the category of 'Plant and Machinery', the sub-question was whether the peripherals could be classified as Computers. Since the functions performed by the peripherals are different from that of a computer, the High Court held that they cannot be classified as "Computers". We notice that the decision rendered by the Hon'ble Karnataka High Court in the case of Hindustan Aeronautics Ltd (supra), which was followed by Pune Bench of the Tribunal in the case of Serum Institute of India Ltd.(supra) would apply to the facts of the present case.

13. We have noticed that certain items of assets are in the nature of Plant and machinery. It is the claim of the assessee that other items are also used as part of Plant and Machinery. Hence, we are of the view that this issue requires fresh examination at the end of the AO in accordance with the decision rendered by the Hon'ble Karnataka High Court in the case of Hindustan Aeronautics Ltd (supra). Accordingly, we restore this issue to the file of the AO for examining the same afresh in the light of discussions made supra by following the

decision rendered by the Hon'ble Karnataka High Court in the case of Hindustan Aeronautics Limited (supra)."

5.2 Since facts of this issue are identical in this year also, following the decision rendered by the Tribunal in AY 2013-14, we restore this issue to the file of the AO with similar directions.

6.0 The next issue relates to disallowance made out of Sales Promotion expenses. The assessee had incurred expenses on giving of gifts/product information items to Ayurvedic doctors and general chemists. The AO noticed that the assessee claimed a sum of Rs.76.77 Crores as "Sales Promotion" expenses. The above said amount included expenses incurred for gifts, product reminders, promotional aids, product literature etc., to doctors amounting to Rs.10.77 Crores. The AO noticed that the gifts so given by the assessee consisted of Files, Pen, Mouse pad, paper weight, visiting card holders, pen stand, medical apparatus, room fresheners, lamp, key chain etc. It was submitted by the assessee that the cost of each item of gift is priced below Rs.500/-. The AO took the view that, as per MCI guidelines applicable to Allopathic doctors, there is a ban on doctors from accepting gifts from any pharmaceutical or allied health care industry. He took the view that the principle underlying the above said ban will also equally apply to Ayurvedic doctors. Further, the AO noticed that the assessee could not furnish details number of items of gifts given to each of the doctors. He was of the view that there is a possibility that the cumulative value of gifts given to each of the doctors may be more than Rs.1000/-. Accordingly, the AO disallowed 20% of the amount spent on gifts given to doctors, which came to be worked out at Rs.2.15 Crores by the AO. The ld. DRP also confirmed the same.

6.1 The Ld A.R submitted that an identical issue was examined by the co-ordinate bench of Tribunal in the assessee's own case in AY 2013-14 in IT(TP)A No.1385/Bang/2017 and the Tribunal, vide its order dated 14.07.2020 has decided the issue in favour of the assessee. We heard Ld D.R on this issue. We notice that the co-ordinate bench has decided this issue in AY 2013-14 in favour of the assessee with the following observations:-

> "15. We have heard the rival contentions and perused the record. Both the parties took support of various decisions to reiterate their respective claims. The ld. DR submitted that the gifts given to doctors are against the ethics and hence, the same is liable to be disallowed, whereas the ld. AR relied on various case laws to contend that these expenditure is allowable as sales promotion expenses and further the amount of each of the gifts did not exceed Rs.1000/- which is limit fixed by the MCI in the code of conduct for not taking any action against the doctors, i.e receipt of gifts having value of less than Rs.1000/- will not attract penal action by MCI. It is pertinent to note that the assessee has spent a sum of Rs.15.26 Crores on gifts given to doctors. It is stated that the nature of gift consists of prescription slips, doctor names, bags, medical testing apparatus, pen, room fresheners, visiting card holders, tissue papers etc. There is no dispute with regard to the fact that all these items carried the Himalaya logo. The Ld A.R submitted that these items are intended to promote popularity of name and products of the company only. Accordingly, he submitted that they are in the nature of advertisement only. We notice that similar claims were made before the AO also, but it was not accepted by him. It is pertinent to note that the assessing officer has inclined to accept the claim in respect of gifts, which are costing less than Rs.1000/-. The AO appears to have taken the view that the limit of Rs.1000/- fixed by the MCI should apply to the cumulative value of gifts given. Accordingly, he has expressed the view that, even if the value of each of the item was less than Rs.1000/-, there is possibility that the assessee would have given more number of items to the

ayurvedic doctors and hence the cumulative value of items given to each doctor may exceed Rs.1000/-. Since exact details of number of items given to each of the doctors are not available, the AO has taken the view that part of expenses is required to be disallowed. The AO, accordingly, computed quantum of gifts given to doctors at Rs.13.47 Crores and disallowed 20% of the same on estimated basis. It can be noticed that the AO has, in fact, accepted the claim of the assessee that these expenses are related to the business and hence he has accepted and allowed 80% of the expenditure as deduction. He has disallowed 20% on estimated basis only on the reasoning that the cumulative value of items given to each of the doctors may exceed Rs.1000/- in a year and on further reason that the same is excessive. The relevant observations made by the AO are extracted below:-

> "6.4 The assessee is not able to give a value based flow chart showing how many gifts are given to each doctors nor are they able to link the number of gifts items which is given to each Doctor or produce confirmation from each recipient, due to the huge volumes of gifts dispersed and also due to the fact that the field staff are given these gifts for further distribution and the logistics involved to itemize and track such gifting would be too voluminous to tabulate.
>
> But the fact remains that the total expenditure under this head is a huge amount to be spent on sales promotion without proper tabulation of how and to whom these expenses are spent on.
>
> 6.5 The assessee firm is also not able to compute the amount and value of gifts given to a particular doctor/clinic for usage, as to whether the total amount spent on a particular doctor would be above or below Rs.1000/- at a particular gifting instance or during the year. Keeping all the above factors in mind and also keeping in view the quantum of expenditure incurred, I disallow 20% of the amounts incurred under the following heads:

Gifts to Doctor:-
Brand Reminder

Cost less than Rs.100	:	9,95,53,309
Cost less than Rs.500	:	3,25,94,673
Cost less than Rs.1000	:	25,69,462
		13,47,17,444

6.6 20% of the above amount is disallowed as being excessive expenditure on gifts to Doctors which is not confirmed by the recipients and not being an ethical practice to promote the sales of the firm among Ayurvedic Doctors."

We notice that the various case laws relied upon both the parties related to complete disallowance of sales promotion expenses, whereas in the instant case, the AO has made estimated disallowance of 20% of sales promotion expenses claimed by the assessee. Normally, when the AO has accepted 80% of the expenditure as in the nature of sales promotion expenditure, in our view, there should be some valid reason to disallow 20% of the expenditure on estimated basis. In the instant case, the reasons given by the AO are that

(a) the cumulative value of gifts given to each of the doctors would have exceeded Rs.1000/-.

(b) the quantum of expenditure is huge and excessive.

We have noticed that the AO has presumed that the cumulative value of Gifts would have exceeded Rs.1000/-. First of all, the question as to whether the limit of Rs.1000/- fixed by MCI would apply to the value of each item of gift or cumulative value in a year is debatable question. Secondly, the question as to whether the code of conduct prescribed for individual doctors should also be made applicable to pharma companies is another debatable question. Be that as it may, we have noticed earlier that the limit of Rs.1000/- has been prescribed by Medical Council of India for not taking any penal action against the doctors who had accepted gifts having value of

> Rs.1000/-. Hence it has been interpreted that the gifts having value of less than Rs.1000/- could be given. In any case, it was not shown to us that the notification issued by MCI shall be applicable to ayurvedic doctors also. Hence it cannot be conclusively said that the notification issued by MCI shall apply to Ayurvedic doctors also, to whom the sales promotion items have been given by the assessee. Further we have noticed that the AO has taken the view that the cumulative value of gifts should have exceeded Rs.1000/- and hence there is violation of MCI regulations. We have observed earlier that the said view itself is debatable one. Further, the view so taken by AO is based on presumptions only. Hence the first reasoning given by the AO could not be affirmed by us. The second reasoning given is that the quantum of expenditure is excessive. It is well settled principle of law that the income tax officer cannot sit on the arms chair of a business man and could decide the quantum of expenses. So long as it is seen that the expenses have been incurred for business purposes on commercial considerations, the same is allowable as deduction. Hence the second reasoning given by the AO also would fail. We notice that the AO has made estimated disallowance @ 20% of the expenditure claimed by the assessee on the basis of two reasoning given by him, which have been rejected by us. When the AO is accepting 80% of the expenditure, we do not find any justification for disallowing the remaining 20%. Hence, we are unable to sustain the estimated disallowance made by the AO. Accordingly, we direct the AO to delete the disallowance."

6.2 During the year under consideration also, the AO has given identical reasoning for disallowing 20% of the expenses on gifts and promotional aids given to doctors. Accordingly, following the decision rendered by the co-ordinate bench in AY 2013-14, we direct the AO to delete the impugned disallowance.

7.0 The next issue relates to the Transfer Pricing adjustment made in respect of goods sold to Associated Enterprises (AEs).

During this year, the assessee reported following international transactions:-

1. Export of Semi-finished products -Rs. 2,98,04,235
2. Export of Ayurvedic Medicaments and Preparations -Rs.169,87,78,383
3. Web designing and Support service -Rs. 26,04,816
4. Reimbursement of Expenses -Rs. 3,21,21,390

The TPO has made adjustment in respect of export of ayurvedic medicines and preparations. Out of the above amount, Export to Associated Enterprises was Rs.157.14 crores, on which the TPO has worked out Transfer pricing adjustment.

7.1 The assessee submitted that it has followed pricing policy of cost plus 15% in respect of exports made to AEs. The assessee has selected Transactional Net Margin Method (TNMM) as most appropriate method and OP/OR as Profit Level Indicator. The assessee has compared profit margin earned on exports made to AEs with the profit margin earned by it in respect of Personal care products.

7.2 The TPO, however, held that TNMM is not appropriate method. He took the view that Cost Plus Method is the most appropriate method. The TPO also held that the "rate of Gross profit" earned by the assessee in Personal care products division (consumer product division) should be adopted for determining the ALP of the Exports made to AE. The TPO worked out the ALP of international transactions of Exports to AE at Rs.245.36 crores by adopting Gross profit rate applicable to "Personal care products division". The value of international transaction declared by the assessee was Rs.157.14 crores. Accordingly, the TPO made transfer

pricing adjustment of Rs.88,22,36,414/-. The Ld DRP also confirmed the same.

7.3 The Ld A.R submitted that an identical issue has been considered by the co-ordinate benches in AY 2010-11 to 2013-14 and the same was decided in favour of the assessee.

7.4 We have heard Ld D.R and perused the record. We notice that an identical issue has been considered by the Tribunal in AY 2013-14 in ITA No.: IT(TP) A No.1385/Bang/2017 and it was decided in favour of the assessee as under:-

> "20. In the grounds urged by the assessee on this issue, the assessee has raised two preliminary issues, viz.,
> (a) It has questioned the validity of reference made to TPO u/s 92CA and
> (b) It has also questioned the action of TPO in treating the foreign companies as Associated Enterprises of the assessee.
> These issues have been urged in ground nos. 7.1 to 7.6. Both the parties agreed that the issue relating to validity of reference made to TPO has been decided against the assessee by the co-ordinate bench in assessee's own case in IT(TP)A No.807/Bang./2016 dated 04-07-2018 relating to AY 2011-12. The issue relating to AE relationship was declined to be examined by the co-ordinate bench in the above said year and it appears that the assessee has not objected to the same. Following the decision rendered by

the co-ordinate bench referred above, we reject these grounds.

21. The ground numbers 7.7 to 8.4 relates to the adoption of "Cost Plus Method" as most appropriate method by the TPO and consequent transfer pricing adjustment made by him, which were confirmed by Ld DRP. Identical issues were considered by the co-ordinate bench in assessee's own case in IT(TP)A No.807/Bang./2016 dated 04-07-2018 relating to AY 2011-12 reported in (2018)(96 taxmann.com 335). We extract below the relevant discussions made by the co-ordinate bench:-

"**8.1** Ground VIII (*supra*) is raised in respect of the rejection of the assessee's TP Study/documentation done adopting TNMM as the Most Appropriate Method (MAM) and the TPO's adoption of CPM as the MAM in place of TNMM. Ground IX (*supra*) is in respect of the alleged flaws in determination of ALP based on CPM, without admitting CPM as the MAM. In Ground No.X, the assessee is aggrieved with the TPO/DRP action is not allowing adjustments as per Rule 10B(1)(c)(iii) of the IT Rules, 1962 ('the Rules'), without prejudice to the assessee's objection on adoption of CPM as MAM. As these grounds (*supra*) are inter-related and deal with the merits of the case, we deem it appropriate to consider these grounds together.

8.2 Briefly stated, the facts relevant for adjudication of these grounds are as under:-

8.2.1 The assessee firm is engaged in the business of manufacture and sale of (a) herbal pharmaceutical products (ayurvedic medicaments and preparations); (b) consumer/personal care products and (c) animal health care products. The manufactured products are sold in India (domestic

sales) and are also exported to AEs/related entities outside India. The exports to related entities are from all these ranges of products, i.e. pharmaceutical products, consumer/personal care products and animal health care products. The assessee also sells these products to unrelated parties in CIS countries. In India, pharmaceutical products are driven by the prescription of Doctors. In CIS countries, Ayurveda is widely recognized and therefore largely the practice is akin to India. However, in the other countries, the international business for these products is largely, driven by marketing and advertisement and not by prescription; as is the case with the personal care range of products in India. The personal care division in the domestic market undertakes full fledged marketing activities; including advertisement, sales promotion, etc. However, in respect of exports to AEs/related parties outside India, the entire marketing activities is done by the AEs as the assessee only manufactures the goods as per requirement of the AEs and dispatches the same to them.

8.2.2 In the year under consideration, the assessee exported products amounting to Rs. 74,26,02,810 to AEs. In its TP Study, the assessee selected TNMM as the MAM for determination of the ALP of the international transactions with its AEs. As per its TP Study, the net margin earned by the assessee in respect of personal care division in the domestic segment at 11.30% was compared to the net margin of 15.80% from exports to its AEs. This was stated to be done as the pharmaceutical range of products are on par with the personal care range of products exported outside India and further the margin of domestic pharma division was not comparable as the parameters of marketing, manufacturing, competition, exposure and acceptance of ayurvedic products by customers, government control, etc are entirely different in India for pharma division.

8.2.3 On the other hand, the personal care division products are sold through distributors and the same is market driven and therefore the ranges of personal care division in India was considered with export to AEs. Since the net margin from exports to AEs was higher than the net margin from domestic sales to unrelated parties, the assessee concluded that its exports to AEs were at arm's length.

8.2.4 The TPO after examining the assessee's TP Study issued show cause notice to the assessee proposing to substitute CPM as the MAM in place of TNMM adopted by the assessee. In this regard, the TPO compared the gross margin earned on exports at 23.32% as against gross profit of 50.65% earned by the domestic consumer product division and proposed Transfer Pricing Adjustment. The assessee filed its objections thereto challenging the adoption of CPM as the MAM, inter alia, that the GP ratio differed mainly in respect of the marketing, distribution, selling and other similar expenses incurred by the assessee in the domestic market, whereas no such expenditure was incurred by it in respect of exports to AEs, as such expenses were incurred by the AEs in their respective territories and not by the assessee. It was also submitted that there were inherent difficulties in applying CPM and contended that, without admitting that CPM is the MAM, the TPO ought to reduce the gross profit margin earned in the domestic market on account of various difference between domestic sales such as marketing and selling costs, discounts, administrative costs, etc. whereas export sales to AEs are at a price ex-factory. Therefore, since the gross profits would be different in both these segments, they cannot be compared by applying CPM. It was also contended that since the net margin in both segments are less effected by transactional differences at net profit level, therefore TNMM is the MAM.

8.2.5 The TPO, however, rejected the assessee's contention and passed order under Section 92CA of the Act wherein he considered CPM as the MAM and considered the Gross Profit margin earned in the consumer product division for bench marking. The TPO also held that the assessee acted as a contract manufacturer in respect of products manufactured and exported to AEs as it did not undertake distribution, advertisement, marketing and selling expenditure and alleged that the goods are sold at a mark up of 15% on cost. The TPO computed the Gross Profit margin on cost of goods sold in the domestic consumer product division at 102.63% and the cost of goods sold to AEs amounting to Rs. 56,94,29,812 was accordingly increased by the above rate to Rs. 115,38,35,749. From this, the exports to AEs amounting to Rs. 74,26,02,810 was reduced and the Transfer Pricing Adjustment in respect of exports to AEs was determined

at Rs. 41,12,32,939. The DRP upheld these views/actions of the TPO.

8.3.1 Before us, the learned Authorised Representative of the assessee sought to explain the transactional and functional differences between the domestic sales to unrelated parties and export sales to AEs to justify the GP margin under the segments. The learned Authorised Representative, referring to the TPO's order under Section 92CA of the Act, argued that the TPO accepted that various expenditure like distribution, marketing, advertisement, selling, administrative costs, etc were incurred in the domestic market segment and that the same was not incurred in connection with exports to AEs. It was submitted that in the domestic market, since the assessee had to incur huge expenditure on distribution, marketing, advertisement, selling, etc. in the domestic market, the selling price and gross profit of products for sale in domestic market was fixed at a high price. On the other hand, as the AEs themselves incur similar expenses in the foreign markets, the selling price of products exported to AEs does not factor in similar expenditure and hence the selling price and gross profit of these products are lower when compared to that of products sold in the domestic market.

8.3.2 The learned Authorised Representative referred to and placed reliance on OECD Guidelines for transfer pricing, illustration given thereunder and various judicial pronouncements in order to explain why TNMM and not CPM be regarded as the MAM. It was submitted that CPM cannot be considered as MAM due to transactional and functional differences between domestic and export sales and that TNMM be taken as the MAM as it was less affected by the transactional and functional differences as comparison is made at the net profit level. The learned Authorised Representative submitted that, without prejudice to the assessee's above contentions, if CPM is to be considered as the MAM, there being various differences between domestic sales and exports sales, adjustments should be allowed for all these differences. Arguments were also put forth that the assessee was a full fledged manufacturer and not a contract manufacturer as held by the TPO for the purpose of applying CPM.

8.4 Per contra, the learned Departmental Representative for Revenue argued justifying the action of the TPO in adopting CPM as the MAM due to the difference in G P Margin in domestic and export sales. The learned Departmental Representative filed a chart showing the percentage of GP to cost of goods sold, in both consumer products in domestic market and exports to AEs for Assessment Years 2009-10 to 2013-14 and submitted that due to huge difference in G P rate in both the above segments, the Transfer Pricing Adjustment made by the TPO is fully justified. The learned Departmental Representative contended that TNMM cannot be considered as the MAM since distribution, marketing, selling expense are incurred only in the domestic market and not in connection with the products exported to AEs. The learned Departmental Representative relied on various judicial pronouncements to contend that CPM was the MAM to be adopted in the case on hand.

8.5.1 We have heard the rival contentions, perused and carefully considered the material on record; including the judicial pronouncements cited. The first issue for consideration is that of what would be the MAM in the facts and circumstances in the case on hand.

As per Sec. 92C(1) of the Act, the ALP in relation to an international transaction hall be determined by any of the following methods, being the MAM, having regard to the nature of transaction or class of transaction OR class of associated persons OR functions performed by such persons OR such other relevant factors as the Board may prescribe, viz.,

(*a*) Comparable Uncontrolled Price Method;

(*b*) Resale Price Method;

(*c*) Cost Plus Method;

(*d*) Profit Split Method;

(*e*) Transactional Net Margin Method;

(*f*) Such other method as may be prescribed by the Board.

Sub-section 2 of Section 92C of the Act provides that the MAM referred to in sub-section (1) shall be applied, for determination of the ALP, in the manner as may be prescribed.

Rule 10B of the IT Rules, 1962 provides for the determination of ALP under Section 92C of the Act. The TPO in the case on hand has applied CPM as the MAM. Rule 10B(1)(c) deals with the determination of ALP as per CPM and the same is extracted hereunder :—

"(*c*) cost plus method, by which,—

(*i*) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(*ii*) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(*iii*) the normal gross profit mark-up referred to in sub-clause (*ii*) is adjusted to take into account the functional and other differences, if any, between the international transaction [55b]*[or the specified domestic transaction]* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(*iv*) the costs referred to in sub-clause (*i*) are increased by the adjusted profit mark-up arrived at under sub-clause *(iii);*

(*v*) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;"

8.5.2 As per CPM, the direct and indirect costs of production incurred by the enterprise in respect of property transferred to an AE is increased by the 'adjusted profit mark up' to determine the ALP. The 'adjusted profit mark up' is determined by making adjustments to 'normal gross profit mark up' to take into account

the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions OR between the enterprises entering into such transactions, which could materially affect such profit mark up in the open market. The 'normal gross profit mark up' means the gross profit mark up on direct and indirect costs of production arising from the transfer of the same OR similar property by the enterprise or by an unrelated enterprise, in a comparable uncontrolled transaction OR a number of such transactions.

8.5.4** In the case on hand, the assessee compared the net profit margin from domestic consumer product division with the net profit margin for exports to AEs. At page 46 of his order, the TPO has held that the exports to AEs is comparable in terms of nature of goods to the domestic consumer product division and therefore this section is considered as comparable to exports to AEs. Thus, there is no dispute on the domestic consumer product division being compared with exports to AEs. The TPO, however, compared the gross margin of domestic consumer product division with the gross margin of exports to the AEs. In doing so, we find the TPO disregarded the mandate of Rule 10B(1)(c) of the Rules which require determination of 'adjusted profit mark up' by making adjustments to the 'normal gross profit mark up' by taking into account the functional and other differences between the international transactions and the comparable uncontrolled transactions. (** Mistake in numbering)

8.5.5 It is an undisputed fact on record that, in respect of finished goods exported to AEs, the entire marketing, adjustment, distribution and sales activities are performed by the AEs and not by the assessee. The TPO has acknowledged/accepted this fact at various places in his order under Section 92CA of the Act; viz. at the 1st para on page 3 and 6, last para of page 4, 2nd para on page 5, etc. The TPO, however, rejected TNMM as the MAM and adopted CPM for determination of ALP of sale of finished goods to the assessee for the reason that, even though the products sold in the domestic consumer product division are comparable to the products sold to AEs, the functions performed, assets employed and risks undertaken in both the segments are not the same. The

selling price and gross profit of products sold in the domestic consumer division is higher than that of the products exported to AEs for the reason that the assessee in the domestic consumer product division undertakes all function and incurs expenditure on distribution, marketing, advertisement, transportation, sales promotion, commission, travel, salary, travelling, administrative costs and also undertakes risks such as market risk, debt risk, etc. Therefore the selling price and gross profit of products sold in the domestic consumer products are fixed at a higher level than in the case of export of finished goods to AEs where the selling price is the ex-factory price; the freight at actual is collected by the assessee and also as all other expenditure mentioned above like distribution, marketing, advertisement, transportation, sales promotion, etc. are entirely incurred by the AEs and not by the assessee. Therefore, since the assessee does not undertake the above functions and risks, the selling price of products sold to Assessing Officer are fixed considering a net margin of 15% on the estimated costs.

8.5.6 In our considered view, the TPO has completely disregarded the above important differences in functions performed, assets employed and risks undertaken by the domestic consumer product division and export to AEs; the pricing policy followed by the assessee due to these differences in both segments. In this view of the matter, we are of the considered opinion that the TPO's approach, in applying the gross profit margin of the domestic consumer product division to the cost of goods sold in exports to AEs to determine the ALP, is factually erroneous and contrary to the mandate of Rule 10B(1)(c) of the Rules.

8.5.7 As per Rule 10B(2), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following namely :—

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

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

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

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

As per Rule 10B(3), an uncontrolled transaction shall be comparable to an international transaction if :—

"E (3) An uncontrolled transaction shall be comparable to an international transaction if—

(*i*) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences."

The effect of Rule 10B(2) and (3) is to compare an international transaction with an uncontrolled transaction with reference to the parameters as explained at (a) to (d) above and to make reasonably accurate adjustments to eliminate the material effects of differences between the international transactions and uncontrolled transactions.

8.5.8 In the case on hand, as discussed above, the assessee mentions a higher gross margin in the domestic market because it incurs significant administration, selling and distribution expenses, etc. In case of group concerns (AEs) since the administration, selling, distribution and other expenses are incurred by the group concerns themselves, necessitating the levying of higher margins for the group concerns/AEs and consequently, keeping correspondingly lower margin for the assessee. Before the TPO, the assessee put forth the above discussed explanations in respect

of functional differences between exports to AEs and the domestic consumer product division (extracted at pages 16 to 21, pages 31 to 33 of TPO's order). Several other differences like public awareness of ayurvedic products in India and outside India, popularity of Brand 'Himalaya' in India and abroad, support of doctors and Govt. of India and abroad, etc. were explained before the TPO. The assessee also submitted that if CPM is considered as the MAM, then the gross profit margin earned in the domestic market should be reduced on account of the many/various differences like, freight to move goods to the sales depots and subsequently to the stockists, commission to C&F Agents through whom the sales are achieved, filed staff salaries, sales commission to employees, travelling cost to promote and achieve sales all over India, communication charges, brand premium, allowances for negative publicity in the international market, etc.

8.5.9 Rule 10B(1)(c) r.w. Rule 10B(3) provides for making reasonably accurate adjustments to eliminate the material effects of differences between transactions being compared. In the case on hand, from the details on record, the differences between domestic sales and export sales are large in number and some being qualitative, unless reasonably accurate adjustments are made to normal gross profit mark up to eliminate the material effects of the many differences between domestic sales and export sales, the two margins cannot be compared. In our view, to give a mathematical number to all these differences would mean indulging in the exercise within a realm of subjectivity which is to be avoided. We are conscious of the principle that CPM can be applied in the case of a manufacturer selling goods to both AEs and non-AEs. However, in our considered view, in the peculiar factual matrix of the case on hand, as discussed and laid out above, we are of the view that CPM cannot be considered as the MAM. In coming to this view, we are fortified by the decision of the Pune Bench of the ITAT in the case of *Drilbits International (P.) Ltd.* v. *Dy. CIT* [2011] 142 TTJ 86, wherein on similar facts and circumstances, it was held that gross profit mark up on domestic sales cannot be compared with gross profit on export sales to AE, reasonably accurate adjustments cannot be made to eliminate the differences between the domestic sale; export sales and

consequently CPM cannot be considered as the MAM; and in this regard at para 50 thereof held as under :—

"50. Considering the above submissions, vis-à-vis the method i.e. CPM (cost plus method) adopted by the learned TPO to determine the ALP, which has been relied upon by the learned Departmental Representative, we find that the learned TPO while adopting CPM has failed to appreciate several material aspects of the issue as discussed above. In our view, the learned TPO was not justified in comparing the gross margin in export segment vis-a-vis gross margins in domestic segment. There are various differences in the functions performed and the risk assumed in these two segments and therefore, the same cannot be considered as comparable cases for determining the ALP. There is no marketing risk in the export segment, no risk of bad debts, no product liability risk in export segments whereas the assessee has to bear all these risks in the domestic segment. The contractual statements also defer in the domestic segment vis-a-vis export segments. There are different characteristics and contractual terms in the two segments and further geographical and marked differences are also present. Thus, we are of the view that it is very difficult to make suitable adjustments for these differences, hence the CMA method is not appropriate method for determining the ALP. The learned TPO, in our view, has thus erred in adopting the CPM method as appropriate method."

8.5.10 Similarly, the ITAT, Pune Bench in the case of *Alfa Lavel (I) Ltd.* v. *Dy. CIT* [2014] 46 taxmann.com 394/149 ITD 285 (Pune - Trib.), rejected CPM as the MAM. In its decision in that case, where the assessee was engaged in the business of manufacture and sale of various industrial products such as decanters, separators, etc. to its AE located abroad as well as in the domestic sector, in view of the fact that there were various differences in export segment and domestic segment, such as market fluctuations, geographic differences, volume difference, credit risk, RPT, etc., the Bench held that the TPO was not justified in adopting CPM as the MAM as suitable adjustments are not possible.

8.5.11 The learned Departmental Representative for Revenue placed reliance on the decision of the Delhi Bench of ITAT in the case of *Wrigley India (P.) Ltd.* v. *Addl. CIT* [2011] 14

taxmann.com 91/48 SOT 53 (URO) (Delhi) to put forward the proposition that CPM should be considered as the MAM for manufacture and sale of finished goods in the domestic markets and exports to AEs. In fact, in this decision (*supra*), the Tribunal held that 'since the marketing and advertisement expenditure has to be also incurred by the AEs to market the product in their respective territories, therefore this aspect for making adjustments as provided in Rule 10B(1)(c)(iii) has to be considered. It is thus seen that the above decision relied on by the learned Departmental Representative also recognizes that adjustments have to be made as per Rule 10B(1)(c)(iii) under CPM also. No doubt, as a proposition, the above principle holds good, however, as we have held that, in the case on hand reasonably accurate adjustments cannot be made to determine the adjusted profit mark up as per Rule 10B(1)(c), CPM cannot be considered as the MAM.

8.5.12 The learned Departmental Representative also placed reliance on the decision in the case of *Diamond Dye Chem Ltd.* v. *Dy. CIT* in ITA No.3073/Mum/2006 dt.14.5.2010, wherein the Tribunal accepted CPM as MAM for the following reasons as held at para 35 thereof, which is extracted hereunder :—

"35. We find the assessee is manufacturing Optical Brightening Agents (OBAs) which are being used in textile and paper industries and which are exported by the assessee to the AEs as well as Non-AEs. Therefore, we do not find any merit in the contention of the assessee that there is product dissimilarity between goods exported to AEs and unrelated parties and, therefore, the Cost Plus Method is not applicable. Further the learned counsel for the assessee also could not satisfactorily explain as to what are the substantial differences in the functional and risk profiles of the activities undertaking by the assessee in respect of the exports made to the AEs and Non-AEs. Therefore, we do not find merit in the submission of the learned counsel for the assessee that in cases where the differences in functional profile are so material that the same cannot be reasonably adjusted while carrying out a gross profit analysis, it may be appropriate to consider a net level analysis using operating margin in view of Rule 10B(1)(c)(iii). Therefore, the submission of the learned counsel for the assessee that if at all an internal comparison has to be carried out in the instant case then it should be carried out at the

operating level i.e., using the net/operating margin. Further we find force in the submission of the learned DR that since the cost data for the manufacture of products are available as per cost audit report, the reliability there of is assured and therefore Cost PlusMethod is the most appropriate method. In this view of the matter and in view of the detailed discussion by the learned CIT (A), we hold that the Cost Plus Method (CPM) is the most suitable method for the international transactions with AEs in the instant case."

In this decision (*supra*), the Tribunal accepted CPM as the MAM considering the fact that the assessee was not able to satisfactorily explain the substantial difference in the FAR analysis in respect to exports to AEs and non-AEs and therefore did not accept that comparison should be made at the operating level using the net operating margin. In the case on hand, however, the assessee has brought on record many functional, quantitative and qualitative differences between the domestic consumer product division and the exports to AEs. As discussed earlier, reasonably accurate adjustments cannot be made in the case on hand to determine the adjusted profit mark up as per Rule 10B(1)(c) and therefore CPM cannot be considered as the MAM. Consequently, the aforesaid decision relied on by the learned Departmental Representative is not applicable to the facts of the case on hand.

8.5.13 The OECD, TP Guidelines, 2010 relied on by the assessee provides that CPM may become less reliable when there are differences between the controlled and uncontrolled transactions and those differences have a material effect on the attribute being used to measure arm's length conditions. It further states that when there are material differences that affect the gross margins earned in controlled and uncontrolled transactions, adjustments should be made to account for such differences. The extent and reliability of those adjustments will affect the relative reliability of the analysis.

8.5.14 On the other hand, the OECD,TP Guidelines, 2010, provides that TNMM is less affected by the transactional and functional differences as seen form Part III, B.2 at 2.68 thereof :—

"2.68 One strength of the transactional net margin method is that net profit indicators (e.g. return on assets, operating income to sales, and possibly other measures of net profit) are less affected

by transactional differences than is the case with price, as used in the CUP method. Net profit indicators also may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins. Differences in the functions performed between enterprises are often reflected in variations in operating expenses. Consequently, this may lead to a wide range of gross profit margins but still broadly similar levels of net operating profit indicators. In addition, in some countries the lack of clarity in the public data with respect to the classification of expenses in the gross or operating profits may make it difficult to evaluate the comparability of gross margins, while the use of net profit indicators may avoid the problem."

8.5.15 Rule 10B(1)(c) deals with the determination of ALP a per TNMM. As per this Rule, the net profit margin from a comparable uncontrolled transaction is adjusted to take into account the differences between the international transactions and comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market. This is compared with the net profit margin from the international transactions entered into with an AE. TNMM requires establishing comparability at a broad functional level, requiring comparison between net margins derived from the operation of the uncontrolled transactions and net margin derived in similar international transactions. Thus, TNMM removes the limitations of other methods and since the comparison is made at the net profit level, it is the only method where comparison is possible when there are differences in the transactions and further making reasonable adjustments to the comparable transaction is impossible. The Hon'ble Delhi High Court in the case of *Sony Ericsson Mobile Communications India (P.) Ltd.* v. *CIT* [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 held that the TNMM is a preferred TP Method for determination of ALP of international transactions for its proficiency, convenience and reliability and in TNMM preference should be given to internal or in-house comparables; as held in paras 89 and 90 thereof :—

"89. The TNM Method has seen a transition from a disfavoured comparable method, to possibly the most appropriate Transfer Pricing method due to ease and flexibility of applying the compatibility criteria and enhanced availability of comparables.

Net profit record/data is assessable and within reach. It is readily and easily available, entity-wise in the form of audited accounts. The TNM Method is a preferred transfer pricing arm's length principle for its proficiency, convenience and reliability. Ideally, in TNM Method preference should be given to internal or in-house comparables. In absence of internal comparables, the taxpayer can and would need to rely upon external comparables, i.e. comparable transactions by independent enterprises. For several reasons, database providers, it is apparent, have the requisite information and data of external comparables to enable comparability analysis of the controlled and uncontrolled transactions with necessary adjustment to obtain reliable results under TNM Method. This method also works to the benefit and advantage of the tax authorities in view of convenience and easier availability of data not only from third party providers, but on their own level, i.e. assessment records of other parties.

90. The strength of the TNM Method is that net profit indicators are less affected by transactional differences in comparison with some other methods. This method is more tolerant to functional differences between controlled and uncontrolled transactions in comparison with resort to gross profit margins……"

8.5.16 In the case on hand, the net margin earned by the assessee in respect of personal care division in the domestic segment at 11.30% was compared to the net margin from exports to AEs at 15.80%. Since the net margin from exports to AEs was higher than the net margin from domestic sales to unrelated parties, the assessee concluded that its exports to AEs were at arm's length. The TPO has taken AE sales comprising of both pharma and personal care products and compared the same with the personal care products of the domestic segment. Since the products compared are different, consequently the gross profits are also different. Further, the number of differences and adjustments to be carried out for comparison purposes as detailed from page 19 of the TPO's order are large in number and therefore where differences are many, CPM cannot be considered as MAM. Consequently, in our considered view, TNMM is the MAM in the peculiar facts and circumstances of the case on hand."

22. As regards the view of the TPO that the assessee is a contract manufacturer, the co-ordinate bench in the assessee's own case for assessment year 2011-12 (supra) has held as under:-

"**9.1** The TPO held that the assessee acted as a contract manufacturer in respect of products exported to AEs since the products are sold to AEs at cost plus 15% and the assessee does not undertake any other functions. The OECD, TP Guidelines, 2010 explain the meaning of contract manufacturing with an example wherein a 100% subsidiary company assembles products (a) at the expense/risk of the holding company; (b) based on all necessary component, know how provided by the holding company (c) based on guarantee provided by the holding company for purchase of products. The OECD, TP Guidelines further states that in contract manufacturing, the producer may get extensive instructions about what to produce, in what quantity and of what quality and therefore in such circumstances, the producing company bears low risk. The Guidelines also provide that a contract manufacturer under control of principal, manufactures the product on behalf of the principal, using technology that belongs to the principal, where purchase of the products manufactured and remuneration are guaranteed by the principal, irrespective of whether and if so at what price the principle is able to re-sell the product.

9.2 In the case on hand, the products involved are standard goods manufactured by the assessee and selling them in the ordinary course of its business, both in the domestic and overseas markets. The assessee does not depend on the technology of the AEs for manufacture of products; whose specifications whether technical or otherwise are decided by the assessee itself. At para 1.2 on page 3 of his order under Section 92CA of the Act, the TPO has accepted that the assessee has its own range of products and the AEs only choose from the standard products which are manufactured by the assessee for the Indian Market. In our view, the TPO's understanding of a contract manufacturer will make every manufacturer of goods in India who would not only make domestic sales but also effect sales to an overseas distributor as a contract

manufacturer. A co-ordinate bench of this Tribunal in the case of *Essilor Mfg. India (P.) Ltd.* v. *Dy. CIT* [2016] 67 taxmann.com 377 held that an assessee carrying out its independent activity of manufacturing cannot be treated as a contract manufacturer. It was held that in such circumstances CPM cannot be applied and TNMM will be the MAM. In view of the overall consideration of the peculiar facts and circumstances of the case, as discussed above, we hold that CPM adopted by the TPO is incorrect and contrary to the facts of the instant case and that the assessee is justified in adopting TNMM for determining the ALP in respect of finished goods exported to AEs. In this view of the matter, the Transfer Pricing Adjustment of Rs. 41,12,32,939 made by the TPO by adopting CPM is accordingly deleted. Consequently, ground No. VIII & IX raised by the assessee are allowed."

23. We notice that the co-ordinate bench has held in AY 2011-12 that the assessee is justified in adopting TNMM as most appropriate method for determining the Arm's Length Price of the international transactions of export of finished goods to its Associated Enterprises. It has also held that the assessee cannot be considered to be a contract manufacturer. Accordingly, the co-ordinate bench has deleted the Transfer pricing adjustment made on this point in AY 2011-12. The Ld A.R submitted that the decision rendered in AY 2011-12 was also followed in the assessee's own case in AY 2010-11 in IT(TP)A No.187/Bang/2015 dated 30-04-2019. He invited our attention to the following observations made by the Tribunal in AY 2010-11 with regard to the ALP of exports made to AEs:-

"6.6 For the year under consideration also, the TPO has accepted the fact that in respect of sale of products in India, the assessee has undertaken marketing, selling and administrative functions and the

assessee has not performed any such functions in respect of sales to AEs. The number of differences and adjustments to be carried out for comparability purposes as laid out at page 17 of the TPO's order are many in number and therefore, where differences are many, CPM cannot be considered as the MAM. In this view of the matter and following the decision of the Co-ordinate Bench of this Tribunal in the assessee's own case for Assessment Year 2011-12 (supra), we hold that TNMM is the MAM. Under the said method, the assessee has earned net margin of 13.39% from exports to its AEs whereas the net loss suffered by the assessee in respect of the personal care division in the domestic segment is (-) 10.16%. As the net margins from the assessee's exports to its AEs is higher when compared to the result of its margins in respect of transactions in the personal care division in the domestic segment, the price of the sale of finished goods are at arms length. In this factual view of the matter, the TP Adjustment of Rs.38,84,32,314/- made by the TPO by adopting CPM as the MAM is accordingly deleted. Consequently, grounds 5 to 7 are disposed off as above."

24. In assessment year 2010-11, the co-ordinate bench has also examined the Arms length price of export to AEs under TNM method. It has compared Net margin rate declared by the assessee in respect of "Domestic - Personal Care Division" with the net margin rate declared in Exports to AE. After comparison, the co-ordinate bench has held that the net margin rate from assessee's exports to AE is higher when compared to the result of its margins in

respect of transactions in the personal care division in the domestic segment and accordingly held that the price of sale of finished goods to its AE is at arm's length. Accordingly, the co-ordinate bench has deleted the T P adjustment made in respect of Exports made to AEs. Before us, the Ld A.R submitted that the Net profit margin declared during the year under consideration was 12.60% in Export to AE and the net profit margin declared in the domestic personal care division was 1.19%. Accordingly, he submitted that the international transaction of Export to AEs is at arms length and hence the impugned T P adjustment should be deleted.

25. We heard the parties on this issue and perused the record. We have noticed that the CPM method adopted by the TPO for bench marking the international transaction of Export to AEs has been rejected by the Co-ordinate bench in AY 2010-11 and 2011-12 in the assessee's own case. Accordingly, consistent with the view taken by the co-ordinate bench in the assessee's own case in the above said years and for the detailed reasons discussed in the order of the Tribunal, we also hold that the assessee was justified in adopting TNMM as most appropriate method for determining the Arm's Length Price of the international transactions of export of finished goods to its Associated Enterprises.

> 26. While bench marking the international transaction of Export to AEs under Cost Plus method, the TPO has taken "Domestic Personal Care division" as 'uncontrolled internal comparable'. The reasoning given by TPO is available at pages 14 & 15 of his order. The co-ordinate bench has also taken "Domestic – Personal Care Division" as uncontrolled comparable in AY 2010-11. Accordingly, we are of the view that "Domestic Personal Care division" can be taken as uncontrolled comparable under TNM method in this year also."

7.5 We notice that the co-ordinate benches are consistently holding that the TNM method is the most appropriate method for determining the ALP of the exports of ayurvedic medicaments and preparations. Consistent with the view so taken, we reject the decision to TPO to adopt Cost Plus Method in this year and hold that the TNM method is the most appropriate method. Both the assessee and the TPO have taken "Domestic Personal care division" as uncontrollable comparable.

7.6 The co-ordinate bench has also rejected the view of the TPO to adopt Gross profit ratio as Profit level Indicator, while rejecting the Cost Plus Method as Most appropriate method. The Tribunal held that the net profit ratio should be adopted as Profit Level Indicator. The observations made by the Tribunal in AY 2013-14 in this regard are extracted below:-

> 27. We notice that the TPO has adopted "Gross Profit Margin rate" as PLI under Cost Plus Method, while the contention of the assessee is that "net profit margin rate"

should be taken as PLI. In this regard, the Ld A.R submitted that the "Net Profit Margin rate" shall be the appropriate PLI in the facts and circumstances of the case. He submitted that the co-ordinate bench has taken the net profit margin rate as PLI under TNM method in AY 2010-11. He further submitted that the TPO himself has accepted that

(a) AEs perform marketing function and the assets required to perform the function of marketing are owned by the AEs.

(b) In AY 2012-13, the TPO has expressed the view that the Corporate expenses should not be debited to "Exports to AE section".

(c) The TPO has also observed in AY 2012-13 that the administrative and selling expenses are not incurred on export to AEs.

The Ld A.R submitted that the division wise profit and loss account prepared by the assessee for the year under consideration adheres to the view taken by the TPO. He submitted that the TPO has, in principle, has accepted the division wise profit and loss account except with regard to discounts, i.e., The assessee had deducted discounts and discounts for damaged goods from Sales figure, while the TPO has taken it as a Profit and Loss item. He submitted that this adjustment made by TPO will not have any impact when the net profit margin rate is taken as PLI. He submitted that the assessee had to incur Corporate expenses, Administrative expenses and Marketing

expenses for "domestic personal care division", while these expenses are not required to be incurred/allocated for "Exports to AE segment". The Marketing expenses is, in fact, huge expenditure incurred by the assessee. Since the assessee has to factor in huge marketing expenses and other expenses that are required to be incurred for domestic segment in the selling price, the G.P margin rate is bound to be higher in respect of "Domestic – Personal care division". Hence comparison of G.P margin rate of both divisions would give distorted picture, as Sales pricing methodology is totally different between both segments. Accordingly, he submitted that the comparison of net profit margin rate is ideal one in the facts and circumstances of the case, as "net margin rate" is more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margin rate. We find merit in the said contentions.

28. During the year under consideration, the assessee has declared net profit margin rate @ 1.19% for "Domestic – Personal care division" and @ 12.60% for "Exports to AE division". Admittedly, the net profit margin rate of "Exports to AEs division" is more than the uncontrolled comparable selected by the assessee/TPO. Hence price charged for export of finished goods to AEs is at arms length. In AY 2010-11 also, the co-ordinate bench has given a finding that the price charged for export of finished goods to AEs is at arms length, since the net profit margin

> rate was higher in that division vis-à-vis the Domestic – Personal care division. Accordingly, the co-ordinate bench held that the TP adjustment made in this regard is liable to be deleted. The facts available in this year also are identical and accordingly we hold that the T.P adjustment made by the AO in respect of international transaction of Export to AEs is liable to be deleted. Accordingly we direct the AO to delete the same."

7.7 During the year under consideration, i.e., in AY 2014-15, the assessee has furnished segmental profit and loss account and the same has been extracted by TPO at page 4 & 5 of his order. The assessee had deducted "Discounts" from the Gross sale amount. We notice that TPO has recast the segmental profit and loss account, since he was of the view that the expenditure relating to "Discounts"should be taken as a "Profit and Loss item", i.e., it should not be deducted from the Gross Sales. It appears that the TPO has made some other adjustments also. The aggregate amount of Net Profit shown in the Segmental Profit and Loss account prepared by the assessee was Rs.92.35 crores, while the aggregate amount of net profit shown in the Profit and loss account prepared by TPO was Rs.11.66 crores. Since the TPO has only recast the segmental profit and loss account by shifting the discount expenses from "before gross profit item" to "after gross profit item" the aggregate amount of net profit should not change. Hence it appears that the TPO has made some more adjustments while preparing the profit and loss account, even though he did not discuss about it in his order.Hence, we proceed to discuss the issues on the basis of segmental profit and loss account prepared by the assessee.

7.8 The assessee has shown the rate of net profit margin at 12.31% in “Consumer products -Domestic” (Personal care division), while the margin earned by the assessee in respect of “Export Sales to AEs” was 24.03%. Accordingly, it was submitted that its export made to associated enterprises was at arms length. However, the TPO has re-cast the profit and loss account at pages 6 and 7 of his order. Accordingly, he has worked out the net profit margin @ 0.58% in “Domestic-Personal care division” and at 24.03% in “Exports to AEs” division. Since the TPO proceeded to compare gross profit margin, he has ignored net profit margin. We have earlier rejected the methodology adopted by the TPO and we have upheld the assessee’s stand on TNMM and Net profit margin.

7.9 We have held that, in the segmental Profit and Loss account prepared by TPO, certain items of expenses have not been correctly considered, since the aggregate amount of Net profit worked out by the Transfer Pricing Officer did not match with that of the assessee. There should not be any dispute that the methodology consistently followed to work out net profit year after year should be followed in this year also. It should not be tinkered with, unless proper reasons are given. The TPO has not given any reason as to why he altered the aggregate amount of Net profit. Hence the workings made by TPO is liable to rejected. We have noticed that the net profit margin worked out by the assessee in “Domestic – Personal care division” was 12.31%. The net profit margin worked out for “Exports to AEs” was 24.03%. Hence the net profit margin earned in the exports to AEs division is higher than its comparable “Domestic – Personal care division”. Hence it has to be held that the international transactions of making exports to AEs are at arms length and hence no T.P adjustment is called for. Accordingly, we

direct deletion of Transfer pricing adjustment made in respect of Exports to AEs.

8. The next issue relates to the Transfer pricing adjustment made in respect of Advertisement and Marketing expenses. The TPO took the view that the assessee is incurring huge amount towards Selling and Marketing Expenditure. He took the view that these expenses go to increase the brand name owned by the Parent company. Accordingly, the TPO proceeded to find out average selling expenses incurred by comparable companies. He noticed that the average selling and marketing expenses incurred by the comparable companies work out to 5.25%. Accordingly, the TPO took the view that the selling and marketing expenses incurred over and above 5.25% of the sales is "non-routine AMP expenditure", which was incurred towards increasing brand name held by Parent company. The TPO also worked out the net profit margin (OP/OR) declared by the Comparable companies, which came to be 0.06%. Accordingly, the TPO worked out the net profit margin (OP/OR) of the assessee by excluding "non-routine AMP expenses", which came to be 20.02%. Hence the excess profit was 19.97% (20.02% (-) 0.06%). The TPO took the share of Associated Enterprises at 25%. Accordingly, he made transfer pricing adjustment of Rs.87,47,35,998/- in respect of the selling and marketing expenses.

8.1 We heard the parties and perused the record. The AO/TPO has made identical transfer pricing adjustments in AY 2013-14 and 2011-12 also. Accordingly, identical issue was considered by the co-ordinate bench in AY 2013-14 and the same was decided in favour of the assessee by following the decision rendered by the co-ordinate bench in AY 2011-12. The discussions made by the Tribunal in AY 2013-14 are extracted below:-

"33. We notice that an identical issue was examined by the co-ordinate bench in the assessee's own case in AY 2011-12. The relevant discussions made by the co-ordinate bench in assessment year 2011-12 are extracted below:-

"11. Ground No.XI - Advertisement, Marketing & Sales Promotion (AMP) Expenses - Transfer Pricing Adjustment : Rs. 31,69,02,034.

11.1 In the course of proceedings, the TPO noted that the assessee had incurred huge advertisement and selling expenditure in marketing its products. Taking into account the fact that the brand name and logo 'Himalaya' is owned by M/s. Himalaya Global Holding Ltd; Cayman Islands, the TPO held that the legal owner, namely, M/s. Himalaya Global Holding Ltd., Cayman Islands (viz. holding 88% share in the assessee firm) should meet the expenditure on promotion of the brand name OR it should compensate the assessee for performing the function of developing the brand name and logo in India. The TPO was of the view that the AMP expenditure incurred by the assessee is in excess of the gross profit itself, it cannot be said that the entire AMP expenditure is incurred for the purpose of the assessee's business. In this view of the matter, the TPO applied the 'Bright Line Test' to identify the expenditure on AMP which is routine in nature and which an entity working at arm's length is expected to incur and held the balance expenditure to be non-routine and for the purpose of development of the brand and logo. The TPO worked out the non-routine AMP identifying the percentage of AMP expenditure (i.e. selling and marketing expenditure/sales) incurred by uncontrolled companies and in this context selected five companies as comparables and determined the average percentage of selling and marketing expenditure to sales @ 24.05%. The TPO applied this rate to sales of Rs. 197,25,42,327 and the routine expenses were determined at Rs. 47,43,96,429. Reducing this amount from the actual selling and marketing

expenditure of Rs. 77,62,07,890, the non-routine expenditure was computed at Rs. 30,18,11,461 and after adding a mark up of 5% on this, the TPO determined the adjustment at Rs. 31,69,02,034. The DRP upheld and confirmed the above views/contentions of the TPO.

11.2.1 Before us, the learned Authorised Representative for the; assessee placed reliance on the decisions of the co-ordinate bench of this Tribunal in the case of *Essilor India (P.) Ltd.* v. *Dy. CIT* [2016] 68 taxmann.com 311 (Bang. - Trib.); *Dy. CIT* v. *Nike India (P.) Ltd.* in IT (TP) Appeal No.232/Bang/2014 and other judicial pronouncements to contend that in the absence of any agreement OR arrangement with M/s. Himalaya Global Holdings Ltd., Cayman Islands to incur AMP expenses on its behalf to promote the brand value of the products, the AMP expenses cannot be treated as an international transaction.

11.2.2 Reliance was placed by the learned Authorised Representative on the Affidavit of Sri Meeraj Alim Manal dt.27.8.2012 (pages 452 to 454 of Paper Book 2), the major shareholder of M/s. Himalaya Global Holdings Ltd., Cayman Islands ('HGH'), to contend that it is the assessee firm which has developed all its assets including the trademarks of the products in India and the assessee is exclusively and beneficially entitled to explore and use the same in India. It was submitted that as per the above Affidavit, the legal ownership of the brand with 'HGH' was necessitated by the fact that the assessee, being a firm was not recognized as a legal entity outside India and therefore 'HGH', being a partner and a legal entity was recognized as the owner of the brand. It was contended that Sec. 92 of the Act is a machinery provision and not a charging section and therefore notional income cannot be charged to tax. According to the learned Authorised Representative, the advertisements aired OR printed do not carry the name of 'HGH' and in this regard, relying on the certificate issued by M/s. Starcom Worldwide (page 471 of Paper Book - 2) submitted that the advertisement expenses are for the Indian Market only as these advertisements are not aired in the international market. The learned Authorised Representative further contended that the 'Bright Line Test' adopted by the TPO for making the Transfer Pricing Adjustment

has no legal sanctity and hence entire Transfer Pricing Adjustment should be deleted.

11.2.3 Without prejudice, it was contended by the learned Authorised Representative that selling expenses do not form part of AMP and consequently if the correct amount of advertisement expenses is considered, it would be seen that it is well within the routine AMP limit determined by the TPO. In this context, the learned Authorised Representative prayed for the deletion of the Transfer Pricing Adjustment on AMP expenditure.

11.3 Per contra, the learned Departmental Representative placed strong reliance on the order of the TPO. It was contended that as the assessee is not the legal owner of the brand 'Himalaya', any AMP expenses incurred by the assessee will directly or indirectly result in promotion of the brand 'Himalaya' owned by 'HGH' Cayman Islands. It was therefore argued that the TPO rightly made the Transfer Pricing Adjustment on AMP.

11.4.1 We have heard the rival contentions, perused and carefully considered the material on record; including the judicial pronouncements cited. The question of whether incurring AMP expenditure result in an international transaction was considered at length by a co-ordinate bench of this Tribunal in the case of *Essilor India (P.) Ltd.* (*supra*) which decision was followed by another co-ordinate bench of this Tribunal in the case of *Nike India (P.) Ltd.* (*supra*). In the case of *Nike India (P.) Ltd.* (*supra*), after considering various judicial pronouncements on the subject, the co-ordinate bench held that in the absence of any arrangement between the assessee and the foreign AE for incurring AMP expenditure, no Transfer Pricing Adjustment can be made in respect of AMP expenditure. In this regard, we find that at paras 19 to 22 of its order in the case of *Essilor India (P.) Ltd.* (*supra*), it was held as under :—

> '19. In the present case, the assessee-company imports the lens from its foreign AE and after some processing, sells the products on its own. However, the amount of value addition on account of processing in terms of total revenue is not clear from the material on record. That apart, the assessee-company has been throughout contesting before all the authorities the very existence of international transaction on account of

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

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

(*i*) *Maruti Suzuki India Ltd.* v. *CIT* (282 CTR 1),

(*ii*) *CIT* v. *Whirlpool of India Ltd.* (129 DTR (169),

(*iii*) *Bausch & Lomb Eyecare (India) (P.) Ltd.* v. *Addl. CIT* (129 DTR 201) and

(*iv*) *Yum Restaurants (India) Pvt. Ltd.* v. *ITO* (ITA No.349/2015 dated 13/01/2016) and

(*v*) Honda Seil Products

In the above-mentioned decisions, the issue of the very existence of international transaction on incurring AMP expenditure and the method of determination of ALP was the subject matter of appeal before the Hon'ble Delhi High Court. The Hon'ble Delhi High Court had categorically held that in the absence of agreement between Indian entity and foreign AE whereby the Indian entity was obliged to incur AMP expenditure of a certain level for foreign entity for the purpose of promoting the brand value of the products of the foreign entity, no international transaction can be presumed. It was further held that the fact that there was an incidental benefit to the foreign AE, it cannot be said that AMP expenditure incurred by an Indian entity was for promoting brand of foreign AE. One more aspect highlighted by the Hon'ble High Court is that in the absence of machinery provisions, bringing an imagined transaction to tax was not

possible. While coming to this conclusion, the Hon'ble High Court had placed reliance on the decisions of the Hon'ble Apex Court in the cases of *CIT* v. *B.C. Srinivasa Setty* (128 ITR 294) and *PNB Finance Ltd.* v. *CIT* (307 ITR 75). The Hon'ble Delhi High Court after referring to its earlier decision in the case of *Maruti Suzuki India Ltd.* (*supra*) and *Whirlpool of India (P.) Ltd.* (*supra*) had considered the question of existence of the international transaction and computation of ALP thereon in the case of *Bausch & Lomb Eyecare (India) (P.) Ltd.* (*supra*) vide para 51 to 65 as under:

> "51. The central issue concerning the existence of an international transaction regarding AMP expenses requires the interpretation of provisions of Chapter X of the Act, and to determine whether the Revenue has been able to show prima facie the existence of international transaction involving AMP between the Assessee and its AE.
>
> 52. At the outset, it must be pointed out that these cases were heard together with another batch of cases, two of which have already been decided by this Court. The two decisions are the judgement dated 11th December 2015 in ITA No. 110/2014 (*Maruti Suzuki India Ltd.* v. *Commissioner of Income Tax*) and the judgment dated 22nd December 2015 in ITA No. 610 of 2014 (The *Commissioner of Income Tax-LTU* v. *Whirlpool of India Ltd.*) and many of the points urged by the counsel in these appeals have been considered in these two judgments.
>
> 53. A reading of the heading of Chapter X ["Computation of income from international transactions having regard to arm's length price"] and Section 92 (1) which states that any income arising from an international transaction shall be computed having regard to the ALP and Section 92C (1) which sets out the different methods of determining the ALP, makes it clear that the transfer pricing adjustment is made by substituting the ALP for the price of the transaction. To begin with there has to be an international transaction with a certain disclosed price.

The transfer pricing adjustment envisages the substitution of the price of such international transaction with the ALP.

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

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

"Meaning of international transaction. 92B.(1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. (2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise."

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

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

58. In *Maruti Suzuki India Ltd.* (*supra*) one of the submissions of the Revenue was: "The mere fact that the service or benefit has been provided by one party to the other would by itself constitute a transaction irrespective of whether the consideration for the same has been paid or remains payable or there is a mutual agreement to not charge any compensation for the service or benefit." This was negatived by the Court by pointing out: "Even if the word 'transaction' is given its widest connotation, and need not involve any transfer of money or a written agreement as suggested by the Revenue, and even if resort is had to

Section 92F (v) which defines 'transaction' to include 'arrangement', 'understanding' or 'action in concert', 'whether formal or in writing', it is still incumbent on the Revenue to show the existence of an 'understanding' or an 'arrangement' or 'action in concert' between MSIL and SMC as regards AMP spend for brand promotion. In other words, for both the 'means' part and the 'includes' part of Section 92B (1) what has to be definitely shown is the existence of transaction whereby MSIL has been obliged to incur AMP of a certain level for SMC for the purposes of promoting the brand of SMC."

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

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

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

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

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

62. In the present case, the mere fact that B&L, USA through B&L, South Asia, Inc holds 99.9% of the share of the Assessee will not ipso facto lead to the conclusion that the mere increasing of AMP expenditure by the Assessee involves an international transaction in that regard, with

B&L, USA. A similar contention by the Revenue, namely, that even if there is no explicit arrangement, the fact that the benefit of such AMP expenses would also enure to the AE is itself sufficient to infer the existence of an international transaction has been negatived by the Court in *Maruti Suzuki India Ltd.* (*supra*) as under:

> "68. The above submissions proceed purely on surmises and conjectures and if accepted as such will lead to sending the tax authorities themselves on a wild-goose chase of what can at best be described as a 'mirage'. First of all, there has to be a clear statutory mandate for such an exercise. The Court is unable to find one. To the question whether there is any 'machinery' provision for determining the existence of an international transaction involving AMP expenses, Mr. Srivastava only referred to Section 92F (ii) which defines ALP to mean a price "which is applied or proposed to be applied in a transaction between persons other than AEs in uncontrolled conditions". Since the reference is to 'price' and to 'uncontrolled conditions' it implicitly brings into play the BLT. In other words, it emphasises that where the price is something other than what would be paid or charged by one entity from another in uncontrolled situations then that would be the ALP. The Court does not see this as a machinery provision particularly in light of the fact that the BLT has been expressly negatived by the Court in Sony Ericsson. Therefore, the existence of an international transaction will have to be established de hors the BLT.

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> 70. What is clear is that it is the 'price' of an international transaction which is required to be adjusted. The very existence of an international transaction cannot be presumed by assigning some price to it and then deducing that since it is not an ALP, an 'adjustment' has to be made. The burden is on the Revenue to first show the existence of an international transaction. Next, to ascertain the disclosed 'price' of such transaction and thereafter ask whether it is an ALP. If the answer to that is in the

> negative the TP adjustment should follow. The objective of Chapter X is to make adjustments to the price of an international transaction which the AEs involved may seek to shift from one jurisdiction to another. An 'assumed' price cannot form the reason for making an ALP adjustment."
>
> 71. Since a quantitative adjustment is not permissible for the purposes of a TP adjustment under Chapter X, equally it cannot be permitted in respect of AMP expenses either. As already noticed hereinbefore, what the Revenue has sought to do in the present case is to resort to a quantitative adjustment by first determining whether the AMP spend of the Assessee on application of the BLT, is excessive, thereby evidencing the existence of an international transaction involving the AE. The quantitative determination forms the very basis for the entire TP exercise in the present case.

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

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

> "75. As an analogy, and for no other purpose, in the context of a domestic transaction involving two or more

related parties, reference may be made to Section 40 A (2) (a) under which certain types of expenditure incurred by way of payment to related parties is not deductible where the AO "is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods." In such event, "so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction." The AO in such an instance deploys the 'best judgment' assessment as a device to disallow what he considers to be an excessive expenditure. There is no corresponding 'machinery' provision in Chapter X which enables an AO to determine what should be the fair 'compensation' an Indian entity would be entitled to if it is found that there is an international transaction in that regard. In practical terms, absent a clear statutory guidance, this may encounter further difficulties. The strength of a brand, which could be product specific, may be impacted by numerous other imponderables not limited to the nature of the industry, the geographical peculiarities, economic trends both international and domestic, the consumption patterns, market behaviour and so on. A simplistic approach using one of the modes similar to the ones contemplated by Section 92C may not only be legally impermissible but will lend itself to arbitrariness. What is then needed is a clear statutory scheme encapsulating the legislative policy and mandate which provides the necessary checks against arbitrariness while at the same time addressing the apprehension of tax avoidance."

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

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

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

22. Applying the above legal position to the facts of the present case, it is not a case of revenue that there existed an arrangement and agreement between the assessee-company and its foreign AE to incur AMP expenditure to promote brand value of its products on behalf of the foreign AE, merely because the assessee-company incurred more expenditure on AMP compared to the expenditure incurred by comparable companies, it cannot be inferred that there existed international transaction between assessee-company and its foreign AE. Therefore, the question of determination of ALP on such transaction does not arise. However, the transaction of expenditure on AMP should be treated as a part of aggregate of bundle of transactions on which TNMM should be applied in order to determine the ALP of its

transactions with its AE. In other words, the transaction of expenditure on AMP cannot be treated as a separate transaction. In the present case, we find from the TP study that the operating profit cost to the total operating cost was adopted as Profit Level Indicator which means that the AMP expenditure was not considered as a part of the operating cost. This goes to show that the AMP expenditure was not subsumed in the operating profitability of the assessee-company. Therefore, in order to determine the ALP of international transaction with its AE, it is sine qua non that the AMP expenditure should be considered as a part of the operating cost. Therefore, we restore the issue of determination of ALP, on the above lines, to the file of the AO/TPO. The grounds of appeal raised by the assessee-company on this issue are partly allowed.'

11.4.2 In the case on hand, the TPO has made the Transfer Pricing Adjustment in respect of AMP expenses on the ground that the said expenditure has resulted in promotion of the brand 'Himalaya' owned by M/s. Himalaya Global Holdings Ltd., Cayman Islands and has applied the 'Bright Line Test' for this purpose. However, neither the TPO nor the Assessing Officer has brought on record any material evidence to substantiate the existence of any agreement or arrangement, either express or implied between the assessee and 'HGH', Cayman Islands for promotion of its brand. The Hon'ble High Court of Delhi in a series of decisions, inter alia, including the case of *Maruti Suzuki India Ltd.* v. *CIT* [2015] 64 taxmann.com 150/[2016] 237 Taxman 256/381 ITR 117 (Delhi) emphasized the importance of Revenue having to first discharge the initial burden upon it with regard to showing the existence of an international transaction between the assessee and the AE. In the case of *Maruti Suzuki India Ltd.* (*supra*), at para 64 it was held as under :—

"64. The transfer pricing adjustment is not expected to be made by deducing from the difference between the 'excessive' AMP expenditure incurred by the Assessee and the AMP expenditure of a comparable entity that an international transaction exists and then proceed to make the adjustment of the difference in order to determine the value of such AMP expenditure incurred for the AE. And, yet, that is what appears to have been done by the Revenue in the present case. It first arrived at the 'bright line'

by comparing the AMP expenses incurred by MSIL with the average percentage of the AMP expenses incurred by the comparable entities. Since on applying the BLT, the AMP spend of MSIL was found 'excessive' the Revenue deduced the existence of an international transaction. It then added back the excess expenditure as the transfer pricing 'adjustment'. This runs counter to legal position explained in *CIT* v. *EKL Appliances Ltd.* (2012) 345 ITR 241 (Del), which required a TPO "to examine the 'international transaction' as he actually finds the same." In other words the very existence of an international transaction cannot be a matter for inference or surmise."

At para 76 of its order, the Hon'ble High Court has held as under :-

"76. As explained by the Supreme Court in *CIT* v. *B.C. Srinivasa Setty* [1981] 128 ITR 294 (SC) and *PNB Finance Ltd.* v. *CIT* (2008) 307 ITR 75 (SC) in the absence of any machinery provision, bringing an imagined international transaction to tax is fraught with the danger of invalidation. In the present case, in the absence of there being an international transaction involving AMP spend with an ascertainable price, neither the substantive nor the machinery provision of Chapter X are applicable to the transfer pricing adjustment exercise."

11.4.3 In our considered view, the requirement of there being an international transaction has not been satisfied in the case on hand. In fact, it is not the case of the TPO that there exists an arrangement between the assessee and 'HGH' to promote the brand by incurring AMP expenses. The case of the TPO is that the AMP expenditure incurred by the assessee has resulted in a benefit to the legal owner of the brand and the logo, i.e. M/s. Himalaya Global Holdings, Cayman Islands. The contentions of the TPO that the foreign AE has benefitted on account of the AMP expenditure incurred and therefore the AMP expenditure cannot be said to have been incurred by the assessee for its own business, etc. have been rejected by the Hon'ble Delhi High Court. In the case of *Sony Ericsson Mobile Communications India (P.) Ltd.* (*supra*), the Hon'ble Delhi High Court at para 121 of its order observed that there is nothing in the Act on Rules to hold that it is obligatory that AMP expenses must be necessarily be subjected to the 'Bright Line Test' as this would amount to adding words in the statute and Rules

and introducing a new concept which has not been recognized and accepted as per the general principles of international taxation accepted and applied universally. In the case of *Maruti Suzuki India Ltd.* (*supra*), the Hon'ble Delhi High Court at paras 84 to 86 thereof have held as under :—

> "84. The Court next deals with the submission of the Revenue that the benefit to SMC as a result of the MSIL selling its products with the co-brand 'Maruti-Suzuki' is not merely incidental. The decision in Sony Ericsson acknowledges that an expenditure cannot be disallowed wholly or partly because its incidentally benefits the third party. This was in context on Section 57(1) of the Act. Reference was made to the decision in *Sassoon J David & Co (P.) Ltd.* v. *CIT* [1979] 118 ITR 261 (SC). The Supreme Court in the said decision emphasised that the expression 'wholly and exclusively' used in Section 10 (2) (xv) of the Act did not mean 'necessarily'. It said: "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 if it satisfies otherwise the tests laid down by the law."
>
> 85. The OECD Transfer Pricing Guidelines, para 7.13 emphasises that there should not be any automatic inference about an AE receiving an entity group service only because it gets an incidental benefit for being part of a larger concern and not to any specific activity performed. Even paras 133 and 134 of the Sony Ericsson judgment makes it clear that AMP adjustment cannot be made in respect of a full-risk manufacturer.
>
> MSIL's higher operating margins
>
> 86. In Sony Ericsson it was held that if an Indian entity has satisfied the TNMM i.e. the operating margins of the Indian enterprise are much higher than the operating margins of the comparable companies, no further separate adjustment for AMP expenditure was warranted. This is also in consonance with Rule 10B which mandates only arriving at the net profit by comparing the profit and loss account of the tested party with the comparable. As far as MSIL is concerned, its operating profit margin is 11.19% which is higher than that of the comparable

companies whose profit margin is 4.04%. Therefore, applying the TNMM method it must be stated that there is no question of TP adjustment on account of AMP expenditure.'

11.4.4 In the case on hand, the net margin from exports to AEs at 15.80% is more than the net margin earned by the assessee in respect of personal care product division in the domestic argument at 11.30%. In the factual matrix of the case, as discussed above, the ALP of the assessee's international transactions with its AEs were at Arm's Length and therefore no separate adjustment for AMP expenditure is called for. We, consequently hold that the Transfer Pricing Adjustment of Rs. 31,69,02,034 made by the TPO in respect of AMP expenditure is to be deleted. Ground No. XI is accordingly allowed."

34. We notice that the co-ordinate bench has, following various decisions, held that the revenue has to first show that the AMP expenses would fall under the category of "international transactions". For that purpose, the revenue has to show that there existed an agreement between the assessee and its AE in the matter of incurring of AMP expenses. Admittedly, it is not shown in the instant case that there existed any agreement relating to incurring of AMP expenses. Thus, we notice that there is no change in facts relating to this issue between the current year and the AY 2010-11/2011-12. It was also held that when TNMM method is applied to benchmark the entire international transactions, then there is no requirement of making separate TP adjustment on account of AMP expenditure. In the earlier paragraphs, we have also held that TNMM as most appropriate method and has also held that the international transaction of Exports to AEs is at arms

length. Hence, no separate adjustment is required to be made in respect of AMP expenses on this account also.

35. We notice that, in this case, there is one more reason to state that the T.P adjustment for AMP expenses is not required. We noticed earlier that the "legal owner" of the "brand and logo" is neither the assessee nor the AEs to which the exports were made. The legal ownership rests with M/s Himalaya Global Holding Ltd, which is one of the partners of the assessee firm. While hearing the appeal of the assessee for AY 2011-12 by the co-ordinate bench, the Tribunal took note of an affidavit dated 27.08.2012 filed by Mr. Meeraj Alim Manal with regard to the ownership of the brand name. At the cost of repetition, we extract below the observations made by the co-ordinate bench in AY 2011-12 on the said affidavit:-

> "**11.2.2** Reliance was placed by the learned Authorised Representative on the Affidavit of Sri Meeraj Alim Manal dt.27.8.2012 (pages 452 to 454 of Paper Book 2), the major shareholder of M/s. Himalaya Global Holdings Ltd., Cayman Islands ('HGH'), to contend that it is the assessee firm which has developed all its assets including the trademarks of the products in India and the assessee is exclusively and beneficially entitled to explore and use the same in India. It was submitted that as per the above Affidavit, the legal ownership of the brand with 'HGH' was necessitated by the fact that the assessee, being a firm was not recognized as a legal entity outside India and therefore

'HGH', beinga partner and a legal entity was recognized as the owner of the brand."

The submissions of the assessee would show that though M/s Himalaya Global Holdings Ltd (HGH) is the legal owner, yet it was admitted that the assessee firm only has developed all its assets including trademarks. Hence the brand name has actually been developed by the assessee. It is also stated that the assessee is exclusively and beneficially entitled to explore and use the same in India. Hence, it is admitted that the legal ownership was transferred to HGH due to business necessity/compulsion. Hence the transfer of legal ownership is an internal arrangement between related parties, which was made on account of business necessities. However, it is made to clear that the right to exploit the brand name, logo, trademarks etc., continue with the assessee only. Hence, the assessee is also beneficiary of AMP expenses or the promotion of brand. In this view of the matter also, the question of making T.P adjustment in respect of AMP expenses on account of "brand promotion" does not arise. Hence, on this reasoning also, the impugned TP adjustment on AMP expenses is liable to be quashed.

36. Accordingly, following the decision rendered by the co-ordinate bench in the assessee's own case in AY 2011-12 (referred above) and also for the reasons discussed in the preceding paragraph, we direct the AO to delete the T.P adjustment made in respect of AMP expenditure."

8.2 The facts and circumstances surrounding this issue is identical in this year also. Accordingly, following the decision rendered by the Tribunal in AY 2013-14 and 2011-12, we direct the AO to delete the transfer pricing adjustment made in respect of Selling and Marketing expenses.

9. The last issue relates to the Transfer pricing adjustment made in respect of royalty. The TPO noticed that the assessee has got “Research and Development” unit and accordingly developing all its products. He also noticed that, if any company wants to market any of its food/medical products in any country, then it has to obtain approval from local authorities of that Country. The drug controller in any Country will need valid test data and clinical reports on the efficacy and genuineness of the drug in order to give approval for marketing the products. The TPO noticed that it is the assessee, which has obtained approval for its products in various Countries. However, it did not directly market any of its products in those Countries, i.e., it has exported the products to its AEs located in that Country, which in turn, has marketed the products

9.1 The TPO noticed that the product registration is owned by the tax payer in foreign lands. The underlying intellectual property based on which the registration was granted (clinical trial data, technical specifics etc) have been generated in R & D unit of the assessee. Accordingly, the TPO took the view

that the bundle of tangible and intangible assets in the product registration belong to tax payer exclusively. However, these registrations are being used by the AEs and they do not remunerate the assessee for it. The relevant observations made by TPO are extracted below:-

> "8.2From the submissions made by the taxpayer, it is noticed that the product registration is owned by the tax payer. The underlying intellectual property based on which the registration was granted (clinical trial data, technical specifics etc.) have been generated in R & D unit of the tax payer. It is amply clear that the bundle of tangible and intangible assets in the product registration belong to tax payer exclusively. These registrations are being harnessed by AEs and surprisingly they do not remunerate the taxpayer for it."

Accordingly, the TPO took the view that the AEs should compensate the assessee by paying royalty. He estimated the royalty @ 2% of the net sales of AEs. Accordingly he made transfer pricing adjustment of Rs.3,39,75,568/- towards royalty.

9.2 The Ld A.R submitted identical adjustment was made by TPO in AY 2013-14 and it was deleted by the Tribunal.

9.3 We heard Ld D.R and perused the record. We notice that an identical issue has been examined by the co-ordinate bench in AY 2013-14 (supra) and it was decided as under:-

"37. The next issue urged by the assessee relates to the Transfer Pricing adjustment relating to "royalty". The facts relating thereto are discussed in brief. The TPO noticed that the assessee is having a "Research & Development" unit in India and accordingly developing all its products. He also noticed that, if any company wants to market any of its food/medical products in any country, then it has to obtain approval from local authorities of that Country. The drug controller in any Country will need valid test data and clinical reports on the efficacy and genuineness of the drug in order to give approval for marketing the products. The TPO noticed that it is the assessee, which has obtained approval for its products in various Countries. However, it did not directly market any of its products in those Countries directly, i.e., it has exported the products to its AEs located in that Country, which in turn has marketed the products.

38. The TPO called for sample application forms submitted to Drug control authorities of various Countries like Nigeria, Romania, Ghana, Latvia etc. He noticed that the assessee has furnished Clinical study report, technical specifications etc., and applied for registration. He also noticed that one of the conditions put by the concerned authorities is that they can visit to India in order to audit the manufacturing facilities of the assessee in India. The TPO noticed that the assessee possesses 597 products registrations in various

Countries. The TPO took the view that the "Product registrations/license" is an intangible asset. The TPO noticed that the assessee did not market its products directly by using the "Product registration/license" obtained from various Countries. However, it has indirectly marketed the products through its AEs and has also allowed its AEs to use the Product registration/license. Accordingly, he took the view that the assessee should have collected royalty from its AEs. Accordingly, he took the view that the AEs have exploited the benefits of the product licences obtained by the assessee without paying royalty or usage charges to the assessee. Following observations made by the TPO are relevant here:-

> "3.6 It is also observed that an AE which is resident in UAE is marketing products in African Countries using taxpayer's product registration. Had tax payer itself marketed the products in Africa, it would have gained the entire profits. The AE based in UAE/Dubai is getting the profits because it performs the critical functions-assets-risks. But the taxpayer is performing the critical function of providing license to AE to trade in the African Country; the taxpayer is owner of the critical tangible and intangible assets underlying the license; and taxpayer is taking all the risk of research and clinical trials. Hence, the taxpayer has a critical FAR role in the business of UAE-based AE in African Countries."

Since the TPO took the view that the "Product registration/licenses" constitute an intangible asset, he also took the view that the assessee would have charged royalty from third parties for using such intangibles.

39. Accordingly, the TPO issued a show cause notice to the assessee asking it to show as to why ALP of royalty should not be determined on use of intangible assets, referred above. The assessee submitted that the selling price charged to its AEs is inclusive of everything. It was also submitted that nowhere in the world, a manufacturer would sell the goods for a price and also charge separate amount for royalty. The assessee also submitted that the TPO has made TP adjustments in respect of sale of goods to the AEs and hence no further adjustment is required on account of royalty.

40. The TPO, however, took the view that the royalty payable on usage of a license/product registration is an independent transaction, i.e., independent of export. Hence it is a separate intangible and the assessee would have charged royalty from non-related parties. Accordingly the TPO held that the ALP of the royalty should be determined. He noticed that the royalty rates reported by Association of University Technology Managers (AUTM) and the Licensing Executive Society (LES) range from 0.1% to 25%. The TPO noticed that the products manufactured by taxpayer are both pharma and beauty care products, whose product registrations vary in complexity. Accordingly, the TPO held that the

ALP of royalty may be determined at 2% of the export value of products exported to the AEs of the assessee. Accordingly he proposed T.P adjustment, towards royalty on usage of product registration/licenses, of Rs.2,52,10,867/-. The Ld DRP also confirmed the same.

41. The Ld A.R submitted that the price charged by the assessee on exports would include all the costs incurred by it for sale of its products in foreign countries. He submitted that the view taken by the TPO is against trade practice, i.e., no manufacturer would charge separate amount as royalty over and above the selling price. He submitted that the product license/registration could be obtained only by the manufacturer of the drugs, since the manufacturer alone would hold the details of clinical trials, technical details of products etc. He submitted that it is primary condition prescribed by any Country to obtain product registration/licences before marketing the drugs/beauty products and the same has to be obtained only by the manufacturer, before marketing the products in a Country. Hence it is only a matter of compliance with concerned Government regulations. He submitted that the decision as to direct marketing of products by itself or marketing the products through distributors appointed, is a commercial decision/business strategy of any business concern. The compliance of Government regulations actually help or enable the assessee to market its products in those Countries and hence the

real beneficiary is the assessee only. He submitted that the AEs are marketing the products as mere traders and they are not concerned with the registration formalities. In fact, the dealers should have obtained necessary license to deal with pharma products at their individual level. Accordingly, the Ld A.R submitted that the view taken by the tax authorities in this regard is contrary to trade practice. He submitted that the TPO did not make similar kinds of adjustments in AY 2011-12 or earlier years. Accordingly, he contended that impugned TP adjustment should be deleted.

42. The Ld D.R, however, reiterated the views expressed by TPO. She submitted that the "principle of res-judicata" will not apply to income tax proceedings, as held by the co-ordinate bench in the case of Nike India (P) Ltd vs. DCIT (2013)(34 taxmann.com 282)(Bang.-Trib.). Hence the fact that no TP adjustment was made in AY 2011-12 and earlier years would not debar the AO/TPO to make adjustments in this year. She submitted that the product registration/license is a separate intangible asset, which has been used by the AEs without adequately compensating the assessee. The Ld DR submitted that the AEs could not have conducted the business in their respective countries without these licenses. The Ld DR submitted that,had the assessee has not obtained the product license, the AEs would have obtained it themselves. She submitted that the assessee would have collected royalty from third parties

for use of these licenses. The Ld D.R further submitted that there is no requirement of existence of any agreement for payment of royalties for use of intangibles.

43. The Ld D.R placed her reliance on the decision rendered by Delhi bench of Tribunal in the case of Dabur India Ltd vs. ACIT (2017)(83 taxmann.com 305), which has since been affirmed by Hon'ble Delhi High Court in the same case reported in (2018)(89 taxmann.com 78)(Delhi). She submitted that, in the above cited case, the Tribunal and High Court has upheld the ALP adjustment made in respect of royalty payable by foreign AE of the assessee for using the brand name "Dabur" in its products, even though there was no agreement for charging royalty.

44. The Ld A.R, in the rejoinder, submitted that the selling price charged to the AE subsumes all expenses including the alleged royalty. He submitted that the assessee has also exported to non-AEs and did not charge royalty separately. He further submitted that the AEs did not carry on any manufacturing activity and assessee has not given any license to the AEs. It has simply exported the finished goods for resale only.

45. He submitted that the decision rendered in the case of Dabur India Ltd (supra) is not applicable to the facts of the present case. He submitted that, in the case of Dabur India Ltd, the foreign AE was carrying on manufacturing activity and the assessee therein gave license to the said

AE to use its brand name on the products manufactured by the foreign AE. It was also noted that the said products were manufactured earlier by another company (unrelated to the assessee), from whom the assessee had collected royalty for use of its brand name. The said company was acquired by the assessee and hence it became its AE. After becoming AE, it stopped collecting royalty contending that there is no agreement to pay royalty. Under the above set of facts, it was held that the TPO was justified in making T.P adjustment. He submitted that the assessee herein is simply exporting the finished goods to its AEs, which in turn, sell those products as mere traders. The AEs do not carry on any manufacturing activity and there was no necessity to give license to them. The product registration/license is only a basic formality to be complied with in order to market finished products and hence it cannot be said that the same has resulted in any intangible asset.

46. We heard rival contentions on this issue and perused the record. We noticed that the assessee has exported finished goods to its AEs located in various Countries and the AEs have only marketed the goods. Since the finished goods exported by the assessee are drugs and beauty care items, the assessee was required to comply with the requirement of local laws of the concerned Country with regard to marketing of the said products. There should not be any dispute that the technical details;

the details of clinical trials etc., are available with the assessee only, since it has actually developed the products. Hence the assessee could submit those details to the concerned Government authorities for getting product registration/license. The TPO has expressed the view that the concerned AEs would have obtained the product registration/license, if the assessee had not obtained the same. However, it is the undisputed fact that, if at all the AEs wanted to obtain product registration/license, they have to get relevant details from the assessee only.

47. The assessee has submitted that such kind of approvals are required to market pharma products in any country. Hence these licenses enable the assessee to market its products. The AEs, in the capacity of distributors, should have also obtained separate license for trading in pharma products. There is also no dispute that the AEs have marketed products as re-sellers only. It is also submitted that it is not the commercial practice to charge any amount as royalty over and above the selling rate. In our view, this submission of the assessee is a reasonable one and also makes sense.

48. We have gone through the decision rendered in the case of Dabur India Ltd. The facts prevailing in the case of M/s Dabur India Ltd are discussed in brief. M/s Dabur India Ltd used to provide its expertise and also permit use of its name “Dabur” to a UAE based entity named M/s

Redrock. There was an agreement between both the parties, as per which M/s Redrock has to pay royalty @ 1% to M/s Dabur India Ltd. Subsequently M/s Dabur India Ltd acquired 100% shareholding in M/s Redrock. Consequently M/s Redrock was renamed as M/s Dabur International Ltd. It is pertinent to note that M/s Dabur International Ltd was manufacturing certain items with the support of M/s Dabur India Ltd and it was also manufacturing certain other items without such support. However, it used the brand name of "Dabur" for all its products, i.e, whether the products were produced with or without the support of M/s Dabur India Ltd. However, during the year under consideration, it did not pay the royalty of 1% on the products manufactured without the support of M/s Dabur India Ltd. The TPO determined ALP of royalty @ 1%, as the same rate was paid by erstwhile M/s Redrock. The action of the TPO was upheld by the Tribunal and the Hon'ble Delhi High Court.

49. We notice that the facts prevailing in the case of M/s Dabur India Ltd is totally different from the facts prevailing in the instant case. We have noticed that M/s Dabur International ltd was manufacturing certain goods without the support of M/s Dabur India Ltd, but used the Dabur brand name for those items also. Hence it was a clear case of exploitation of Brand name belonging to M/s Dabur India Ltd. Non-charging of Royalty was sought to be defended by submitting that there was no agreement for

collecting royalty. The said contention was rejected by the Tribunal and High Court. On the contrary, in the instant case, the foreign AEs do not manufacture any product, i.e., they only market the finished products exported by the assessee.

50. The product registration/licensing are requirement of statute, without which the said products could not be marketed in those countries. As noticed earlier, such kinds of product registration/license could be obtained by the manufacturer only, in normal circumstances. The traders should have obtained separate license for trading in the drugs/beauty items. Hence, it cannot be said that the traders have exploited the registration/license obtained by the suppliers under the various statutes. Further, the manufacturers and other suppliers of the products sell them at profit and the practice or presumption is that the supplier has determined the selling price by taking into account all relevant costs. The Ld A.R also submitted that the obtaining product registration/license is usually the responsibility of the manufacturer and it is not the trade practice to levy separate charges as royalty over and above the selling price. He also submitted that the assessee has not collected any amount over and above the selling price from export made to non-AEs. We have noticed that the tax authorities have taken the view that the assessee would have collected royalty amount for finished goods exported to unrelated parties. However, the Ld A.R pointed out that

> the assessee has not collected any amount over and above the selling price either from domestic customers or from non-AEs. Hence, the basic premise of the TPO, which formed the basis for determining ALP of alleged royalty fails here. Accordingly, we are of the view that, in the facts and circumstances of the case, it cannot be taken that the AEs have exploited the product registration/license obtained by the assessee from various Governments. Hence the question of payment of royalty does not arise. Accordingly, we set aside the order passed by AO/TPO on this issue and direct the AO to delete this T.P adjustment."

9.4 The facts and circumstances, being identical in this year also, we direct the AO to delete the T.P adjustment made by way of royalty.

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

Order pronounced in the open court on 7th Dec., 2020

Sd/- **(N.V Vasudevan)** **Vice President**	**Sd/-** **(B.R. Baskaran)** **Accountant Member**

Bangalore,
Dated 7th Dec., 2020.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar,
ITAT, Bangalore.